Bank of England
Banking Act report
1988/89

Banking Act 1987

Annual report under the Banking Act for 1988/89

This report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 28 February 1989 is presented to the Chancellor of the Exchequer, and by him to Parliament, pursuant to section 1(3) of the Act.

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Contents

Annual report under the Banking Act for 1988/89

Introduction

The policy developments which sprang from the new Banking Act of 1987 have now worked through fully into the Bank's supervision, but the Bank has continued to respond to many supervisory issues at both a domestic and an international level. Particularly prominent this year has been the international agreement on a capital adequacy framework, in the development of which the Bank was closely involved; arrangements for the modification of the system applied in the United Kingdom to take account of it have subsequently been announced. The Bank has also developed closer contacts with other supervisors, both in the United Kingdom and overseas. The Board of Banking Supervision has been a valuable source of advice during the year.

This year's report begins with a review of market developments during the year, particularly those of supervisory interest. Further sections cover domestic policy developments and international initiatives in which the Bank has played a part; review the Bank's supervisory activities under the Act and enforcement of it; and finally report on the staffing and organisation of Banking Supervision Division and the enhancement of its information systems. The Appendices include a statement of the Bank's approach to the vetting of shareholder controllers of authorised institutions. The Annual Report of the Board of Banking Supervision is annexed at pages 45–46.

Part I
Market developments

Introduction

1988 was a successful year for many banks in the United Kingdom as they took advantage of a buoyant domestic economy while finding it unnecessary to make provisions on their international business on anything like the scale seen in 1987.

This marked a continuation of the trend in underlying profitability which was evident last year. However, with growth in the economy moderating and with competition in many areas remaining intense, it is doubtful whether profits can go on rising at the rate observed recently. Against this background strategies and cost structures remain under review.

This year's assessment of market developments begins with an overview of business activity for the banking sector as a whole followed by a section on those institutions involved in merchant and investment banking. Further paragraphs look at the experience of the large British banks[1] and of overseas banking institutions operating in the United Kingdom.

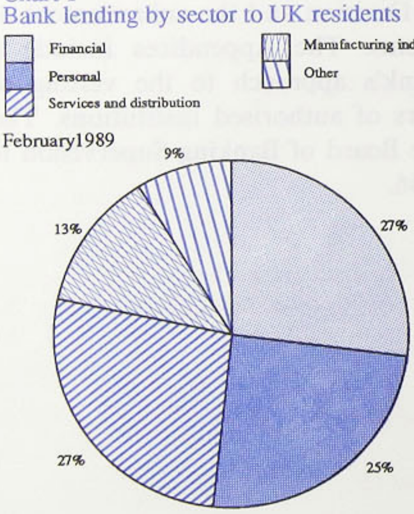
Business trends

Loan portfolios

In contrast with bank lending overseas, which rose by 5% in the twelve months to February 1989, lending to UK residents grew strongly by 28% over the year. Lending to the corporate sector rose by 33%, partly attributable to takeover and merger activity and the financing of management buy-outs. Lending to the financial sector was more muted, especially in the first half of the year.

Lending to the personal sector rose by 22% over the twelve months, with lending for house purchase or other housing-related transactions important, particularly in the first half of the year. The shares represented by different sectors at end-February 1989 are illustrated in Chart 1.

Chart 1
Bank lending by sector to UK residents



(1) This and other terms used in Part I are defined on pages 13–14, where sources of information are also identified.

Chart 2
Loans for house purchase

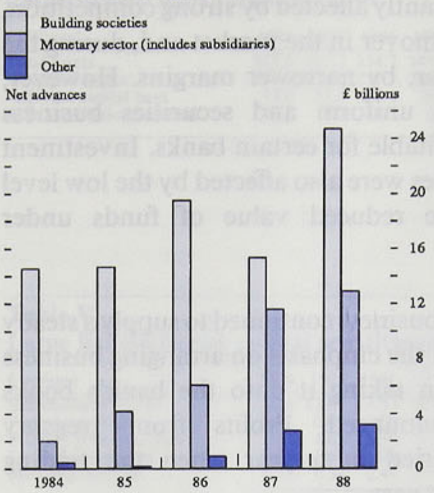


Table I
Large British banks: personal lending[a]

£ billions *Percentages in italics*	1984	1985	1986	1987	1988
Total lending for house purchase	14.4	17.5	21.6	28.8	37.7
As percentage of personal advances	*51.0*	*51.9*	*53.8*	*56.8*	*59.0*
As percentage of total sterling advances	*19.6*	*20.3*	*21.7*	*23.8*	*24.1*
Other lending to persons	13.8	16.3	18.5	21.9	26.2
As percentage of total sterling advances	*18.8*	*18.9*	*18.6*	*18.1*	*16.7*

(a) Data are end-November from 1987, mid-November for preceding years.

The banks' reliance on the personal borrower for a substantial proportion of their income continues to bring them into competition with the building societies. In 1988, banks took advantage of the strong demand for housing finance; however, despite a 24% increase in lending over the year to November 1988, their share of new mortgage financing dropped from 42% in the second half of 1987 to around 32% during 1988 in the face of heavy competition from the building societies. Chart 2 illustrates the UK monetary sector's total new advances (net of repayments) for house purchase and demonstrates the societies' success in recovering market share.

Table I shows the continued increase in lending by the large British banks for house purchase during 1988 both in absolute terms and as a proportion of their total domestic business.

Liability management

Banks' lending has grown more rapidly than their traditional retail deposits. A significant structural change to expense patterns during the year under review was the announcement by several large banks of interest-bearing current accounts in an attempt to counter competitive pressure from building societies. Banks are having to fund a greater proportion of their business through wholesale markets or at interest rates closer to those prevailing in wholesale markets.

Merchant and investment banking

1988 was a year of mixed fortunes for merchant and investment banking business, with overall profits depressed compared with those for the previous year, often as a result of low turnover across a range of operations.

Corporate finance income proved generally strong with advisory activity high as takeover and merger activity remained buoyant. Independent houses without a major in-house securities capacity did not appear to be at a disadvantage to the integrated players. However, the lower level of trading volume in equity markets often resulted in reduced income from underwriting fees.

Business closely related to stock market activity remained severely affected by the market's difficulties following the sharp adjustment of October 1987. The majority of banks' securities markets operations, both equities and fixed interest, were significantly affected by strong competition, by lower levels of turnover in the market and, during the latter half of the year, by narrower margins. However, experience was not uniform and securities business continued to be profitable for certain banks. Investment management activities were also affected by the low level of activity and the reduced value of funds under management.

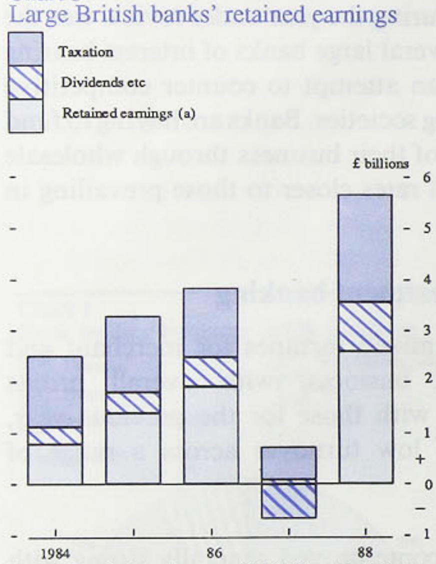
Traditional banking business continued to supply a steady source of income but the emphasis on arranging business for a fee rather than taking it onto the bank's books became more pronounced. Profits from treasury operations were varied in a year when the trading environment was not easy.

In the light of such pressures, merchant banking strategies, activities and costs necessarily remained under review. However, there was little evidence to support the perception widely held at the time of 'Big Bang' that to be successful British merchant banks would need to become either integrated global houses or small niche players.

Table II
Large British banks: earnings

	1984	1985	1986	1987	1988
Trading profits before bad debts (£ billions)	4.55	4.97	5.58	6.02	6.85
Pre-tax profits (£ billions)	2.50	3.29	3.84	0.73	5.66
Post-tax profits (£ billions)	1.12	1.80	2.48	0.09	3.68
Pre-tax return on equity (%)	*19.7*	*24.6*	*24.3*	*3.9*	*27.4*
Post-tax return on equity (%)	*8.8*	*13.4*	*15.7*	*0.5*	*17.8*
Pre-tax return on total assets (%)	*0.85*	*1.10*	*1.20*	*0.21*	*1.51*

Chart 3
Large British banks' retained earnings



(a) In 1987 retained earnings were − £ 0.64 billion, after dividends etc of £ 0.73 billion.

Table III
Large British banks: sources of new capital (a)

£ billions	1984	1985	1986	1987	1988
Retained earnings	0.78	1.39	1.91	−0.64	2.76
Perpetual debt	1.20	3.82	1.25	0.09	0.25
Term subordinated debt	1.29	0.05	0.29	0.45	1.91
Share issues	0.28	0.70	1.42	1.96	1.33
	3.55	5.97	4.29	1.85	6.25

(a) Excludes certain items affecting reserves, such as surpluses on property revaluations.

Earnings and capital adequacy of large British banks

Table II shows the profitability of the large British banks between 1984 and 1988. There was a steady upwards movement in the return on equity and on total assets, after making allowance for the large new provisions against problem country debt made in 1987. Trading profits before provision for bad debts rose by 14% compared with 8% in the previous year. Chart 3 demonstrates the relationship between pre-tax profits and retained earnings.

The recovery in banks' retained earnings from 1987 lessened their reliance on capital issues as a means of increasing capital and reserves. Nonetheless, as market conditions were favourable, the large British banks raised over £2 billion of debt and, as Table III also illustrates, over £1.3 billion of equity—the bulk attributable to a rights issue by Barclays.

The strength of retained earnings and the raising of new equity has not only improved banks' overall capital ratios, as set out in Table IV, but has also provided high quality tier one capital as measured by the Basle framework (see

Table IV
Large British banks: capital ratios

£ billions	1984	1985	1986	1987	1988
Total assets	315.8	303.2	334.7	345.3	392.6
Weighted assets	245.4	236.0	251.7	268.3	316.1
Adjusted capital base	18.6	23.0	26.5	26.1	32.0
Risk asset ratio (per cent)	7.6	9.7	10.5	9.7	10.1

Table V
Large British banks: capital constituents

£ billions	1984	1985	1986	1987	1988
Shareholders' funds	12.16	13.91	17.53	18.73	22.60
Preference shares	0.01	0.01	0.01	0.01	0.01
Primary perpetual debt	—	4.05	5.39	4.18	4.70
General provisions	1.79	1.67	1.29	1.09	1.02
Minority interests	0.78	0.38	0.44	0.41	0.78
Primary capital	14.75	20.02	24.67	24.43	29.11
Secondary capital	6.18	5.70	5.30	5.07	7.18
Total capital	**20.92**	**25.72**	**29.97**	**29.50**	**36.28**
Memorandum item[a]					
Tier 1 capital				*16.17*	*20.03*
Tier 2 capital				*12.73*	*16.08*

(a) The sum of Tiers 1 and 2 capital is smaller than the figure for total capital owing to lack of headroom in Tier 2.

Part II). It has thus improved the headroom in tier two for the inclusion of other elements of capital such as perpetual debt and property revaluation reserves. A number of banks have capitalised part of their revaluation reserves by issuing shares against them. The Bank, in consultation with members of the Basle Committee and other EC supervisors, agreed that the share capital so created was indistinguishable from other equity, and should therefore be treated as tier one capital. Table V shows the constituents of capital as currently defined, with, as a memorandum item, their approximate allocation into tiers one and two on the basis agreed in Basle. All but a few UK banks already meet the minimum standard capital ratio set in that framework.

Assessment of capital adequacy must also take into account the quality of a bank's assets. In contrast to 1987, when the five largest banks increased the overall level of specific provisions from roughly 10% to 30% of their total exposures to problem countries, the banks made relatively little additional provision during 1988. This reflected a belief that, despite the varying circumstances of individual countries, conditions had changed insufficiently in aggregate to warrant a major adjustment. This judgment was consistent with the criteria set out in the Bank's matrix framework (see page 17).

Commercial bad debt experience in 1988 was better than in the previous year, so confirming the trend of the recent past. This represents a further improvement in the position of the domestic corporate sector in particular and a reduction in loan loss experience on lending to the personal sector. With debt a higher proportion of income, this latter feature could be reversed as the effects of sharply increased interest rates in the second half of 1988 work through, especially if disposable income were to come under pressure and the fall in housing turnover to be translated into lower prices.

Table VI
Four largest banks' sources of income

£ billions	1984	1985	1986	1987	1988
Net interest	7.51	7.82	8.34	8.78	9.84
Foreign exchange	0.26	0.28	0.41	0.36	0.38
Fees and commissions	2.98	2.99	3.30	3.80	4.19
Other	0.52	0.47	0.56	0.75	0.99
Total income	**11.27**	**11.56**	**12.61**	**13.69**	**15.41**

Table VII
Four largest banks' interest margins

Percentages	1984	1985	1986	1987	1988
Domestic	5.62	5.67	5.59	5.50	5.11
International	2.18	2.16	2.03	1.81	1.94
Overall	**3.42**	**3.62**	**3.64**	**3.64**	**3.65**

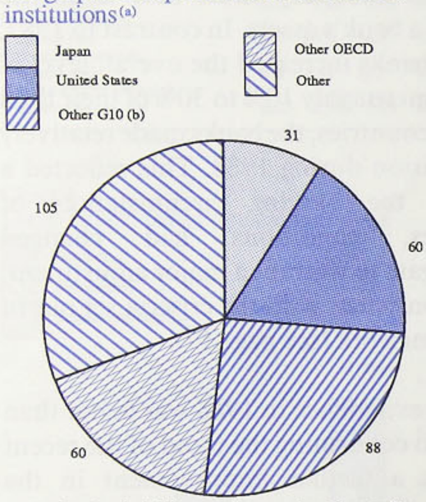
Income and expenditure of large British banks

The four largest UK banks enjoyed a substantial rise in most types of income in 1988, as Table VI illustrates. A movement towards higher-yielding domestic business combined with high volumes produced strong growth in net interest income, although, as Table VII shows, there was a further reduction in domestic interest margins. There was, however, a small recovery in international margins. During the year, spreads on lending to large

Table VIII
Large British banks: costs

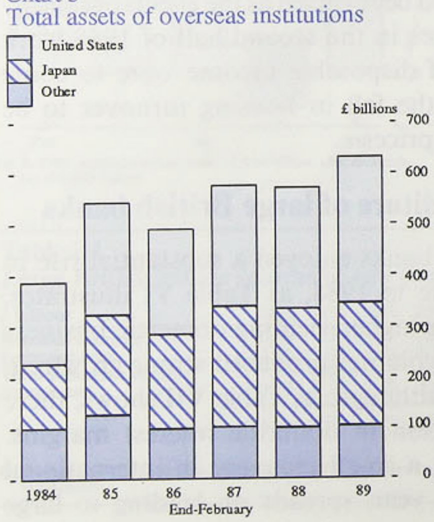
£ billions	1984	1985	1986	1987	1988
Staff	5.60	5.64	6.18	6.64	7.57
Premises and equipment	1.75	1.77	1.91	2.02	2.36
Other	2.03	2.02	2.26	2.68	3.02
Total operating costs	**9.38**	**9.43**	**10.35**	**11.35**	**12.95**

Chart 4
Geographical representation of overseas institutions[(a)]



(a) Branch and subsidiary operations, together with controlling stakes in consortium banks.
(b) Including Swiss banks.

Chart 5
Total assets of overseas institutions



corporate borrowers remained tight and those on lending to medium-sized companies narrowed, reflecting increased competition. Loans to small businesses and to individuals continued to attract relatively high spreads.

The pressure on margins and the increasing difficulty of generating more fee income continue to lead banks to re-examine their operating costs. Table VIII illustrates how bank expenditures continue to rise quite sharply in absolute terms. The application of high technological investment combined with cost-cutting measures such as relocation may produce considerable benefits in due course but the short-term effect has been to increase costs.

Overseas banking institutions

The strength of both the domestic and the international economy in 1988 enabled many overseas-owned institutions and UK branches of overseas banks to improve their performance. Such a development is encouraging since, as in other countries, there is often a tendency for overseas operations to be less profitable than indigenous ones because of the difficulty in penetrating the local market; they may also suffer from overbanking in the areas in which they operate.

Chart 4 shows the number of overseas-owned institutions and UK branches of overseas banks by their area of origin, while Chart 5 illustrates the proportion of business attracted by the major national groups in terms of their sterling and foreign currency assets. The aggregate growth exhibited by the Japanese banks is evident. The changing shares of the foreign currency business of the various country groupings operating in the United Kingdom is considered in an article in the May 1989 issue of the *Bank of England Quarterly Bulletin*.

Many of these institutions took advantage of the demand for property-related finance to expand their sterling portfolios, while a number, including several from the United States, were able to exploit their expertise in mergers and acquisitions and specialist leasing activity. Major banks also developed their lending business in the medium-sized corporate market while some, including a few European banks, are beginning to become more prominent in the small business sector across the country. At present, overseas participation in the deposit-taking market is often a feature of those institutions with traditional associations in the UK population.

In the wholesale markets, the Japanese banks continue to occupy a key position in such instruments as CDs. Having previously been particularly involved in syndicated credits and money-market dealings, they are now becoming more prominent in a range of activities, including foreign exchange, where some are taking positions in a broader range of currencies.

In the securities area, the experience of overseas banks has mirrored that of domestic banks, with several substantial losses recorded and some withdrawals from particular markets taking place. By way of contrast, there has been an increase in the volume of letter of credit business, which is a useful source of fee and commission income, especially for those banks from countries currently affected by debt-servicing difficulties whose other operations may be constrained.

A number of banks are choosing London as a location for managing their European operations, although there is a wide variation in the degree of autonomy afforded such headquarters. The competition facing British financial centres, with the current trend towards the liberalisation of exchange and other financial controls across the world, should not, however, be underestimated. The continued strong competition this implies for domestic institutions will heighten the need for cost control and the accurate identification of product profitability. Consideration of the costs and benefits of a presence in the United Kingdom may lead some banks to review their position.

Conclusions

In 1989, bank margins are likely to remain under pressure. It will be some years before the full benefits of the present cost reduction programmes and investment in technology are felt. In the meantime, banks are likely to face less buoyant economic conditions and overcapacity in some of the markets in which they operate. In these circumstances, careful risk assessment and close control over arrears which may arise will be important in order to ensure any rise in loan loss rates is kept to a minimum.

Many banks have reorganised their business structure to reflect their perceptions of business opportunities. In part, this process has been seen in previous years but some features have become more prominent than hitherto. A number of banks have chosen to extend the range of their near or non-banking business, often exploiting the ability to market products through various outlets to gain further fee and commission income. Some banks have responded to losses in securities operations by bringing their securities and merchant banking subsidiaries into a closer relationship with other wholesale and treasury business.

Such policies, which have not yet had a major effect on the banking sector as a whole, reflect a widely held opinion that it will become increasingly necessary to pursue these opportunities if banks are to meet the challenges of greater competition in their core business. There is also a recognition that retail banks need to exploit more fully the opportunities offered by current account relationships with their customers. At the same time banks are concentrating more on allocating capital resources within their business in the most efficient manner possible.

Glossary of terms for Part I

Sources of data:	*Audited financial statements for the large British banks, with the exception of the tables on capital ratios and mortgage lending. Bank of England statistical returns for overseas banking institutions. The tables relating to loan portfolios adopt the sectoral classifications used in the* Bank of England Quarterly Bulletin *and in the Central Statistical Office's* Financial Statistics. *In some instances, previous year's figures have been restated in the light of more recent information and changes in accounting policy. Not all the columns in the tables balance, on account of rounding.*
Large British banks	Barclays, Lloyds, Midland, National Westminster and Standard Chartered (the five largest banks) together with Bank of Scotland, The Royal Bank of Scotland and the TSBs. All data for these banks are consolidated. Calendar year-end information except for Bank of Scotland, The Royal Bank of Scotland and the TSBs; 1988 data for Bank of Scotland are annualised half-year figures.
Trading profits before bad debts	Profit before taxation adding back bad debt provisions (including the exceptional problem country charges in 1987).
Pre-tax profits	Profit after bad debt provisions but before taxation.
Post-tax profits	Profit after taxation and before extraordinary items; includes amounts attributable to minority shareholders in subsidiary operations.
Return on equity	Percentage ratio of pre/post-tax profits to average shareholders' funds plus minority interests. Shareholders' funds defined as paid-up share capital and reserves.
Return on total assets	Percentage ratio of pre-tax profits to average total assets.
Retained earnings	Current year's post-tax profits after extraordinary items and distributions.
Term subordinated debt	Subordinated debt with a fixed maturity and satisfying the Bank of England's conditions for secondary capital.
Perpetual debt	Undated subordinated debt, satisfying the Bank of England's conditions for primary or secondary capital.
Primary perpetual debt	Perpetual debt eligible for inclusion as primary capital under Bank of England rules. Qualifying criteria require that the debt can only be converted into primary capital instruments, is available at all times to absorb losses, and provides for the deferment of interest payments in certain circumstances.
Total assets	Balance sheet footings.
Weighted assets	Total assets adjusted in accordance with the risk weightings as set out in the supervisory notice, *Measurement of capital* (as amended.).

Adjusted capital base	Total capital (see below)—less: goodwill, equipment, connected lending of a capital nature, investments in subsidiaries and associates, and holdings of bank paper in excess of concession.
Risk asset ratio	Percentage ratio of adjusted capital base to weighted assets.
Primary capital	The total of shareholders' funds, minority interests, general provisions and primary perpetual subordinated debt.
Secondary capital	Perpetual debt not included in primary capital together with term subordinated debt.
Total capital	The sum of primary capital and secondary capital.
Tier 1 and Tier 2 capital	As defined under the agreement on international convergence of capital measurement and capital standards (see page 20 in Part II).
Net interest income	Gross interest income less interest paid on borrowings.
Other income	Includes investment income.
Interest margin	Net interest income/average interest-earning assets.
Interest spread	The difference between average interest rate earned on interest-earning assets and average interest rate paid on interest-bearing funds.

Part II
Policy developments

II.1 Domestic policy

Notices and proposals

Capital adequacy

The Bank's present approach to calculating a bank's capital ratio focuses primarily on its balance sheet, taking into account credit and other risks. As reported last year, this approach will soon be modified to take account of the framework of measurement developed by the Basle Supervisors Committee,[1] which includes comprehensive coverage of off-balance-sheet credit risks. The principal features of the Basle framework are largely unchanged from those of the December 1987 proposals[2] reported last year, with the exception of a revised treatment of country transfer risk. In a paper published in October 1988,[3] the Bank set out how it would apply the framework to UK-incorporated banks. The European Commission's parallel work on the Own Funds[4] and Solvency Ratio[5] Directives appears likely to result in a very similar framework.

The Basle framework was designed to apply on a consolidated basis to internationally active banks. The Bank however will apply it to all authorised institutions incorporated in the United Kingdom,[6] and on an unconsolidated as well as a consolidated basis. The present practice of setting individual 'trigger' and 'target' ratios[7] will continue; in most cases those ratios will be above the internationally agreed 8% minimum. The Bank will not consider a change in a bank's actual ratio as a result of applying the new framework to be, of itself, a justification for revising the trigger or target ratio. Nor does the Bank expect to be using the transitional arrangements[8] offered by Basle, as UK banks are already capable of meeting the 8% standard.

The Bank intends to implement the new standard of measurement as rapidly as possible. Changes to the statistical reporting framework are being agreed with the British Bankers' Association and the Bank expects that the formal transfer to a Basle-based framework will take place by the end of 1989.

Loan transfers and securitisation

Schemes for transferring the risks associated with banks' loan assets by selling, securitising or sub-participating them have been developing rapidly. The Bank's concerns resulted in the issue

(1) *International convergence of capital measurement and capital standards*, July 1988. See also part II.2.

(2) *Proposals for international convergence of capital measurement and capital standards.*

(3) *Implementation of the Basle convergence agreement in the United Kingdom*, BSD/1988/3.

(4) Awaiting publication.

(5) COM (88) 194. These directives are discussed more fully in part II.2.

(6) With the exception of the discount houses, whose capital adequacy regime is described on page 28.

(7) These terms are explained in paragraph 2.12 of the *Statement of principles*, which is available from the Bank on request.

(8) Except for the quantity of general provisions allowed in tier two capital. All provisions against identified losses or impairments in value, including country debt, will be excluded from capital.

of a consultative paper[1] setting out its proposed supervisory response. This paper was summarised in last year's report. Following consultation with the banking community, accountants and lawyers, the Bank issued a policy notice in February 1989.[2] This adheres to the basic approach of the original proposals, designed to insulate banks from risk in respect of assets they have sold, although some detailed modifications were agreed by the Bank as a result of the consultative process.

A consensus was reached on criteria for excluding from a bank's balance sheet single loans (or parts of loans) which have been sold. But deeper differences between the Bank and the banking community were apparent over the allowable extent of a bank's business links with a vehicle whose assets it originates and/or services. The Bank has carried through to the notice its intention to insulate banks from commercial pressure—or legal compulsion—to support losses arising in the scheme. It requires that a bank may not provide liquidity support to its vehicle, nor intentionally bear interest rate risks arising from the scheme. However the Bank has modified its proposals in a number of ways, in particular by allowing the agent to retain an option to repurchase fully-performing loans when the total of securitised loans has fallen to 10% of its maximum value.

The Bank has not applied the conditions set out in the notice retrospectively to schemes existing at the date of the consultative paper's issue.

Consolidated supervision

The Bank's requirements for adequate capital ratios to be maintained by each bank in a banking group, in line with those expected of entirely independent banks undertaking the same range and scale of business, were set out in a notice[3] issued in March 1986. Under this policy the Bank does not weight in a bank's unconsolidated risk asset ratio loans to group companies incorporated in the United Kingdom and authorised under the Banking Act; certain intra-group contingent liabilities are also excluded. This avoids double counting of risk in a bank's capital ratios, which would result from risk weighting loans to a group company while also deducting the investment in that company from the bank's capital.

Having reassessed the methods of risk management within banking groups, and its requirements for capital distribution, the Bank has issued an amending notice.[4] This sets out certain restricted circumstances in which the Bank will extend the range of intra-group exposures not weighted in the calculation of a bank's unconsolidated risk asset ratio. In such circumstances, the Bank is prepared to agree the same 'target' and 'trigger' risk asset ratios for all banks in the group.

In all other respects, the Bank's policy on consolidated supervision set out in the 1986 notice remains unchanged.

Liquidity stock

The Bank's *Revised proposals for a stock of high quality liquidity*[5] were issued in December 1988; they are the result of extensive discussion with the banking community and consultation with overseas monetary and supervisory authorities following the publication of earlier proposals[6] described in last year's report. The policy will complement the mismatch framework currently used by the Bank.

The liquidity stock will provide banks with

(1) *Loan transfers and securitisation*, 8/87, issued in December 1987.

(2) BSD/1989/1.

(3) *Consolidated supervision of institutions authorised under the Banking Act 1979*, BSD/1986/3.

(4) BSD/1989/2, March 1989.

(5) 3/88.

(6) *Proposals for a stock of high quality liquidity*, 2/88, issued in March 1988.

protection against unanticipated liquidity shocks. It will comprise only readily realisable assets with low credit risk, some of which, grouped into an upper tier, the Bank or other monetary authorities would be prepared to purchase.

The revised proposals reflect a reassessment by the Bank of its responsibilities for overseas branches. In addition, while retaining the two-tier concept of the earlier paper, the new proposals have revised the balance between the tiers. It was previously proposed to limit the quantity of tier two assets by reference to the level of tier one assets; the revised proposals will subject tier two assets to a conversion factor of 20%. Their contribution will therefore be independent of the size of the upper tier. If a UK-incorporated bank does not hold two thirds of its total stock in the form of tier one sterling assets, a 10% conversion factor will be applied to the second tier assets in the stock.

The revised proposals have also extended the permitted range for the ratio of stock to short-term liabilities of individual banks, reflecting the present levels of high quality liquid assets held both by the major groupings of banks and by the system as a whole. Should the revisions result in inadequate levels of sterling tier one assets being held by banks, the policy may be reconsidered.

Following the issue of the revised proposals, further discussions were held with the UK banking community and other monetary and supervisory authorities were consulted. The Bank is currently reviewing the comments received.

Policy implementation

Country debt provisioning: the Bank's matrix

In August 1987 the Bank published its debt provisioning matrix to act as a means of assessing the adequacy of provisions against loans to countries experiencing debt servicing and repayment difficulties. The matrix and an explanation of how it is used are contained in Appendix 1 of last year's report.

The Bank has sought to ensure that banks carry at least the minimum level of provisions implied by the matrix. However, past evidence may show that some types of trade finance, for example, are reasonably certain to be recoverable in full. Where this is the case, the Bank recognises that it may be inappropriate for such claims to be included in the total exposure against which the matrix is to be applied. At the same time, the Bank has resisted the release of provisions purely in response to an improvement in the matrix score, which may be short term. For instance, there may be doubt whether a country which has recommenced interest payments following a rescheduling agreement will be able to continue them.

Working within the matrix guidelines, UK-incorporated banks in general increased their provisions during 1987 to an average level of around 30% of their outstanding exposure. This average level has increased slightly in 1988 to some 32%. The matrix scores are periodically reviewed and have continued to provide a common reference point for banks when discussing provisioning levels with their auditors, the Inland Revenue and the Bank itself.

The Bank's relationship with auditors and reporting accountants

The Banking Act 1987 introduced an explicit requirement[1] for authorised institutions to maintain adequate records and systems; subsequently the Bank published three notices to institutions[2] setting out how it intended to exercise its powers under this provision of the Act. As part of the first round of the new arrangements,

(1) Schedule 3, paragraph 4(7).

(2) (a) *Guidance note on accounting and other records and internal control systems and reporting accountants' reports thereon*, BSD/1987/2.
(b) *Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes*, BSD/1987/3.
(c) *The Bank of England's relationship with auditors and reporting accountants*, BSD/1987/4.

the Bank has been engaged in commissioning, receiving and reviewing reports and in holding trilateral meetings with institutions and their reporting accountants. The process was described in last year's report.

These arrangements break new ground. The Bank has therefore co-operated fully in the development of the accounting profession's guideline[1] for approaching this work. Originally issued as an exposure draft in February 1988, it was published in its final form in March 1989.

The Bank's supervision has benefited from the insights and analysis provided by the reports and from closer contacts forged with the accounting profession. Improvements in records and controls have already been seen, as weaknesses are identified and addressed.

It was accepted at an early stage that it was neither practicable nor desirable to require larger banks to commission reports annually covering their entire records and internal control systems. In these cases, a rolling programme has been started so that only a particular business sector or level of control will be examined in any one year. The bank's high level controls—that is, the method by which the board of directors and senior management exercise control over day-to-day business operations—were in many cases selected for examination in the first year.

The Bank's relationship with securities and other supervisors

The importance of co-ordination between different supervisors has increased with the integration of financial markets and the implementation of the Financial Services Act. It is needed either when a single institution is subject to authorisation and supervision by two or more bodies, or when a number of supervisors have responsibility for the individual parts of a financial group. In the first case, formal mechanisms have been developed to minimise supervisory overlap, and to enable one supervisor to monitor the institution's financial position on behalf of the others. Where other areas within the Bank have overlapping supervisory responsibilities, close informal liaison between the Divisions concerned, as detailed in last year's report, takes the place of these mechanisms. In the second case, arrangements have been developed to ensure adequate communication between supervisors (including others within the Bank), so that no part of the group escapes supervision.

Memoranda of Understanding with the Financial Services Act supervisors

To minimise overlapping supervision of a single institution, Memoranda of Understanding (MoU) have been agreed between the Bank[2] and the Financial Services Act (FSA) supervisors. The terms of those with the SIB, TSA and IMRO were reported last year; agreement has been reached since with the AFBD and FIMBRA on similar terms. The Bank is currently the lead regulator for all authorised institutions covered by these arrangements, and generally reports quarterly to the other supervisor on each institution's capital adequacy during the period. It will also provide such other information as is considered material to the supervision of the institution's investment business. Reporting under the MoU began during the course of the year.

Supervision of UK financial groups

While each UK supervisor retains statutory responsibility for the institution it authorises, a lead regulator has been identified for each UK financial conglomerate. The lead regulator undertakes to promote exchanges of information between supervisors and to co-ordinate any necessary remedial action. It is expected that a 'college of supervisors' for each financial group will meet at least once a year, chaired by the lead regulator. The implementation of these arrangements for the principal banking

(1) *Auditing Guideline—Banks in the United Kingdom,* published by the Institute of Chartered Accountants in England and Wales.

(2) Separate MoU have been agreed by Banking Supervision Division, Wholesale Markets Supervision Division and Gilt-Edged Division, taking account of their various responsibilities.

conglomerates commenced towards the end of 1988.

UK branches of overseas banks

During the course of the year the SIB agreed lead regulator arrangements with a number of overseas banking supervisors. These cover the authorisation and continuing supervision of UK branches of overseas banks under the FSA. In many of these agreements the Bank has undertaken to act as an intermediary between the overseas supervisor and the SIB, passing on such information as will be needed by the SIB or SROs to authorise the bank. These arrangements assist the FSA supervisors to fulfil their responsibilities under the Act while avoiding unnecessary reporting burdens upon the branches.

The majority of UK branches of overseas banks have now been authorised under the FSA. However, pending agreement with some overseas supervisors a number continue to have interim authorisation. The SIB expects to reach agreement with the remaining overseas supervisors over the coming months.

Sterling issues

Revised arrangements for issues of sterling paper were announced by the Chancellor in the 1989 Budget and set out in a notice issued by the Bank.[1] The main effects were to abolish timing consent for sterling capital market issues (except for those made by local authorities); to remove the non-statutory minimum maturity of five years which previously applied to issues of sterling bonds and floating-rate notes; and to liberalise the rules governing the issuance of sterling commercial paper.

New Exempt Transactions Regulations[2] under the Banking Act broadened the range of institutions, both UK and overseas, permitted to use sterling commercial paper without infringing the deposit-taking provisions of the Act, and reduced the minimum denomination to £100,000. It was also announced that, later this year, the maximum maturity of sterling commercial paper would be extended to five years.

At the same time the Bank has reviewed the regime for short-term paper issues by banks and building societies. A revised notice[3] issued in March 1989 removed the previous constraint under which they could issue only certificates of deposit in the sub-five year maturity range. These institutions may now issue paper of any title provided that the title is not liable to cause confusion with certificates of deposit.

Codes of conduct

In a letter of July 1988 to all authorised institutions the Bank re-emphasised that compliance with existing codes of conduct and conduct of business rules is expected of them. Failure in this respect will be taken into account in considering an institution's continuing fulfilment of the Banking Act's Schedule 3 criteria.[4] Banks will also be expected to adhere to the guidance set out in the statement of principles on money laundering agreed by the Basle Committee and reported below.

(1) *Sterling issues*, March 1989.

(2) Statutory Instrument 1989 No 465; see page 26.

(3) *Certificates of deposit and other short-term paper issues by deposit-taking institutions.*

(4) See paragraph 2.30 of the *Statement of principles.*

II.2 International developments

The Basle Supervisors Committee[1]

The Committee has continued to meet regularly in 1988/89, convening on four occasions. The Chairman since 1977, Mr Peter Cooke, an Associate Director of the Bank of England, stepped down during the year following the agreement of the Committee's convergence framework and in anticipation of his retirement from the Bank; he was succeeded by Mr Huib Muller, Executive Director of De Nederlandsche Bank NV.

Convergence of capital adequacy

In December 1987, the Basle Supervisors Committee published its *Proposals for international convergence of capital measurement and capital standards*. Each of the G10 supervisors then held consultations with banking associations in their country, which helped to shape their thinking in reviewing the paper. The resulting agreement, endorsed by G10 Governors and issued in July 1988,[2] retained the structure proposed by the earlier paper and outlined in last year's report, but contained a number of detailed changes.

The most significant modification to the framework concerns the treatment of country transfer risk in the risk weighting system. The great majority of comments received urged that the favourable weighting applied to claims on domestic governments and banks should be extended to claims on similar institutions of industrialised countries. The Committee looked to existing groupings based on this criterion, rather than seeking to define their own. It was agreed that the OECD[3] provided an appropriate choice, reflecting the views of the banking markets.

In response to the final Basle agreement, national authorities of the G10 countries have begun to issue their own papers, indicating how they will use their discretion under the agreement, and the banks to which the measurement will be applied. The Bank's paper was issued in October 1988; the application of the framework in the United Kingdom is described on page 15.

The European Commission has been kept closely in touch with developments, in order that the Basle framework and its own parallel proposals for Own Funds and Solvency Ratio Directives should, as far as possible, be consistent. The United Kingdom and other Basle Committee members in the EC have taken an active part in Community discussions on these directives.

Other work

In addition to this work principally on credit risk, the Basle Committee has established a number of sub-groups to consider other forms of risk to which banks may be exposed. Work is proceeding on the measurement of banks' exposure to foreign exchange risk, interest-rate risk and position risk. The European Commission has observer status on all three groups.

In addition, representatives of the Basle Committee met a number of securities regulators in September 1988 to discuss issues arising in the supervision of financial conglomerates. The meeting explored the allocation of responsibilities, exchange of information, and the possibility of convergence of national regulations with particular regard to position risk. Further meetings between the supervisors are planned.

At its December 1988 meeting, the Committee endorsed a statement of principles on money laundering, intended to prevent banks being used in transactions involving funds derived from criminal activity, particularly drug trafficking.

(1) Committee on Banking Regulations and Supervisory Practices.

(2) *International convergence of capital measurement and capital standards.*

(3) Together with Saudi Arabia and any other countries which may contribute to the IMF's General Arrangements to Borrow.

Bank supervisors of the G10 countries have recommended the statement to their banks, and it is hoped that non-G10 supervisors will also associate themselves with the initiative. The principles adhere closely to existing best banking practice in the United Kingdom, and the Bank expects UK banks to adhere to the standards they set.

The Tokyo conference

The fifth international conference of banking supervisors was held in Tokyo in October 1988, with the Japanese Ministry of Finance and the Bank of Japan acting as joint hosts and co-sponsors with the Basle Supervisors Committee. Bank officials joined the representatives of 96 countries attending.

Formal discussion centred on capital adequacy requirements, changes in banking—both innovative techniques and increasing international integration of markets—and the supervision of asset quality.

Participants welcomed the agreement reached by the Basle Supervisors Committee on a framework for international banks' capital adequacy measurement and standards (described above) which could have worldwide application. They felt it was important that the agreement should be put into effect, while recognising that certain aspects might appropriately be reviewed during its transitional period.

It was agreed that supervisory co-operation and, in particular, similar national approaches to major supervisory issues were desirable. Provisioning policies, methods of ensuring diversification of risks in relation to lending and procedures for assessing the quality of a bank's assets and internal control procedures were discussed. Participants also expressed their appreciation of Mr Peter Cooke's contribution to the development of international banking supervisory co-operation.

The conference provided a valuable opportunity for exchanges of views on a variety of issues, and for personal contacts to be made. The next such conference will take place in Frankfurt in 1990.

The European Community

The internal market: EC directives

The formal adoption in June 1988 of a directive intended to complete *the liberalisation of capital movements within the Community*[1] laid the basis upon which realisation of the internal market in financial services depends. All remaining barriers to the free movement of capital within the Community will be removed, except for those arising from the requirements of monetary policy or prudential regulation. The directive will be implemented in most Member States in mid-1990.

Complementary to this is the elimination of restrictions on the provision of financial services across borders within the Community. To this end the European Commission has been focusing efforts on three key directives in the banking field, a draft *Second Banking Co-ordination Directive*,[2] an *Own Funds Directive*[3] and a draft *Solvency Ratio Directive*.[4] The scope of these directives was described fully in last year's report. Council working parties have met frequently during the year to consider the first two proposals and recently began negotiations on the last. The Bank has continued to work closely with government departments in the Community discussions.

The *Own Funds Directive*, which sets out the Community's definition of a bank's capital base for supervisory purposes, was adopted in April 1989. The definition of capital is very similar to the one developed by the Basle Supervisors Committee. Similarly, the *Solvency Ratio Directive*, which introduces a uniform risk weighting system for Community credit institutions, is expected to reflect the Basle framework closely.

(1) 88/361/EEC.
(2) COM (87) 715.
(3) Awaiting publication.
(4) COM (88) 194.

The European Commission announced in April 1989 a revised proposal on reciprocity, to be incorporated in the text of the *Second Banking Co-ordination Directive.* While this is a constructive step towards meeting Member States' concerns, the proposal will need clarification and further consideration. In particular it must be shown to be designed to promote liberalisation of banking markets, not to build protectionist barriers, before the United Kingdom can decide whether to lift its reservations on the inclusion of such a proposal.

During 1988, the Commission has widened the scope of its work in the financial field to encompass the liberalisation of investment business. The list of core banking activities annexed to the Second Banking Co-ordination Directive includes certain investment activities. But, while the directive will enable banks to transact such business in other Member States without the need for host country authorisation, non-bank specialist securities houses would not have enjoyed this freedom. To redress this imbalance, the Commission has proposed a draft *Investment Services Directive*[1] which, by establishing an authorisation procedure for investment business, will confer the same 'single licence' as the Second Banking Co-ordination Directive will offer to banks. It is not envisaged that banks will require separate authorisation under this directive for their investment activities, although certain of its provisions will apply to them.

The Commission has not at this stage attempted to harmonise the diverse conduct of business requirements for investment activities within the Community, and the single licence will not therefore exempt banks or investment businesses from complying with local conduct of business rules. The present text would, however, open up to them membership of Community stock exchanges, securities markets and futures and options exchanges.

Because of the close relationship between this directive and the Second Banking Co-ordination Directive, many of the articles reflect, *mutatis mutandis*, the latter's provisions. In particular, a reciprocity clause identical to that originally drafted for the banking directive has been included. There is also an annex containing a list of investment activities which the Investment Services Directive will liberalise.

Common minimum standards of prudential supervision and of financial soundness are necessary as a basis for home country supervisory responsibility for EC banks operating under the single banking licence. The same principle applies to investment business. The *Investment Services Directive* will establish certain prudential standards; and preliminary discussions at Community level are taking place with a view to establishing a parallel capital directive which will introduce minimum capital requirements for investment businesses which are not credit institutions. Discussions on a capital adequacy regime relating to market risks are also taking place in this context. The Commission is following closely other international work in this area.

Work has also been carried forward on several other proposals concerning the banking sector. Final agreement was reached this year by the Council on *a directive on the publication of annual accounting documents by branches of banks in the Community;*[2] and the Commission issued *a recommendation concerning payment systems, and in particular the relationship between cardholder and card issuer.*[3]

Under discussion within the Commission at present are preliminary proposals for amending

(1) COM (88) 778, adopted by the Commission in December 1988.
(2) 89/117/EEC.
(3) 88/590/EEC.

the 1983 directive on consolidated supervision. A proposal for a mortgage credit directive[1] awaits further consideration in the Council; it now incorporates the substance of the earlier proposal for a directive on mortgage bonds. Its purpose is to abolish obstacles faced by credit institutions undertaking mortgage business throughout the Community, but it may have been superseded by work on the Second Banking Co-ordination Directive. Also awaiting Council consideration is a proposal on the winding up and reorganisation of credit institutions.[2]

EC supervisory bodies

During the year the Banking Advisory Committee (BAC) and the Contact Group of EC Supervisory Authorities ('Groupe de Contact') have each met regularly, maintaining their close working relationship particularly on practical and technical supervisory matters. Mr Brian Gent, a Deputy Head of Banking Supervision Division, was elected chairman of the Groupe de Contact in 1988.

As reported last year a new Community-wide solvency observation calculation was commissioned by the BAC, covering a large number of Community credit institutions. This exercise has enabled Member States to assess the likely impact of the capital adequacy proposals in the Own Funds and Solvency Ratio Directives. The results of the exercise confirmed the Bank's expectation that the great majority of UK institutions participating either met or exceeded the proposed 8% minimum solvency ratio. Now that the detail of the two directives is clearer, the BAC has taken the decision to repeat the exercise in 1989, with a wider and more representative sample of banks from some countries, to gain a more realistic indication of the national average solvency ratios in Member States.

(1) COM (87) 255.

(2) COM(88)4.

Part III
Operational supervision

The authorised population

Authorisations

The level of applications for authorisation under the Banking Act (shown in Table IX) was low this year. In total twelve authorisations were granted, compared with twenty-one in 1987/88. Nine (fourteen last year) were of overseas-incorporated institutions wishing to operate in the United Kingdom and the other three (seven in 1987/88) were of UK-incorporated institutions. One institution withdrew its application. The Bank also considered a number of draft applications.

Table IX
Applications and authorisations

Year to end-February	1983	1984	1985	1986	1987	1988	1989
Applications	36	37	23	25	34	21[(a)]	13
Authorisations	25	26	28	18	37	21	12

(a) Including the submission under the 1987 Act of two applications which lapsed on the repeal of the 1979 Act and thus had to be resubmitted.

Of the 551 institutions authorised at end-February 1989, 256 were overseas-incorporated institutions with UK branches (254 at the same time last year), 68 were UK-incorporated subsidiaries of overseas institutions (72 in 1987/88) and 17 were UK-incorporated joint ventures between overseas institutions and, in some cases, between overseas and UK institutions (21 in 1987/88). Authorised institutions from 64 countries have offices in this country: the geographical origin of overseas institutions is shown in Appendix 5.

Table X
Number of authorised institutions

End-February	1984	1985	1986	1987	1988	1989
UK-incorporated	358	355	343	334	313	295
Incorporated outside the United Kingdom	240	250	252	254	254	256
	598	605	595	588	567	551

Surrenders

There were twenty-seven surrenders in 1988/89 (thirty-three in 1987/88). In two cases institutions surrendered authorisation which had already been restricted, and two institutions surrendered when it had become apparent that the Bank's powers to revoke had become exercisable and that the Bank was likely to start revocation procedures. Ten institutions surrendered because of group reorganisations with authorisation already existing in or being granted to a successor or a company in the same group, and four surrendered because of mergers with other institutions and the grant of authorisation to successor institutions taking over their business. Nine institutions surrendered following a decision to cease accepting deposits in the United Kingdom.

Where an institution has surrendered, the Bank will continue to have a supervisory interest in it until it has repaid all its deposit liabilities. The Bank may, *inter alia*, require the provision of information from such institutions and give them directions in the interests of depositors. The Bank gave directions following surrender in one case during the year.

Revocations and restrictions

No authorisations were revoked by the Bank under section 11 of the Act during the year. As noted in last year's report, one institution which appealed last year against the Bank's decision to revoke its authorisation withdrew its appeal and the revocation therefore came into effect. The Bank gave notice of its intention to revoke the authorisation of one institution under section 11 but, following receipt of new information provided in representations by the institution, decided not to proceed with revocation.

The Bank restricted the authorisation of two institutions under section 12 of the Act. One institution is now operating under conditions designed to protect the interests of depositors and potential depositors; in the other case, the institution's authorisation was already restricted and the Bank took action to alter the conditions; the institution is not now authorised under the Act.

Table XI
Revocations and restrictions (a)

Year to end-February	1983	1984	1985	1986	1987	1988	1989
Revocation of authorisation	1	—	—	5	1	2	—
Restriction of authorisation (b)	1	2	2	4	2	5	2
Revocation of restricted authorisation (b)	4	2	2	—	3	—	—

(a) The table records cases in the year that the Bank's formal notice of revocation or restriction was given. In some cases, the revocation did not take effect until the following year and in a few cases the institution surrendered, or a conditional authorisation expired, before the revocation notice took effect. In addition, the Bank has used its powers more than once in respect of a few institutions. It is *not* therefore a record of authorisations revoked or restricted but of the use of the Bank's powers.

(b) The terms of the 1987 Act are here used to record use of the corresponding powers under the 1979 Act.

In every case where the Bank moved to revoke or restrict an authorisation the decision reflected the view that some of the criteria in Schedule 3 to the Act were not fulfilled. Reasons for concluding that the 'prudent conduct' criterion was not fulfilled included poor lending strategies, inadequate management and staffing, inadequate records and systems, inadequate provision for bad and doubtful debts, and inadequate capital. In one case the Bank concluded that the business was not being conducted with appropriate professional skills. In the case where the Bank altered the conditions of a restricted authorisation it appeared to the Bank that while certain of the criteria which previously were not fulfilled were then fulfilled, one criterion remained unfulfilled, and by a greater margin than before.

Appeals and liquidations

No appeals against the Bank's decisions or directions were lodged during 1988/89.

The Bank did not make any applications for winding-up orders under section 92 of the Act during the year.

Supervision and enforcement

Statement of principles

Section 16 of the Act provides that the Bank shall publish a statement of principles and that any material changes in these principles shall be included in the following annual report under the Act. The Bank's statement was published simultaneously with last year's report and is available separately on request. The following changes in the statement should be noted.

- The following papers are added to the table in paragraph 2.5 of the statement:

Title	**Date of issue**
Supervisory treatment of ECU Treasury bills (BSD/1988/2)	October 1988
Loan transfers and securitisation (BSD/1989/1)	February 1989
Consolidated supervision (BSD/1989/2) (amendment to the 1986 paper)	March 1989

- The words 'A consultative paper . . . January 1987;' in paragraph 2.13 are replaced by the words 'The Basle Committee issued its agreement *International convergence of capital measurement and capital standards* in July 1988. The Bank has issued a notice (BSD/1988/3) setting out how it proposes to implement the Basle convergence agreement in the United Kingdom;'.

- The words 'Proposals for a stock of high quality liquidity (2/88), issued in March 1988' in paragraph 2.15 are replaced by the words 'Revised proposals for a stock of high quality liquidity (3/88), issued in December 1988'.

Appendix 1 sets out some of the considerations which guide the Bank in its approach to the vetting of potential and existing indirect and shareholder controllers.

Statutory instruments

Appendix 4 of last year's report summarised the orders and regulations which had been introduced under the Banking Act up to April 1988. Since then two further statutory instruments have been made under the Act:

1989 No 125 The Banking Act 1987 (Exempt Persons) Order 1989
This added Crown Agents Financial Services Limited to the list in Schedule 2 to the Act of persons exempted from section 3 (restriction on acceptance of deposits).

1989 No 465 The Banking Act 1987 (Exempt Transactions)(Amendment) Regulations 1989
These amended the Banking Act 1987 (Exempt Transactions) Regulations 1988. They made changes to the exemption for sterling commercial paper and amended the list of public undertakings in Schedule 2, the main changes being the deletion of references to the British Steel Corporation and the insertion of references to London Regional Transport, the Post Office and successors to the electricity boards. A brief description of the new sterling commercial paper exemption is given in part II above (page 19).

Interviews, visits and prudential/statistical returns

Over three thousand interviews were conducted during 1988/89, a slight increase over the number in the previous year. Over two thirds were non-routine meetings to discuss specific issues. Of the routine prudential interviews, just under half were conducted on the institution's premises. Officials visited the United States of America and a number of countries in Europe and the Middle and Far East; discussions were held with bank supervisors and visits made to UK banks' offices and the head offices of institutions with branches and subsidiaries in the United Kingdom.

In addition to interviews for routine prudential purposes and on specific issues, the Bank regularly sends review teams consisting of seconded bankers and accountants and Bank staff to visit authorised institutions. Such visits can take up to a week; their purpose is to provide more detailed knowledge of the institution's management structure, key business and operational areas, and internal control systems and procedures. Occasionally applicants for authorisation are subject to such a review.

These visits are conducted with the agreement of the institutions concerned, and do not involve use of the Bank's statutory powers of investigation. Reviews are in some cases followed by later visits to enable the Bank to monitor progress—for example in taking remedial action in respect of any weaknesses identified and discussed with management. During the year there were 126 review team visits (including follow-ups and foreign exchange visits by secondees) compared with 132 in 1987/88; 57 were to domestic institutions and 69 to subsidiaries and branches of overseas banks (86 and 46 respectively last year). 77 visits covered the full range of activities, while 16 targeted loan book quality and 33 operating and control systems. The Bank also conducted 57 visits to institutions to review or establish foreign exchange exposure guidelines.

The Bank monitors closely the reporting record of all authorised institutions and seeks improvements where necessary. There has been a perceptible improvement in the timeliness of submission of prudential returns during the year.

Investigations into authorised institutions

As foreshadowed in last year's report, the section 39 powers to require an institution to commission a report by reporting accountants have been used routinely to establish whether systems and records are maintained in accordance with the requirements of the Act and to comment on the accuracy of prudential and statistical returns (see part II.1 above). Nearly all institutions have now been asked to provide the Bank with such a report and most of the results have been received. The section 39 powers have also been used in nine cases in response to identified problems. Additionally, one such report was required from a controller of an authorised institution and one from a significant shareholder. Four investigations under section 41 were begun during the year. The use of the section 41 powers (and their equivalent under section 17 of the 1979 Act) is shown in Table XII.

Table XII
Use of section 17/41 powers

Year to end-February	1983	1984	1985	1986	1987	1988	1989
Number of investigations	2	4	3	5	4	6[(a)]	4

(a) One under section 17 of the 1979 Act and 5 under section 41 of the 1987 Act.

Shareholder controllers of authorised institutions

Appendix 1 sets out some of the considerations which guide the Bank in its operation of the vetting procedures in sections 21 and 22 of the Act. Persons intending to become shareholder or indirect controllers of UK-incorporated authorised institutions are required by section 21 to notify the Bank in advance, and existing shareholder controllers must also notify the Bank before the voting power which they (with any associates) are entitled to exercise or control is increased above 50% or 75%. The Bank may object to a proposed controller unless it is satisfied that:

- the person concerned is a fit and proper person to become a controller of the type in question,
- the interests of depositors and potential depositors will not otherwise be threatened,
- having regard to the person's likely influence, the institution concerned will continue to fulfil the criteria for authorisation or, if any of them is not fulfilled, that the person is likely to undertake adequate remedial action.

If it appears to the Bank that an existing shareholder controller of an authorised institution incorporated in the United Kingdom is not or is no longer fit and proper to hold his position the Bank may, instead of or as well as moving to restrict or revoke the institution's authorisation, object under section 24 to his remaining in his position.

Where a person becomes or continues to be a shareholder controller having received a notice of objection, the Bank may under section 26 direct that those of his shares (or of any of his associates which were not held by them before he became a controller) are to be restricted in one or more ways. It may, for example, direct that any transfer of the shares is void or suspend the voting rights in respect of the shares. In addition, the court may, on application of the Bank, order the sale of any specified shares.

During the year the Bank received forty-five notifications of new or increased control under section 21 of the Act (more than one in respect of some institutions). In one case it issued notices of objection under section 22 of the Act. In this case, the Bank was not satisfied that the interests of depositors and potential depositors would not be threatened by the new controllers.

In two cases the Bank issued notices of intention to object because it was not satisfied that the persons concerned were fit and proper to become controllers of an authorised institution, nor that the criteria in Schedule 3 to the Act would continue to be fulfilled with respect to the institution concerned. In the first case, the persons concerned withdrew their notifications; in the second, the Bank decided not to object as there were other, preferable, means available of protecting the interests of depositors. Some proposed controllers decided, after giving notice under section 21, not to proceed following discussions with the Bank.

The Bank gave notices of objection under section 24 to existing controllers of one institution and imposed restrictions on their shareholdings under section 26.

Representative offices of overseas institutions

Any overseas institution wishing to establish a representative office in the United Kingdom is required under the Act to give two months' notice. During that time the Bank may object to the institution's name under section 75 of the Act if the name appears misleading to the public or otherwise undesirable. It may also (before and after establishment) require the provision of information or documents under section 79. Twenty-one institutions have given the Bank notice under section 75 in the past year (twelve in 1987/88). During the year the Bank also became aware of eight instances seeming to involve the establishment of representative offices contrary to section 75. Following approaches from the Bank, most were immediately closed. In a few cases the Bank made formal investigations under section 42 of the Act, suspecting illegal deposit-taking or fraudulent inducement to make deposits.

Banking names and descriptions

Thirty-two authorised institutions changed their name during the year after having notified the Bank under section 70 of the Act; the Bank also considered thirteen proposals by authorised institutions to change their business names. The Bank did not issue any notice of objection to a proposed name change by an authorised institution in 1988/89.

The Bank also considered over 150 names submitted during the year by unauthorised institutions which included terms such as 'bank' or 'banking' with a view to assessing whether the name as a whole would be likely to breach the prohibition on the use of banking names in section 67 of the Act. The Bank indicated that seven of the proposed names appeared to breach the prohibition.

The prohibition on deposit-taking

A number of suspected cases of illegal deposit-taking came to the Bank's notice in 1988/89. Although the overall case load was little changed at forty (thirty-seven in 1987/88), this included several instances potentially more serious than those in the previous year. The largest proportion of cases dealt with (fifteen) were identified by Banking Supervision Division; the general public and authorised institutions also brought a significant number of cases to the Bank's attention. The implementation of the Financial Services Act led to some of these potentially more serious cases being referred to the Bank by the SIB and SROs, with whom close working relationships have been developed.

Section 42 of the Banking Act 1987 provides the Bank with the power to require information, documents and explanations from suspects and others who are believed to have information relevant to suspected breaches of the deposit-taking prohibition. These powers were invoked in five cases during the year (two in 1987/88). Three of these cases involved overseas institutions which had not given notice under section 75 of the Act but appeared to have opened a representative office. In a few of the cases investigated charges under section 3 of the Act are being considered. In one case the Bank applied to the court successfully under section 93 for an injunction restraining a person from committing further breaches of the Act and from dissipating his assets.

As in past years a number of the cases investigated involved inadvertent contraventions and the position has been regularised without any loss to the public and without the need for prosecution.

Discount houses

The discount houses' business is predominantly in the wholesale markets, where they run risks arising from interest rate movements on their high quality liquid assets rather than the credit risks involved in most banking business. The capital requirements against those risks are different from those applied to all other UK-incorporated banks, and are administered by the Bank's Wholesale Markets Supervision Division.

In October 1988 the Bank published a paper[1] which introduced a number of refinements to the measurement of discount houses' capital adequacy, bringing it closer to that applied to the gilt-edged market makers. Generally, the changes brought a slight reduction in the capital requirements imposed on the houses. In addition, the supervisory treatment of hedging has been amended, following a process of consultation with

(1) *Bank of England operations in the sterling money markets.*

the houses. It now reflects better the risk reduction achieved by the use of derivative instruments such as futures. These new arrangements took effect at the end of March 1989.

The October paper also announced the Bank's willingness to extend the range of counterparties with which it deals in the sterling money markets. The paper set out the supervisory arrangements which apply to such counterparties and invited new applications. In January 1989 the Bank announced that it would establish money-market dealing relationships with two new counterparties; one is a gilt-edged market maker which continues to be supervised by the Bank's Gilt-Edged Division.[1]

The total number of the Bank's money-market dealing counterparties has thus risen to ten. Four discount houses are under non-UK ownership; of these, one has recently changed hands, being acquired by one of the French 'maisons de réescompte'.

(1) See Annex 2 to the above paper.

Part IV
Organisation and staffing of Banking Supervision Division

Staff

Over the year there has been a continued expansion in staff numbers in Banking Supervision Division (see Chart 6) reflecting the implementation of the Banking Act 1987 and work in connection with the Financial Services Act.

The current budget of some 200 staff is not scheduled to increase in the year to end-February 1990, although the Division is seeking to rectify the present slight shortfall in numbers. Four secondees from the clearing banks and seven from firms of chartered accountants currently work in the Division. The Bank benefits from, and attaches great importance to, their contribution to the supervisory process, and acknowledges the willingness of the clearing banks and major accounting firms to find suitable secondees.

Chart 6
Staff numbers in Banking Supervision Division

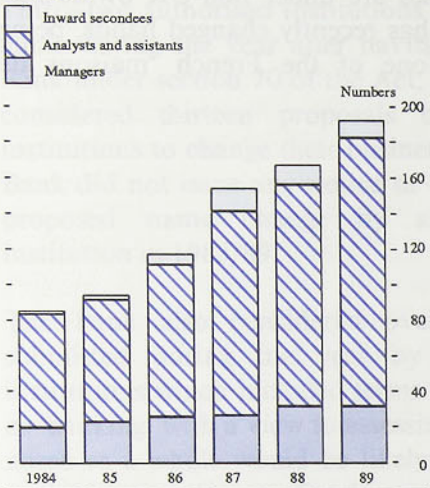


Table XIII
Allocation of Banking Supervision Division staff

	Staff(a)		Institutions(a)	
UK retail and merchant/investment banks	27	*24*	71	*71*
UK branches and subsidiaries of overseas banks	78	*63*	325	*330*
Medium and smaller UK institutions	46	*43*	146	*158*
Policy and legal matters	27	*23*	—	—
Administration	15	*15*	—	—
Total	**193**	*168*	**542(b)**	*559(b)*

(a) Figures for 1987/88 are shown in *italics*.
(b) These figures exclude the discount houses, supervised by Wholesale Markets Supervision Division.

Training

Staff attended a wide variety of external courses, most tailor-made for the Division's needs in banking, legal and accountancy matters. Internal courses are also available to members of the Division, and the Bank's comprehensive graduate training programme is attended by all new graduates. As appropriate, new entrants to the Division (including the graduate intake) also participate in a five-week training course run by the Division.

A number of staff currently working in the Division have benefited from outward secondment: at present two managers are on secondment to the banking sector, one to a merchant bank, and one to a clearing bank. It is intended to increase the scope and number of such assignments.

Visits to Banking Supervision Division

During the year over forty personnel from institutions abroad (mostly central banks) visited the Division, principally to learn something of, or to increase familiarity with, its supervisory work. Individual programmes were drawn up for each visit, most of which were of one or two days' duration. Some longer visits formed part of wider tours of the Bank generally. In addition, the Division benefits from contact with teams of overseas supervisors inspecting the UK operations of their banks.

Information systems

After two years of development, a computerised management information system was introduced in Banking Supervision Division in 1989. This enables the manipulation of a sophisticated database containing most of the statistical and textual data used in banking supervision. It is fully integrated with word processing and other office automation facilities as well as personal computing. All these are provided through a single workstation of which there are currently some 130 serving the Division. The integration of computing and office functions within a single system is the most sophisticated development yet undertaken by the Bank, and utilises components at the leading edge of current information technology. It has no known equivalent within the City.

Substantial security features have been applied to ensure that this database is available only to staff within the Division, and its development has been undertaken in such a way that maximum flexibility is provided for the changing needs of the banking supervisors. Its phased introduction and tailoring for individual needs is expected to continue throughout 1989.

Vetting of shareholder and indirect controllers of authorised institutions incorporated in the United Kingdom

All persons proposing to become shareholder controllers or indirect controllers (as defined in section 105 of the Banking Act 1987) of authorised institutions incorporated in the United Kingdom have to notify the Bank under section 21. Existing shareholder controllers are also required to notify before the voting power which they (either alone or with associates) are entitled to exercise or control rises above 50% or 75%.

The Bank will consider the person concerned in terms of the criteria in section 22(1). This subsection provides that the Bank may serve a notice of objection unless it is satisfied—

'(a) that the person concerned is a fit and proper person to become a controller of the description in question of the institution;

(b) that the interests of depositors and potential depositors of the institution would not be in any other manner threatened by that person becoming a controller of that description of the institution; and

(c) without prejudice to paragraphs (a) and (b) above, that, having regard to that person's likely influence on the institution as a controller of the description in question, the criteria in Schedule 3 to this Act would continue to be fulfilled in the case of the institution or, if any of those criteria is not fulfilled, that that person is likely to undertake adequate remedial action.'

In order to decide whether it is satisfied on these points, and whether it should give a notice of objection or non-objection, the Bank will seek information about the person concerned. It normally requires the potential controller to complete a detailed questionnaire and seeks further information and documents as appropriate, both from the potential controller and from others (including in some cases other regulatory authorities). The considerations relevant to assessing whether the person is a fit and proper person are summarised in paragraphs 2.41–2.47 of the Statement of principles published under section 16 of the Act in May 1988. The amount of information which the Bank will require will depend on its existing knowledge of the potential controller, the size of the shareholding involved, its understanding of the proposed role of the shareholder and on the nature, state and conduct of the business of the authorised institution concerned. If the proposed shareholding is to be large and the person envisages playing an active role in guiding the conduct of the authorised institution the Bank will normally require a considerable amount of information. If, on the other hand, the shareholding is to be small, the shareholder intends to play a passive role, and there are no obvious causes for concern, the information sought may be correspondingly less.

In discharging its functions under the Act, the Bank keeps under review the fulfilment of the Schedule 3 authorisation criteria, including the fit and proper criterion relating to controllers. The Bank expects both authorised institutions and the controllers themselves to inform it of any material developments which may cast doubt on the continued fitness and propriety of the controllers or which otherwise indicate a possible threat to the interests of depositors and potential depositors.

The Bank, in discharging its supervisory functions, will, as appropriate, seek further information, both from the controller and from third parties. Where the authorised institution is the subsidiary of the controller, the Bank will take account of the state and conduct of the controller and other members of its group in conducting supervision on a consolidated basis. It may use its powers under section 39(6) to require the provision of information and documents from such companies. Investigators appointed under section 41 to investigate an authorised institution may also investigate various connected companies, including holding companies. Where the shareholder controller is not a holding company the Bank may use its powers under section 39(9) to require the provision of documents and information.

The suitability of controllers may, of course, change over time. A controller's financial position may deteriorate; new ownership and management may be introduced; and the controller may decide to follow a misconceived and imprudent strategy. It is also possible that the controller's role in relation to the authorised institution may change—for example, from a passive to an interventionist role. The controller may be fit and proper to play one role but not another. As paragraph 2.41 of the statement of principles notes—

> 'Shareholder controllers and indirect controllers . . . may hold a wide variety of positions in relation to an authorised institution, and the application of the fit and proper criterion must take account of this. The key consideration is the likely or actual impact on the interests of depositors and potential depositors of a person holding his *particular position* as controller. This is viewed in the context of the circumstances of the individual case, . . .'.

Where the Bank has doubts about the continued suitability of a shareholder controller or indirect controller it will, as noted above, seek further information. It may decide that its powers to revoke have become exercisable—because in terms of section 11(1)(a) the fit and proper criterion 'may not be . . . fulfilled'. In such circumstances it has the option of revoking the authorisation, or of imposing restrictions, or of using suasion to encourage steps which would reduce the risk of harm to the authorised institution and thus to the interests of its depositors and potential depositors. The Bank might, for example, ask the controller not to play a part in the direction of the authorised institution and require the authorised institution (by the use of powers or otherwise) not to transact any new business with the controller. Part 5 of the statement of principles sets out the general principles to which the Bank has regard in deciding what action to take when its powers to revoke or restrict have become exercisable.

If it appears to the Bank that a shareholder controller of an authorised institution incorporated in the United Kingdom is not or is no longer a fit and proper person it may give that controller a notice of objection under section 24. Where a shareholder controller continues to be such a controller after having been served with such a notice the Bank may exercise its powers under section 26. The Bank may, for example, by notice in writing direct that the controller may exercise no voting rights in respect of specified shares in the authorised institution (or its holding company). It can also apply to the court, under section 26(3), to order the sale of such shares. In deciding whether to exercise its revocation or restriction powers or its powers under section 26 the Bank takes account of all the relevant facts of the particular case. In some cases, rather than use its statutory powers, the Bank may rely on measures by the authorised institution to 'insulate' itself from the controller and on undertakings by that controller to minimise his influence prior to an early sale of its shares. Sometimes it may be appropriate to use restriction powers simultaneously with the use of section 26 (for example, to remove the controller's voting power). In other cases, however, where there are also concerns about the authorised institution, revocation may be appropriate.

Appendix 2

Current supervisory notices

The following is a list of policy and practice notices issued by Banking Supervision Division which are currently in force:

Title	Date of issue
Measurement of capital	September 1980
Foreign currency exposure	April 1981
Measurement of liquidity	July 1982
Connected lending; accounts; large exposures; fraudulent invitations; floating charges (BSD/1983/1)	April 1983
Foreign currency options	April 1984
Notice on advertising code of conduct	March 1985
Note issuance facilities/revolving underwriting facilities (BSD/1985/2)	April 1985
Statistical notice to monetary sector institutions (released in conjunction with previous paper)	April 1985
Further notice on advertising code of conduct and attachments	November 1985
Large exposures in relation to mergers and acquisitions (BSD/1986/1)	February 1986
Subordinated loan capital (BSD/1986/2)	March 1986
Consolidated supervision (BSD/1986/3)	March 1986
Measurement of capital (BSD/1986/4) (amendments to the 1980 paper)	June 1986
Statistical notice to monetary sector institutions (released in conjunction with previous paper)	June 1986
Letter to authorised institutions concerning debt provisioning	August 1987
Large exposures (BSD/1987/1)	September 1987
Guidance note on accounting and other records and internal control systems and reporting accountants' reports thereon (BSD/1987/2)	September 1987
Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes (BSD/1987/3)	October 1987
The Bank of England's relationship with auditors and reporting accountants (BSD/1987/4)	December 1987
Large underwriting exposures (BSD/1987/1.1) (to be read in conjunction with the large exposures paper)	February 1988
Advertising for deposits (BSD/1988/1)	April 1988

Title	Date of issue
Supervisory treatment of ECU Treasury bills (BSD/1988/2)	October 1988
Implementation of the Basle convergence agreement in the United Kingdom (BSD/1988/3)	October 1988
Loan transfers and securitisation (BSD/1989/1)	February 1989
Consolidated supervision (BSD/1989/2) (amendment to the 1986 paper)	March 1989

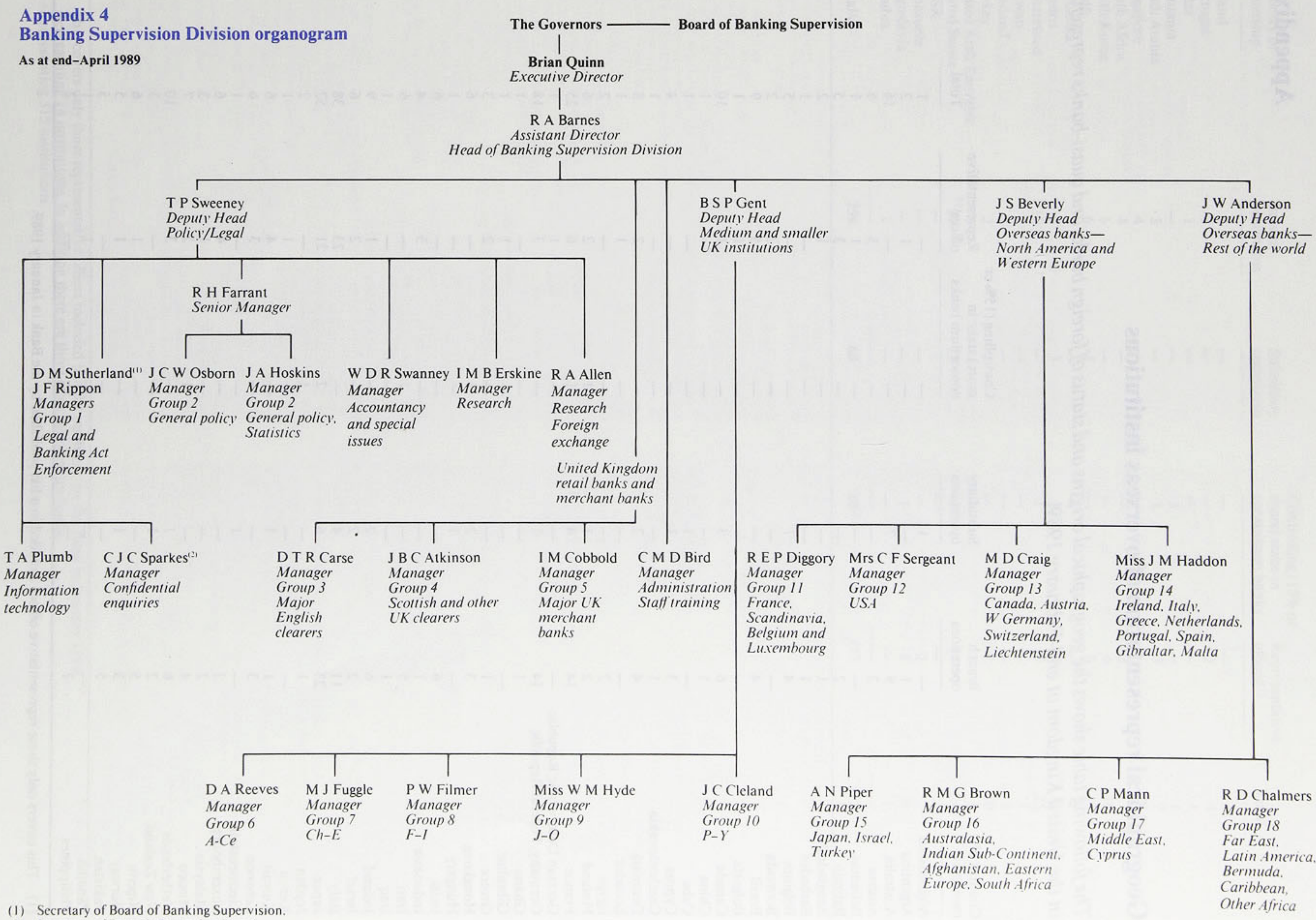
Current consultative papers

The following is a list of consultative policy papers issued by Banking Supervision Division but not formalised as policy notices; they remain open for discussion with interested parties.

Title	Date of issue
Accountants' reports to supervisors: requirements for branches of overseas banks	May 1986
The role of audit committees in banks	January 1987
Revised proposals for a stock of high quality liquidity (3/88)	December 1988

Appendix 4
Banking Supervision Division organogram

As at end–April 1989



(1) Secretary of Board of Banking Supervision.
(2) Secretary of Deposit Protection Board.

Geographical representation of overseas institutions

The following table shows the geographical origins and status of foreign banks and quasi-banks represented in the United Kingdom at end-February 1989.

Country of ownership	Branch operations	Subsidiary operations	Controlling (15% or more) stake in consortium banks	Representative offices(1)	Total
Afghanistan	—	1	—	—	1
Argentina	1	—	—	1	2
Australia	9	7	—	—	16
Austria	3	—	—	3	6
Bahamas	—	—	—	1	1
Bahrain	2	—	—	3	5
Bangladesh	1	—	—	1	2
Barbados	1	—	—	—	1
Belgium	4	1	—	—	5
Bermuda	—	—	—	2	2
Brazil	4	—	—	5	9
Bulgaria	—	—	—	1	1
Canada	6	3	—	1	10
China	1	—	—	—	1
Cuba	—	1	—	—	1
Cyprus	3	1	—	—	4
Czechoslovakia	1	—	—	—	1
Denmark	4	2	—	2	8
Ecuador	—	—	—	1	1
Egypt	2	—	—	—	2
Finland	2	1	1	2	6
France	14	4	1	6	25
German Democratic Republic	—	—	—	1	1
Germany, Federal Republic	14	1	—	3	18
Ghana	1	—	—	—	1
Gibraltar	—	—	—	1	1
Greece	1	—	—	2	3
Hongkong	3	2	1	—	6
Hungary	—	1	—	—	1
India	6	—	—	—	6
Indonesia	1	—	—	3	4
Iran	5	—	1	—	6
Iraq	1	—	—	—	1
Ireland	6	2	—	1	9
Israel	2	2	—	2	6
Italy	11	4	—	23	38
Japan	23	6	2	21	52
Jordan	1	—	1	—	2
Kenya	—	—	—	1	1
Kuwait	1	1	—	4	6
Lebanon	3	—	—	3	6
Liechtenstein	—	1	—	—	1
Luxembourg	2	—	—	4	6
Malaysia	2	—	—	1	3
Mexico	4	—	1	2	7
Netherlands	6	1	—	3	10
New Zealand	2	1	—	—	3
Nigeria	5	—	—	1	6
Norway	3	1	—	1	5
Pakistan	5	—	—	—	5
Panama	—	—	—	1	1
Philippines	2	—	—	—	2

(1) This covers only those representative offices included in a list published by the Bank in January 1989.

Country of ownership	Branch operations	Subsidiary operations	Controlling (15% or more) stake in consortium banks	Representative offices[1]	Total
Poland	1	—	—	—	1
Portugal	3	—	—	2	5
Qatar	1	—	—	—	1
Rumania	—	—	1	—	1
Saudi Arabia	3	—	1	3	7
Singapore	4	—	—	—	4
South Africa	4	—	—	3	7
South Korea	6	—	—	4	10
Spain	6	1	—	8	15
Sri Lanka	1	—	—	—	1
Sweden	3	3	1	4	11
Switzerland	10	—	1	14	25
Taiwan	1	—	—	—	1
Thailand	3	—	—	—	3
Turkey	2	1	—	7	10
United Arab Emirates	4	—	—	1	5
United States	35	18	7	14	74
USSR	—	1	—	—	1
Venezuela	—	—	—	2	2
Yugoslavia	—	—	1	8	9
Zambia	1	—	—	—	1
Totals	**256**	**68**	**20**[2]	**177**	**521**[3]

(1) This covers only those representative offices included in a list published by the Bank in January 1989.
(2) Representing 14 institutions. In addition there are three other consortium banks.
(3) Representing 515 institutions.

The authorised population

List of institutions authorised at 28 February 1989

1. UK-incorporated [1]

ANZ McCaughan Merchant Bank Ltd
Adam & Company plc
Afghan National Credit & Finance Ltd
Airdrie Savings Bank
Aitken Hume Ltd
Ak International Bank Ltd
Albaraka International Bank Ltd
Alliance Trust (Finance) Ltd
Allied Arab Bank Ltd
Anglo-Romanian Bank Ltd
Anglo Yugoslav Bank Ltd
Henry Ansbacher & Co Ltd
Arbuthnot Latham Bank Ltd
Argonaut Securities Ltd
Assemblies of God Property Trust
Associated Credits Ltd
Associated Japanese Bank (International) Ltd
Associates Capital Corporation Ltd
Atlanta Trust Ltd
Authority Bank Ltd
Avco Trust Ltd

BC Finance Ltd
BNL Investment Bank plc
Banco Hispano Americano Ltd
Bank in Liechtenstein (UK) Ltd
Bank Leumi (UK) plc
Bank of America International Ltd
Bank of Boston Ltd
Bank of Cyprus (London) Ltd
Bank of Scotland
Bank of Tokyo International Ltd
Bank of Wales plc
Bankers Trust International Ltd
Banque Belge Ltd
Banque de la Méditerranée (UK) Ltd
Banque Nationale de Paris plc
The Baptist Union Corporation Ltd
Barclays Bank plc
Barclays de Zoete Wedd Ltd
Barclays Bank Trust Company Ltd
Baring Brothers & Co Ltd
Benchmark Bank plc
Beneficial Bank plc
Boston Safe Deposit and Trust Company (UK) Ltd
British & Commonwealth Merchant Bank plc
The British Bank of the Middle East
British Credit Trust Ltd
The British Linen Bank Ltd
British Railways Savings Company Ltd
Brown, Shipley & Co Ltd
Bunge Finance Ltd
Burns-Anderson Trust Company Ltd
Business Mortgages Trust plc

CL-Alexanders Discount plc
Canadian Laurentian Bank Ltd
James Capel Bankers Ltd
Cater Allen Ltd
Central Capital Mortgage Corporation Ltd
Chancery plc
The Charities Aid Foundation Money Management Company Ltd
Charter Consolidated Financial Services Ltd
Chartered Trust plc
Charterhouse Bank Ltd
Chase Investment Bank Ltd
Chesterfield Street Trust Ltd
Citibank Trust Ltd
Citicorp Investment Bank Ltd
City Merchants Bank Ltd
City Trust Ltd
Clive Discount Company Ltd
Close Brothers Ltd
Clydesdale Bank plc
Clydesdale Bank Finance Corporation Ltd
Combined Capital Ltd
The Commercial Bank of the Near East plc
Consolidated Credits Bank Ltd
Co-operative Bank plc
Coutts & Co
Coutts Finance Co
Craneheath Securities Ltd
Credito Italiano International Ltd
Credit Suisse First Boston Ltd

Daiwa Europe Bank plc
Dalbeattie Finance Co Ltd
Darlington Merchant Credits Ltd
Dartington & Co Ltd
Deacon Hoare & Co Ltd
Den norske Creditbank plc
The Dorset, Somerset & Wilts Investment Society Ltd
Dryfield Finance Ltd
Dunbar Bank plc
Duncan Lawrie Ltd

EBC Amro Bank Ltd
E T Trust Ltd
Eagil Trust Co Ltd
East Trust Ltd
Eccles Savings and Loans Ltd
Edington plc
Enskilda Securities-Skandinaviska Enskilda Ltd
Equatorial Bank plc
Euro-Latinamerican Bank plc
Everett Chettle Associates
Exeter Trust Ltd

FIBI Bank (UK) Ltd
Fairmount Trust Ltd
Family Finance Ltd
Federated Trust Corporation Ltd
FennoScandia Bank Ltd
Financial & General Bank plc
James Finlay Bank Ltd
First Indemnity Credit Ltd
First Interstate Capital Markets Ltd
First National Bank plc
First National Commercial Bank plc
Robert Fleming & Co Ltd
Ford Financial Trust Ltd
Ford Motor Credit Co Ltd
Foreign & Colonial Management Ltd
Forward Trust Ltd
Robert Fraser & Partners Ltd
Frizzell Banking Services Ltd

Gartmore Money Management Ltd
Gerrard & National Ltd
Girobank plc
Goldman Sachs Ltd
Goode Durrant Bank plc
Granville Trust Ltd
Gresham Trust plc
Greyhound Bank Ltd
Grindlays Bank plc
Guinness Mahon & Co Ltd
Gulf Guarantee Bank plc

HFC Bank plc
Habibsons Bank Ltd
Hambros Bank Ltd
Hampshire Trust plc
The Hardware Federation Finance Co Ltd
Harrods Bank Ltd
Harton Securities Ltd
Havana International Bank Ltd
The Heritable & General Investment Bank Ltd
Hill Samuel Bank Ltd
Hill Samuel Personal Finance Ltd

(1) Including partnerships formed under the law of any part of the United Kingdom.

C Hoare & Co
Julian Hodge Bank Ltd
Holdenhurst Securities plc
Humberclyde Finance Group Ltd
Hungarian International Bank Ltd

3i plc
3i Group plc
IBJ International Ltd
Industrial Funding Trust Ltd
International Commercial Bank plc
International Mexican Bank Ltd
International Westminster Bank plc
Iran Overseas Investment Bank Ltd
Itab Bank Ltd
Italian International Bank plc

Jabac Finances Ltd
Japan International Bank Ltd
Jordan International Bank plc
Leopold Joseph & Sons Ltd

King & Shaxson Ltd
Kleinwort Benson Ltd

Lazard Brothers & Co Ltd
Libra Bank plc
Little Lakes Finance Ltd
Lloyds Bank plc
Lloyds Bank (BLSA) Ltd
Lloyds Bank (France) Ltd
Lloyds Bowmaker Ltd
Lloyds Merchant Bank Ltd
Lombard Bank Ltd
Lombard & Ulster Ltd
Lombard North Central plc
London Arab Investment Bank Ltd
London & Continental Bankers Ltd
London Law Securities Ltd
London Scottish Bank plc
Lordsvale Finance plc

MLA Bank Ltd
McDonnell Douglas Bank Ltd
McNeill Pearson Ltd
Manchester Exchange and Investment Bank Ltd
W M Mann & Co (Investments) Ltd
Manufacturers Hanover Ltd
The Mardun Investment Co Ltd
Marks and Spencer Financial Services Ltd
Mase Westpac Ltd
Matheson Bank Ltd
Medens Trust Ltd
Meghraj Bank Ltd
Mercantile Credit Company Ltd
Mercury Provident plc
Merrill Lynch International Bank Ltd
The Methodist Chapel Aid Association Ltd
Midland Bank plc
Midland Bank Finance Corporation Ltd
Midland Bank Trust Company Ltd
Minories Finance Ltd
Minster Trust Ltd
Moneycare Ltd
Samuel Montagu & Co Ltd
Moorgate Mercantile Holdings plc
Morgan Grenfell & Co Ltd
Moscow Narodny Bank Ltd
Mount Banking Corporation Ltd
Mutual Trust and Savings Ltd
Mynshul Bank Ltd

NIIB Group Ltd
National Guardian Mortgage Corporation Ltd
National Westminster Bank plc
NatWest Investment Bank Ltd
The Nikko Bank (UK) plc
Noble Grossart Ltd
Nomura Bank International plc
Northern Bank Ltd
Northern Bank Executor & Trustee Company Ltd
North West Securities Ltd
Norwich General Trust Ltd

Omega Trust Co Ltd
Orion Royal Bank Ltd

PK English Trust Company Ltd
PaineWebber International Bank Ltd
Panmure Gordon Bankers Ltd
The People's Bank Ltd
Philadelphia National Ltd
Pointon York Ltd
Postipankki (UK) Ltd
Prestwick Investment Trust plc
Privatbanken Ltd
Provincial Bank plc

Quin Cope Ltd

Ralli Investment Company Ltd
R Raphael & Sons plc
Rathbone Bros & Co Ltd
Rea Brothers Ltd
Reliance Bank Ltd
Riggs A P Bank Ltd
N M Rothschild & Sons Ltd
Roxburghe Guarantee Corporation Ltd
The Royal Bank of Scotland plc
Royal Trust Bank
RoyScot Trust plc

SDS Bank Ltd
SFE Bank Ltd
SP Finance Ltd
Sangster Trust Corporation
Saudi International Bank
(Al-Bank Al-Saudi Al-Alami Ltd)
Scandinavian Bank Group plc
Schroder Leasing Ltd
J Henry Schroder Wagg & Co Ltd
Scotiabank (UK) Ltd
Scottish Amicable Money Managers Ltd
Seccombe Marshall & Campion plc
Secure Homes Ltd
Security Pacific Trust Ltd
Shire Trust Ltd
Singer & Friedlander Ltd
Smith & Williamson Securities
Société Générale Merchant Bank plc
Southsea Mortgage & Investment Co Ltd
Spry Finance Ltd
Standard Chartered Bank
Standard Chartered Bank Africa plc
Standard Chartered Merchant Bank Ltd
Standard Property Investment plc
Sterling Bank & Trust Ltd
Svenska International plc

TSB England & Wales plc
TSB Northern Ireland plc
TSB Scotland plc
Treloan Ltd
Trucanda Trusts Ltd
Tyndall & Co Ltd

UBAF Bank Ltd
UCB Bank plc
Ulster Bank Ltd
Ulster Bank Trust Company
Union Discount Company Ltd
The United Bank of Kuwait plc
United Dominions Trust Ltd
Unity Trust Bank plc

Wagon Finance Ltd
Wallace, Smith Trust Co Ltd
S G Warburg & Co Ltd
S G Warburg Discount Ltd
Welbeck Finance plc
Western Trust & Savings Ltd
Whiteaway Laidlaw Bank Ltd
Wimbledon & South West Finance Co Ltd
Wintrust Securities Ltd

Yamaichi Bank (UK) plc
Yorkshire Bank plc
H F Young & Co Ltd

2. Incorporated outside the United Kingdom(1)

African Continental Bank Ltd
Algemene Bank Nederland NV
Allied Bank of Pakistan Ltd
Allied Banking Corporation
Allied Irish Banks plc
Allied Irish Finance Co Ltd
Allied Irish Investment Bank plc
Al Saudi Banque SA
American Express Bank Ltd
Amsterdam-Rotterdam Bank NV
Arab African International Bank
Arab Bank Ltd
Arab Banking Corporation BSC
Australia & New Zealand Banking Group Ltd

(1) Includes partnerships or other unincorporated associations formed under the law of any member State of the European community other than the United Kingdom.

Banca Commerciale Italiana
Banca della Svizzera Italiana
Banca Nazionale dell'Agricoltura SpA
Banca Nazionale del Lavoro
Banca Serfin SNC
Banco Bilbao-Vizcaya
Banco Central, SA
Banco de la Nación Argentina
Banco de Sabadell
Banco de Santander, SA
Banco di Napoli
Banco di Roma SpA
Banco di Santo Spirito
Banco di Sicilia
Banco do Brasil SA
Banco do Estado de São Paulo SA
Banco Espirito Santo e Comercial de Lisboa
Banco Exterior – UK SA
Banco Mercantil de São Paulo SA
Banco Nacional de México SNC
Banco Português do Atlântico
Banco Real SA
Banco Totta & Açores SA
Bancomer SNC
Bangkok Bank Ltd
Bank Julius Baer & Co Ltd
Bank Bumiputra Malaysia Berhad
Bank für Gemeinwirtschaft AG
Bank Handlowy w Warszawie SA
Bank Hapoalim BM
Bank Mees & Hope NV
Bank Mellat
Bank Melli Iran
Bank Negara Indonesia 1946
Bank of America NT & SA
Bank of Baroda
The Bank of California NA
Bank of Ceylon
Bank of China
Bank of Credit and Commerce International SA
Bank of India
The Bank of Ireland
The Bank of Montreal
Bank of New England NA
The Bank of New York
Bank of New Zealand
The Bank of Nova Scotia
Bank of Oman Ltd
Bank of Seoul
The Bank of Tokyo, Ltd
The Bank of Yokohama, Ltd
Bank Saderat Iran
Bank Sepah-Iran
Bank Tejarat
Bankers Trust Company
Banque Arabe et Internationale d'Investissement
Banque Belgo-Zairoise SA
Banque Bruxelles Lambert SA
Banque du Liban et d'Outre-Mer SAL
Banque Française du Commerce Extérieur
Banque Indosuez
Banque Internationale à Luxembourg SA
Banque Internationale pour L'Afrique Occidentale SA
Banque Nationale de Paris
Banque Paribas
Banque Worms
Barbados National Bank
Bayerische Hypotheken – und Wechsel – Bank AG
Bayerische Landesbank Girozentrale
Bayerische Vereinsbank
Beirut Riyad Bank SAL
Bergen Bank A/S
Berliner Bank AG
Berliner Handels-und Frankfurter Bank
Byblos Bank SAL

CIC – Union Européenne, International et Cie
Caisse Nationale de Crédit Agricole
Canadian Imperial Bank of Commerce
Canara Bank
Cassa di Risparmio delle Provincie Lombarde
The Chase Manhattan Bank, NA
Chemical Bank
Cho Hung Bank
Christiania Bank og Kreditkasse
The Chuo Trust & Banking Co, Ltd
Citibank NA
Commercial Bank of Korea Ltd
Commerzbank AG
Commonwealth Bank of Australia
Confederacion Española de Cajas de Ahorros
Continental Bank, National Association
Copenhagen Handelsbank A/S
Crédit Commercial de France
Crédit du Nord
Crédit Lyonnais
Crédit Lyonnais Bank Nederland NV
Crédit Suisse
Creditanstalt-Bankverein

Credito Italiano
Cyprus Credit Bank Ltd
The Cyprus Popular Bank

The Dai-Ichi Kangyo Bank, Ltd
The Daiwa Bank, Ltd
Den Danske Bank af 1871 Aktieselskab
Deutsche Bank AG
Deutsche Genossenschaftsbank
The Development Bank of Singapore Ltd
Discount Bank and Trust Company
Dresdner Bank AG

Fidelity Bank NA
First Bank National Association
First Bank of Nigeria Ltd
First City National Bank of Houston
First Commercial Bank
First Interstate Bank of California
The First National Bank of Boston
The First National Bank of Chicago
First Wisconsin National Bank of Milwaukee
Fleet National Bank
French Bank of Southern Africa Ltd
The Fuji Bank Ltd

Generale Bank
Ghana Commercial Bank
Girozentrale und Bank der österreichischen Sparkassen AG
Götabanken
Gulf International Bank BSC

Habib Bank AG Zurich
Habib Bank Ltd
Hanil Bank
Harris Trust and Savings Bank
Hessische Landesbank-Girozentrale
The Hokkaido Takushoku Bank Ltd
The Hongkong and Shanghai Banking Corporation

The Industrial Bank of Japan, Ltd
The Investment Bank of Ireland Ltd
Irving Trust Company
Istituto Bancario San Paolo di Torino

Jyske Bank

Kansallis-Osake-Pankki
Keesler Federal Credit Union
Korea Exchange Bank
Korea First Bank
Kredietbank NV
The Kyowa Bank, Ltd

The Long-Term Credit Bank of Japan, Ltd

Malayan Banking Berhad
Manufacturers Hanover Trust Company
Mellon Bank, NA
Middle East Bank Ltd
The Mitsubishi Bank, Ltd
The Mitsubishi Trust and Banking Corporation
The Mitsui Bank, Ltd
The Mitsui Trust & Banking Co Ltd
Monte dei Paschi di Siena
Morgan Guaranty Trust Company of New York
Multibanco Comermex SNC
Muslim Commercial Bank Ltd

NCNB National Bank of North Carolina
NCNB Texas National Bank
National Australia Bank Ltd
National Bank of Abu Dhabi
National Bank of Canada
National Bank of Detroit
The National Bank of Dubai Ltd
National Bank of Egypt
National Bank of Greece SA
The National Bank of Kuwait SAK
The National Bank of New Zealand Ltd
National Bank of Nigeria Ltd
The National Commercial Bank
National Bank of Pakistan
Nedbank Ltd
Nederlandsche Middenstandsbank NV
New Nigeria Bank Ltd
The Nippon Credit Bank, Ltd
Norddeutsche Landesbank Girozentrale
The Northern Trust Company

Osterreichische Länderbank AG
Oversea-Chinese Banking Corporation Ltd
Overseas Trust Bank Ltd
Overseas Union Bank Ltd

Philadelphia National Bank
Philippine National Bank
Provinsbanken A/S

Qatar National Bank SAQ

Rabobank Nederland
(Coöperatieve Centrale Raiffeisen-Boerenleenbank BA)
Rafidain Bank
Republic National Bank of New York
Reserve Bank of Australia
The Riggs National Bank of Washington, DC
Riyad Bank
The Royal Bank of Canada
The Rural and Industries Bank of Western Australia

The Saitama Bank, Ltd
The Sanwa Bank, Ltd
Saudi American Bank
Seattle-First National Bank
Security Pacific National Bank
Shanghai Commercial Bank Ltd
The Siam Commercial Bank, Ltd
Skandinaviska Enskilda Banken
Société Générale
Sonali Bank
State Bank of India
State Bank of New South Wales
State Bank of South Australia
State Bank of Victoria
State Street Bank and Trust Company
Südwestdeutsche Landesbank Girozentrale
The Sumitomo Bank, Ltd
The Sumitomo Trust & Banking Co Ltd
Svenska Handelsbanken
Swiss Bank Corporation
Swiss Cantobank (International)
Swiss Volksbank

Syndicate Bank

TC Ziraat Bankasi
TDB American Express Bank
The Taiyo Kobe Bank, Ltd
The Thai Farmers Bank Ltd
The Tokai Bank, Ltd
The Toronto-Dominion Bank
The Toyo Trust & Banking Company, Ltd
The Trust Bank of Africa Ltd
Turkish Bank Ltd
Türkiye Iş Bankasi AŞ

Uco Bank
Ulster Investment Bank Ltd
Union Bank of Finland Ltd
Union Bank of Nigeria Ltd
Union Bank of Norway
Union Bank of Switzerland
United Bank Ltd
United Mizrahi Bank Ltd
United Overseas Bank
(Banque Unie pour les Pays d'Outre Mer)
United Overseas Bank Ltd

Volkskas Ltd

Westdeutsche Landesbank Girozentrale
Westpac Banking Corporation

The Yasuda Trust & Banking Co Ltd

Zambia National Commercial Bank Ltd
Živnostenská Banka National Corporation

Changes to the list of authorised institutions

The following changes were made during the year to the list of authorised institutions:

Additions

1. UK-incorporated

Boston Safe Deposit and Trust Company (UK) Ltd
Central Capital Mortgage Corporation Ltd[1]
S G Warburg Discount Ltd[2]

2. Incorporated outside the United Kingdom

Al Saudi Banque SA[3]
Banco Bilbao-Vizcaya[4]
Banque Arabe et Internationale d'Investissement
Generale Bank
Monte dei Paschi di Siena
NCNB Texas National Bank
Provinsbanken A/S
Südwestdeutsche Landesbank Girozentrale
Union Bank of Norway

Deletions

1. UK-incorporated

A1 Credit plc
Atlantic International Bank Ltd
Auban Finance Ltd
BAII plc
Bradford Investments plc
Castle Phillips Finance Co Ltd
Central Capital Mortgage Corporation Ltd[1]
Chemical Bank International Ltd
Cyprus Finance Corporation (London) Ltd
Dunsterville Allen plc
East Midlands Finance Co Ltd
Ensign Finance Ltd,
Euromed Fundings Ltd
European Brazilian Bank plc
H T Greenwood Ltd
Legal & General (Money Managers) Ltd
Northern Bank Development Corporation Ltd
Phillips & Drew Trust Ltd
SBCI Swiss Bank Corporation Investment banking Ltd
The Teachers & General Investment Co Ltd
Thorncliffe Finance Ltd

2. Incorporated outside the United Kingdom

Al Saudi Banque SA[3]
Badische Kommunale Landesbank Girozentrale
Banco de Bilbao SA[4]
Banco de Vizcaya SA[4]
First RepublicBank Dallas, NA
Landesbank Stuttgart Girozentrale
National Bank of Fort Sam Houston

Name changes

1. UK-incorporated

ANZ Merchant Bank Ltd	*to*	ANZ McCaughan Merchant Bank Ltd
Beneficial Trust Ltd	*to*	Beneficial Bank plc
Carlyle Finance Ltd	*to*	Julian Hodge Bank Ltd
Chancery Securities plc	*to*	Chancery plc
Commercial Financial Services Ltd	*to*	UCB Bank plc
Consolidated Credits & Discounts Ltd	*to*	Consolidated Credits Bank Ltd
East Anglian Securities Trust Ltd	*to*	East Trust Ltd
Financial & General Securities Ltd	*to*	Financial & General Bank plc
James Finlay Corporation Ltd	*to*	James Finlay Bank Ltd
First National Securities Ltd	*to*	First National Bank plc
Goode Durrant Trust plc	*to*	Goode Durrant Bank plc
Greyhound Guaranty Ltd	*to*	Greyhound Bank Ltd
Gulf Guarantee Trust Ltd	*to*	Gulf Guarantee Bank plc
HFC Trust & Savings Ltd	*to*	HFC Bank plc
Harrods Trust Ltd	*to*	Harrods Bank Ltd
Hill Samuel & Co Ltd	*to*	Hill Samuel Bank Ltd
Investors in Industry plc	*to*	3i plc
Investors in Industry Group plc	*to*	3i Group plc
Mynshul Trust Ltd	*to*	Mynshul Bank Ltd
National Guardian Finance Corporation Ltd	*to*	National Guardian Mortgage Corporation Ltd
Oppenheimer Money Management Ltd	*to*	Gartmore Money Management Ltd
The People's Trust & Savings Ltd	*to*	The People's Bank Ltd
Rathbone Bros & Co	*to*	Rathbone Bros & Co Ltd
Reliance Trust Ltd	*to*	Reliance Bank Ltd
Shawlands Securities Ltd	*to*	Frizzell Banking Services Ltd
Svenska Handelsbanken plc	*to*	Svenska International plc
TCB Ltd	*to*	First National Commercial Bank plc
Thames Trust Ltd	*to*	Banque de la Méditerranée (UK) Ltd
Vernons Trust Corporation	*to*	Sangster Trust Corporation

2. Incorporated outside the United Kingdom

Banco Totta & Açores EP	*to*	Banco Totta & Açores SA
Continental Illinois National Bank and Trust Company of Chicago	*to*	Continental Bank, National Association
Trade Development Bank	*to*	TDB American Express Bank

(1) The former company of this name changed its name to Central Capital Holdings Ltd on 30 June and a company recently authorised in the name of Central Capital Mortgages (UK) Ltd changed its name to Central Capital Mortgage Corporation Ltd on the same date.

(2) Supervised by Wholesale Markets Supervision Division.

(3) Following a change in its ownership, the business of Al Saudi Banque SA was transferred to a new legal entity which was named Al Saudi Banque SA. The entity previously called Al Saudi Banque SA has ceased to be authorised.

(4) Following the merger of Banco de Bilbao SA and Banco de Vizcaya SA the two banks surrendered their authorisation and all business was transferred to the newly authorised institution Banco Bilbao-Vizcaya.

Annual Report by the Board of Banking Supervision

Board of Banking Supervision
Membership as at 28 February 1989

Chairman:	The Rt Hon Robert Leigh-Pemberton	*ex officio*
	Sir George Blunden	*ex officio*
	Brian Quinn	*ex officio*
	Sir Donald Barron	
	J A Caldecott	
	A J Hardcastle	
	N J Robson	
	Harry Taylor	
	Sir Philip Wilkinson	

This is the Board's report for the year to the end of February 1989. There were two changes in the membership of the Board during the year. Mr Brian Quinn became an ex-officio member as Executive Director of the Bank responsible for banking supervision in succession to Mr R D Galpin, who resigned from his position as Director of the Bank with effect from 31 March 1988. Sir Philip Wilkinson was appointed to the Board with effect from 30 September 1988 in the place of Mr Deryk Vander Weyer, who resigned on grounds of ill-health. The Board wishes to express its gratitude to Mr Vander Weyer for the major contribution he made as a member of both the Board and its non-statutory predecessor.

The Board met thirteen times during the year. It maintained under review all aspects of the Bank's work relating to its responsibilities under the Banking Act; the independent members gave advice to the ex-officio members on matters of supervisory policy and on the conduct of individual cases.

Reports on the work of Banking Supervision Division were received each month. These dealt with both matters of general policy and the Bank's handling of individual cases—in particular, those in which formal action under the Act might be required. The independent members identified several issues on which they saw a need to have further information; and in these and other cases offered advice where they thought it right to do so. In addition, the Bank sought the views of the independent members on a wide range of questions, including those raised by all consultative papers issued by the Division. During the year there were no instances of disagreement between the ex-officio and the independent members requiring notification to the Chancellor of the Exchequer pursuant to section 2(5) of the Act.

The Board reviewed developments relating to a large number of authorised institutions and covering a wide range of circumstances. Some of the most difficult cases related to questions of the suitability of controllers or intending controllers. The Board played an active part during the year in advising the Bank in relation to the position of Equiticorp International plc as controller of Guinness Mahon & Co Ltd.

The Board advised on several policy issues, perhaps the most important and difficult of which was the Bank's treatment of loan transfers and securitisation. In particular, members considered detailed comments from the British Bankers' Association on the Bank's proposals regarding asset packaging schemes and mortgage funding vehicles. They contributed to the thinking on the set of conditions now published which, if met, would enable the Bank to be satisfied that the attendant risks had been fully removed from banks' balance sheets and that the assets could be disregarded for capital adequacy purposes.

The Board provided further advice on the rules applying to 'expert' underwriters in the context of the Bank's large exposures policy. In the light of the Board's comments, the Bank modified its original proposals to permit an additional element of flexibility.

Members considered the implications of the possible conversion of building societies to company status. They offered advice on appropriate capital ratios for societies that do convert, having regard to the broader range of business to be undertaken and the problem of priority liquidation rights.

The Board also discussed papers on banks' recent experience in the fields of property and consumer credit lending and three papers dealing with specific sectors of the banking industry.

Secretary, by order of the Board