Bank of England Banking Act report for 1994/95

Banking Act 1987

Annual report under the Banking Act for 1994/95

This report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 28 February 1995 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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Introduction

The structure of this year's Annual Report differs from that of previous years. **Part I** picks out six subjects which have been given priority in our work and which are of wider interest. The first five are described in terms intended to encourage debate.

Part II, which follows, provides the **macroeconomic context** to the year's events, the **market developments** of which are summarised in **Part III**. This is followed by **policy developments** in **Part IV** and by a description of the **legal framework and operational supervision** in **Part V**. Finally, **Part VI** reviews the **organisation and staffing of Supervision and Surveillance** (formerly Banking Supervision Division).

It should be noted that this Report does not deal at any length with the problems of Barings, which went into administration at the end of the 1994/95. A brief factual record is provided in the 'Market Developments' section of Part III. Analysis must await the publication of the results of the Inquiry described there.

Part I

Principal developments and priorities

Lending conditions in the UK market

The past year has seen a marked relaxation of lending conditions for large corporate borrowers in the United Kingdom. The most visible sign of this easing has been a sharp fall in margins on syndicated lending which are now at the lowest levels seen since 1989. Other indications can be found in lower fees, lengthening maturities and looser covenant standards. Competition to lend to the highest-quality corporate borrowers has been intense as many banks have largely dealt with the asset quality problems of the early 1990s and have seen their capital rise well above minimum supervisory requirements. At the same time, demand for bank credit from companies has been low (see Part II).

From a supervisory perspective, a key concern is that banks may no longer be charging borrowers adequately for the risks they are taking. There could be good reasons why margins on lending to high-quality companies should have fallen. Banks may be reducing the risk premium they charge borrowers in the expectation of a period of more stable economic growth. The formal risk-pricing systems for

lending adopted by some banks[1] may also suggest lending to highly rated corporate borrowers as part of a diversified loanbook warrants narrower margins. There is a risk, though, that tighter margins on lending to high-quality borrowers will drag down margins for less creditworthy borrowers and that banks will be tempted to boost their interest income by taking on lower-quality lending on which margins are higher but do not adequately reflect the additional risk.

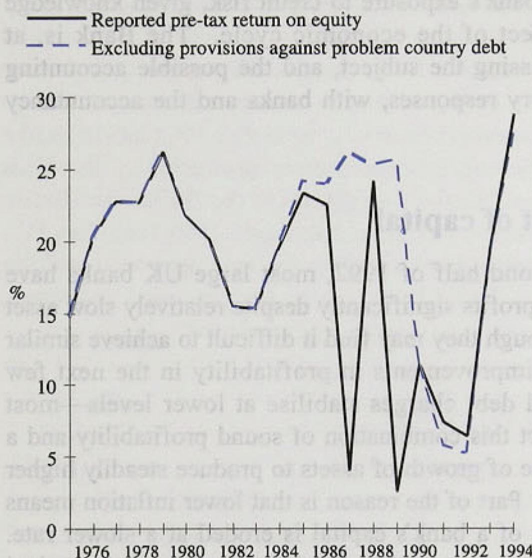
It is often argued that another reason for the reductions in margins is that banks now pay greater attention to the value of the whole customer relationship, including other 'ancillary' business, rather than the return to lending alone. Lending syndicates are typically smaller than, say, five years ago, with participating banks often drawn from those which the customer has decided to use regularly for its banking needs. As a result, it is said, banks may be more prepared than in the past to acquiesce in low margins on straightforward lending, which they see as the key to other, more profitable, business. Although this may be true, banks need to ensure they have the systems to measure the total return on a relationship in this way. The risk is that projections of the volume, profitability or durability of ancillary business available to offset low margins on lending may prove to have been exaggerated, especially if many of the banks in the syndicate are competing for the same business.

Not all the competition to lend has been on price: in a number of cases loan covenants have also been loosened. This is a worrying development. A willingness to compromise on standards of financial covenants may mean the scope for lenders to monitor the financial health of borrowers, receive early warning of problems and press for remedial action is considerably diminished. This presumes that the covenants specified are relevant and it may be that the resistance of borrowers stems from cases in which financial ratios have been applied in inappropriate or excessively formulaic ways in the past. The ratios covered in loan documentation should, in theory, correspond closely to those which prudent borrowers already monitor as part of their financial management and hence be neither unfamiliar nor unduly restrictive. Resistance to such covenants in a borrowers' market suggests both sides may have lost sight of their value to some extent and it is time to re-consider their content in the light of what they are designed to achieve. In the long run, banks will lose out if they allow lending standards to slip and properly worded covenants have an important role to play in ensuring that high standards are maintained.

(1) See box at the end of Part III for more detail on such techniques.

Chart 1

Large UK banks: Pre-tax return on equity 1975-94



The cyclical nature of bank profitability and provisioning policy

Bank profits tend to move in line with the economic cycle (see Chart 1). This pattern is driven by changes in the charge for bad and doubtful debts (of the main determinants of profit, this is much more closely correlated with the state of the economy than are income and costs). The bad debt charge is the way credit risk is recognised in a bank's profit and loss account. Current accounting practice is to make a specific provision for credit risk only when the recovery of a loan is in serious doubt following a deterioration in the creditworthiness of the borrower. As a result, the bad debt charge is related to changes in the observed incidence of borrower default rather than changes in the amount of credit risk the bank is running. This creates a timing difference between the recognition of income and credit risk on loans in a bank's accounts. Banks tend to expand their loanbooks in an economic upturn and take all the income from the new lending into profit, even though part of the lending margin was charged to cover expected future credit losses. In a subsequent recession, a bank's bad debt charge will reflect the credit risk which the bank knowingly took on—and charged for in its lending margin—as well as any unexpected credit losses due to underestimation of the severity of the economic downturn or of the credit risk inherent in the portfolio.

This timing difference can raise supervisory concerns. A bank which expands its loanbook and increases its exposure to credit risk will initially appear more profitable and expand its capital base as it takes the extra income to its reserves. Only some years later will the increased risk be reflected in the bank's accounts.

It is also an important reason why it can be misleading to look at one year's bank profits in isolation. UK banks achieved record levels of profitability in 1994—the aggregate pre-tax return on equity of the large UK banks was 29% compared with an average of around 14% in 1983-93—but this was in the context of UK economic recovery. Profits will almost certainly decline when the economic cycle turns down, although this decline will be less severe to the extent that greater macroeconomic stability is achieved in the United Kingdom.

The bank profit cycle has become more pronounced over the last two decades. This may reflect a greater willingness by banks to accept higher risks (leading to more bad debts) but with an associated rise in operating income. If this is the case, the timing difference between changes in credit risk and their recognition in a bank's accounts has become a more important concern.

In theory the problem could be addressed by changing the way banks account for loans: for example, by setting aside a provision against the 'expected loss' at the time a loan is made or by deferring the recognition of part of the income from new lending. These possibilities raise difficult conceptual and practical problems, as does the alternative that the Bank take account of the issue in its supervisory requirements. Nonetheless, it should be possible to find a way in which either provisioning or capital requirements can better reflect changes in a bank's exposure to credit risk, given knowledge about the effect of the economic cycle. The Bank is, at present, discussing the subject, and the possible accounting and supervisory responses, with banks and the accountancy profession.

Repayment of capital

Since the second half of 1992, most large UK banks have increased net profits significantly despite relatively slow asset growth. Although they may find it difficult to achieve similar year-on-year improvements in profitability in the next few years—as bad debt charges stabilise at lower levels—most analysts expect this combination of sound profitability and a fairly slow rate of growth of assets to produce steadily higher capital ratios. Part of the reason is that lower inflation means the real value of a bank's capital is eroded at a slower rate. Put another way, in a world of stable prices, banks' nominal balance sheets will only increase in size if they do more business in volume terms.

Most banks seek to maintain a margin of comfort above the minimum capital requirements set by the supervisors (which in turn reflect the need for banks to have adequate capital in relation to the nature and scale of their operations). As a supervisor, the Bank takes comfort from strong capitalisation of banks but recognises that it may be economically inefficient for banks to maintain capital well in excess of their needs. There is also a risk that resistance from supervisors to attempts by banks to reduce surplus capital could encourage an expansion of balance sheets, whether by new lending or acquisition, into areas which will not earn an adequate risk-adjusted return. The Bank has therefore reviewed the circumstances in which it is willing to allow banks to repay capital (or, in the case of subordinated term debt, to pre-pay it). For the Bank to consent, it will need to be convinced that the institution's capital is in excess of its needs for the foreseeable future. This requirement will be more onerous where a bank is seeking to repay Tier 1 capital rather than Tier 2 capital. The Bank's willingness to consider repayments of Tier 1 is, nonetheless, a relaxation of its previous policy[1]

(1) As set out in the Statement of Principles which it has published under section 16 of the Banking Act 1987.

where no net repayment of permanent shareholders equity (Tier 1) was envisaged, except where a bank had fundamentally reduced the scale of its business.

The Capital Adequacy Directive, Basle and VAR models

The Capital Adequacy Directive (CAD) comes into effect on 1 January 1996. For the first time, this will provide a framework for the measurement of market risk applying to all EU banks (hitherto capital adequacy requirements have focused on the measurement of credit risk).

Since the CAD was agreed in 1993, many banks have increased their securities trading activities (and, in some cases, their exposure to market risk). The more sophisticated banks have also invested heavily in systems to measure market risk more accurately for their internal control purposes. Much of this work has been based on the development of in-house 'value-at-risk' (VAR) models.[1] Over the last year, banking supervisors in the European Union and in the Basle Committee on Banking Supervision have been considering whether they should incorporate this work in their supervision and, if so, how.

At the heart of the debate has been the fact that the framework set out in the CAD, and also in the 1993 Basle Consultative Paper on Market Risk, is based on a different methodology, commonly known as the 'building block' or 'standardised' approach. Although the capital charges it specifies are derived from empirical analysis and take account of some hedges—for example, long and short positions in the same stock index—they do not make any allowance for the fact that the risks inherent in a large, diversified portfolio are likely to be less than a simple aggregation would suggest.[2]

Banks with large, diversified trading books have argued that supervisors should permit use of VAR models to calculate capital charges because these do take account of such portfolio effects. Although recognising that relatively few banks currently have VAR models covering all their trading activities, the Basle supervisors have accepted this argument in principle, and have proposed supervisory safeguards that would need to accompany the wider use of VAR models. A revised consultative paper was published in April and the Basle market risk package is expected to be finalised at the end of the year, with implementation due by 1998.

In the meantime, banks will have to comply with the capital requirements of the CAD from 1 January 1996. For many, this will represent an improvement in their control of market

(1) For an explanation and further detail see the box in Part IV.

(2) This is because the various market risks to which such a bank is exposed are unlikely to crystallise, and lead to losses, at the same time.

risk. But for the relatively few that currently use VAR models meeting the standards Basle has proposed, the systems needed to ensure compliance with the CAD on a daily basis may duplicate internal risk-management models which may themselves be used to calculate capital requirements in the future. In order to reduce the costs to this group of banks, supervisors in the European Union have agreed an approach to implementation called 'benchmarking'. Banks opting for this approach would calculate their CAD capital requirement using the standardised methodology on dates set *ex post* by the supervisor. They would then be required to hold capital based on the higher of this benchmark amount (scaled up proportionately in line with any subsequent increase in the capital requirement produced by the bank's VAR model) and a multiple of the capital requirement produced by the VAR model, calculated in the way set out in the Basle consultative proposal on market risk issued in April 1995 (see Part IV). As a result, while banks opting for this approach will be complying with the CAD, their need for additional investment in reporting systems should be much reduced.

Derivatives disclosure

Throughout 1994/95 the Bank has participated fully in a number of internationally co-ordinated initiatives to improve information about over-the-counter derivative markets.[1] While central banks have a general interest in information concerning the scale of activity in individual derivative markets, supervisory interest is twofold. First, ensuring that banks disclose, through their public accounts, information that allows investors and depositors to make informed decisions about the nature of their business and the scale of risks run; and second, ensuring that data provided to supervisors is comprehensive. There have been a number of important private-sector initiatives[2] to improve disclosure of derivatives activities over the past year. The contribution of the working party set up by the G10 Central Bank Governors which produced the 'Fisher Report'[3] is also welcome and timely.

As regards supervisory information provided to the Bank, existing requirements already capture credit risk, while the introduction of the CAD will greatly improve the data received on the market risks in trading books. The Bank has collaborated with other Basle supervisors to review and assess what information supervisors require in this area.

(1) See box in Part IV for details.

(2) Eg. 'A Preliminary Framework for Public Disclosure of Derivatives Activities and related Credit Exposures', The Institute of International Finance, August 1994; and 'Derivatives: Practices and Principles (Appendix 1: Working Paper of the Accounting and Reporting Subcommittee)', Group of Thirty, July 1993.

(3) 'A discussion paper on Public Disclosure of Market and Credit Risks by Financial Intermediaries', Bank of International Settlements, September 1994 (known as the 'Fisher Report').

Supervision and Surveillance in the Bank

The Bank introduced a new internal management structure[1] on 1 July 1994 in which most functions were divided between two wings—Monetary Stability and Financial Stability—reflecting the Bank's main core purposes. Supervision forms part of the Financial Stability Wing. It has been combined with much of the surveillance work previously done in the International Divisions. This involves the monitoring of risks to financial stability arising from other countries to which UK institutions have significant exposures or from which banks operating in the United Kingdom originate. The international work of the Bank has thereby been given a new and sharper focus with surveillance staff now working alongside the supervisors to enhance the Bank's understanding of risks arising outside the United Kingdom. This will also help the Bank to develop a better overall view of the whole bank in the case of UK branches of overseas banks, and to understand overseas supervisory environments more fully.

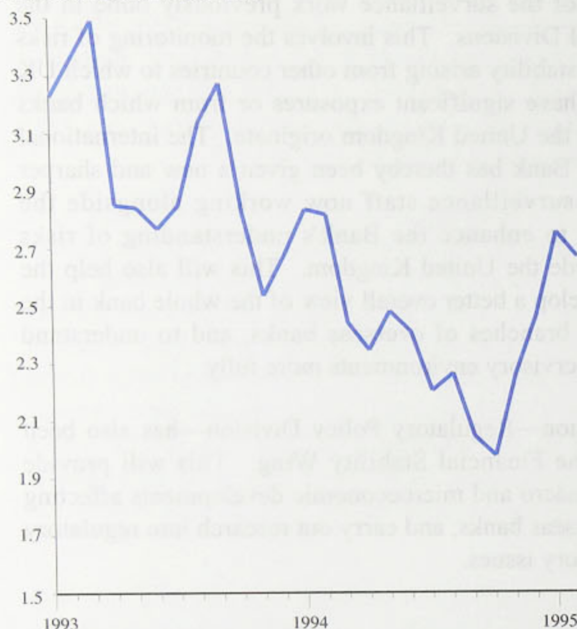
A new division—Regulatory Policy Division—has also been created in the Financial Stability Wing. This will provide analysis of macro and microeconomic developments affecting UK and overseas banks, and carry out research into regulatory and supervisory issues.

(1) See structure chart in Appendix 1.

Part II
Macroeconomic context

Chart 2

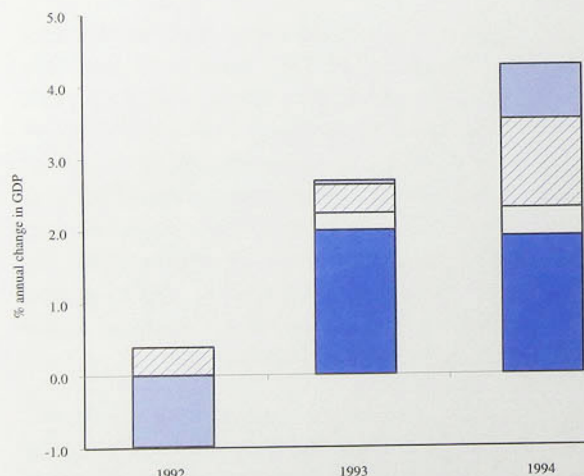
RPIX Inflation[1]



(1) Retail price index excluding mortgage interest payments.

Chart 3

Contributions to GDP growth[1]



(1) 'Investment' includes stockbuilding; the factor cost adjustment is not shown, so the sum of the components differs slightly from the overall annual change in GDP (these changes in the years shown were 1992: -0.5%, 1993: 2.1% and 1994: 3.9%).

Overview

Inflation remained low throughout 1994/95 while the economic recovery continued. In the year to end-February, the annual rise in the retail prices index excluding mortgage interest payments (RPIX) was 2.7% (see Chart 2). Increasing sensitivity to prices by consumers (contributing to a narrowing of margins by retailers) and restrained earnings growth helped to limit price increases over the year. In the second half of 1994, however, the balance of evidence began to point to increasing inflationary pressures in the medium term. In response, short-term official interest rates were increased three times between September and February, in each case by a half a percentage point.

UK growth, meanwhile, was strong in 1994, with a rise in GDP of 3.9%. Output growth slowed in the second half of the year but remained above trend, indicating a further narrowing of the gap between actual output and its potential level. Unlike some previous recoveries, growth has been less dependent on domestic demand with external demand being an important stimulus (Chart 3). In 1994 exports grew by 11½%, compared with import growth of just over 8%. With the invisibles balance also improving, the current account for the year was almost in balance.

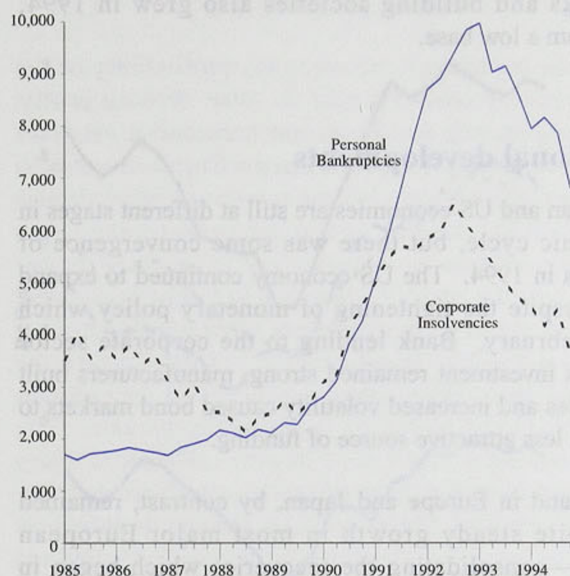
Corporate sector

In this more favourable economic environment, companies were able to increase their profits. Measured as a percentage of GDP, income (before dividends) of industrial and commercial companies (ICCs) was over 13% in 1994, almost twice the recent low reached in 1991. The number of corporate insolvencies per quarter also declined further over the year, despite rising in the third quarter (Chart 4).

The improving financial position of their corporate customers was an important reason for the sharp reduction in UK banks' charges for bad and doubtful debts in 1994. Another was the continued recovery in the commercial property market (many bank loans are secured on commercial property and if the borrower's creditworthiness deteriorates to the point where a provision is needed, the size of the provision will depend in large part on the valuation of the security). This recovery began in 1993, and in 1994 the Jones Lang Wootton capital growth index rose by 5%, despite falling back slightly in the last quarter of the year (Chart 5). This improvement is not

Chart 4

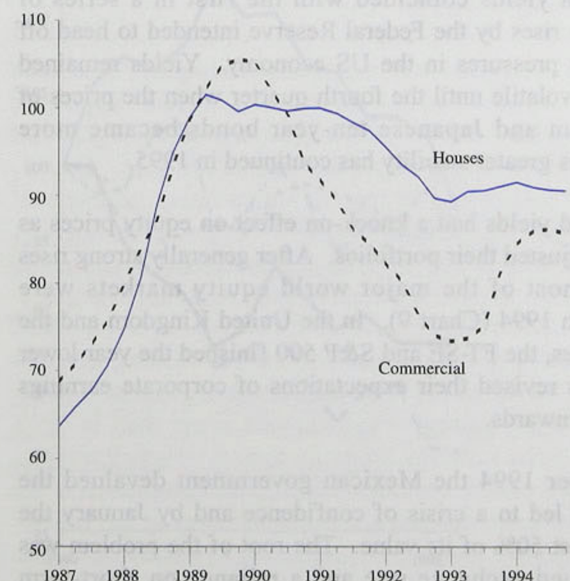
Insolvencies in England and Wales[1]



(1) Number per calendar quarter (seasonally adjusted).

Chart 5

Property prices[1]



(1) Houses: Halifax UK house price index (rebased), 1990=100; commercial: Jones Lang Wooton capital growth index (rebased), 1990=100.

uniform however. Although rents for some prime sites have increased as localised shortages of good-quality, modern office space have developed, rents on secondary offices and on industrial property have often not recovered. Banks and investing institutions remain reluctant to provide funds for new developments, whether speculative or pre-let. An important downward pressure on market rents is that many existing lettings (typically on properties leased before the recession) remain 'over-rented': whereby the rent paid exceeds the current market rent.

In contrast to previous recoveries, companies have not increased their bank borrowing as their profitability and financial positions have improved (Chart 6). Companies actually made net repayments of bank debt in 1993 and 1994. One reason is that corporate investment has not yet increased strongly. Indeed, investment by ICCs in 1994 was slightly lower than in 1993.[1] Another is that many companies have been able to finance expansion from retained earnings. Where they did look to external sources of finance in 1993 and 1994, most large companies preferred to issue equity and bonds. Net capital issues by ICCs in 1994 were, however, slightly lower than the high level of 1993, perhaps reflecting the increase in the cost of issuing capital which followed the turbulence in financial markets early in the year, and in the second half of 1994 and first quarter of 1995 the amount of new syndicated lending by banks began to increase.

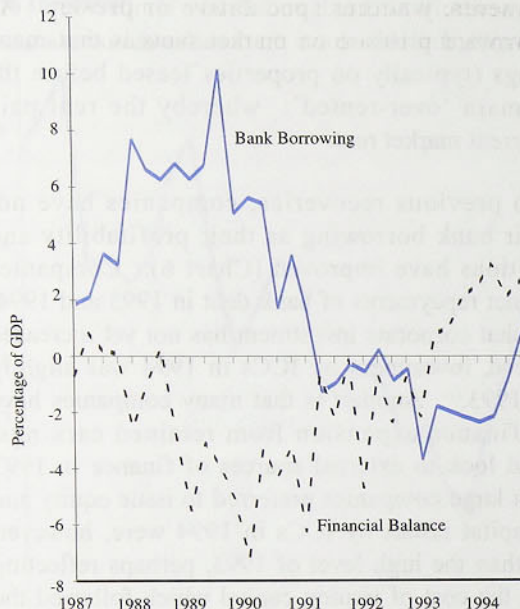
As total outstanding corporate borrowing from banks has fallen (by around £17 billion since the end of 1992), individual banks have often found it difficult to replace loans made in the late-1980s which are now maturing. One effect has been intense competition to lend, especially to high-quality corporate borrowers, leading to lower margins (see Part I). This may, in part, explain the recent pick-up in syndicated lending.

Personal sector

The personal sector has emerged from recession less strongly than the corporate sector. Although unemployment fell by 337,000 to 2½ million over 1994, real disposable income grew by just 1.2%, as previously announced tax and social security increases came into effect. Consumer confidence was also affected by a decline in real wealth over the year as the housing market remained flat and equity and bond prices fell, affecting life insurance and pension fund assets as well as direct holdings. At the end of 1994, an estimated 1.25 million households still had negative equity in property totalling around £6 billion (Chart 5).

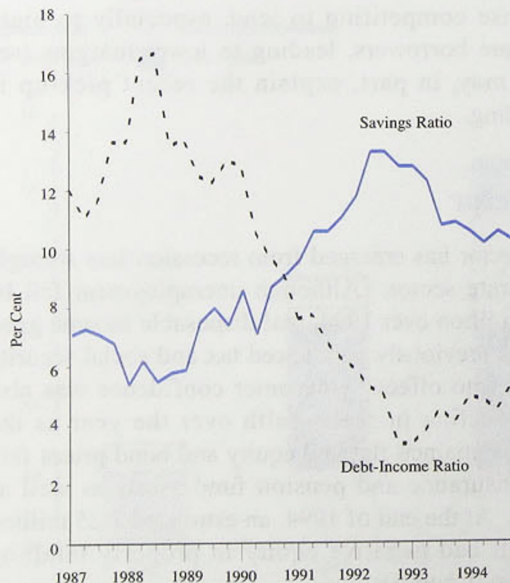
(1) The true strength of investment in manufacturing and services is, however, masked in the overall figures by large declines in the mining and utilities sectors.

Chart 6
Corporate sector bank borrowing and financial balance[1]



(1) Quarterly borrowing net of repayments. The financial balance of the corporate sector is defined as retained earnings less expenditure on fixed assets and the increase in the book value of its stocks.

Chart 7
Personal sector savings and flow-of-debt-to-income ratio[1]



(1) Personal sector sterling borrowing from (debt-income ratio), and saving with (savings ratio), banks and building societies as a percentage of their personal disposable income.

Despite this subdued picture, individuals were more willing to borrow to finance consumption in 1994. Banks' net new credit card lending was higher in the third quarter of 1994 than at any time since 1990 and other bank credit—personal loans and overdrafts—has also increased. Mortgage lending by all banks and building societies also grew in 1994, although from a low base.

International developments

The European and US economies are still at different stages in the economic cycle, but there was some convergence of growth rates in 1994. The US economy continued to expand strongly, despite the tightening of monetary policy which began in February. Bank lending to the corporate sector increased as investment remained strong, manufacturers built up inventories and increased volatility caused bond markets to be seen as a less attractive source of funding.

Credit demand in Europe and Japan, by contrast, remained weak despite steady growth in most major European economies—consolidating the recoveries which began in 1993—and clear signs that Japan was emerging from its protracted recession. In Japan the immediate outlook for activity is uncertain in the aftermath of the Kobe earthquake.

Financial market developments

After a boom in bond prices during 1993, prices fell sharply in most world markets in the first quarter of 1994 (Chart 8). This rise in yields coincided with the first in a series of interest rate rises by the Federal Reserve intended to head off inflationary pressures in the US economy. Yields remained higher and volatile until the fourth quarter when the prices of US, German and Japanese ten-year bonds became more settled. This greater stability has continued in 1995.

Higher bond yields had a knock-on effect on equity prices as investors adjusted their portfolios. After generally strong rises in 1993, most of the major world equity markets were depressed in 1994 (Chart 9). In the United Kingdom and the United States, the FT-SE and S&P 500 finished the year lower as investors revised their expectations of corporate earnings growth downwards.

In December 1994 the Mexican government devalued the peso. This led to a crisis of confidence and by January the peso had lost 50% of its value. The root of the problem was an overvalued exchange rate and a reliance on short-term portfolio investment to finance the resulting high current

Chart 8

Ten-year government bond yields

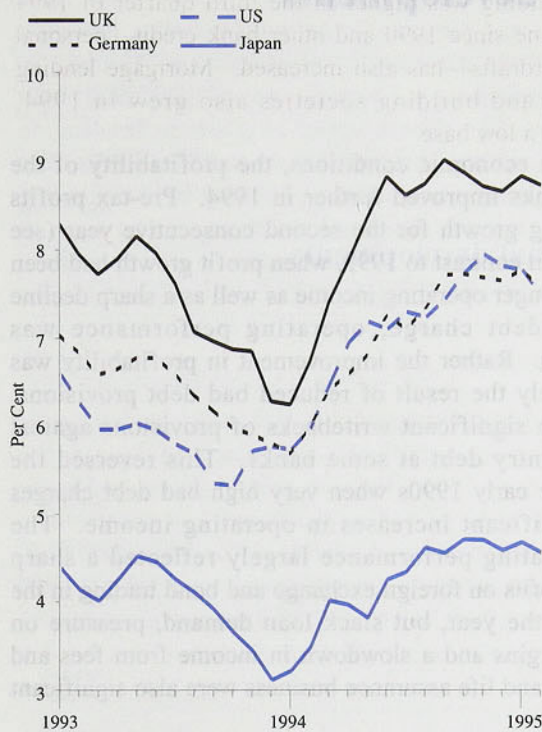
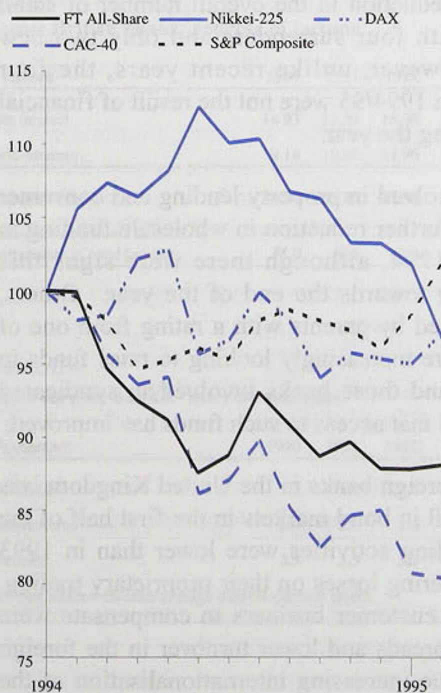


Chart 9

Equity market indices(1)



(1) Rebased, January 1994=100.

account deficit. The events in Mexico led to fears of contagion effects on other Latin American and some Asian markets, causing volatility in currencies and stock prices. By the end of February, most other markets had recovered, to varying extents, from the Mexican shock, although Mexico itself was still severely affected, and Brady bonds were still trading between 5% and 10% down on their November value.

Part III
Market developments

Overview

In favourable economic conditions, the profitability of the large UK banks improved further in 1994. Pre-tax profits showed strong growth for the second consecutive year (see Table I) but, in contrast to 1993, when profit growth had been driven by stronger operating income as well as a sharp decline in the bad debt charge, operating performance was disappointing. Rather the improvement in profitability was almost entirely the result of reduced bad debt provisions, together with significant writebacks of provisions against problem country debt at some banks. This reversed the pattern of the early 1990s when very high bad debt charges masked significant increases in operating income. The weaker operating performance largely reflected a sharp decline in profits on foreign exchange and bond trading in the first half of the year, but slack loan demand, pressure on domestic margins and a slowdown in income from fees and commissions and life assurance business were also significant factors.

Table I
Large British banks: earnings

£ billions	1990	1991	1992	1993	1994
Operating profits before bad debts	7.93	9.05	10.14	11.33	10.47
Pre-tax profits	3.39	2.34	2.12	5.45	8.58
Post-tax profits	1.74	1.38	1.09	3.57	5.74
Pre-tax return on equity (%)	*12.70*	*8.76*	*8.16*	*19.47*	*28.93*
Post-tax return on equity (%)	*6.50*	*5.42*	*4.18*	*12.75*	*19.35*
Return on total assets (%)	*0.66*	*0.42*	*0.35*	*0.80*	*1.21*

1994 was a period of restored stability for those of the small banks which survived the financial pressures of the early 1990s, but the Bank continues to monitor the small-bank sector closely. The reduction in the overall number of small banks continued, with four surrenders and only two new authorisations. However, unlike recent years, the four surrenders recorded in 1994/95 were not the result of financial pressures arising during the year.

Some small banks involved in property lending and consumer credit experienced a further reduction in wholesale funding in the earlier part of 1994, although there were signs this pressure was abating towards the end of the year. Others, principally those owned by parents with a rating from one of the credit agencies, are increasingly looking to raise funds in the capital markets and those banks involved in syndicated borrowing have found that access to such funds has improved.

The profitability of foreign banks in the United Kingdom was affected by the turmoil in bond markets in the first half of the year. Profits on trading activities were lower than in 1993 with some banks suffering losses on their proprietary trading. Attempts to increase customer business to compensate were hampered by lower spreads and lower turnover in the foreign exchange market. The increasing internationalisation of the London market was apparent from the number of banks incorporated outside the European Economic Area choosing

to base their European activities on a UK subsidiary and use the provisions of the Second Banking Co-ordination Directive (2BCD) to establish branches in other EEA countries. A number of large European banks also decided to concentrate their investment banking and treasury operations in London.

In February 1995, the merchant bank Barings was placed in administration following large losses on futures and options trading by a Singapore subsidiary. The businesses of the authorised institution, Baring Brothers and Co, were subsequently purchased by Internationale Nederlanden Group NV, with no loss to depositors.

On 27 February, the Chancellor asked the Board of Banking Supervision to investigate the Barings collapse. This investigation has the following aims: to establish the facts that led to the collapse, to reach any immediately applicable conclusions; and to draw out any broader lessons there may be for supervisory and regulatory arrangements. The Board asked Ian Watt, an adviser to the Governors and Head of the Bank's Special Investigations Unit, to lead the first, fact-finding stage. He is being assisted by lawyers, accountants and a derivatives expert drawn from outside the Bank.

Bank earnings

Table II
Large British banks: sources of income

£ billions	1990	1991	1992	1993	1994
Net interest	14.93	15.59	16.09	16.40	16.61
Non-interest	9.14	10.69	11.86	13.40	12.98
Total income	**24.07**	**26.28**	**27.94**	**29.79**	**29.59**
Non-interest income as a percentage of total income	*38.0*	*40.1*	*42.4*	*45.0*	*43.9*

Table III
Four largest banks: interest margins(1)

Percentages	1990	1991	1992	1993	1994
Domestic	4.3	4.0	3.8	3.6	3.6
International	1.9	2.1	2.3	2.0	1.9
Overall	**3.3**	**3.3**	**3.3**	**2.9**	**2.9**

(1) Net interest income/average interest-earning assets.

Despite the favourable economic background, and a further reduction in the amount of suspended interest on non-performing loans, the net interest income of the large banks was only slightly up on the previous year (Table II). Intense competition in the domestic retail savings market, tight lending margins in the face of weak demand for new borrowing and lower trading profits combined to bring about a further slight fall in the four large banks' overall interest margin (Table III).

Non-interest income was lower than in 1993, after increasing in each of the previous eight years (Table II). Income from fees and commissions on traditional banking business decreased for the second successive year, underlining the difficulties the large banks now face in producing earnings growth from this source. The overall decline does, however, mask significant differences in performance between individual banks (Table II). The fragility in bond markets in the first half of the year, together with more stable foreign exchange markets, depressed dealing income. Several banks incurred losses on their proprietary bond-trading positions, but lower turnover, against a background of investor uncertainty, was also a significant factor. Life assurance continued to be an important source of income for the large banks, but earnings were adversely affected by the

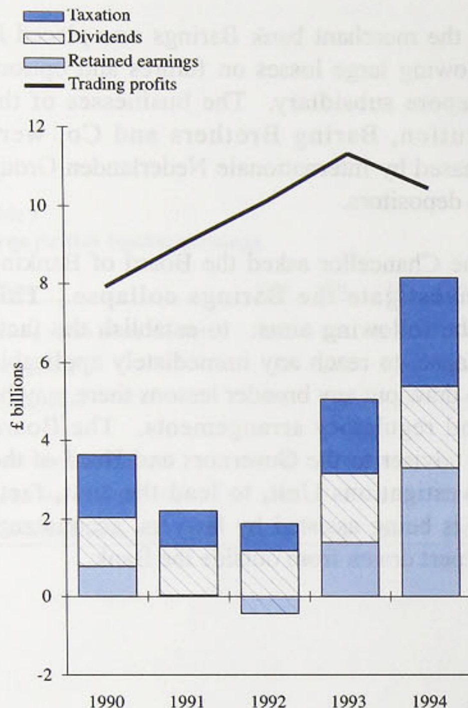
deterioration of consumer confidence following the pension transfers controversy.

1994/95 saw mixed fortunes for the smaller banks, reflecting the diversity within this category of institutions. Lending by those banks specialising in hire purchase and instalment credit for consumers has shown signs of growth, leading to improved profitability, and some of the smallest banks have found niche opportunities to lend. Lending by the property banks, though, remains depressed and there are few signs of any renewed confidence in this market or of a sustained recovery in profitability. Many banks have continued to seek an increase in fee-earning opportunities in the absence of a healthy lending market.

Barings apart, the performance of the UK merchant banks was uneven, with aggregate profits for the sector well down on the high levels seen in 1993. Bond-market weakness and lower trading volumes reduced trading profits and this was the main reason for the fall in earnings. Some banks did, nonetheless, see strong performances in asset management, brokerage and corporate finance, both in the United Kingdom and overseas.

Chart 10

Large British banks: retained earnings



Costs

The large banks have all implemented major cost reduction programmes in recent years. In part, this reflects a recognition on the part of management that banks need to narrow their cost base if they are to compete effectively, particularly with building societies, in a deregulated environment. Containing costs will also become more important as low inflation means banks can no longer expect increased expenditure to be offset by rising nominal asset values and if increases in non-interest income remain difficult to achieve. The aggregate cost:income ratio of the large banks rose in 1994, for the first time in four years (Table IV).

Table IV

Large British banks: costs

£ billions	1990	1991	1992	1993	1994
Staff	9.17	9.55	9.83	10.15	10.40
Premises and equipment	3.04	3.49	3.67	3.23	3.46
Other	3.89	4.20	4.27	4.52	5.26
Total operating costs	**16.09**	**17.24**	**17.77**	**17.90**	**19.12**
As percentage of total income	*66.9*	*65.6*	*63.6*	*60.1*	*64.6*

The increase in operating costs this year was caused in part by the initial cost of new ventures (primarily in investment banking and private banking) at several banks, which was greater than savings achieved elsewhere in their businesses. Several of the banks took further steps to reduce staff numbers and branch networks, but cost reductions achieved here were often offset by higher salary and benefits costs, with remuneration increasingly being linked to performance and profitability.

The deterioration in the cost:income ratio in 1994 may well be reversed as investment programmes currently in progress add to operating income over the medium term. Nonetheless, it underlines the challenges the banks face in making further

Table V
Large British banks: domestic bad debt provisions and charges

£ billions	1990	1991	1992	1993	1994
Stock of domestic commercial provisions(1)	4.2	7.0	8.2	7.5	6.3
As percentage of total lending	*1.7*	*2.9*	*4.2*	*3.5*	*2.7*
Charge for domestic bad and doubtful debts	3.5	5.9	6.7	4.7	2.1
As percentage of total lending	*1.4*	*2.4*	*3.0*	*2.0*	*0.9*

(1) All figures for stocks are year- end; charges are gross charges during the year.

Table VI
Large British banks: sources of new capital(1)

£ billions	1990	1991	1992	1993	1994
Retained earnings	0.77	0.04	-0.42	1.41	3.31
Perpetual debt(2)	-0.81	0.22	1.47	1.75	-0.27
Term subordinated debt	-0.51	1.32	1.30	0.52	0.76
Ordinary share issues	0.52	0.14	0.06	0.03	0.05
Total	**-0.03**	**1.72**	**2.41**	**3.71**	**3.85**

(1) Excludes certain items affecting reserves, such as surpluses on property revaluations.
(2) Includes preference shares

Table VII
Large British banks: capital constituents

Convergence basis

£ billions	1990	1991	1992	1993	1994
Tier 1					
Ordinary shares	7.23	7.37	7.43	7.49	7.57
Preference shares	0.10	0.47	0.50	0.78	0.76
Reserves	15.22	15.64	15.66	17.27	20.65
Minorities	1.01	1.11	1.22	1.66	1.26
Deductions	–	–	-0.05	-0.05	–
Total Tier 1	**23.56**	**24.59**	**24.77**	**27.13**	**30.24**
Tier 2					
Property revaluation reserves	1.61	0.75	0.27	0.16	0.12
Hybrid capital	5.89	6.11	7.33	8.89	8.82
General provisions	1.50	1.72	2.06	2.21	2.25
Tier 2 minorities	–	–	0.01	0.01	0.01
Qualifying subordinated loan stocks	7.37	8.70	9.93	10.19	10.68
Headroom deduction	-0.49	-0.57	-0.49	-0.19	0.00
Total net Tier 2	**15.89**	**16.87**	**19.18**	**21.27**	**21.88**
Other deductions	-2.49	-2.65	-3.06	-3.41	-3.18
Total net capital	**36.96**	**38.83**	**40.88**	**44.98**	**48.95**

Table VIII
Large British banks: capital ratios

Convergence basis

£ billions	1990	1991	1992	1993	1994
Total assets	517.6	529.2	607.8	676.8	711.4
Weighted assets	396.0	391.5	411.2	417.3	424.4
Total net capital	37.0	38.8	40.9	45.0	48.5
Risk asset ratio (%)	**9.3**	**9.9**	**9.9**	**10.8**	**11.4**

progress in this area following the cost reduction programmes of the past few years.

Asset quality

Domestic bad debt charges were substantially lower in 1994, continuing the improvement in asset quality that began in 1992 (Table V). The reduction reflected the better economic conditions in the large banks' major markets, notably the United Kingdom and United States (see Part II). Improvement occurred across all categories of borrower although, within the United Kingdom, the strongest improvement was seen in personal and small business lending. In addition, several of the large banks benefited from substantial net releases of provisions against problem-country debt. In some cases, however, this was offset by additional provisions to cover possible losses in connection with pension transfers.

Capital

The improvement in profits during the year outpaced the growth of dividends, resulting in a higher level of retained earnings. This, together with subdued loan demand and a general shift into lower risk-weighted assets, led to a further overall improvement in the risk asset ratios of the large UK banks. Their combined capital ratios now stand at their highest level since the introduction of the 1988 Basle Accord (Tables VII and VIII).

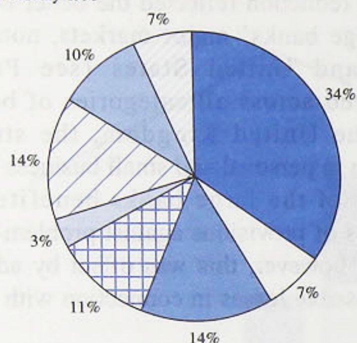
International developments

Continued buoyancy in economic conditions in the United States contributed to a further improvement in the profitability of US commercial banks in 1994. Lower loan loss provisions largely offset reduced trading profits associated with falls in bond prices early in the year. In the first quarter of 1995, US banks' trading profits are likely to have been lower because of the fall in the value of emerging-market securities. Nevertheless, it should be noted that US banks' exposure to Mexico (and Latin America generally) has fallen substantially since the mid-1980s.

The operating income of European banks was generally stable or slightly down in 1994. Many European banks suffered falls in trading income and revaluation losses on securities portfolios as a result of unsettled conditions in bond and equity markets. With some exceptions, banks in Germany and France needed to make lower provisions against problem loans than in 1993 and this limited the effect of such losses on

Chart 11

Geographical representation of overseas institutions



Branches, subsidiaries and controlling stakes in consortium banks

overall profitability. The asset quality of northern European banks also improved, particularly in the Nordic countries, but (notably in Finland) this was from a low base. Poor asset quality remained an issue in southern Europe, and many banks were required to make further provisions and write-offs; banks in Italy were particularly affected.

Conditions remained difficult for banks in Japan where competition for lending to highly rated borrowers was acute, resulting in a narrowing of margins. Banks also continued to suffer from the legacy of extensive property lending in the late 1980s. There were encouraging signs that some banks are dealing with their asset-quality problems through more active provisioning and write-offs, but several areas of fragility remain, particularly among the smaller, domestic institutions.

1994 was generally a good year for the large UK banks' US operations. In the main, the improvement was the result of a decline in loan loss provisions, but net interest and other operating income were also higher than 1993, fuelled in part by lending growth. In some cases, higher income was partially offset by increased costs associated with restructuring or the development of new business lines.

The large UK banks' continental European operations were less successful than their US operations in 1994 and the banks continue to be highly selective in their approach to the European Single Market. Some have decided to withdraw from certain countries, having failed to establish a satisfactory foothold, and most are keeping their European businesses under careful review.

Glossary of terms for Part III

Sources of data	Audited financial statements for the large British banks; the table on capital ratios is from Bank of England statistical returns. Because of rounding, the columns in the tables may not balance.
Large British Banks	Barclays, Lloyds, Midland, National Westminster, Abbey National, Bank of Scotland, The Royal Bank of Scotland, Standard Chartered and the TSB. All data for these banks are consolidated. Calendar year-end information except for Bank of Scotland (1994 data are based on interim figures), The Royal Bank of Scotland (end-September) and the TSB (end-October).
Four large banks	Barclays, Lloyds, Midland and National Westminster.
Consortium banks	Institutions majority-owned by two or more banks but with none of them individually holding over 50% of the equity.
Trading profits	Profit before taxation and bad debt provisions.
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 Tier 2 capital.
Hybrid (debt/equity) capital	Perpetual cumulative preferred shares and perpetual subordinated debt meeting the Bank's requirements which include that the debt must be able to absorb losses and allow the bank to continue trading and that interest can be deferred in certain circumstances. (Perpetual **non cumulative** preferred shares are included in Tier 1 capital)
Weighted assets	Total on and off-balance-sheet assets adjusted in accordance with the risk weightings as set out in the supervisory notice: *Implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3)* (as amended).
Adjusted capital base	Total capital (Tier 1 and Tier 2) less goodwill, connected lending of a capital nature, investments in subsidiaries and associates, and holdings of bank capital instruments other than those held within a market-making concession.
Risk asset ratio	Percentage ratio of adjusted capital base to weighted risk assets.

Tier 1 and Tier 2 capital	As defined in the Bank's notice to institutions *Implementation in the United Kingdom of the Directive on Own Funds of Credit Institutions* (BSD/1990/2) (as amended).
Headroom deduction	Tier 2 capital which cannot count towards capital because of insufficient Tier 1 or upper Tier 2 on an institution's books.
Net interest income	Gross interest income less interest paid on borrowings.
Other income	Includes investment income.
Interest margin	Net interest income as a percentage of average interest-earning assets.

Risk-based pricing

Many banks are continuing to work on techniques which will enable them to set risk-adjusted profitability targets for business areas, customer relationships and individual transactions, and to measure actual returns against these. One of the more interesting developments has been the application of this approach to traditional lending. A number of major UK banks, like many in the United States, are pressing ahead with the development of systems which will allow them to set the required margin on individual loans in accordance with their risk characteristics.

These techniques highlight the need for loan pricing to be set to cover the various costs incurred by the bank: the direct cost of funding the loan; the credit assessment and other administrative costs associated with providing, servicing and monitoring the loan; the cost of insuring, or self insuring, against the risk that amounts will be lost because of borrower default ('expected losses'); and, finally, the cost of capital, held to protect the bank against the chance that actual losses will be greater than their mean expected magnitude ('unexpected losses').

Banks can clearly gain a competitive advantage by reducing their funding costs or by reducing credit-assessment costs and overheads. More interesting perhaps, (and assuming a bank is not insuring itself against credit risk externally), is the way the costs associated with credit risk can be reduced by building a diversified loan portfolio. Because of the law of large numbers, a bank can base its pricing on mean expected write-offs for loans of a similar type across the portfolio. Diversification will also reduce the variance of expected credit losses on the portfolio as a whole and thus reduce unexpected losses. As a result, the likelihood of a bank's earnings in any one period being negative will be lower, the bank will have a correspondingly lower need for economic capital[(1)] to be allocated to individual loans and, other things being equal, the bank should have a competitive advantage.

The risk that all or part of a loan will need to be written off is a function both of the creditworthiness of the borrower and of the bank's ability to recover money in the event of a default. This highlights the benefit to banks of systems which grade loans according to objective estimates of default frequency for different types of borrower. It also emphasises the value of good early-warning systems that can detect a deteriorating situation and give the bank the opportunity to take corrective action before a default takes place; as well as the importance of security, efficient work-out procedures and other measures that can reduce the actual loss to a bank following a default.

The development of systems which link loan pricing more directly to the risk of loss to the bank—and thereby lead to a more efficient allocation of credit—is welcome. Banks which do not develop formal risk-pricing systems will have to find other ways to price loans according to risk or be in danger of losing their good customers through overcharging while earning an inadequate return from less creditworthy borrowers.

At the same time, however, a proper judgement of a system's performance can only really be made over a full economic cycle and, a move to risk-based pricing can bring technological, cultural and operational challenges. For example, expected default frequencies are difficult to estimate where historic data is scarce and may be unreliable when fundamental changes occur to the economy. This problem is worse still in new markets or markets where there has been little experience of losses to date. Many systems emphasise the importance of security. Where this is so, banks need to be aware both of the possibility of a decline in the realisable value of the security in an economic downturn and of the importance of operational controls over the security.

The risk-based method may well lead to a loss of some discretion to lending officers, and not all will welcome the change of approach. There is a particular need for a bank's senior management to be seen to be committed to the value of a new system. Banks need to guard against deliberate manipulation of the system to meet performance targets, and reliance on the model to the exclusion of other known risks for which it does not allow. In the transitional period, banks' commitment to the approach may wane where they lose some business, on pricing grounds, to other banks which are not following a risk-based approach.

Many banks are combining the initiatives described above with systems to measure the profitability of entire customer relationships rather than individual transactions. In some cases, lending is used as a means of securing other, often fee-based, business with a higher risk-adjusted return. Where banks wish to take account of the wider customer relationship in setting required pricing levels, they clearly need to have confidence in their systems for measuring income and allocating costs. It should be remembered, however, that banks still have to cope with these issues even if they are carrying on business in the traditional way. In this sense, the risk-based pricing approach merely makes more explicit the need for such questions to be properly addressed.

(1) The supervisory capital requirement (risk weighting) applied to the loan by supervisors will not be lower; but the Bank does consider the degree to which a bank's assets are diversified when setting trigger and target capital ratios for individual banks.

Bank performance indicators

A number of financial and accounting ratios are commonly quoted in analyses of bank performance. Although these can be revealing—for example, when comparing different banks or when trying to identify a trend across a number of years—they must be used with care because of a combination of the nature of banking, accounting conventions and the complexity of many modern financial institutions. This box reviews the indicators which are most frequently used.

Profitability

The pre-tax **return on equity** (ROE) is the usual measure of profitability. The pre-tax **return on assets** (ROA) is also sometimes quoted, but this can be misleading if a high return on assets reflects only high business risk: the ROE should adjust for this possibility to the extent that high business risk coincides—as it should—with low gearing (defined as debt divided by equity). The biggest problem with judging performance by looking at a bank's ROE in any particular year arises from the timing difference between the recognition of income, expenses and risk in a bank's accounts. Broadly, income and costs are taken through the profit and loss account annually over the life of the loan but credit risk is only recognised when the recovery of a loan is in serious doubt. Because borrowers are more likely to encounter difficulties in a recession, changes in the bad debt charge cause reported profits to have a clear cyclical pattern. Although an increase in income, whether the result of expansion of the loanbook or an increased net interest margin, would normally be considered a positive development, an outside commentator, lacking detailed knowledge of a bank's portfolio, is not in a position to judge the extent to which such an increase might cover any change in the level of risk that a bank has decided to take on. This will become clear only when the risk is recognised, through the bad debt charge, in subsequent years. Equally, a bank with a rapidly-growing loanbook is more likely to have a higher ROE because problems are less likely to emerge shortly after a loan has been approved while the bank will recognise the extra income on its expanding loanbook.

The bad debt charge can affect the ROE in another way. Provisioning is not a precise science and banks will differ in how conservative they are when making assumptions about, for example, the value of security. As a result, different banks will have different levels of provision in their balance sheet for the same level of risk. One consequence is that a bank which raises relatively large provisions will reduce the equity element of the ROE equation and thus improve its ROE in subsequent years, as long as the provision remains on its balance sheet.

Asset quality

It is similarly difficult to draw authoritative conclusions from the most commonly used ratios of asset quality in the absence of detailed knowledge of a bank's portfolio. A high level of **bad debt charge to loans** is an indicator of deteriorating asset quality. However, a low ratio may mask a reluctance to provide against problem loans, indicating deeper problems.

Similarly a high **stock of provisions to loans** might indicate a poor-quality portfolio or, more positively, a conservative approach to provisioning. In either event, comparisons are distorted by differences in the speed at which doubtful loans—and associated provisions—are written off, which can be influenced by differing national tax treatments.

A high ratio of **provisions to non-performing loans** is probably a better indicator of adequate provisioning, although the timing of write-offs, and definitional problems regarding non-performing loans (especially in the case of overdrafts), do cause difficulties. Moreover, banks rightly point out that their provisioning needs should not be determined by such broad-brush ratios but by the distinct needs of their own portfolios. In particular, the ratio will not show if non-performing loans are well-secured, in which case low provisions would indicate that recoveries are expected to be high.

Efficiency

The most commonly used indicator of the efficiency of banks and building societies is the **cost:income ratio**. This does have its strengths: it is easy to calculate and should be readily understood. Moreover, the failure of a bank to hold down costs should indeed result in a deterioration (ie rise) in this ratio relative to its peers. However, its broad-brush nature means that differences between banks—or even changes from one year to the next for the same bank—may be caused by factors other than cost efficiency.

For example, the ratio will alter for reasons to do with income as well as costs. This was a particular feature at some banks in 1993, when trading profits rose sharply. Income levels can also be affected by the level of credit and market risk assumed. More generally, given that profits can be broadly defined as income less costs, the amount of additional information obtained from expressing the difference as a ratio is necessarily somewhat limited.

It can also be misleading to compare the cost:income ratios of different types of bank or, by extension, of diversified banking groups with different business mixes. To take three examples, retail banking involves higher administrative costs than corporate banking; maintenance of the money transmission system is particularly expensive; and fee-earning businesses tend to have a relatively high cost:income structure. A high cost:income ratio is thus not necessarily an adverse sign in itself, particularly if the business is profitable, high-volume and low-risk. There may also be more technical accounting reasons why one bank's cost:income ratio differs from another's. For example, a bank will tend to have a lower ratio if it has a large life assurance subsidiary whose contribution is included as a one-line entry (ie income net of costs) in the bank's consolidated profit and loss account.

Part IV
Policy developments

(1) Changes implemented in the United Kingdom[(1)]

Repos and reverse repos

In November 1994, the Bank issued a notice (BSD/1994/4) concerning the treatment of repurchase agreements ('repos'), and stock borrowing and lending, for capital adequacy and large exposures reporting purposes. The notice supplemented the Bank's notice BSD/1990/3 ('Implementation in the United Kingdom of the Solvency Ratio Directive').

It was recognised that in some cases the Bank's existing treatment of repos and reverse repos (and stock borrowing and lending) did not give an accurate measure of the risks in these transactions. The notice therefore offers banks an alternative treatment applicable to deals involving OECD government securities only. The new approach is optional and banks may only use it where certain minimum requirements—concerning documentation, daily marking to market of positions and regular recalculation of collateral—are met.

Under the new treatment for repos, capital requirements are applied to cover issuer risk (on the security repo'd) and counterparty risk (the difference between the value of the security sold and the collateral taken). Under the existing treatment only the issuer risk is captured. For reverse repos, the new treatment requires capital to be held only against counterparty risk (the difference between the value of the security bought and the collateral provided). Under the existing treatment, these transactions are treated as collateralised loans. The new approach is likely to result in a reduction in the capital requirement for reverse repos with a small increase in the requirement for repos.

Off-balance-sheet netting

To date, because of uncertainties relating to the interaction of insolvency law in different jurisdictions and the legal status of off-balance-sheet netting agreements, off-balance-sheet netting has been recognised for supervisory purposes only where contracts are subject to novation. However, the Basle Accord was amended in July 1994 to give wider recognition to bilateral netting agreements (including close-out agreements) in the calculation of a bank's counterparty exposures, provided certain legal requirements are met.

The Bank intends to recognise netting agreements only where a bank has obtained legal opinions stating that they are legally secure in all relevant jurisdictions. For this purpose, relevant jurisdictions include: that in which the counterparty is incorporated—and, if the foreign branch of a counterparty is involved, that in which the branch is located; that of the law governing the individual transactions; and that of the law that governs any other contract or agreement necessary to effect the netting. In addition, a bank must demonstrate that exposures to the counterparty are monitored on a net basis.

Negotiation of an amendment to the Solvency Ratio Directive is in progress to bring EU legislation into line with Basle. In the meantime, EU banks have been put at some competitive disadvantage in relation to their G10 competitors. In recognition of this fact, a letter was sent to banks in October 1994 stating that, where banks would otherwise be close to their target risk asset ratio under the present Solvency Ratio Directive calculation, the Bank would be prepared to take into account another calculation of the risk asset ratio based on the amended Basle Accord. If this 'Basle ratio' were well above the bank's target ratio, the Bank would be more tolerant of the position than would normally be the case. Under no circumstances, however, would a bank's 'Solvency Ratio Directive ratio' be allowed to fall below the 8% minimum laid down in that directive.

Commitments

In May 1995, the Bank issued amended definitions detailing the way 'other commitments' should be reported for capital adequacy purposes on the form BSD1. Commitments have a credit conversion factor of either 0% or 50%, depending on whether they have an original maturity of over one year or one year and under. The new definition clarified the Bank's understanding of the meaning of 'original maturity' and set out the circumstances in which undrawn commitments of one year or under can be extended at

(1) A list of the policy and practice notes by Supervision and Surveillance (formerly Banking Supervision Division) currently in force is included in Appendix 2.

maturity without losing the 0% weighting (in essence, where the offer to extend is made in the final 30 days of a bilateral facility, or the final 60 days of a syndicated facility, following a full credit review of the potential borrower). The amendments were made following extensive discussions with the main banks affected through the British Bankers' Association. The Bank also raised the subject in the Basle Committee on Banking Supervision's capital liaison group.

Work of other bodies

Money laundering

In February 1995, the Joint Money Laundering Steering Group published revised editions of its Money Laundering Guidance Notes which refined and expanded earlier guidance in certain areas: for example, in relation to tax offences. The Bank continues to assess the adequacy of banks' systems and controls to counter money laundering in the light of the Guidance Notes.

Accounting developments

In March 1994, the Accounting Standards Board issued Financial Reporting Exposure Draft 8 (FRED 8), 'Related Party Disclosures', which proposes disclosure of related party transactions (where material), and disclosure of the name of the party controlling the reporting entity. It defines related parties in general terms based on control and influence, and includes two categories of potential related party, deemed and presumed.

The Accounting Standards Board issued two new standards in September 1994: Financial Reporting Standard 6 (FRS 6), 'Acquisitions and Mergers', and Financial Reporting Standard 7 (FRS 7), 'Fair Values in Acquisition Accounting'. FRS 6 comes into effect for accounting periods commencing on or after 23 December 1994. It supersedes Statement of Standard Accounting Practice 23, 'Accounting for Acquisitions and Mergers', and some of the disclosure requirements of Statement of Standard Accounting Practice 22, 'Accounting for Goodwill'. It makes merger accounting compulsory where certain legal and accounting criteria are satisfied. It also widens the definition of group reconstructions and allows merger accounting for an increased number of such combinations, although this treatment is not compulsory.

FRS 7, which also comes into effect for accounting periods commencing on or after 23 December 1994, incorporates from FRED 7 the concept that acquisition-related provisions should not be included when establishing the fair values of the assets and liabilities of the acquired entity.

In December 1994, the Cadbury Committee issued guidance to directors of listed companies, and of companies quoted on the Unlisted Securities Market, on stating their compliance with the Code of Best Practice in respect of 'Going Concern and Financial Reporting' and 'Internal Control and Financial Reporting'. In response, the Auditing Practices Board have issued a guidance bulletin to auditors on reporting on going concern and Statement of Auditing Standards 130, 'The Going Concern Basis in Financial Statements'. Guidance from the Audit Practices Board on internal control systems is awaited.

(2) Implementation in progress

Capital Adequacy Directive

The EU Capital Adequacy Directive (CAD) sets minimum capital requirements for market risks in the trading books of banks and investment firms. The Bank has to provide a framework for its implementation in the United Kingdom by 1 July 1995 and the new CAD rules must become effective from 1 January 1996.

After a period of consultation with a group of market practitioners, the Bank issued a detailed consultative document setting out its proposed implementation of the CAD in December 1994. A successful series of seminars was held to present this document to the market, and the Bank received many detailed and considered responses before the end of the consultation period in February 1995.

The Bank has also been in discussion with the Securities and Investments Board (SIB) and the Securities and Futures Authority (SFA) to ensure that it takes the views of other UK regulators fully into account in its implementation of the CAD. A final policy notice S&S/1995/2, 'Implementation of the Capital Adequacy Directive for UK banks', was issued in April 1995. At the same time, a new reporting form providing information on risks in institutions' trading books was circulated for comments.

With the implementation of the CAD, banks will have the option of using models when reporting foreign exchange risk and, to a more limited extent, when calculating the risks in complex derivatives portfolios before reporting under the standard CAD format. A small team of supervisors has begun to visit banks to examine these models. These visits involve a review of the operating environment as well as of the mathematics backing the models.[1]

Investment Services Directive

Work on the implementation of the Investment Services Directive (ISD) continues prior to its implementation from 1 January 1996. Although the directive is relevant primarily to investment firms and regulated markets, some of its provisions will affect credit institutions. The Bank is in discussion with the Securities and Investments Board (SIB) and the Self Regulating Organisations (SROs) to ensure the Directive's requirements are implemented in a way that should change as little as possible the division of the supervision of banks between the Bank and the SROs. A guide to how the ISD might affect banks was issued by the Bank in August 1994.

Post-BCCI Directive

This Directive (formally entitled a 'Directive to Reinforce Prudential Supervision within the European Union following the Collapse of BCCI') is likely to be adopted shortly following conciliation proceedings between the Council of Ministers and the European Parliament. It will need to be implemented in Member States within a year of its adoption and the Bank is working with HM Treasury to decide what changes will be needed to UK legislation.

The Directive covers not only credit institutions but also investment firms and insurance companies. It has four main provisions: first, it gives supervisors powers to refuse authorisation where group and ownership links prevent effective supervision; second, it requires financial undertakings to have their head office in the same Member State as their registered office; third, it allows a widening of the range of disclosure gateways allowing supervisors to provide information to, amongst others, those supervising the accountancy profession and bodies responsible for the detection and investigation of breaches of company law (including external inspectors); and fourth, Member States must place a duty on auditors, and experts (such as reporting accountants) appointed by supervisors, to report material breaches of relevant laws and certain other concerns to the supervisory authorities. In the United Kingdom, auditors have had a statutory duty to report relevant information to supervisors since May 1994.

Deposit Guarantee Directive

The Bank is assisting HM Treasury in the drafting of regulations to amend the Banking Act 1987 and the Building Societies Act 1986 so as to implement the provisions of the EU Directive on Deposit Guarantee Schemes. The Regulations will be made under section 2(2) of the European Communities Act 1972 and must come into effect on 1 July 1995.

As a result of the changes to the deposit protection scheme under the Banking Act to be made by the Regulations, qualifying deposits placed with the UK branch of a credit institution incorporated in another EEA country will be covered by the institution's home country deposit protection arrangements, rather than by the UK scheme as previously. The UK scheme will, conversely, be widened to cover branches of UK-incorporated institutions throughout the EEA. The other main changes are the extension of the UK scheme to include deposits in other EEA currencies and the ECU, as well as sterling, and the increase in the percentage of cover offered by the UK scheme from 75% to 90% of protected deposits. The maximum amount of deposits protected for each depositor will remain £20,000 (unless the sterling equivalent of ECU 22,222 is greater).

The UK scheme will also make provision for 'top up' cover for UK branches of EEA banks whose home state cover and/or scope is less generous than that offered by the UK scheme. This 'top up' cover will give depositors with those branches which choose to pay for this option the same total level of cover as that offered to depositors with UK authorised institutions. Branches of banks from outside the EEA will remain in the UK scheme unless, on an application by them, the Deposit Protection Board is satisfied their home country scheme provides equivalent cover to UK depositors.

(1) These visits result in a decision whether or not to recognise the model for the purpose of CAD reporting. Recognition does not imply approval or any other endorsement of the technical merit or appropriateness of a model. Responsibility for models and their use remains entirely with the bank concerned.

The Regulations will also require banks to provide actual and intending depositors with information about deposit protection arrangements and put restrictions on references to deposit protection in advertisements. In May 1995, the Deposit Protection Board sent a circular to all banks which currently contribute to the UK scheme with a leaflet summarising its provisions to accompany all literature provided to depositors in the normal course of business and to be supplied to them on request. The Board also circulated a leaflet setting out the procedure for making claims which, under the terms of the Directive, banks must make available to depositors on request, and a brief description of the UK scheme to be included in deposit advertisements if banks choose to do so.

(3) Areas under discussion

Basle market risk proposals

The consultation period for the Basle market risk proposals ended in December 1993. Since then, the Bank has been actively involved in the production of a revised discussion paper. This was issued in April 1995 but, given the need for consultation with market practitioners, it is unlikely that an amendment to the Basle Accord to cover the capital adequacy treatment of market risk will be finalised much before the end of this year.

The Basle proposals continue to contain a 'standardised methodology' (commonly described as the 'building-block approach'), and at present the majority of banks are expected to adopt this. It is similar to the framework set out in the EU Capital Adequacy Directive, although the Basle supervisors have extended it to incorporate commodity position risk and have devised a more detailed treatment of options risk.

The principal innovation—introduced in response to market comment on the 1993 consultative document—is the introduction of an alternative methodology for the calculation of market risk, based on the use of in-house 'value-at-risk' (VAR) models. The principal distinguishing characteristic of such models is the allowance made for portfolio effects.[1] They are therefore most appropriate for banks with large, diversified trading books.

Basle supervisors propose to allow banks to use VAR models subject to a range of safeguards. First, minimum standards are set regarding model parameters—the confidence interval, holding period, quantity of historical data analysed, and (in the case of interest rate risk) the number of maturity bands used. Second, in order to ensure a bank has adequate capital in the face of abnormal market shocks, co-variances across risk classes (eg interest rate and foreign exchange) are not taken into account. In addition, the capital charge generated is scaled up by a multiplication factor, and the model user must have the capacity to conduct 'stress tests', to calculate the possible losses on the portfolio under extreme assumptions. Third, and very importantly, model users must satisfy a range of qualitative standards:

- A bank should have an independent risk control unit responsible for the design and implementation of its risk management system. This should report directly to senior management, and evaluate the relationship between measures of risk exposure and trading limits. It should also conduct regular 'back testing' ie comparison between the risk measure generated by the model and the actual profit and loss.

- Senior management should be actively involved in risk control and review the daily reports produced by the risk control unit.

- The VAR model must be closely integrated into day-to-day risk management.

- The results of a programme of stress tests should be reviewed by senior management and should be reflected in the policies and limits set by management and the board of directors.

- An independent review of the risk measurement system should be carried out regularly as part of the bank's internal auditing.

If the Basle proposals on VAR models are adopted, the Bank will need to recognise such models before they can be used for supervisory reporting purposes by UK banks. As with the model recognition work currently in progress in relation to the CAD, the Bank will need to be satisfied not only with the mathematics of the model but also with the bank's control environment: in particular, it will want to be sure that all relevant staff understand its output.

(1) The box in Part IV—taken from an article in the May 1995 *Bank of England Quarterly Bulletin*—provides more detail on VAR models.

(4) Liaison with other supervisors

The Basle Committee on Banking Supervision

The Committee met four times during the year. Discussions concentrated on proposals for the supervision of market risk (see above). Consultative papers on the supervision of market risk, interest rate exposure measurement and off-balance-sheet netting were published in April 1993. The Committee has since been engaged in revising its proposals in the light of the comments received from market participants.

Further work was carried out on the supervision of financial conglomerates, the prudential management of derivatives and multilateral netting systems.

In July, the G10 Governors agreed an amendment to the 1988 Basle Accord changing the criteria defining the group of countries (known as 'the Club' or 'Zone A') whose central governments, local governments and banks carry lower risk weightings. Following the change, these countries comprise new and existing members of the OECD (together with countries that have concluded special lending arrangements with the IMF associated with its General Arrangements to Borrow), provided they have not rescheduled their external sovereign debt to official or private-sector creditors in the previous five years. In effect, this has meant two changes to the Bank's previous definition: the inclusion of countries which have become members of the OECD since the Basle Accord was reached in 1988, and the addition of the 'no rescheduling' test. The Committee agreed that Basle countries should implement the change early in 1995 and the Bank did so in March by issuing a notice (S&S/1995/1) amending its previous notice BSD/1990/3 ('Implementation in the United Kingdom of the Solvency Ratio Directive').

EU supervisory bodies

The Banking Advisory Committee (BAC) and the Contact Committee of EU Supervisory Authorities ('Groupe de Contact') met regularly during 1994 to discuss prudential questions at EU level.

In addition to the exercise of its 'comitological' function (ie approving technical amendments to existing EU legislation), the BAC continued to work alongside the Commission in the preparation, application and interpretation of EU banking legislation. Subjects discussed over the course of 1994 included the prudential treatment of derivatives, restrictions on the free provision of services imposed by host countries in the name of the 'general good', 'constitutive codification' (ie merging the various banking Directives into one text), and transparency and double-charging in cross-border payments. The BAC was assisted by the GTIAD (a working group on interpretation), as well as by two special sub-groups on derivatives and financial conglomerates.

The Groupe de Contact continued to act as a forum for reviewing developments in Member States' supervisory systems, conducting comparative studies of different aspects of these systems, and for exchanging confidential information of mutual interest to EU banking supervisory authorities. Subjects covered by the Groupe de Contact during the course of the year included: the techniques used by home country banking supervisory authorities under the Second Banking Co-ordination Directive (2BCD) to supervise the activities of branches located in other Member States; national requirements in respect of credit institutions' internal control systems and procedures; and the supervision of bureaux de change within the European Economic Area. Much of the Groupe de Contact's work was made available to the Banking Advisory Committee and/or the European Monetary Institute's Banking Supervisory Sub-Committee.

The EMI Banking Supervisory Sub-Committee

The Sub-Committee, under the chairmanship of Mr Quinn, an Executive Director of the Bank, met three times last year. Since 1 January 1995, the new EU members—Austria, Finland and Sweden—have been full participants.

In the area of crisis management, a report has been completed which describes the relationship between the supervisors and the lender of last resort in EU/EFTA member countries. In particular, this report sets out principles and guidelines which can be applied in the lender of last resort role.

Work on financial fragility continues, with a working group studying developments in the way in which banks manage their credit risk. A new working group to consider the main principles and to establish best practices relating to procedures for banks' internal control mechanisms has also been established. In addition, the Sub-Committee will be considering disclosure practices in relation to derivatives.

In June 1994, the Working Group on Credit Registers submitted its report on a limited experiment which it had conducted on information sharing between five participating countries. The experiment demonstrated that supervisory information relating to the indebtedness of individuals could be extracted from one county's central credit register and transmitted to another supervisory authority in another Member State within a workable timescale.

Memoranda of Understanding with other EEA supervisors

During the course of the year, the Bank continued to hold bilateral meetings with the banking supervisory authorities of other EEA states. The principal purpose of these meetings was to exchange information on banks with presences in both countries; to resolve any bilateral difficulties arising from the administration of the Second Banking Coordination Directive; and, more generally, to exchange views on supervisory developments and other issues of mutual interest. The terms of such co-operation are spelt out in bilateral Memoranda of Understanding which the Bank has negotiated with each of its supervisory counterparts in the European Economic Area.

(5) Other

Derivatives market survey

In general, supervisors are interested in the different risks arising from trading activities rather than the particular instruments that a bank might choose to trade in. Data on an individual bank's use of particular over-the-counter products are therefore of limited use. However, aggregate data, giving measures of market size and market concentration, can be valuable when assessing the market and credit risks run by individual institutions. Such data also have wider uses to central banks: for example, in understanding the transmission mechanism for monetary policy.

In the light of perceived deficiencies in existing aggregate data, the G10 Governors asked the Euro-Currency Standing Committee to examine what information was needed and how it might be collected. The work of this committee led to the setting-up of a derivatives market survey (to run alongside the existing triennial foreign exchange survey) and to the publication of a report (known as the 'Brockmeijer Report'). The survey was co-ordinated by the Bank of International Settlements, and involved 26 central banks, each of which collected information on derivatives activity in its country. The UK survey took place in April 1995 but the results will probably not be available for some months.

Peer group review

Last year's report noted that a model had been agreed for a 'system of peer group review'. Such a system was suggested by Sir Thomas Bingham in his report on the supervision of BCCI as one way in which host-country supervisors can receive independent verification that home-country supervisors are really doing their job. Thus, a primary objective of the exercise is to provide supervisors with more information about one another's supervisory regimes. During 1994, the Bank became the first supervisor to submit its supervision to a review by its peers in accordance with the agreed model. This review proved valuable in two ways: it gave the Bank the benefit of an independent perspective on its supervisory operations, and it provided a working prototype for similar exercises elsewhere. The Bank is now seeking to involve additional countries in the process and to encourage a second country to be reviewed.

Derivatives data

As derivative markets have grown, interest in data that illuminate the activities of individual firms has increased. Work has therefore been progressing in three areas: appropriate accounting rules for 'off-balance-sheet instruments'; reporting to supervisors (in the case of regulated firms); and disclosure through published accounts.

When assessing off-balance-sheet transactions, accountants are generally concerned to ensure that realised and unrealised profits/losses (and fee or premium income/expense) are fairly reflected in the financial statements—both as to the carrying value of open positions and the allocation of profit and loss to appropriate financial periods. This accounting can be done either on a cash/accruals basis—reflecting payments made and received, as they occur—or by regularly revaluing contracts so that accounts reflect their current market value/price. However, some argue that a special treatment is required where a particular contract is held as a hedge for a position that is accounted for in a different manner.

Setting accounting standards is often in the hands of the accounting profession, the independence of which varies between countries. In the United Kingdom, the Accounting Standards Board issues Financial Reporting Standards which have the force of law. The Board also approves certain bodies for the purpose of issuing Statements of Recommended Accounting Practice (SORPs) which, although intended to be authoritative, are not mandatory. The British Bankers' Association (BBA) is one such recognised body and the Bank of England encourages banks to adopt BBA SORPs. A SORP on off-balance-sheet instruments was issued in November 1991 and is currently being revised. At an international level, the International Accounting Standards Committee (IASC) works to encourage convergence amongst national bodies, although in many countries (including the United Kingdom) its published standards have no automatic authority. The IASC has published two exposure drafts (E40 and E48) on accounting for financial instruments. Both E40 and E48 envisaged setting down rules for the recognition, measurement and disclosure of financial instruments. In late-1994, however, the IASC decided to split the project into two parts, with a standard on disclosure (IAS 32) being approved in March 1995, leaving recognition and measurement issues to be dealt with subsequently. In the meantime, the private-sector G30 report (published in July 1993) contained four recommendations on accounting practice.

Supervisors are, of course, interested in banks' profitability (and therefore in the accuracy and appropriateness of profit recognition); they are also interested in data that illuminate the risks that a firm faces and the nature of its business. Assessment of risks involves not just a snapshot (as in the published accounts) but consideration of how a firm's portfolio might evolve over time—for example, its sensitivity to market movements. In the United Kingdom, reporting to banking supervisors captures the credit risks associated with derivatives trading. Supervisors also receive information on foreign exchange exposure—including that arising from derivative contracts. Once the CAD is implemented, banks' exposure—through trading activities—to interest rate risk and equity position risk will also be reported. Other information—on, for example, systems and controls and business plans—is specific to each bank and therefore not amenable to standard reporting. It is, nonetheless, collected from banks through prudential interviews, regular access to management information and specially requested reports.

It is unusual to attempt international co-ordination of prudential reporting requirements. However, the Basle Supervisors Committee has been considering which data on derivatives should be collected from banks. There is a particular concern to limit the reporting burden, by eliminating unnecessary inconsistencies between supervisory data and that requested for other purposes (for example, macroprudential and macroeconomic reasons).

Profitability, exposure to risk and descriptions of a firm's business and controls are all important aspects of disclosure through published accounts. Supervisors have an interest in ensuring that market participants are well-informed about their counterparties—both because this improves assessments of credit risk and because it reduces the likelihood of ill-informed market reactions to unexpected events. They are therefore following closely the work on disclosure initiated by the G10 Central Bank Governors, and the reactions to the report of the working party chaired by Peter Fisher of the Federal Reserve Bank of New York, which was published in September 1994. This went further than previous private sector work in this area (eg as published by the Institute of International Finance), by advocating disclosure of market risk, as well as of credit risk, on over-the-counter (OTC) derivative positions.

Value-at-risk models

This box describes in more detail the two main value-at-risk (VAR) modelling techniques.

Variance/covariance analysis uses summary statistics, calculated from historic data on price volatilities and correlations within and between markets, to estimate likely potential losses. Price changes are assumed to be normally distributed; this enables a bank to calculate a confidence level—a figure for the value at risk over the next 24 hours that it can be, say, 95% or 99% confident will not be exceeded. The confidence level is calculated by reference to the standard deviation of past percentage price changes multiplied by a scaling factor.

To give an example, if a bank has positions in interest rate related instruments—bonds, swaps, forward rate agreements etc—in three markets (the United Kingdom, the United States and Germany), the following statistics will be calculated for each market; they might run to many thousands if a full variance/covariance approach were being used:

- the volatilities of government bond prices in a large number of maturity bands—for example, the standard deviation of daily percentage price changes—converted to a 99% confidence interval by multiplying by 2.3;[(1)]

- correlations in price movements between the maturity bands (ie along the yield curve) in each market;

- the relationship between price changes in corporate and government securities (in essence, the risk on corporate exposures is separated into the pure interest rate risk on government bonds, and the spread between government and corporate bonds); and

- correlations in price movements between markets.

In order to use these summary statistics to calculate the value at risk from interest rate exposures in a particular market, the portfolio will be broken down into a number of maturity bands. A bank will have a rule enabling nearly identical risks to be netted off against one another. Using sensitivity models, other exposures (for example, large swap books) are reduced to a small number of bond positions with sensitivity to interest rates very similar to the cash flows from the swaps. The bond positions can then be used as a proxy for the swap positions, and are placed in the maturity bands.

To look at the exposure of the total bond book (across all the bond markets), the correlations between price changes at each point in the yield curve in the different markets are calculated. This technique is applied to equity books in a similar way: for a bank's equity positions in each market, the likely volatility (given a 99% confidence interval) of the index is calculated, as is the likely correlation between movements in the indices in different markets. The VAR approach can also be used to capture the *beta* risk—the risk that prices of individual equities will not move exactly in line with the index. Similarly, the currency position risk arising from the securities positions is captured by calculating the volatility of each currency and the correlations between them. And, depending on how comprehensive the VAR model is, the interest rate, equity and foreign exchange exposures may all be considered together to give an overall picture of likely losses, by calculating the correlations between price movements in the separate risk groups.

It is difficult to allow fully for the non-linear risks arising in option portfolios—exposures in gamma[(2)]—using this technique. The approach implicitly assumes that a portfolio's value varies linearly with changes in market level. This is clearly not the case with options, and the problem is particularly significant when there are large market movements.

The other method of VAR modelling is *historical simulation*. Here, the trading book is reduced to its essential elements (using maturity bands for the interest rate exposures, as in the first approach). Historical data covering two years or so is then used to calculate the changes in the value of the book that *would* have been experienced had it been held throughout the period. (It is not possible simply to revalue the current book over the past, without reducing it to its essential elements, because data on all individual bonds and equities is usually not stored over long periods by the banks; in any case, in earlier periods some bonds would not have been in existence. Even if the bond *had* been in existence, its residual maturity would have been different in earlier periods, leading to different price volatilities.) Using this technique, it is possible to calculate the 99% confidence interval *without* assuming that the price changes are normally distributed, by computing the loss which was not exceeded on 99% of occasions.

Clearly, a main difference between the two approaches is that with the first the confidence interval is calculated statistically, whereas with historical simulation it is observed. The variance/covariance method uses the assumption that the price changes are normally distributed to derive the confidence level; that assumption is not, however, entirely realistic, since prices tend to exhibit more extreme movements than is consistent with a normal distribution (the observed distribution has fatter tails than a true normal distribution). By assuming normality, therefore, the approach may understate the likely volatility.

Another difference is that the simulation method can encompass the spread and basis risk between instruments, and can also be expanded to encompass the non-linear gamma risks in option portfolios.[(3)]

(1) Since the returns are normally distributed, there is a 1% probability that the return will be greater than 2.326 deviations from the mean.

(2) The *delta* of an option is the rate of change of its price with respect to changes in the prices of an underlying asset. Its *gamma* is the rate of change of the value of the option with respect to its delta.

(3) The *spread risk* is the risk of changes in the spread between corporate and government bond prices; the *basis risk* is the risk that, where a position is hedged by a non-identical instrument, the prices of the two positions will move differently.

Part V
The legal framework and operational supervision

A. Developments in the legal framework

Statutory instruments

No statutory instruments have been made under the Banking Act 1987 since last year's Report was published.

The Banking Coordination (Second Council Directive) (Amendment) Regulations 1995[1] were made under the European Communities Act 1972 and laid before Parliament on 4 May. They amend the 2BCD Regulations[2] to reflect Leichtenstein's membership of the European Economic Area[3] and come into force on 1 June 1995.

Statement of Principles

The following papers are added to the table in paragraph 2.5 of the Statement of Principles published in May 1993 by the Bank under section 16 of the Act:

Treatment of Repurchase Agreements and Stock Lending and Borrowing for Capital Adequacy and Large Exposures Purposes (BSD/1994/4, November 1994)

Amendment to the Bank's notice on the Implementation of the Solvency Ratio Directive in the United Kingdom: Re-definition of Zone A (S&S/1995/1)

Implementation in the UK of the Capital Adequacy Directive (S&S/1995/2)

The Bank has also reviewed its policy on the repayment of permanent (Tier 1) capital. Paragraph 2.12 of the Statement of Principles states that such repayments would only be expected to occur as part of a capital reconstruction the Bank had approved. The Bank will now also consider allowing repayments where it is convinced that the institution's capital is in excess of its needs for the foreseeable future (see Part I).

The Statement of Principles contains a number of references to money laundering in the context of the Bank's interpretation of the criteria in Schedule 3 to the Banking Act 1987. The Bank's interpretation of the criteria now takes into account the revised edition of the Joint Money Laundering Steering Group's Guidance Notes, published in February 1995 (see Part IV).

Recent court decisions

Mount Banking Corporation Ltd (In Administration)

In the 1993/94 Annual Report, it was reported that, following the rejection of their appeal to the Banking Appeal Tribunal, the two directors of Mount Banking Corporation who had been found not fit and proper for their positions by the Bank had subsequently appealed to the High Court. At the time the Report was published, one of them had withdrawn his appeal.

The appeal of the second individual was heard in May 1994. Mr Justice Vinelott upheld the decision of the Tribunal, rejected the appeal and awarded the Bank its costs. He found that 'it cannot possibly be said that the decision of the Tribunal contradicted the true and only conclusion from the evidence before it'.

The judgment clarifies the test to be applied by the Banking Appeal Tribunal in such cases. Namely, it must make its own evaluation of the evidence and, having done so, decide whether the Bank's decision went beyond the range of what could be said to have been justified by that evidence. The judge concurred with the Tribunal's view that it was entitled 'to give the policies and approach of the Bank of England, as the statutory regulator with unrivalled experience in the field, very considerable weight'.

Mr G F C Mellstrom

Mr Mellstrom sought judicial review of the Bank's decision that he was not fit and proper to be a director

(1) S.I. 1995 No.1217.

(2) S.I. 1992 No.3218.

(3) See page 27 of the 1993/94 Bank of England, *Banking Act Report*.

and controller of National Guardian Mortgage Corporation Ltd. He claimed the procedure followed by the Bank was unfair to him because he was only able to make his statutory representations in response to the matters disclosed in the Bank's notice to him, and not other matters in the Bank's files which it had not mentioned in the notice. The case was heard in January 1995. Mr Justice Schiemann held that the Bank had not relied on any material which had not been disclosed, there was no requirement to disclose material not relied upon, and Mr Mellstrom had not been denied natural justice. He dismissed the application with costs.

B. Operational supervision

(i) The 'authorised population'

The 'authorised population' comprises institutions authorised under the Banking Act 1987 and European authorised institutions ('EAIs'). EAIs are authorised by the relevant home state authority and carry on activities in the United Kingdom under the 2BCD Regulations. They are not authorised by the Bank.

The authorised population rose again in 1994/95 (see Table IX). The number of institutions permitted to accept deposits in the United Kingdom, by contrast, fell to 481. The difference is made up by the increasing number of EAIs which in the United Kingdom are entitled only to carry on activities other than deposit-taking, usually by offering services on a cross-border basis only.

Institutions authorised under the Banking Act

There were 379 institutions authorised under the Banking Act as at the end of February 1995. Of these institutions, 155 were represented in the United Kingdom by branches of institutions incorporated outside the European Economic Area and 224 were incorporated in the United Kingdom. Of the UK-incorporated institutions, 74 were subsidiaries of overseas companies and 8 were joint ventures involving overseas institutions.

European authorised institutions

As at end-February 1995, there were 146 institutions recognised under the 2BCD Regulations as European authorised institutions. Of these, 102 have branches in the United Kingdom which are entitled (amongst other things) to accept deposits in the United Kingdom, and 3 have branches in the United Kingdom which are entitled only to carry on other of the activities listed in Schedule 1 of the 2BCD Regulations. The remaining 41 EAIs offer services only on a cross-border basis into the United Kingdom.

Table IX
The 'authorised population'[(1)]

End-February	1988	1989	1990	1991	1992	1993	1994	1995
UK-incorporated	313	295	289	275	263	253	232	224
Incorporated outside the United Kingdom	254	256	259	255	255	255	286	301
Total	**567**	**551**	**548**	**530**	**518**	**508**	**518**	**525**
of which:								
EAIs with UK branches entitled to accept deposits in the United Kingdom						*79*	*97*	*102*
Other EAIs						*–*	*32*	*44*

(1) Includes European authorised institutions, which are not authorised under the Banking Act—see above.

Applications for authorisation

In the year to end-February 1995, six applications for authorisation under the Banking Act were granted by the Bank—three to UK-incorporated institutions and three to institutions incorporated overseas which wished to open branches in the United Kingdom. A further application in this latter category was refused.

New European authorised institutions

During 1994/95, five new EAIs became entitled to establish branches in the United Kingdom for the purpose of accepting deposits; one EAI previously entitled only to provide cross-border services also became entitled to establish a deposit-taking branch in the United Kingdom. One other EAI also established a branch, not entitled to accept deposits, in the United Kingdom. A further 12 new EAIs and one existing EAI became entitled to carry on, by the provision of cross-border services, various listed activities.

Table X
New authorisations under the Banking Act and new EAIs

Year to end-February	1987	1988	1989	1990	1991	1992	1993	1994	1995
Banking Act authorisations	37	21	12	15	15	25	26	5	6
New EAIs with UK branches entitled to accept deposits in UK								5	5
Other new EAIs								32	13

Surrenders

In 1994/95, 16 authorisations were surrendered compared with 30 in 1993/94. Of these, five followed group re-organisations—including one where a new group company subsequently obtained authorisation under the same name—and a further three followed administrations where no prospect of selling the institution as a going concern was found. One institution decided to surrender after a change in its shareholder controllers; another surrendered having wound down its activities and failed in its attempts to find a purchaser. Two overseas- incorporated institutions surrendered following take-overs by other banks; the four others surrendered in order to focus their activities in their home market.

In cases where an institution surrenders its authorisation but retains deposits, the Bank's supervisory role continues until such time as all depositors are repaid—such institutions are 'former authorised institutions' within the meaning of Section 106 of the Banking Act 1987. There were 26 former authorised institutions as at 28 February 1995. The Bank has the power to give such directions to former authorised institutions as it considers necessary in the interests of depositors. Directions were given to two former authorised institutions in 1994/95 and directions given previously remained in force over two others.

One institution ceased to be a European authorised institution during the year.

Revocations, prohibitions and restrictions

Sections 11 to 14 of the Banking Act provide the Bank with powers to take action against an authorised institution on a number of grounds. These powers may be exercisable, *inter alia*, if it appears to the Bank that any of the minimum criteria for authorisation set down in Schedule 3 of the Act is not or has not been fulfilled, or may not be or may not have been fulfilled, in respect of the institution. In the year 1994/95, no institution had its authorisation revoked but restrictions were put on the authorisation of one institution and remained in force in relation to one other institution.

Table XI
Revocations and restrictions [(1)]

Year to end-February	1990	1991	1992	1993	1994	1995
Revocation of authorisation [(2)]	–	3	1	3	1	–
Restriction of authorisation	2	4	4	12	7	1
Revocation of restricted authorisation	–	–	–	2	–	–

(1) The table only relates to institutions authorised under the Banking Act. It 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 its authorisation, or a conditional authorisation expired, before the revocation took effect. It is not therefore a record of authorisations revoked or restricted but of the use of the Bank's powers.

(2) Including the expiry of a time limited authorisation.

Appeals

One appeal was lodged against the Bank's decision to exercise its powers in 1994/95. The appeal was withdrawn before the preliminary hearing stage. Two other appeals were also made in relation to the Bank's decisions, in one case on a point of law to the High Court and in the other for judicial review. The details are given in the 'Recent Court decisions' section above.

Administration orders and liquidations

One authorised institution was placed in administration, on the application of its directors, in 1994/95. Another continued in administration. Previously agreed creditors' voluntary arrangements (CVAs) remained in effect in the case of three institutions.

(ii) Supervision of the 'authorised population'

Interviews, visits and prudential/statistical returns

Approximately 3,000 meetings were held during 1994/95, a similar level to the previous year. The majority—over 1,800—were non-routine meetings held to discuss specific issues. The Bank's routine meetings are of two main types: the prudential interview to discuss the institution's performance and any attendant supervisory issues; and the trilateral meeting attended by the Bank, the institution and its reporting accountants, at which the discussion is focussed on reports produced by the reporting accountants under Section 39 of the Act. In 1994/95, there were 670 routine prudential interviews with UK authorised institutions and 357 trilateral meetings.

The Bank continues to operate its review team system, whereby Bank staff, together with bankers and accountants seconded to the Bank, or specialist Bank

staff with relevant financial market experience, visit the premises of authorised institutions to assess the quality of their lending and the adequacy of their systems and controls. Depending on the size and nature of the institution under review, such visits may cover the full range of its activities or concentrate on particular business areas. 'Special' review team visits are also carried out which focus on a specific issue of concern. Visits range from a day or two at one location to longer and more complex visits which may extend into weeks and cover multiple locations. Review teams typically comprise two or three people. During the year, 111 full review team visits were carried out, along with a further 17 'special' visits.

In addition, visits are conducted to review the foreign exchange operations of institutions and assess them against the guidelines set by the Bank for foreign exchange position-taking. The total number of such visits during the year was 16.

A small team of supervisors has begun to visit banks to examine the models banks will have the option to use when reporting foreign exchange risk under the CAD and, to a more limited extent, when calculating the risks in derivatives portfolios before reporting under the standard CAD format. This involves a review of the operating environment as well as the mathematics backing the models. In time, such visits will supersede the previous foreign exchange visits mentioned above. Given the scale of the model recognition task, the Bank has needed to prioritise carefully in order to ensure that the banks able to benefit materially from model recognition are visited early. As at 30 April 1995, visits had been made to 19 institutions with another 30 visits planned before the end of 1995.

The review team, foreign exchange and model recognition visits are conducted with the co-operation of the institution and do not involve the use of the Bank's statutory powers.

Bank staff regularly undertake visits to the head offices of institutions with branches in the United Kingdom and parent banks with UK-authorised subsidiaries; they also engage in discussions with overseas supervisors. Such visits extended to 33 countries during 1994/95 and 162 meetings were held, at home and abroad, with overseas supervisors. This was double the number held in 1993/94.

Use of powers to obtain information

Section 39 of the Act gives the Bank powers to require an institution to commission reports from accountants, to establish, among other things, the adequacy of its systems and controls and the accuracy of its prudential returns. Section 39 reports are commissioned regularly as part of the Bank's routine supervision of UK authorised institutions and special reports may also be commissioned if a specific area of concern is identified. In addition, Section 39 allows the Bank to require an institution, former authorised institution or other persons (for example, an institution's controllers) to provide documents and other information to the Bank.

During 1994/95, 610 Section 39 reports were commissioned (260 of them on overseas branches), including 11 special reports.

Section 41 of the Act empowers the Bank to commission reports from competent persons on authorised or former authorised institutions where areas of concern have been identified and where it is in the interests of depositors to do so. Unlike Section 39 reports, Section 41 reports are not commissioned routinely and no such reports were commissioned during 1994/95.

The Bank is able to use its investigatory powers under sections 39 and 41 of the Banking Act in relation to European authorised institutions in order to carry out its limited functions[1] under the 2BCD Regulations in relation to such institutions and to assist the relevant home state authority. The Bank did not use these powers in 1994/95.

Shareholder controllers of authorised institutions

The Banking Act provides that persons must notify the Bank of their intention to become a shareholder controller of an authorised institution which is incorporated in the United Kingdom, or to increase their level of control through any of the threshold levels defined in the Act. The Bank assesses, among other things, their fitness and properness to become shareholder controllers at the proposed threshold. 27 notifications for new or increased control were received in 1994/95. 20 were passed without objection and one was withdrawn. Six remained outstanding on 28 February 1995.

(1) The Bank is responsible only for the supervision of local liquidity (in co-operation with the relevant home state supervisory authority).

Representative offices of overseas institutions

In 1994/95, 24 overseas institutions notified the Bank of their intention to establish representative offices in the United Kingdom, and two institutions notified the Bank of their intention to change the name used by them in the United Kingdom. In one case, the Bank objected to the proposed name.

Appendix 5 lists in full those overseas institutions which have at some time notified the Bank of their intention to establish a UK representative office and which have received a notice of non-objection from the Bank to the name of the proposed office. The list appears in the Banking Act Report for the first time, and it is intended that it will be published in the same way annually in future. Publication here replaces the Bank's previous practice of publishing a separate list of representative offices every six months.

Overseas institutions[1] are required under section 75 of the Banking Act 1987 to give the Bank at least two months notice of their intention to establish a representative office in the United Kingdom, in such manner and form as the Bank shall specify.[2] Overseas institutions which established representative offices before the Banking Act 1987 came into force but which notified the Bank of the establishment of such offices under section 40 of the Banking Act 1979 were not required to notify under the 1987 Act.

The Act gives the Bank powers to object to the proposed names of representative offices if they would be misleading to the public or otherwise undesirable. The Bank also has the power to call for relevant information. These limited requirements apart, the Act specifies no criteria that an overseas institution must meet in order to establish a representative office.

It must be stressed that the presence of an institution's name on the list should not be taken to indicate in any way that the Bank has been or is satisfied as to the integrity or financial soundness of that institution. The Bank does not supervise representative offices and it has no powers to do so.

Banking names and descriptions

In 1994/95, 18 institutions changed their registered names after giving notice to the Bank under section 70 of the Act. No notices of objection to the proposed name changes were issued.

The Bank also examined 105 names submitted during the year by persons who were not authorised under the Banking Act or European authorised institutions, in order to consider whether such names would be likely to breach the prohibition on the use of banking names as set out in Section 67 of the Act. The Bank indicated that 29 of the proposed names would, or might be likely to, breach the Act.

In August 1994 the Bank prosecuted the directors of a company under Section 69 of the Act, which prohibits the use of banking descriptions without authorisation. The directors pleaded guilty at a Magistrates Court to using a banking description in conjunction with their company name. They were fined £1,850 and ordered to pay costs.

Discount houses

There have been no changes in the names or number of discount houses over the year. The Bank continues to have a direct dealing relationship in the sterling money markets with seven discount houses authorised under the Banking Act 1987 and one gilt-edged market-maker.

The discount houses are supervised by the Wholesale Markets Supervision Division of the Bank. Arrangements for the supervision of capital adequacy are broadly unchanged from those set out in the Bank's paper of October 1988, 'Bank of England Operations in the Sterling Money Markets', although some refinements have been made. The Bank has continued to monitor the houses' positions under the terms of the EU Second Banking Coordination Directive and the Consolidated Supervision Directive. In addition, the Bank has continued to monitor the houses' compliance with the terms of their exemption from the Solvency Ratio Directive.

During 1996, a number of prospective changes will affect the discount houses' business. The establishment of an open gilt repo market will broaden the range of instruments in the sterling wholesale markets, perhaps particularly at the short maturities in which the discount houses specialise. The introduction of real time gross settlement, including

(1) The terms 'overseas institution', 'representative office', and 'establishment' are defined in Section 74 of the *Banking Act*.

(2) These requirements do not apply to representative offices established by 'European authorised institutions' and 'European subsidiaries'.

the Bank extending intra-day credit against eligible collateral, will be relevant to the pattern of demand for high-quality liquid instruments. In addition, the discount houses will be subject to a new supervisory regime from the beginning of 1996, when the EU Capital Adequacy Directive is implemented. At the same time, the discount houses' current exemption under the Solvency Ratio Directive will end.

(iii) Prohibition on unauthorised deposit-taking

The workload involved in investigating and, where appropriate, prosecuting cases of suspected illegal deposit-taking has continued to be heavy. Overall during the year, investigators were involved with 52 separate cases (43 in 1993/94). As in recent years, a relatively small number of major cases dominated, particularly those which have, or will, come before the courts.

It was reported last year that two cases had been committed for trial and these were both completed during the year. In one case, Lesley John Everett pleaded guilty to a number of counts under Section 35 of the Banking Act 1987 (fraudulent inducement to make a deposit) and was given a custodial sentence of two years (reduced to one year on appeal). In the other case, Ian Craig Reuben and Lawrence Michael Reuben who were directors of Sylcon Finance Limited, a company that had taken deposits, were both given custodial sentences of six months on each of five counts under Section 3 of the Act (unauthorised deposit-taking); these sentences were to run consecutively. On appeal, however, the sentences were amended to two consecutive terms of six months and three concurrent terms of six months, making a total term of imprisonment of one year.

The Bank is taking prosecutions forward in two other cases. In the first, three individuals have been committed to appear at a Crown Court for offences under the Banking Act 1987, one with offences under Sections 3 and 35 and two with offences under Section 3. In the other case, two individuals have been charged with offences under Sections 3 and 35. A number of other cases are being investigated which may give rise to further prosecutions.

In two current cases, the Bank successfully applied to the High Court for injunctions which restrained further deposit-taking and, in one case, also restricted the disposal of the assets of the persons concerned while the Bank's investigation continued. In a further case, the Bank successfully applied to a Magistrates Court for the issue of a search warrant under Section 43 of the Act on the grounds that there were reasons to doubt there would be full compliance with requirements imposed under the Bank's normal investigatory powers under Section 42.

In a further case the Bank concluded that an individual had been in breach of Section 35 by making a false statement to induce deposits but it was decided that it would not be in the public interest, bearing in mind the Code for Crown Prosecutors, to proceed with such a prosecution. Accordingly, a formal caution was issued to the person concerned who admitted the offence.

The Bank's powers under section 42 of the Act (requiring the provision of relevant documents, information and answers to investigators) were exercised in 19 new investigations (12 in 1993/94) with a total of 68 individual notices being served (71 in 1993/94).

Where the Bank's investigators identify serious non Banking Act offences, information is passed to the Crown Prosecution Service or Serious Fraud Office, as appropriate. Two cases prosecuted by the Crown Prosecution Service (but where convictions were only obtained for Banking Act offences) were completed during the year. In one case, where the Bank had previously undertaken an investigation using its powers under Section 42 and one of the Bank's investigators was a witness at the trial, two individuals were convicted of offences under Section 35 and were given custodial sentences of two years. In the other case, the Bank provided advice on Banking Act matters and the individual concerned was convicted on charges under Sections 3 and 35 and received a custodial sentence of six months.

The Bank has also been involved with a case which was handed to the Serious Fraud Office last year. The defendant was tried and found guilty of offences under Section 35 for which he received a custodial sentence of 3 years.

Part VI
Organisation and staffing of Supervision and Surveillance

Supervision and Surveillance within the new Bank structure

On 1 July 1994, the Bank introduced a new management structure which divided its activities into two wings: financial stability and monetary stability. Within the financial stability wing, supervision was aligned with surveillance. The organisation charts in Appendix 1 show how the Supervision and Surveillance area is subdivided (including senior staff and their specific responsibilities) and how it fits into the new management structure of the Bank as a whole. It comprises five divisions, two dealing with UK institutions, two with overseas banks and surveillance, and one with banking supervisory policy. Surveillance is located in the overseas banks' divisions but provides services to the rest of the Bank.

Surveillance is a refocusing of work formerly undertaken in the Bank's International Divisions. It concentrates on a group of around 70 countries that are considered relevant to UK financial stability, either because banks from those countries are authorised to take deposits in the United Kingdom, or because UK banks have significant operating presences in, or exposures to, them. Surveillance is primarily concerned with four issues: first, monitoring any economic and political developments which may influence financial stability in the countries concerned; second, keeping abreast of the regulatory framework, payment and settlement systems and other matters bearing on systemic stability, including major fraud and corruption; third, tracking particular markets to which UK institutions are exposed, whether directly or indirectly; and finally, remaining informed about the activities and global strategies of major institutions, the particular risks they face outside the United Kingdom and the key individuals who control them.

Staff

Staff numbers for end-February 1995 as shown in Table XII reflect the addition of surveillance staff under the new structure. In the last 18 months approximately 25 additional supervisory staff have also been employed. For the year to end-February 1996 the budgeted number of staff in Supervision and

Table XII
Allocation of Supervision and Surveillance Staff

End-February	1991	1992	1993(1)	1994	1995(2)
Senior Managers	34	32	30	29	41
Managers, Analysts and Assistants	149	147	146	152	199
Inward Secondees/Review Teams	11	10	10	11	10
Support services(3)				57	72
Total	194	189	186	249	322

(1) Figures include 3 managers, 7 analysts and assistants, and 2 secondees who subsequently transferred to the Legal Unit or the Special Investigations Unit.
(2) Includes 42 surveillance staff previously working in the Bank's former International Divisions.
(3) Until May 1993, support services staff were budgeted for centrally in the Bank.

<table>
<tr><th></th><th colspan="2">Staff</th><th colspan="2">Institutions</th></tr>
<tr><th></th><th>1994</th><th>1995</th><th>1994</th><th>1995</th></tr>
<tr><td>Major UK banks' division(1)</td><td>27</td><td>31</td><td>73</td><td>71</td></tr>
<tr><td>Small & medium UK institutions & enforcement(2)</td><td>41</td><td>47</td><td>96</td><td>94</td></tr>
<tr><td>Industrial world division(3)</td><td rowspan="2">64</td><td>56</td><td rowspan="2">332</td><td>251</td></tr>
<tr><td>Developing world division(4)</td><td>60</td><td>102</td></tr>
<tr><td>Supervisory policy division(5)</td><td>39</td><td>28</td><td>–</td><td>–</td></tr>
<tr><td>Administration</td><td>21</td><td>20</td><td></td><td></td></tr>
<tr><td>Support services(6)</td><td>57</td><td>80</td><td>–</td><td>–</td></tr>
<tr><td>Total</td><td>249</td><td>322</td><td>511(7)</td><td>518(7)</td></tr>
</table>

(1) Group 3- 5 on the organogram at Appendix 1.
(2) Groups 6- 10 (1995 figure includes Enforcement).
(3) Group 11- 15.
(4) Groups 16- 20.
(5) Groups 1, 2 and Deposit Protection Board (1994 includes Enforcement and IT).
(6) 1995 figure includes IT.
(7 Excluding the 7 discount houses.

Surveillance is 334, of which 200 are supervisory staff, 42 surveillance staff and 92 support (including administration) staff. The area has continued to benefit from the contribution of the area's eight inward secondees (three from clearing banks and five from the main accounting firms).

Training of staff

The training programme for supervisors, involving external courses in accountancy, banking, legal issues and alertness to fraud and malpractice, has continued and has been extended to surveillance staff since the mid-1994 reorganisation. In order to ensure the training programme continues to reflect the needs of modern supervision, a firm of external consultants has been brought in to establish current training needs and to identify how these can best be met in a cost-effective fashion. It is hoped that a new training

programme will be in place in time for the main influx of new staff in the autumn. All new entrants to Supervision and Surveillance continue to receive an introductory course on banking supervision, and new graduates also participate in a Bank-wide graduate training programme.

Several staff have again been released on secondment. Overseas, staff are working in Hong Kong, the Cayman Islands, Gibraltar, and at the Bank for International Settlements and the European Commission. Within the United Kingdom, secondments to banks have enabled staff to gain experience both of risk management in trading products such as derivatives, and corporate credit analysis.

Training provided by Supervision and Surveillance

Overseas supervisory authorities have continued to seek the Bank's training and advice. In 1994/95, there was less emphasis than in previous years on formal training programmes in the United Kingdom, and correspondingly more on training and technical assistance delivered in recipient countries. A majority again related to the countries of the former Soviet Union and other formerly centrally planned economies, but not to the exclusion of more traditional developing-world contacts.

Visits from overseas central banks and governments increased in 1994/95; most were short visits for familiarisation with the Bank's supervisory methods but some longer programmes were also undertaken.

In addition, overseas visitors, mostly from central banks, have visited the Bank on short-term programmes to familiarise themselves with the Bank's supervisory work. During 1994/95, such visits numbered 14, considerably fewer than in the previous year, though internal re-organisation made it difficult to accommodate such visits during part of the year.

Information technology

The creation of Supervision and Surveillance led to an increase in demand for IT services in 1994/95. The information systems inherited from the Banking Supervision Division were not designed for the much larger number of users following the re-organisation and had difficulty coping. In response, a project was begun to install a more powerful central processor and to provide every member of staff with a networked PC. It is on target for completion during 1995.

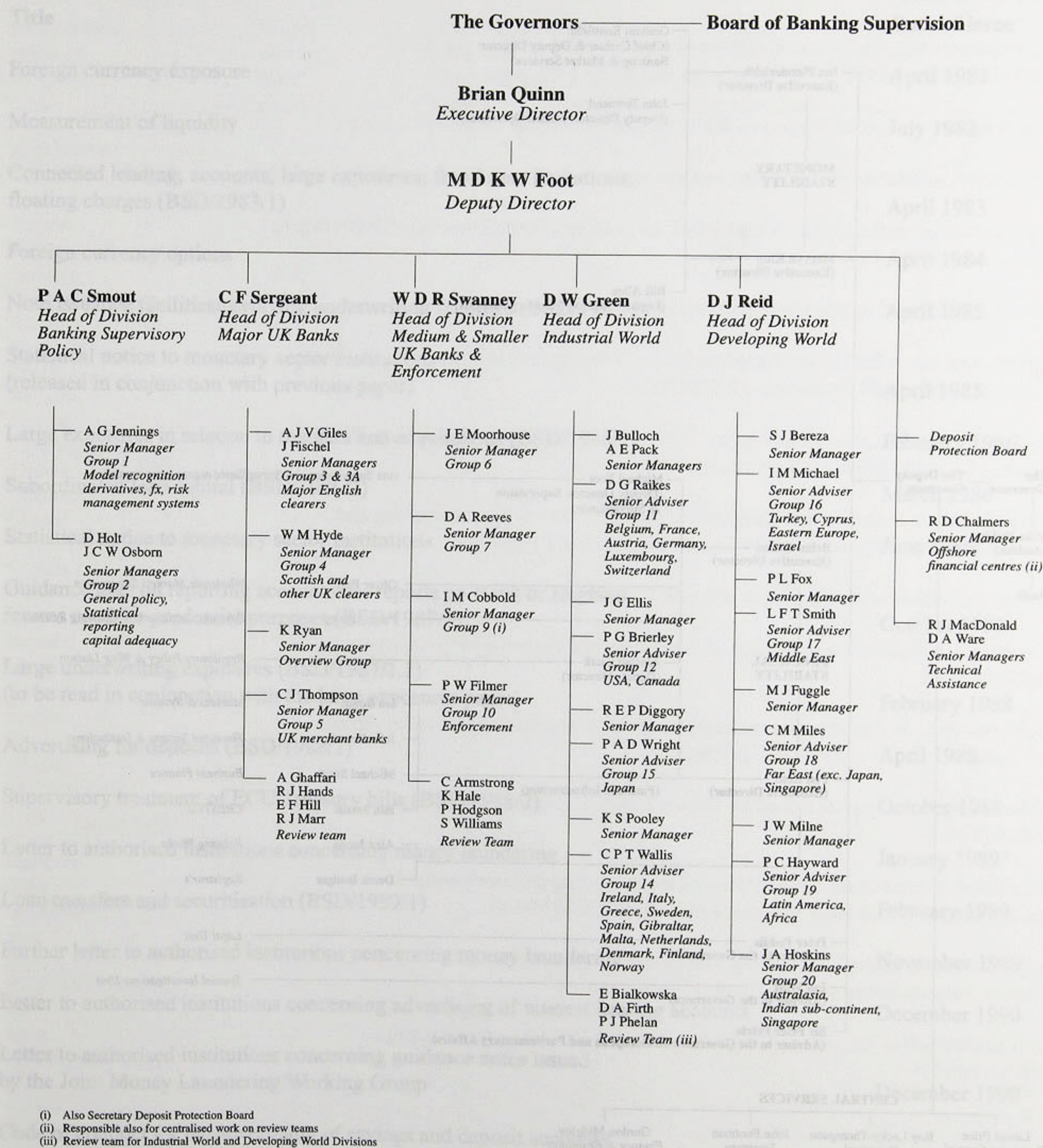
Efforts are being made to ensure that all staff are aware of the system's capabilities so that greater benefit can be obtained from the area's IT investment.

During the year, the first phase of a 'Windows'™-based, core system for non-statistical supervisory data was successfully established. Enhancements to office automation facilities were also made and these will continue throughout 1995/96.

The results of a pilot exercise to automate the interrogation of documents filed electronically are being evaluated. The major text-searching elements of this study were successful but certain technical questions remain to be resolved.

Supervision and Surveillance organogram

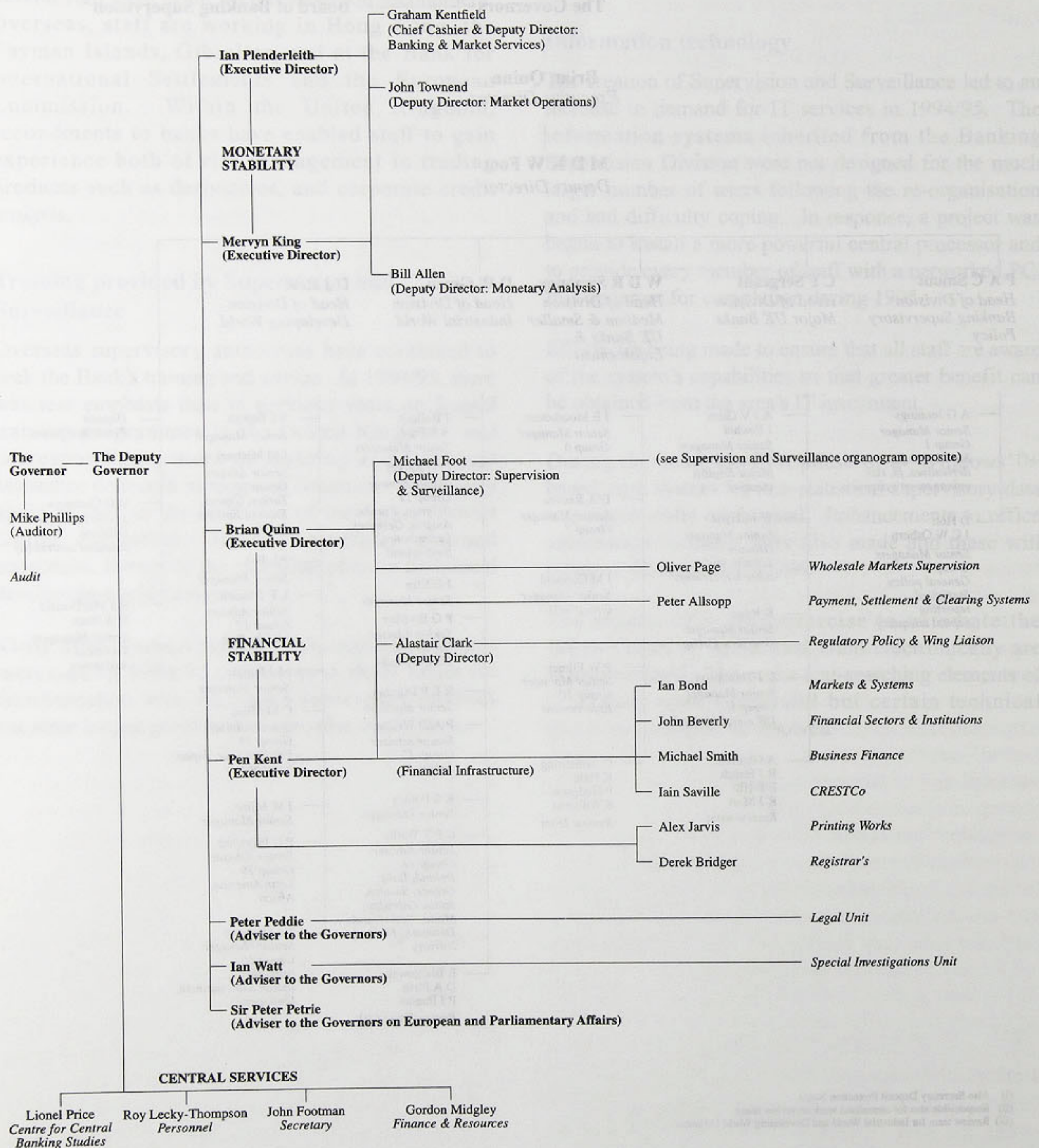
As at 28 February 1995



(i) Also Secretary Deposit Protection Board
(ii) Responsible also for centralised work on review teams
(iii) Review team for Industrial World and Developing World Divisions

Bank of England organogram

As at 28 February 1995



Current supervisory notices

The following is a list of policy and practice notices issued by Supervision and Surveillance (Banking Supervision Division before 1 July 1994) which are currently in force.

Title	Date of issue
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
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
Large exposures in relation to mergers and acquisitions (BSD/1986/1)	February 1986
Subordinated loan capital (BSD/1986/2)	March 1986
Statistical notice to monetary sector institutions	June 1986
Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes (BSD/1987/3)	October 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
Supervisory treatment of ECU Treasury bills (BSD/1988/2)	October 1988
Letter to authorised institutions concerning money laundering	January 1989
Loan transfers and securitisation (BSD/1989/1)	February 1989
Further letter to authorised institutions concerning money laundering	November 1989
Letter to authorised institutions concerning advertising of interest bearing accounts	December 1990
Letter to authorised institutions concerning guidance notes issued by the Joint Money Laundering Working Group	December 1990
Code of conduct for the advertising of savings and deposit accounts and money-market accounts	December 1990

Implementation in the United Kingdom of the Directive on Own Funds of Credit Institutions (BSD/1990/2)	December 1990
Implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3)	December 1990
Statistical notice to reporting banks on capital adequacy treatment of deferred tax assets	December 1990
Implementation in the United Kingdom of the Directive on Own Funds of Credit Institutions (BSD/1992/1) (amendment to the 1990 paper)	January 1992
Loan transfers and securitisation (BSD/1992/3) (amendment to the 1989 paper)	April 1992
Verification of interim profits in the context of the Own Funds Directive (BSD/1992/5)	August 1992
Implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1992/6) (amendment to the 1990 paper)	November 1992
Letter to authorised institutions concerning debt provisioning (the new matrix)	February 1993
Implementation in the United Kingdom of the Directive on the Consolidated Supervision of Credit Institutions (BSD/1993/1)	March 1993
Statements of principles (Banking Act 1987 Section 16; The Banking Coordination (Second Council Directive) Regulations 1992 Schedule 7)	May 1993
Implementation in the United Kingdom of the Directive on the Monitoring and Control of Large Exposures of Credit Institutions (BSD/1993/2)	October 1993
On-balance-sheet netting and cash collateral (BSD/1993/3)	December 1993
The Bank of England's relationship with auditors and reporting accountants (BSD/1994/1)	March 1994
Guidance note on reporting accountants' reports on accounting and other records and internal control systems (BSD/1994/2)	March 1994
Subordinated loan capital issued by UK-incorporated authorised institutions (BSD/1994/3)	May 1994
Treatment of repurchase agreements and stock lending and borrowing for capital adequacy and large exposures purposes (BSD/1994/4)	November 1994
Implementation in the United Kingdom of the Solvency Ratio Directive (S&S/1995/1) (further amendment to the 1990 paper)	March 1995
Implementation in the United Kingdom of the Capital Adequacy Directive (S&S/1995/2)	April 1995

Geographical representation of overseas institutions

The following table shows the geographical origins and status of overseas institutions represented in the United Kingdom at end-February 1995.

Geographical origin of ownership	Branch of an overseas bank[1]	UK incorporated subsidiary of an overseas		Controlling (15% or more) stake in a consortium bank	Representative offices[2]	Total
		Bank[1]	Non-Bank			
Afghanistan	–	1	–	–	–	1
Argentina	1	–	–	–	1	2
Australia	5	5	–	–	3	13
Austria	4	–	–	–	1	5
Bahamas	–	–	–	–	4	4
Bahrain	2	1	–	–	3	6
Bangladesh	1	–	–	–	2	3
Belgium	6	–	–	–	–	6
Bermuda	1	–	–	–	1	2
Brazil	4	–	–	–	5	9
Bulgaria	–	–	–	–	1	1
Canada	6	5	–	–	–	11
Cayman Islands	–	–	–	–	1	1
China	1	–	–	–	5	6
Columbia	–	–	–	–	1	1
Croatia	–	–	–	–	2	2
Cuba	–	1	–	–	–	1
Cyprus	2	2	–	–	–	4
Czech Republic	1	–	–	–	2	3
Denmark	4	1	–	–	–	5
Ecuador	–	–	–	–	2	2
Egypt	1	1	–	–	–	2
Finland	3	–	–	–	2	5
France	16	7	1	–	11	35
Germany	17	2	–	–	4	23
Ghana	1	–	–	–	–	1
Gibraltar	–	–	–	–	1	1
Greece	4	–	–	–	1	5
Hong Kong	4	3	–	–	1	8
Hungary	–	1	–	–	–	1
India	6	1	–	–	–	7
Indonesia	2	–	–	–	2	4
Iran	5	–	–	1	–	6
Iraq	1	–	–	–	–	1
Ireland	10	1	–	–	2	13
Israel	2	2	–	–	2	6
Italy	15	1	–	–	26	42
Jamaica	–	–	–	–	3	3
Japan	28	6	4	–	15	53
Jordan	1	–	–	1	–	2
Kenya	–	–	–	–	1	1
Kuwait	–	1	–	1	2	4

(1) Includes institutions authorised to conduct banking business in the country of origin.

(2) Representative offices as listed in Appendix 5 (not comparable with the numbers in previous *Reports*).

Geographical origin of ownership	Branch of an overseas bank[1]	UK incorporated subsidiary of an overseas		Controlling (15% or more) stake in a consortium bank	Representative offices[2]	Total
		Bank[1]	Non-Bank			
Lebanon	1	–	–	–	2	3
Libya	–	–	–	1	–	1
Luxembourg	1	–	–	–	4	5
Former Yugoslav Republic of Macedonia	–	–	–	–	1	1
Malaysia	2	–	–	–	2	4
Mexico	5	1	–	–	4	10
Montenegro	–	–	–	–	1	1
Netherlands	6	–	–	–	1	7
New Zealand	–	–	–	–	2	3
Nigeria	2	–	–	–	3	5
Norway	2	–	–	–	–	2
Pakistan	4	–	–	–	2	6
Panama	–	–	–	–	2	2
Philippines	1	1	–	–	1	3
Poland	1	–	–	–	–	1
Portugal	4	–	–	–	1	5
Qatar	1	–	–	–	–	1
Romania	–	–	–	1	–	1
Russia	–	1	–	–	6	7
Saudi Arabia	4	2	–	1	3	10
Serbia	–	–	–	1	3	4
Singapore	4	–	–	–	–	4
Slovenia	–	–	–	–	2	2
South Africa	3	3	–	–	3	9
South Korea	7	3	–	–	8	18
Spain	9	1	–	–	6	16
Sri Lanka	1	–	–	–	–	1
Sweden	4	1	–	–	–	5
Switzerland	9	1	–	–	15	25
Taiwan	2	–	–	–	4	6
Thailand	3	–	–	–	1	4
Togo	–	–	–	–	1	1
Turkey	2	1	–	–	5	8
Ukraine	–	–	–	–	1	1
UAE	4	–	–	–	–	4
USA	23	9	4	2	14	53
Venezuela	–	–	–	–	2	2
Zambia	1	–	–	–	–	1
Totals	**260**	**66**	**9**	**9** (1)	**208**	**552** (2)
of which						
EEA countries[3]	105	14	1	–	59	179
Other Europe	15	6	–	2	41	64
North America	29	14	4	2	14	63
Japan	28	6	4	–	15	53
Australia & New Zealand	5	5	–	–	5	15
Other Asia	38	9	–	–	28	75
Middle East	22	7	–	5	12	46
Other	18	5	–	–	34	57

(1) Representing 8 institutions.
(2) Representing 547 institutions.
(3) Other than the United Kingdom.

List of institutions authorised as at 28 February 1995

This list is made available pursuant to section 17 (2) of the Banking Act 1987 as amended by The Banking Coordination (Second Council Directive) Regulations. The inclusion of an institution does not mean that the Bank of England in any way guarantees its obligations. The list includes institutions authorised by the Bank of England under the Banking Act 1987 and European authorised institutions.

(i) Institutions authorised by the Bank of England

The following institutions are authorised by the Bank of England under the Banking Act 1987 to accept deposits in the United Kingdom

1. UK incorporated[1]

ABC International Bank plc
ANZ Grindlays Bank plc
AY Bank Ltd[2]
Abbey National plc
Abbey National Treasury Services plc
Adam & Company plc
Afghan National Credit & Finance Ltd
Airdrie Savings Bank
Alexanders Discount plc
Alliance Trust (Finance) Ltd
Allied Bank Philippines (UK) plc
Allied Trust Bank Ltd
Alpha Bank London Ltd
Anglo Romanian Bank Ltd[2]
Henry Ansbacher & Co Ltd
Arbuthnot Latham & Co, Ltd
Assemblies of God Property Trust
Associates Capital Corporation Ltd
Avco Trust plc

Banamex Investment Bank plc
Bank Leumi (UK) plc
Bank of America International Ltd
Bank of Cyprus (London) Ltd
Bank of Montreal Europe Ltd
Bank of Scotland
Bank of Scotland Treasury Services plc
Bank of Tokyo International Ltd
Bank of Wales plc
Bankers Trust International plc
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
Belmont Bank Ltd
Beneficial Bank plc
The British Bank of the Middle East
The British Linen Bank Ltd
British Railways Savings Company Ltd
Brown, Shipley & Co Ltd

CIBC Bank plc
CLF Municipal Bank plc
Caledonian Bank plc
Cater Allen Ltd
Central Hispano Bank (UK) Ltd
The Charities Aid Foundation Money Management Company Ltd
Chartered Trust plc
Charterhouse Bank Ltd
Chase Investment Bank Ltd
Chemical Investment Bank Ltd
Citibank International plc
City Trust Ltd
Clive Discount Company Ltd
Close Brothers Ltd
Clydesdale Bank plc
Commercial Bank Trust plc
Consolidated Credits Bank Ltd
The Co-operative Bank plc
County NatWest Ltd
Coutts & Co
Credit Suisse Financial Products

Daiwa Europe Bank plc
Dalbeattie Finance Co Ltd
Dao Heng Bank (London) plc
Davenham Trust plc
The Dorset, Somerset & Wilts Investment Society Ltd
Dryfield Trust plc
Dunbar Bank plc
Duncan Lawrie Ltd

Eccles Savings and Loans Ltd
Exeter Bank Ltd

FIBI Bank (UK) plc
Fairmount Capital Management Ltd
Financial & General Bank plc
James Finlay Bank Ltd
First National Bank plc
First National Commercial Bank plc
The First Personal Bank plc
First Trust Bank (AIB Group Northern Ireland plc)
Robert Fleming & Co Ltd
Ford Credit Europe plc
Foreign & Colonial Management Ltd
Forward Trust Ltd
Forward Trust Personal Finance Ltd
Frizzell Bank Ltd

Gartmore Money Management Ltd
Gerrard & National Ltd
Girobank plc
Goldman Sachs Ltd
Granville Bank Ltd
Gresham Trust plc
Guinness Mahon & Co Ltd

HFC Bank plc
HSBC Investment Bank Ltd

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

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

3i plc
3i Group plc
IBJ International plc
Iran Overseas Investment Bank Ltd[2]
Italian International Bank plc

Jordan International Bank plc[2]
Leopold Joseph & Sons Ltd

KDB Bank (UK) Ltd
KEXIM Bank (UK) Ltd
King & Shaxson Ltd
Kleinwort Benson Ltd
Kleinwort Benson Investment Management Ltd
Korea Long Term Credit Bank International Ltd

LTCB International Ltd
Lazard Brothers & Co Ltd
Lloyds Bank plc
Lloyds Bank (BLSA) Ltd
Lloyds Bowmaker Ltd
Lloyds Private Banking Ltd
Lombard Bank Ltd
Lombard & Ulster Ltd
Lombard North Central plc
London Scottish Bank plc
London Trust Bank plc
Lordsvale Finance plc

MBNA International Bank Ltd
W M Mann & Co (Investments) Ltd
Marks and Spencer Financial Services Ltd
Matheson Bank Ltd
Matlock Bank Ltd
Meghraj Bank Ltd
Mellon Europe Ltd
Mercury Provident plc
Merrill Lynch International Bank Ltd
The Methodist Chapel Aid Association Ltd
Midland Bank plc
Midland Bank Trust Company Ltd
Minories Finance Ltd
Minster Trust Ltd
Samuel Montagu & Co Ltd
Morgan Grenfell & Co Ltd
Moscow Narodny Bank Ltd
Mutual Trust & Savings Ltd

NIIB Group Ltd
NWS Bank plc
National Bank of Egypt International Ltd
National Bank of Kuwait (International) plc
The National Mortgage Bank plc
National Westminster Bank plc
NationsBank Europe Ltd
The Nikko Bank (UK) plc
Noble Grossart Ltd
Nomura Bank International plc

Northern Bank Ltd
Northern Bank Executor & Trustee Company Ltd
Nykredit Mortgage Bank plc

Omega Trust Co Ltd

PaineWebber International Bank Ltd
Pointon York Ltd
The Private Bank & Trust Company Ltd

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

SBI European Bank Ltd
Sabanci Bank plc
Sanwa International plc
Saudi American Bank (UK) Ltd
Saudi International Bank
(Al Bank Al Saudi Al Alami Ltd)[2]
Schroder Leasing Ltd
J Henry Schroder Wagg & Co Ltd
Scotiabank (UK) Ltd
Scottish Amicable Money Managers Ltd
Scottish Widows Bank plc
Seccombe Marshall & Campion plc
Secure Trust Bank plc
Singer & Friedlander Ltd
Smith & Williamson Securities
Southsea Mortgage & Investment Co Ltd
Standard Bank London Ltd
Standard Chartered Bank
Sun Banking Corporation Ltd
Svenska International plc

TSB Bank plc
TSB Bank Scotland plc
Tokai Bank Europe Ltd
Toronto Dominion Bank Europe Ltd
Turkish Bank (UK) Ltd
Tyndall Bank plc

UBAF Bank Ltd[2]
UCB Bank plc
Ulster Bank Ltd
Union Discount Company Ltd
The United Bank of Kuwait plc[2]
United Dominions Trust Ltd
United Trust Bank Ltd
Unity Trust Bank plc

Wagon Finance Ltd
S G Warburg & Co Ltd
Weatherbys & Co Ltd
Wesleyan Savings Bank Ltd
West Merchant Bank Ltd
Western Trust & Savings Ltd
Whiteaway Laidlaw Bank Ltd
Wimbledon & South West Finance plc (in administration)
Wintrust Securities Ltd
Woodchester Credit Lyonnais plc

Yamaichi Bank (UK) plc
Yorkshire Bank plc

2. Incorporated outside the European Economic Area

ABSA Bank Ltd
Allied Bank of Pakistan Ltd
American Express Bank Ltd[3]
Arab African International Bank
Arab Bank plc
Arab Banking Corporation BSC
Arab National Bank
The Asahi Bank, Ltd[3]
The Ashikaga Bank Ltd[3]
Australia & New Zealand Banking Group Ltd[3]

BSI Banca della Svizzera Italiana[3]
Banca Serfin SA
Banco de la Nación Argentina
Banco do Brasil SA
Banco do Estado de São Paulo SA
Banco Mercantil de São Paulo SA
Banco Nacional de Mexico SA
Banco Real SA
Bancomer SA
Bangkok Bank Public Company Ltd
Bank Julius Baer & Co Ltd[3]
Bank Bumiputra Malaysia Berhad
PT Bank Ekspor Impor Indonesia (Persero)
Bank Handlowy w Warszawie SA
Bank Hapoalim BM
Bank Mellat
Bank Melli Iran
PT Bank Negara Indonesia (Persero)
Bank of America NT & SA[3]
Bank of America Illinois
Bank of Baroda
The Bank of NT Butterfield & Son Ltd
Bank of Ceylon
Bank of China
The Bank of East Asia Ltd
The Bank of Fukuoka Ltd[3]
Bank of India
Bank of Montreal[3]
The Bank of New York[3]
The Bank of Nova Scotia[3]
Bank of Seoul
The Bank of Tokyo, Ltd[3]
The Bank of Yokohama, Ltd[3]
Bank Saderat Iran
Bank Sepah Iran
Bank Tejarat
Bank von Ernst & Co Ltd[3]
Bankers Trust Company[3]
Beirut Riyad Bank SAL

Canadian Imperial Bank of Commerce[3]
Canara Bank
Chang Hwa Commercial Bank Ltd
The Chase Manhattan Bank, NA[3]
Chemical Bank[3]
The Chiba Bank Ltd[3]
Cho Hung Bank
The Chuo Trust & Banking Co, Ltd[3]
Citibank NA[3]
Commercial Bank of Korea Ltd
Commonwealth Bank of Australia[3]
CoreStates Bank NA[3]
Crédit Suisse[3]
Cyprus Credit Bank Ltd
The Cyprus Popular Bank Ltd

The Dai Ichi Kangyo Bank, Ltd[3]
The Daiwa Bank, Ltd[3]
The Development Bank of Singapore Ltd
Discount Bank and Trust Company[3]

Emirates Bank International Ltd

First Bank of Nigeria plc
First Commercial Bank
First Fidelity Bank, NA[3]
The First National Bank of Boston[3]
The First National Bank of Chicago[3]
Fleet Bank of Massachusetts, NA[3]
French Bank of Southern Africa Ltd
The Fuji Bank, Ltd[3]

Ghana Commercial Bank
Gulf International Bank BSC

Habib Bank AG Zurich[3]
Habib Bank Ltd
Hanil Bank
Harris Trust and Savings Bank[3]
The Hiroshima Bank, Ltd[3]
The Hokkaido Takushoku Bank, Ltd[3]
The Hokuriku Bank Ltd[3]
The Hongkong and Shanghai Banking Corporation Ltd

The Industrial Bank of Japan, Ltd[3]

The Joyo Bank Ltd[3]

Korea Exchange Bank
Korea First Bank

The Long Term Credit Bank of Japan, Ltd[3]

Macquarie Bank Ltd
Malayan Banking Berhad
MashreqBank PSC
Mellon Bank, NA[3]
Merchants National Bank & Trust Company of Indianapolis (National City Bank, Indiana)[3]
The Mitsubishi Bank, Ltd[3])
The Mitsubishi Trust and Banking Corporation[3]
The Mitsui Trust & Banking Co Ltd[3]
Morgan Guaranty Trust Company of New York[3]
Multibanco Comermex SA

NBD Bank[3]
Nacional Financiera SNC
National Australia Bank Ltd[3])
National Bank of Abu Dhabi
National Bank of Canada[3]
The National Bank of Dubai Public Joint Stock Company
National Bank of Pakistan
NationsBank, NA (Carolinas)[3]
Nedcor Bank Ltd
The Nippon Credit Bank, Ltd[3]
The Norinchukin Bank[3]
The Northern Trust Company[3]

Oversea Chinese Banking Corporation Ltd
Overseas Trust Bank Ltd
Overseas Union Bank Ltd

Philippine National Bank

Qatar National Bank SAQ

Rafidain Bank (provisional liquidator appointed)
Republic National Bank of New York[3]
The Riggs National Bank of Washington, DC[3]
Riyad Bank
Royal Bank of Canada[3]

The Sakura Bank, Ltd[3]
The Sanwa Bank, Ltd[3]

(3) Non-EEA OECD institutions.

Saudi American Bank
The Saudi British Bank
Shanghai Commercial Bank Ltd
Shinhan Bank
The Siam Commercial Bank Public Company Ltd
Sonali Bank
State Bank of India
State Street Bank and Trust Company[3]
The Sumitomo Bank, Ltd[3]
The Sumitomo Trust & Banking Co Ltd[3]
Swiss Bank Corporation[3]
Syndicate Bank

TC Ziraat Bankasi[3]
The Thai Farmers Bank Public Company Ltd
The Tokai Bank, Ltd[3]
The Toronto-Dominion Bank[3]
The Toyo Trust & Banking Company, Ltd[3]
Türkiye Is Bankasi AS[3]

Uco Bank
Union Bancaire Privée, CBI-TDB[3]
Union Bank of Nigeria plc
Union Bank of Switzerland[3]
United Bank Ltd
United Mizrahi Bank Ltd
United Overseas Bank Ltd[3]

Westpac Banking Corporation[3]

The Yasuda Trust & Banking Co, Ltd[3]

Zambia National Commercial Bank Ltd
Zivnostenská Banka AS

(ii) European authorised institutions

1 European authorised institutions entitled to establish UK branches for the purpose of accepting deposits in the United Kingdom

Name of institution	Country of home State supervisory authority
ABN AMRO Bank NV	Netherlands
AIB Capital Markets plc	Republic of Ireland
AIB Finance Ltd	Republic of Ireland
ASLK CGER Bank NV SA	Belgium
Allied Irish Banks plc	Republic of Ireland
Alpha Credit Bank AE	Greece
Anglo Irish Bank Corporation plc	Republic of Ireland
BfG Bank AG	Germany
Banca Cassa di Risparmio di Torino SpA	Italy
Banca Commerciale Italiana	Italy
Banca di Roma SpA	Italy
Banca March SA	Spain
Banca Nazionale dell'Agricoltura SpA	Italy
Banca Nazionale del Lavoro SpA	Italy
Banca Popolare di Milano	Italy
Banca Popolare di Novara	Italy
Banco Ambrosiano Veneto SpA	Italy
Banco Bilbao Vizcaya	Spain
Banco Central Hispanoamericano SA	Spain
Banco de Sabadell	Spain
Banco di Napoli SpA	Italy
Banco di Sicilia SpA	Italy
Banco Español de Crédito SA	Spain
Banco Espirito Santo e Comercial de Lisboa	Portugal
Banco Exterior de España SA	Spain
Banco Nacional Ultramarino SA	Portugal
Banco Português do Atlântico	Portugal
Banco Santander	Spain
Banco Santander de Negocios SA	Spain
Banco Totta & Açores SA	Portugal

Bank Austria AG	Austria
Bank Brussels Lambert	Belgium
The Bank of Ireland	Republic of Ireland
Bankgesellschaft Berlin AG	Germany
Banque Arabe et Internationale d'Investissement	France
Banque Banorabe	France
Banque Française de l'Orient	France
Banque Française du Commerce Extérieur	France
Banque Indosuez	France
Banque Internationale à Luxembourg SA	Luxembourg
Banque Nationale de Paris	France
Banque Paribas	France
Bayerische Hypotheken und Wechsel Bank AG	Germany
Bayerische Landesbank Girozentrale	Germany
Bayerische Vereinsbank AG	Germany
Belgolaise SA	Belgium
Berliner Bank AG	Germany
Berliner Handels und Frankfurter Bank	Germany
Byblos Bank Belgium SA	Belgium
CARIPLO Cassa di Risparmio delle Provincie Lombarde SpA	Italy
Caisse Nationale de Crédit Agricole	France
Cassa di Risparmio di Verona Vicenza Belluno e Ancona SpA	Italy
Christiania Bank og Kreditkasse	Norway
Commerzbank AG	Germany
Compagnie Financière de CIC et de l'Union Européenne	France
Confederacion Espanola de Cajas de Ahorros	Spain
Crédit Commercial de France	France
Crédit du Nord	France
Crédit Lyonnais	France
Crédit Lyonnais Bank Nederland NV	Netherlands
Creditanstalt-Bankverein	Austria
Credito Italiano	Italy
Den Danske Bank Aktieselskab	Denmark
Den norske Bank A/S	Norway
Deutsche Bank AG	Germany
Deutsche Genossenschaftsbank	Germany
Dresdner Bank AG	Germany
Ergobank SA	Greece
First National Building Society	Republic of Ireland
Generale Bank	Belgium
GiroCredit Bank Aktiengesellschaft der Sparkassen	Austria
Hamburgische Landesbank Girozentrale	Germany
ICS Building Society	Republic of Ireland
Indosuez Carr Futures SNC	France
Internationale Nederlanden Bank NV	Netherlands
Ionian and Popular Bank of Greece SA	Greece
Irish Nationwide Building Society	Republic of Ireland
Irish Permanent plc	Republic of Ireland
Istituto Bancario San Paolo di Torino SpA	Italy
Jyske Bank	Denmark
Kansallis-Osake-Pankki	Finland
Kas Associatie NV	Netherlands
Kredietbank NV	Belgium
Landesbank Berlin Girozentrale	Germany
Landesbank Hessen Thüringen Girozentrale	Germany
MeesPierson NV	Netherlands
Monte dei Paschi di Siena	Italy
National Bank of Greece SA	Greece
Nordbanken	Sweden
Norddeutsche Landesbank Girozentrale	Germany
Postipankki Ltd	Finland
Rabobank (Coöperatieve Centrale Raiffeisen Boerenleenbank BA)	Netherlands
Raiffeisen Zentralbank Osterreich AG	Austria

Skandinaviska Enskilda Banken	Sweden
Société Générale	France
Südwestdeutsche Landesbank Girozentrale	Germany
Svenska Handelsbanken	Sweden
SwedBank	Sweden
Ulster Investment Bank Ltd	Republic of Ireland
Unibank A/S	Denmark
Union Bank of Finland Ltd	Finland
Westdeutsche Landesbank Girozentrale	Germany

2 European authorised institutions entitled to accept deposits in the United Kingdom by the provision of services on a cross-border basis

A European authorised institution may be entitled to accept deposits in the United Kingdom without establishing a branch in the United Kingdom (ie by the provision of services on a cross-border basis). Where an institution's name appears in both sections 1 and 2 of this list, this is because it is entitled to accept deposits in the United Kingdom both by establishing a branch and by accepting deposits on a cross-border basis.

Name of institution	Country of home State supervisory authority
BACOB Bank Luxembourg SA	Luxembourg
BNP Finance	France
Banco Borges & Irmão SA	Portugal
Banco Chemical (Portugal) SA	Portugal
Banque Arabe et Internationale d'Investissement	France
Banque Cogeba-Gonet SA	Luxembourg
Banque de Bretagne	France
Banque de la Cité	France
Banque et Caisse d'Epargne de l'Etat	Luxembourg
Banque Nationale de Paris	France
Banque Nationale de Paris Guyane	France
Banque Nationale de Paris Intercontinentale	France
Banque Paribas Luxembourg	Luxembourg
Banque pour l'Expansion Industrielle	France
Banque Scalbert Dupont	France
Caja de Ahorros de Galicia	Spain
Cedel Bank SA	Luxembourg
Chang Hwa Commercial Bank (Europe) NV	Netherlands
Chiao Tung Bank Europe NV	Netherlands
Compagnie du Crédit Universel	France
Compagnie Financière de CIC et de L'Union Européenne	France
Crédit Universel	France
Den Danske Bank International SA	Luxembourg
DePfa-Bank Europe plc	Republic of Ireland
Deutsche Bank AG	Germany
Deutsche Bau-und Bodenbank AG	Germany
Deutsche Hypothekenbank AG	Germany
Finansbank (Holland) NV	Netherlands
Internationale Nederlanden Bank NV	Netherlands
Irish Permanent plc	Republic of Ireland
Prudential-Bache International Bank SA	Luxembourg
Robeco Bank (Luxembourg) SA	Luxembourg
SNVB Financements	France
Société Nancienne Varin-Bernier	France
Sparekassen Bikuben A/S[(1)]	Denmark
Sydbank Luxembourg SA	Luxembourg

(1) This institution has also established a branch in the United Kingdom entitled to provide certain listed activities which do not, however, include the acceptance of deposits in the United Kingdom.

3 European authorised institutions which are not entitled to accept deposits in the United Kingdom

The following European authorised institutions are entitled to carry on in the United Kingdom by the provision of services certain listed(1) activities other than the acceptance of deposits

(a) European authorised institutions entitled to establish a branch in the United Kingdom

Name of institution	Country of home State supervisory authority
Crédit Agricole Futures	France
Transoptions Finance	France

(b) European authorised institutions not entitled to establish a branch in the United Kingdom

Name of institution	Country of home State supervisory authority
Bear Stearns Bank GMBH	Germany
Caja Bilbao Bizkaia Kutxa	Spain
Crédit Communal de Belgique SA	Belgium
Crédit Européen SA	Luxembourg
Deutsche Centralbodenkredit AG	Germany
Deutsche Hypothekenbank Frankfurt AG	Germany
Europäische Hypothekenbank SA	Luxembourg
Frankfurter Hypothekenbank AG	Germany
Hypothekenbank in Hamburg AG	Germany
Realkredit Danmark A/S	Denmark
Rheinboden Hypothekenbank AG	Germany
Rheinische Hypothekenbank AG	Germany

Changes to the list of institutions

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

(i) Institutions authorised by the Bank of England

1 UK-incorporated

Additions

Bankers Trust International plc(2)
Scottish Widows Bank plc
Weatherbys & Co Ltd

Deletions

Bankers Trust International plc(2)
Bank of Boston Ltd
British & Commonwealth Merchant Bank plc (in administration)
Chesterfield Street Trust Ltd
City Merchants Bank Ltd
FennoScandia Bank Ltd
McNeill Pearson Ltd
Mount Banking Corporation Ltd (in administration)
Peoples Bank plc
Provincial Bank plc
Republic Mase Bank Ltd

(1) ie one or more of the activities listed in Schedule 1 to The Banking Coordination (Second Council Directive) Regulations 1992.
(2) As a result of a corporate restructuring.

Name changes

Aitken Hume Bank plc to Arbuthnot Latham & Co, Ltd
Commonwealth Bank of London plc to Alpha Bank London Ltd
Confederation Bank Ltd to Sun Banking Corporation Ltd
Dryfield Finance Ltd to Dryfield Trust plc
Fairmount Trust Ltd to Fairmount Capital Management Ltd
Frizzell Banking Services Ltd to Frizzell Bank Ltd
Granville Trust Ltd to Granville Bank Ltd
HSBC Investment Banking Ltd to HSBC Investment Bank Ltd
International Mexican Bank Ltd to Banamex Investment Bank plc
Secure Homes Ltd to Secure Trust Bank plc
ULC Trust Ltd to United Trust Bank Ltd

2 Incorporated outside the EEA

Additions

Macquarie Bank Ltd
Nacional Financiera SNC
The Saudi British Bank

Deletions

Bank of New Zealand
Bank of Western Australia Ltd
Boston Safe Deposit and Trust Company
State Bank of New South Wales Ltd
State Bank of South Australia

Name changes

Continental Bank, National Association to Continental Bank
Continental Bank to Bank of America
First Fidelity Bank NA Pennsylvania to First Fidelity Bank, NA
NBD Bank, NA to NBD Bank
The National Bank of Dubai Ltd to The National Bank of Dubai Public Joint Stock Company
NationsBank of North Carolina, NA to NationsBank, NA (Carolinas)
R&I Bank of Western Australia Ltd to Bank of Western Australia

(ii) European authorised institutions

1 European authorised institutions entitled to establish UK branches for the purpose of accepting deposits in the United Kingdom

Name of institution	Country of home State supervisory authority
Additions	
Alpha Credit Bank AE	Greece
Banca March SA	Spain
Banco Santander de Negocios SA	Spain
Bankgesellschaft Berlin AG	Germany
Indosuez Carr Futures SNC	France
Ionian and Popular Bank of Greece	Greece
Irish Nationwide Building Society	Republic of Ireland
Irish Permanent plc[1]	Republic of Ireland
Deletions	
Gota Bank	Sweden
Irish Permanent Building Society[1]	Republic of Ireland
Name change	
Rabobank Nederland (Coöperatieve Centrale Raiffeisen-Boerleenbank BA) to Rabobank (Coöperatieve Centrale Raiffeisen-Boerleenbank BA)	Netherlands

(1) Irish Permanent Building Society converted to a bank called Irish Permanent plc.

2 European authorised institutions entitled to accept deposits in the United Kingdom by the provision of services on a cross-border basis

Name of institution	Country of home state supervisory authority
Additions	
BACOB Bank Luxembourg SA	Luxembourg
Banque Cogeba-Gonet SA	Luxembourg
Banque Paribas Luxembourg	Luxembourg
Cedel Bank SA	Luxembourg
Den Danske Bank International SA	Luxembourg
Deutsche Bank AG	Germany
Deutsche Bau-und Bodenbank AG	Germany
Finansbank (Holland) NV	Netherlands
Prudential-Bache International Bank SA	Luxembourg
Robeco Bank (Luxembourg) SA	Luxembourg

3 European authorised institutions which are not entitled to accept deposits in the United Kingdom

(a) European authorised institutions entitled to establish a branch in the United Kingdom

Additions	
Banco Santander de Negocios SA	Spain
Transoptions Finance	France
Deletion	
Banco Santander de Negocios Sa	Spain

(b) European authorised institutions not entitled to establish a branch in the United Kingdom

Additions	
Bear Stearns Bank GMBH	Germany
Crédit Communal de Belgique SA	Belgium
Deutsche Centralbodenkredit AG	Germany
Deletion	
Irish Nationwide Building Society	Republic of Ireland

UK representative offices of overseas institutions

The following list includes the names of all overseas institutions which have notified the Bank of their intention to establish a UK representative office under Section 40 of the Banking Act 1979 or under Section 75 of the Banking Act 1987, and for which the Bank has not objected to the name used. The presence of an institution's name on the list should not be taken to indicate in any way that the Bank is satisfied as to the integrity or financial soundness of that institution. ***The Bank does not supervise representative offices or the overseas institutions which they represent and has no powers to do so.***

	Country or Territory of Incorporation
AKBANK TAS	Turkey
ASB Bank Ltd	New Zealand
The Agricultural Bank of China	China
Alliance and Leicester (Isle of Man) Ltd	Isle of Man
Allied Banking Corporation	Philippines
Alfa Bank	Russia
Al-Rajhi Investment Corporation Ltd	Saudi Arabia
Ansbacher Bankers Ltd	Republic of Ireland
Arab Bangladesh Bank Ltd	Bangladesh
Arabian Investment Banking Corp	Bahrain
Bahrain Middle East Bank (EC)	Bahrain
Banca Carige SpA/Cassa di Risparmio di Genova e Imperia	Italy
Banca del Salento SpA	Italy
Banca d'Italia (and Ufficio Italiano dei Cambi)	Italy
Banca March SA	Spain
Banco Bamerindus do Brasil SA	Brazil
Banco Bradesco SA	Brazil
Banco de Crédito Nacional SA	Brazil
Banco del Pacifico (also representing:	Ecuador
Banco del Pacifico SA	Colombia
Banco del Pacifico (Panama) SA	Panama
Pacific National Bank)	USA
Banco Economico SA	Brazil
Banco Gallego SA	Spain
Banco Internacional SA	Mexico
Banco Mercantil CA SACA	Venezuela
Banco Mexicano	Mexico
Banco Nacional de Comercio Exterior SNC	Mexico
Banco NatWest España SA	Spain
Banco Pastor SA	Spain
Banco Pinto e Sotto Mayor	Portugal
Banco Popular Español	Spain
Banco Rio de la Plata, SA	Argentina
Banco Urquijo	Spain
PT Bank Bumi Daya (Persero)	Indonesia
Bank Indonesia	Indonesia
Bank Negara Malaysia	Malaysia
Bank of Bermuda	Bermuda
Bank of Communications	China
Bank of Crete	Greece
The Bank of Japan	Japan
The Bank of Korea	South Korea
The Bank of Kyoto Ltd	Japan
Bank of Taiwan	Taiwan
Bank of Thailand	Thailand
Bank of Western Australia	Australia
Bank Sarasin & Cie	Switzerland
Banpais SA	Mexico
Banque Arjil	France
Banque Internationale de Commerce	France
Banque Multi Commerciale	Switzerland
Banque Privée Edmond de Rothschild	Switzerland
Banque Scandinave à Luxembourg	Luxembourg
Banque Scandinave en Suisse	Switzerland
Banque Transatlantique	France

Banque Transatlantique (Jersey) Ltd	France
Banque Woolwich SA	France
Beogradska Banka DD	Serbia
Bradford & Bingley (Isle of Man) Ltd	Isle of Man
Bremer Landesbank	Germany
Bristol & West International Ltd	Guernsey
Britannia International Ltd	Isle of Man
Brown Brothers Harriman Ltd	USA
Bulgarian Foreign Trade Bank	Bulgaria
Caisse Centrale des Banques Populaires	France
Cantrade Group (representing:	
Cantrade Banca Privata Lugano SA	Switzerland
Cantrade Banque Privée Lausanne	Switzerland
Cantrade Ormond Burrus, Banque Privée SA	Switzerland
Cantrade Privatbank AG	Switzerland
Cantrade Private Bank Switzerland (CI) Ltd	Jersey
Cassa di Risparmio di Firenze SpA	Italy
Central Bank of Kuwait	Kuwait
Central Bank of the Republic of Turkey	Turkey
Ceskoslovenská Obchodni Bank AS	Czech Republic
Chinatrust Commercial Bank	Taiwan
The Chugoku Bank Ltd	Japan
Commercial Bank "Stroyinvest"	Russia
Compagnie Bancaire	France
Comptoir des Entrepreneurs	France
Consolidado UK Ltd (representing:	
Banco Consolidado CA	Venezuela
Banco Consolidado (Panama) SA	Panama
Consolidated Bank NA	USA
Banco Consolidado del Ecuador SA)	Ecuador
Crédit Foncier de France SA	France
Crédit National	France
The Derbyshire (Isle of Man) Ltd	Isle of Man
Deutsche Pfandbrief-und Hypothekenbank AG	Germany
Deutsche Schiffsbank AG	Germany
Donghwa Bank	South Korea
ETI Europe Ltd	Togo
Educational Building Society	Republic of Ireland
Elbim Bank	Russia
Equator Bank Ltd	Bahamas
Etrufin Reserco Ltd (representing:	
Cassa di Risparmio di Carrara	Italy
Cassa di Risparmi di Livorno	Italy
Cassa di Risparmio di Lucca SpA	Italy
Cassa di Risparmio di Pisa	Italy
Cassa di Risparmio di Pistoia e Pescia	Italy
Cassa di Risparmio di San Miniato SpA	Italy
Cassa di Risparmio di Volterra	Italy
Banca del Monte di Lucca)	Italy
Export-Import Bank of Japan	Japan
The Export-Import Bank of Korea	South Korea
Fiduciary Trust International	USA
First Austrian Bank (DIE ERSTE österreichische Spar-Casse-Bank Aktiengesellschaft)	Austria
The First National Bank of Maryland	USA
First National Bank of Southern Africa Ltd	South Africa
First Ukrainian International Bank	Ukraine
Garanti Bank AS	Turkey
Garantia Banking Ltd	Bahamas
The Goldman Sachs Trust Company	USA
Gruppo Arca Nordest (a partnership of:	Italy
Banca Agricola Mantovana	
Banca Antoniana	
Banca Popolare Commercio e Industria	
Banca Popolare dell'Emilia Romagna	
Banca Popolare di Ancona	
Banca Popolare di Bergamo-Credito Varesino SCRL	
Banca Popolare di Crema	
Banca Popolare di Cremona	

Institution	Country
Banca Popolare di Lodi	
Banca Popolare di Sondrio	
Banca Popolare di Verona	
Banca Popolare Veneta	
Banca Popolare Vicentina)	
The Gulf Bank KSC	Kuwait
Habib Nigeria Bank Ltd	Nigeria
The Hachijuni Bank	Japan
Halifax International (Jersey) Ltd	Jersey
The Hokkaido Bank Ltd	Japan
The Hokkoku Bank Ltd	Japan
Hua Nan Commercial Bank Ltd	Taiwan
The Hyakujushi Bank Ltd	Japan
Industrial and Commercial Bank of China	China
Industrial Bank of Korea	South Korea
Interallianz Bank AG	Switzerland
Irish Permanent (IOM) Ltd	Isle of Man
Israel Discount Bank Ltd	Israel
Israel Discount Bank of New York	Israel
The Iyo Bank Ltd	Japan
Jamaica National Building Society	Jamaica
Jammal Trust Bank SAL	Lebanon
The Japan Development Bank	Japan
Jugobanka DD	Serbia
The Juroku Bank Ltd	Japan
The Ka Wah Bank Ltd	Hong Kong
Kenya Commercial Bank Ltd	Kenya
The Kofuku Bank Ltd	Japan
Komercní Banka AS	Czech Republic
Kookmin Bank	South Korea
Koram Bank	South Korea
The Korea Development Bank	South Korea
Korea Housing Bank	South Korea
Kredietbank SA Luxembourgeoise	Luxembourg
Landesbank Schleswig- Holstein Girozentrale	Germany
F van Lanschot Bankiers NV	Netherlands
Leeds Overseas Ltd	Isle of Man
Litex Bank SAL	Lebanon
Maritime Joint Stock Bank	Russia
Meridien International Bank	Bahamas
Montenegro Banka DD Podgorica	Montenegro
Morval & Cie SA, Banque	Switzerland
Most-Bank	Russia
Muslim Commercial Bank Ltd	Pakistan
N & P Overseas Ltd	Isle of Man
National Bank of Bahrain BSC	Bahrain
The National Bank of New Zealand Ltd	New Zealand
National Bank of Nigeria Ltd	Nigeria
National Commercial Bank	Saudi Arabia
National Commercial Bank Jamaica Ltd	Jamaica
National Westminster Bank NJ	USA
National Westminster Bank USA	USA
The Navy Federal Credit Union	USA
Nova Ljubljanska Banka DD	Slovenia
Oryx Merchant Bank Ltd	Cayman Islands
Osmanli Bankasi AS	Turkey
Osuuspankkien Keskuspankki Oy (Okobank)	Finland
People's Bank of China	China
The People's Construction Bank of China	China
Pramex Britannica Ltd (representing: Caisse Centrale des Banques Populaires)	France
Privredna Banka Zagreb DD	Croatia
Promstroybank (represented by AY Bank)	Russia
Republic National Bank of New York (Suisse) SA	USA
Reserve Bank of Australia	Australia
Robeco UK Ltd (representing:	
Banque Robeco (Suisse) SA)	Switzerland

Bank	Country
Royal Bank of Canada (Jersey) Ltd	Jersey
The Royal Bank of Scotland AG	Switzerland
The Royal Bank of Scotland (Gibraltar) Ltd	Gibraltar
The Royal Bank of Scotland (Guernsey) Ltd	Guernsey
The Royal Bank of Scotland (Jersey) Ltd	Jersey
The Royal Bank of Scotland (IOM) Ltd	Isle of Man
The Royal Bank of Scotland (Nassau) Ltd	Bahamas
SE Banken Luxembourg SA	Luxembourg
SKB Banka DD	Slovenia
The Saudi British Bank	Saudi Arabia
The 77 Bank Ltd	Japan
The Shoko Chukin Bank	Japan
Skopbank	Finland
Standard Bank of South Africa Ltd	South Africa
State Bank of New South Wales	Australia
Stopanska Banka AD	Former Yugoslav Republic of Macedonia
Swedbank (Luxembourg) SA	Luxembourg
Swiss Cantobank (International)	Switzerland
Taipei Bank	Taiwan
Texas Commerce Bank NA	USA
UAL Merchant Bank Ltd	South Africa
Ueberseebank AG	Switzerland
Unibanco - União de Bancos Brasileiros SA	Brazil
Union Bank Ltd	Pakistan
United Bank for Africa Ltd	Nigeria
United Commercial Bank	Bangladesh
United Malayan Banking Corporation Berhad	Malaysia
United Overseas Bank, Geneva	Switzerland
Victoria Mutual Finance Ltd (representing Victoria Mutual Building Society)	Jamaica
Vojvodjanska Banka DD	Serbia
Wachovia Bank of Georgia NA	USA
Wachovia Bank of North Carolina NA	USA
Wachovia Bank of South Carolina NA	USA
Woolwich SpA	Italy
Woolwich (Guernsey) Ltd	Guernsey
Yapi ve Kredi Bankasi AS	Turkey
Yorkshire Guernsey Ltd	Guernsey
Zagrebacka Banka DD	Croatia
The Zenshinren Bank	Japan

Annual report by the Board of Banking Supervision

Membership as at 28 February 1995

Chairman:	E A J George	} *ex-officio*
	R L Pennant-Rea	
	B Quinn	
	Jon Foulds	
	Peter Gerrard CBE	
	Sir Alan Hardcastle	
	Lord Swaythling	
	Harry Taylor	
	Sir Dennis Weatherstone	

This is the Board's report for the year to 28 February 1995.

Membership

Sir Peter Leslie was reappointed to the Board with effect from 1 November 1994 and resigned on 31 December 1994. He was replaced by Sir Dennis Weatherstone, who was appointed for a five year term, with effect from 1 January 1995. Lord Swaythling, whose term expired on 31 January 1994, was reappointed for a five year term. The membership of the Board was otherwise unchanged during the course of the year.

Meetings

The Board met regularly each month during the year.

At each meeting, the Board receives a report from Supervision and Surveillance (formerly, Banking Supervision Division), setting out matters both of general supervisory policy and relating to specific institutions. Some matters are reported to the Board for information, whilst others are reported for the purpose of seeking the advice of the Board on specific issues. In particular, the Board is kept informed of cases where Supervision & Surveillance has concerns and where formal action under the Banking Act might be required.

Matters Considered

The Board 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.

There were no instances of disagreement between the ex-officio members and the independent members requiring notification to the Chancellor of the Exchequer pursuant to section 2(5) of the Banking Act 1987.

The Board considered a wide range of policy matters, including issues raised by the proposed implementation of European directives such as the Capital Adequacy Directive, Deposit Guarantee Directive and Winding-Up Directive and, more generally, the Board reviewed the work of the European Monetary Institute's Banking Supervisory Sub-Committee (which is chaired by Mr Quinn). Issues arising from the Basle Market Risk proposals and developments in the derivatives markets were also reviewed by the Board. In addition, the Board

considered the proposed developments in Supervision and Surveillance's policies on liquidity and connected large exposure limits.

With regard to operational matters, in addition to receiving reports on specific institutions and regions of concern to Supervision and Surveillance, the Board reviewed papers on the small bank sector, the supervision of overseas banks, the extent to which reliance can be placed on overseas supervisors and the status of representative offices.

Regular reports from the Special Investigations Unit were reviewed by the Board, as were reports on the work of Supervision and Surveillance's Enforcement Group (dealing with instances of illegal deposit taking). The Board was also briefed on staffing and technological developments in Supervision and Surveillance, particularly in light of the Bank's re-organisation in July 1994.

Further details of some of the matters considered during the year are provided in the main body of the *Banking Act Report*.

On 27 February, the Board was asked by the Chancellor the Exchequer to establish in detail the events that led to the collapse of Barings and to identify the lessons to be drawn for institutions, for the Bank's own regulatory and supervisory arrangements and for the UK system of regulation more generally. The Board will report to the Chancellor with its findings.

Secretary,
by Order of the Board