BANK *of* ENGLAND

BANKING ACT REPORT

1995/96

BANKING ACT 1987

ANNUAL REPORT UNDER THE BANKING ACT FOR 1995/96

This Report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 29 February 1996 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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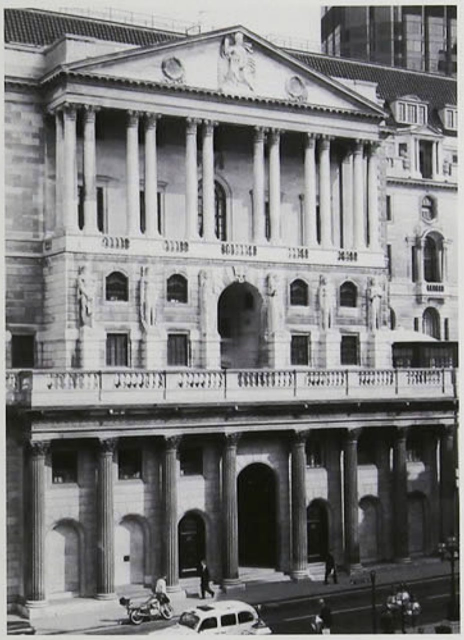
INTRODUCTION

Part I of this *Report* highlights a number of subjects which have been among the Bank's priorities during the year under review. Principal among these has been the work undertaken in the wake of the collapse of Barings, including the implementation of the recommendations set out in the Board of Banking Supervision's Report on the collapse. As one of the measures, last October the Bank commissioned the consultants, Arthur Andersen, to undertake a review of its supervisory practices and processes; this is expected to be completed shortly.



Part II outlines the macroeconomic environment in which banks operated during 1995/96, and Part III describes the year's market developments. Part IV summarises policy developments, and Part V gives a description of the legal framework and operational supervision. Part VI reviews the organisation and staffing of the Bank's Supervision and Surveillance area.

1995/96

Part I PRINCIPAL DEVELOPMENTS AND PRIORITIES

THE BARINGS COLLAPSE AND ITS CONSEQUENCES

Last year's *Banking Act Report* recorded that in February 1995 the merchant bank Barings was placed in administration following large losses on futures and options trading by a Singapore subsidiary, and that the Board of Banking Supervision had acted at the instigation of the Chancellor of the Exchequer to investigate the collapse. The process followed by the Board in conducting its investigation, and a summary of its conclusions, are outlined in the Board's Annual Report, which forms an annex to this *Report*.

In addition to noting the lessons which could be drawn from the collapse for banks' managements and for the Securities and Futures Authority (SFA), the Board's Report, which was published last July, included 17 recommendations concerning the way in which the Bank supervises banking groups, particularly where they contain significant non-banking businesses. The Bank welcomed these recommendations and immediately began work on their implementation. By the end of 1995, it was able to report that 15 had been reviewed in detail with the Board, while the other two were being considered as part of the Arthur Andersen review.

All of the Board's recommendations involved changes in the way the Bank organised and monitored its supervisory work, but some also raised issues of wider interest. Two of these—the extension of the role of consolidated supervision, and the development of regulatory co-operation—are discussed below. In addition, the introduction of quality assurance in supervision is discussed in the box on page 8 which outlines the Arthur Andersen review of banking supervision. But progress has also been made on the other main recommendations, including:

- **Statistical returns:** The Board urged a review of the scope of the statistical returns submitted to the Bank, and recommended that a senior director of each reporting bank should take responsibility for their accuracy. Banks have nominated a relevant director to be responsible for their returns. The introduction of new prudential returns in connection with the Capital Adequacy Directive (see below) has improved the information received from banks and, pending the conclusions of the Arthur Andersen review, and the changes to statistical returns routinely effected through the Banking Statistics Reviews, the Bank has concluded that there is presently a need for further information only in order to enhance consolidated supervision. It is currently assessing the most suitable format for collecting these data.

- **Solo consolidation:** The Board recommended that any proposal to include an active trading subsidiary in a bank's unconsolidated returns (to 'solo consolidate' it) should be submitted for approval by either the Executive Director responsible for Banking Supervision, the Governor or Deputy Governor, and that the Bank's internal guidelines should outline the procedures to be followed in these cases. This has now been implemented; in addition, all solo consolidations will in future be reviewed regularly by the Bank to ensure that they continue to be justified.

- **Internal audit and audit committees:** The Board made two recommendations. First, that the Bank extend its initiative of meeting the internal audit departments of banks including, where appropriate, group internal audit. Good progress has been made here, with the primary focus to date being the major UK-incorporated banks. Second, that the Bank should meet the chairmen of the audit committees of large UK-incorporated banks. Some banks have expressed reservations about this, based on their views of appropriate forms of corporate governance, and have requested that members of their executives be present. The Bank has agreed to such requests, but will review the position in twelve months.

- **Section 39 reports:** The Bank has revised its instructions to reporting accountants to reflect the Board's recommendations that the scope of section 39 reports be extended and used more flexibly, and that on occasion reports cover entities other than the authorised institution, including overseas operations. The revised instructions were issued on 11 April.

- **Large exposures:** The Bank has extended its internal guidelines on the monitoring of banks' large exposures. Any proposed concessions to its normal rules must now be formally referred for approval to the relevant Head of Division within Supervision and Surveillance and subsequently reviewed by the Head of Division on an annual basis, and it has been stressed that any breaches of the guidelines must be reported upwards regularly. The guidance provided to banks on the reporting of large exposures has been re-written, in particular to cover the identification of counterparties when banks are lending for margining or other trading purposes. It is presently with the banking associations for consideration by their members.

Extending consolidated supervision

In essence, the Board recommended that the Bank should seek to understand better the 'significant risks' within a group containing an authorised bank, including, in particular, how these risks are managed and controlled. The Bank has for many years explicitly considered the risks to a bank from its position in a wider group, usually using a mixture of the consolidation of accounts (where appropriate), limits on the bank's exposures to the rest of its group and limits on the large exposures of relevant parts of the group as a whole to outside counterparties. The Board suggested this should be taken further—not with the aim of extending the Bank's supervisory oversight into areas outside banking, but in recognition of the importance of management and control issues for ensuring a bank's continued health should something go wrong elsewhere in the group.

Implementing this has required the development of an approach which, as far as the Bank is aware, will take consolidated supervision further than has been done previously by any banking supervisor. The key innovation has been to develop a set of quantitative and qualitative criteria to assess which operations within a group—whether looked at in terms of separate legal entities or products—qualify as 'significant'. The quantitative tests judge an operation to be 'significant' if it involves more than 5% of a group's regulatory capital; or it generates more than 5% of a group's gross revenues or profits; or it involves a financial exposure of more than 10% of an authorised bank's capital. Since this approach was approved by the Board, the Bank has begun discussions with the main banking associations about how the substantial increases in information that banks will have to provide can best be structured. It has also been assessing, as part of the Arthur Andersen review, the resource implications for the Bank.

Developing regulatory co-operation

Improving co-operation among banking supervisors around the world is a long-standing objective of the Bank and there are well-established channels to help such co-operation, including the Group of Ten (G10) Committee of Banking Supervisors (generally known as the Basle Committee) which celebrated its twentieth anniversary during 1995, and the EU Banking Advisory Committee. The Bank has long had an active programme of visiting countries in which UK banks have significant operations or which have sizable banking presences in the United Kingdom, and of providing help to overseas supervisors visiting foreign banks in the United Kingdom. The process was extended and formalised with the implementation of the European Union's Second Banking Co-ordination Directive (2BCD) in 1993 and the Bank has supplemented this with formal Memoranda of Understanding (MoUs) with other EEA banking supervisors. Additionally, co-operation with non-banking supervisors in the United Kingdom has developed well since the 1986 Financial Services Act, and for some years the Bank has had MoUs with the Securities and Investments Board (SIB) and the main self-regulatory organisations (SROs).

The experience of the Barings case suggested, however, that efforts needed to be increased, in particular:

- To work more closely with other UK regulators. In recent months, the Bank has had extensive discussions with the SIB and the SFA, leading to new and greatly extended arrangements for meeting, conducting joint operations and exchanging information. The Bank has also signed, or is on the point of signing, MoUs with the London International Financial Futures and Options Exchange (LIFFE), the London Clearing House and the London Metal Exchange, and is keeping other UK regulators abreast of developments in its thinking.

- To work more closely with a wider range of overseas banking supervisors. The Bank's programme of bilateral meetings with its overseas counterparts has been stepped up, both with respect to the number of countries involved and to the frequency of meetings. Discussions are in progress with a number of overseas banking supervisors which it is hoped will lead to formal MoUs or exchanges of letters.

A REVIEW OF BANKING SUPERVISION

In its Report into the collapse of Barings, the Board of Banking Supervision recommended that an independent quality assurance (QA) function over banking supervision be introduced in the Bank. Its purpose would be to provide greater assurance to the Bank's senior management that agreed supervisory policies are implemented consistently across the whole range of supervised banks, and to help identify areas where these policies might need to be reviewed in the light of experience with implementation.

In considering the most effective means of introducing QA the Bank quickly identified the need better to define 'Q'. In other words, a clear articulation of the required standards and operating procedures of supervisors was needed, against which the QA function could gauge supervisory activities.

Last October, the Bank appointed a team of management consultants from Arthur Andersen to undertake a review of the appropriateness and effectiveness of the operations of Supervision and Surveillance within the current legislative framework, and to make recommendations to improve its methods, organisation, structure and staffing, as well as designing and testing a prototype QA system. The review's scope specifically excluded Surveillance (except to the extent that it supports the supervisory process), the Deposit Protection Board and the Enforcement area, which investigates and prosecutes illegal deposit-taking.

In fulfilling its remit, the team has conducted interviews and discussions at all levels in the Bank, from the Governors and Directors down, and has engaged in a wide range of discussions with other organisations which have an interest in financial supervision:

- A varied cross-section of authorised institutions has been interviewed; in addition, several firms of accountants have given their views of the reporting accountants' regime.
- Groups representing banks—comprising the British Bankers' Association, the London Investment Banking Association and the Foreign Banks and Securities Houses Association—have been consulted.
- Other UK financial-services supervisors, a number of overseas banking supervisory authorities, and two credit rating agencies have been visited.

The aim of all these discussions has been to understand the different perceptions and opinions of the Bank's supervisory objectives and methods, and to compare its methods and style of supervision with those of other financial regulators, both in the United Kingdom and abroad.

The Review's conclusions are still to be finalised, and so it is not possible to comment on them in detail here. However, so far as the process of supervision is concerned, the basic principles that the team has been developing are building on what is already best practice in the Bank:

- Supervision must start from as clear and detailed a definition as possible of its objectives.
- The risks associated with each authorised bank must then be evaluated, using an agreed basis for assessing risk across the highly diverse population of banks in the United Kingdom.
- In the light of this assessment, a supervisory programme should then be drawn up for each bank for a given period ahead, using a mix of the agreed tools of supervision.

In developing this approach further, the Review has focused on the tools available to the Bank in conducting its supervision, and the way and extent to which they are used: the aim is to ensure that the Bank optimises the mix of resources applied in supervision. To help with this, the team has analysed the ways in which time is used by staff. Additionally, the Review has examined Supervision and Surveillance's methods of recruiting and retaining staff, and the range and level of training and qualification available to supervisors.

Extending the use of a more explicitly focused, risk-based approach may involve a shift of emphasis in the information gathered from banks, and the way it is gathered and processed (Bank staff may, for instance, spend considerably more time visiting each bank than currently). It may also have implications for the quantum of resources used, the mix of skills and experience that will be required, and the nature of the IT and other support which will be necessary.

So far as quality assurance is concerned, the team was, of course, already aware how the QA process is handled within Arthur Andersen. It also established, in the course of its Review, how it is handled by other UK public sector organisations and regulators. Outline proposals on QA were put to the Board of Banking Supervision in January, and a trial run of part of the system designed was conducted during March with the involvement of Bank staff. Because of the amount of documentation required, the full development and installation of a comprehensive QA system will require further time once the Review team's basic framework has been adopted by the Bank.

The Bank has raised issues arising out of the Board's Report in international banking fora such as the Basle Committee, the Banking Advisory Committee and the European Monetary Institute's Banking Supervisors' Sub-Committee. It has also taken an active part in the discussions between the Basle Committee and the Offshore group (which represents banking supervisors in 19 locations including Singapore, Hong Kong and the Channel Islands) about the responsibilities of home and host country supervisors.

- To improve international co-operation among the regulators of different financial industries. This poses major logistical and legal questions. If the management of a securities or futures exchange in another country has concerns about a local subsidiary of a UK bank, who should it contact—its own country's securities supervisor, the securities supervisors in the United Kingdom, or the Bank? How can the hundreds of supervisors around the world (there are, for example, separate insurance regulators in each state in the United States) assess what the home supervisor needs to know and how to avoid providing an unmanageable mass of undigested information? Will the passing of information create legal problems, and can local regulators ensure that their own legal obligations are fully met?

These issues are being debated in a number of international fora, and preliminary conclusions are likely to be outlined in the Reports to be submitted by the Basle Committee and the International Organisation of Securities Commissions (IOSCO) prior to the next G7 summit in Lyon in June. On a practical level, the Bank continues to participate in discussions with a wide range of international non-bank supervisors, seeking to ensure that channels of communication between home and host country supervisors are clear and are used regularly.

Other issues arising from the Barings case

Differences between the Board's Report and the Singapore Report

In September, subsequent to the publication of the Board's Report, a Report was published by inspectors appointed by the Singaporean Minister of Finance to investigate the affairs of Baring Futures Singapore. The two reports are substantially similar in their findings on the technical matters and in particular with regard to the description of Mr Nick Leeson's activities and how the losses arose, the inadequacy of Barings management and the fundamental breakdown in controls which occurred. The main area of difference between the two reports relates to their interpretation of the incident where Mr Leeson created a fictitious receivable at 31 December 1994, 'supported' by spurious confirmatory evidence. The Singapore inspectors found that there was an active effort on the part of two members of Barings management, Mr Peter Norris and Mr James Bax, to downplay the significance of the matter and to discourage independent investigations into it. The Board, which, because of legal difficulties, did not have access to local management and documentation in Singapore, did not find evidence of a cover-up, but concluded that the incident had required much more prompt and firm action by senior management in London and Singapore than it had received.

Hidden funds

Press reports have suggested the existence of substantial funds allegedly controlled by Mr Leeson in secret overseas bank accounts. However, the administrators of Barings have stated that they are not as yet aware of evidence which supports this suggestion, although they will continue to review the position; the Bank is in the same situation. Neither the Singapore inspectors nor the Board's Inquiry reported finding evidence of misappropriation for personal gain, although the Board stated that, in the absence of full access to documentation in Singapore, it could not rule out the possibility that Mr Leeson might have been acting in concert with one or more persons.

Fitness and properness

The Barings case also raised the issue of the fitness and properness of some individuals to take on senior positions of responsibility in banks. Unlike some other regulators (for example the SROs under the Financial Services Act), the Bank does not maintain a register or anything similar of those individuals who are 'fit and proper' to work in senior positions in the banking industry. Instead, the Banking Act requires it to consider whether an individual is fit and proper to be a director[1] or manager[1] in the context of a specific position in a

(1) As defined respectively in Section 105(2) and (6) of the Banking Act.

particular institution. The factors to which the Bank has regard in this respect are set out in paragraphs 2.44 to 2.49 of the Statement of Principles published by the Bank under section 16 of the Banking Act; paragraph 2.44 makes it clear that:

> 'The standards required of persons . . . will vary considerably, depending on the precise position held by the person concerned. Thus a person could be fit and proper for one position but not fit and proper for a position involving different responsibilities and duties.'

These considerations guide the Bank's approach in any review of the position of those persons whose conduct was commented on in the Board's Report, insofar as its supervisory responsibilities make this appropriate. The majority of the senior staff at Barings most closely involved in the events considered in the inquiries in the United Kingdom and Singapore are not currently directors or managers by the definitions referred to above. The fitness and properness of those who are has been reviewed by the Bank.

SUPERVISION OF MARKET RISK

During 1995/96, the Bank continued to develop its understanding of—and control over—the nature and extent of banks' trading activities. As a part of this, it conducted, in parallel with its triennial foreign exchange survey, a survey into the activity of 396 banks and securities houses in the over the counter (OTC) derivatives markets, which formed part of a worldwide survey co-ordinated by the Bank for International Settlements.

The results emphasised the need for clarity about the risks incurred by banks and other participants. Thus, the survey found that at end-March 1995 the notional value of outstanding OTC derivatives contracts booked in the United Kingdom was $12.1 trillion. However, the amounts actually at risk were significantly less; banks' risks from engaging in derivatives activities of this kind cannot sensibly be calculated on a nominal—that is, face-value—basis, since this typically does not directly measure the payment obligations of the parties. Firms' overall portfolios usually include cash positions in instruments and these may hedge some or all of the market risks arising from their derivatives activities.

Nor do notional outstandings reflect participants' amounts at risk from counterparty default—this is better measured by gross market values. At end-March 1995, credit exposure (as measured by gross positive market value) was $320 billion, 2.2% of the survey participants' total gross outstandings in the UK OTC markets. In practice, credit exposures are further reduced by netting and by collateral agreements between counterparties.

The survey's findings were outlined in greater detail in the Bank's February 1996 *Quarterly Bulletin*.

In addition to undertaking work to assess the scale of activity in UK markets during the year, significant advances were made in the Bank's supervision of market risks arising from banks' trading activities in financial instruments. In particular, since 1 January, UK-incorporated banks have been applying the provisions of the European Capital Adequacy Directive (CAD) to their market risks. By bringing these risks into the assessment of banks' capital positions, the CAD regime has represented a fundamental step forward in the measurement of capital adequacy, which had previously concentrated primarily on credit risk.

While debate about whether the capital adequacy framework should be further extended to allow banks to use their own 'value-at-risk' (VAR) models continued during 1995, much of the year was spent undertaking detailed preparations for the introduction of the CAD itself. To allow banks as much time as possible to develop systems for compliance with the directive so that it could be implemented by its target date, the Bank issued a consultative paper which outlined its proposed approach in December 1994 and its CAD Policy Notice in April 1995, well before most other EU regulators. Early in 1995, banks started building the necessary reporting systems, and during the year they formulated trading-book policy statements in detailed consultation with the Bank. To try to ensure that the structure of banks' trading activity has been discussed at the highest level, the Bank has required trading-book policy statements to be approved by their Board of Directors in all but exceptional cases.

In addition, the Bank's Traded Markets Team began work early in 1995 on the recognition of banks' internal risk models; model review visits were made to more than 30 UK-incorporated banks during the year. The Team is comprised of specialists in market risk management and risk-modelling techniques—both individuals seconded to the Bank and Bank staff who have gained the necessary expertise through secondments to leading institutions. In undertaking model reviews, each of which can last several days, the Team examines both the mechanics underlying a bank's models, and the systems and controls environment in the trading area in which these models are used, including aspects such as the independence of risk management, methods of valuation, the trading limit structure and limit-monitoring processes. During the year, the Team also undertook a derivatives benchmarking survey, which examined the pricing methods and risk-factor calculations adopted by a wide range of banks and securities firms. Detailed feedback from this survey was provided to participants, and articles describing the findings appeared in the Bank's *Quarterly Bulletin* in November 1995 and in Risk Magazine in February 1996.

Banks that obtain recognition for their risk models gain lower capital requirements for trading activities than are required under the standard methodology. Almost all the banks reviewed received model recognition in some form, although for many it was contingent on improvements being made to their operating environments within a given timetable and on their model outputs being adapted to make them compatible with the CAD framework. The process of model recognition is continuing, both because additional banks have decided to seek model recognition for the first time and because banks with existing model recognition have sought revisions to models previously reviewed.

The risk models so far reviewed by the Team are sometimes referred to as 'pre-processing models', because their output goes on to be incorporated into the standard CAD capital calculations. Pre-processing models differ from VAR models, which are used by banks to assess overall trading-book capital requirements, sometimes covering a very broad range of instruments. VAR models do not form part of the standard CAD approach; however, the Bank has taken a leading role in discussions among banking supervisors and securities regulators about further developing the supervisory framework for market risk. These culminated in January with the publication by the Basle Committee of an amendment to the 1988 Basle Accord, which included the recommendation that banks be allowed to use VAR models in the calculation of their regulatory capital from the end of 1997. This was a significant further innovation in supervisory methods, and one which was broadly welcomed by the market. Strong support was given, in particular, to the strict qualitative standards proposed for the use of such models, which should encourage continuing improvements in risk-management techniques across the range of banks. In considering the criteria for the use of VAR models, the Committee sought to balance the need to provide incentives for banks to develop and improve their risk management techniques with the need to retain a cushion against potential weaknesses in the modelling process.

The Bank is now participating in discussions among EU Member States to formulate an amendment to the CAD in the light of the Basle Committee's recommendations. The Bank's overriding aim in these deliberations is to ensure that a prudent supervisory framework is in place, but it is also conscious of the need to limit the regulatory compliance costs for banks.

Disclosure of derivatives activities

In last year's *Report*, the Bank outlined its view that greater disclosure by banks of their derivatives exposures—both in published accounts and to supervisors—was desirable. Since then, there have been two significant changes in UK banks' reporting of derivatives exposures to supervisors. First, the introduction of the CAD has involved major changes to the prudential reporting of banks with significant trading activities—in particular, in addition to existing reporting of foreign exchange exposure, banks now report in detail interest rate and equity position risk arising in their trading books. Second, the Solvency Ratio Directive has been amended to permit the netting of counterparty risk on off balance sheet contracts. Although this implies that in terms of supervisory disclosure reporting of net amounts would technically be sufficient—in that these are the data that contribute to the calculation of capital adequacy—the Bank has asked for data to be provided on both gross and net bases. This will enable supervisors to see the volume of derivatives business undertaken by banks and to discuss with them the risk-management and systems issues that arise.

At an international level, the Basle Committee and the Technical Committee of IOSCO published a joint Report in May 1995 on the prudential reporting of derivatives. This focused particularly on the credit and liquidity risks arising from derivatives trading, and proposed a 'Common Minimum

Framework' for prudential reporting in these areas. The Bank took the opportunity presented by CAD to introduce a large proportion of the proposals.

The Bank has continued to participate fully in internationally co-ordinated activities to improve disclosure in public accounts. The indications here are that the level of disclosure has improved since 1993, although significant differences remain in the type and usefulness of the information disclosed by large, internationally active market participants. There have, however, been improvements in the qualitative and quantitative data relating to credit risk, market risk and earnings.

Looking forward, the Bank is now participating in discussions in Basle and with the European Commission about the appropriate accounting policies for derivatives.

BANKING MARKET CONDITIONS IN THE UNITED KINGDOM

The profitability of the UK banking sector improved further in 1995; this was a consequence both of an improvement in operating profits and a further reduction in net bad debt charges. Nevertheless, competition to lend remained intense. Last year's *Report* outlined the significant relaxation of corporate lending conditions that occurred in 1994, which was characterised by falling margins and fees, and a loosening of covenant standards. The scope for significant further easing in 1995 was limited; however, there was some further erosion of margins, with loans to some large companies carrying spreads as low as 12.5 basis points over LIBOR,(1) and many borrowers continued to resist the inclusion of certain loan covenants in documentation. Fees on syndicated credits continued to face downward pressure, and there was a tendency for maturities to lengthen. A considerable portion of lending volume was to borrowers taking advantage of margins perceived to be near their floor to refinance existing debt, often at longer maturities.

Over the past year, there has also been a noticeable increase in the competition among banks, building societies and other financial services companies for lending to individuals, particularly for home mortgages. Discounted mortgage rates and 'cashbacks' have become common, particularly for first-time buyers, as some lenders have sought to increase market share and overall lending growth in a housing market which has remained subdued.

Various factors may be contributing to a decline in margins in these business areas. First, it may be that lenders are beginning to factor into their lending margins the view that low inflation is likely to mean less risk than hitherto of large increases in interest rates of the kind which previously have contributed to significant credit losses. Second, many lenders have examined their past loan losses carefully and some of the narrowing in margins may be to categories of borrower whose track record justifies better terms. Third, lenders to both the retail and corporate markets now try to assess the overall profitability of customer relationships: mortgage business, for example, may offer the opportunity to market other products—such as insurance—to borrowers; while lending to companies is often cited by banks as the key to other, more profitable business. Fourth, consolidation within the financial-services industry, and the emphasis on cost-cutting in recent years, may have reduced the marginal cost of lending. Finally, in respect of mortgages, some building societies have recently reduced their margins as part of a conscious policy built around remaining mutual institutions, stimulating competition as a result.

Such developments are, of course, good news for those with access to this finance. And to the supervisor, it is clear that the banking industry generally is well capitalised and profitable by past standards, and that by international comparison margins in the United Kingdom—at least on home mortgages—have been quite high until recently. It also remains the case that the competition for savings is not as intense as for lending, so that the net effect on margins has been limited by reducing rates to savers. It is, nevertheless, important that lenders continue to assess carefully the terms on which they write business. Caution also needs to be exercised in the methods of accounting which are adopted for any schemes used to induce business.

Finally it is worth noting that banks, in conceding weaker financial covenants in corporate lending, may be reducing their scope for insisting on pre-emptive remedial action if borrowers encounter difficulties in the future. Properly framed covenants offer an important element of protection to lenders and should not impose any unwarranted burden of compliance on

(1) LIBOR is a typical reference rate for the pricing of such loans. However, the average cost of a bank's funding—particularly if it has significant retail deposits—will often be considerably lower.

borrowers; their abandonment confers no tangible benefits and may store up problems for the future.

THE REGULATORY BURDEN ON SMALLER UK BANKS

During the year, the Bank undertook work to assess the burden imposed by regulation on smaller UK banks (broadly defined as UK-incorporated institutions with a balance sheet of less than £500 million). The research focused on the costs imposed by the Bank's supervision; however, the banks' own perception of the 'regulatory burden' may include that from other financial services regulators and from external auditors. That perception seems to be that the overall burden is increasing.

Because of differences in the size and range of business of the smaller UK banks, the cost to banks of the Bank's regulation varies. However, it does seem to have increased in recent years in some respects: particularly, the direct costs of the section 39 regime; the indirect costs of compliance with the Schedule 3 criteria for authorisation; and the management time taken up in statistical reporting. The implementation of the recommendations of the Barings Report may further increase regulation for all banks. Very small banks do, however, escape some of the costs of regulation faced by larger banks; for example, not all of them maintain cash-ratio deposits with the Bank or complete the full range of statistical returns.

There are constraints on the extent to which the burden of regulation can be lightened: the Bank has statutory obligations under the Banking Act and European legislation which it must meet. However, it acknowledges that the range and type of business conducted by some of the smaller banks is less complex—some of them operate in stable regional or niche markets where the business conducted does not vary significantly from year to year. During the year, the Bank took steps to introduce a more explicit internal risk classification of smaller banks and to reduce where possible the supervisory demands on those considered to be in the lowest risk category. The Arthur Andersen review is assisting in the Bank's further development of objective and consistent methods of risk assessment, in order to optimise the direction of supervisory resources towards those banks perceived to pose greater risks, to depositors and to UK financial stability.

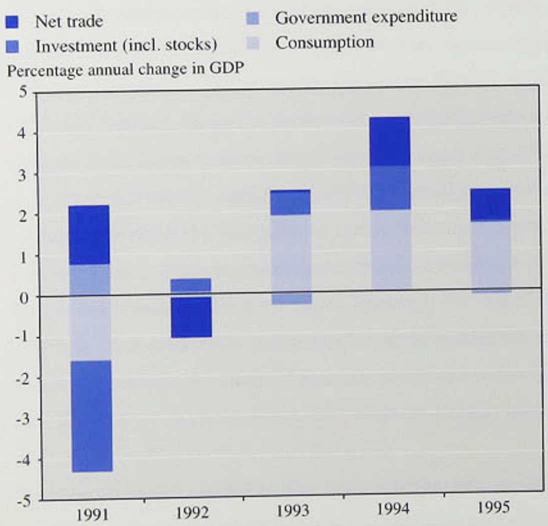
Part II MACROECONOMIC CONTEXT

OVERVIEW

Over the year to February 1996, growth in the United Kingdom slowed gradually; GDP growth for 1995 was 2.5%, compared with 4.0% in 1994. Part of this slowdown was attributed to a decline in export volume growth, as a consequence of increased weakness in the economies of some of the United Kingdom's major trading partners (see Chart 1). Quarterly consumer spending grew smoothly at around its trend rate over the year; the National Lottery may have boosted spending growth to some extent. By contrast, manufacturing output remained weak, and actually fell by 0.3% between the third and fourth quarters of 1995. This combination of factors led to the build-up of stocks for most of the year, though the rate of stockbuilding may have slowed in the fourth quarter. Investment growth was also sluggish in comparison with the equivalent stage of previous recoveries; the overall rate disguised some significant variations between industrial sectors, with construction one of the weakest.

CHART 1

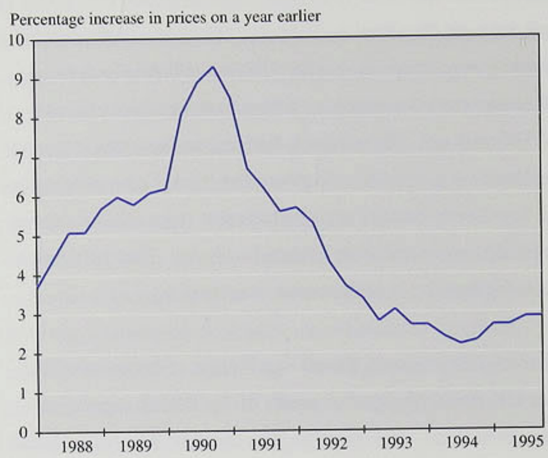
Contributions to GDP growth



Inflation, as measured using the Government's target measure—the retail prices index excluding mortgage interest payments (RPIX)—rose slightly in 1995 (see Chart 2). But costs within some sectors—such as manufacturing—increased more rapidly during the year, putting pressure on margins in these industries. In the property market, prices were broadly flat.

CHART 2

RPIX inflation



CORPORATE SECTOR

The corporate sector continued to strengthen during the year. Gross trading profits remained high, although they fell back slightly at the end of 1995. The financial balances[(1)] of industrial and commercial companies (ICCs) remained positive for most of the year (see Charts 3 and 4), although they moved into a deficit in the final quarter of 1995, largely on account of temporary factors such as one-off dividends. Nevertheless, ICCs were still in a better position to repay new debt as income gearing[(2)] returned to the levels seen in the mid-1980s. Conditions for borrowing were also improved by the continued strong competition in the syndicated loan market, where spreads narrowed further from the low levels noted in last year's *Report*. Firms took advantage of the favourable circumstances and were net borrowers from banks for the first time since 1991. Indeed, such was the strength of the improvement that bank finance exceeded other forms of external finance—such as bond and equity issuance—for only the second time since the mid-1980s.

(1) Equal to saving plus capital transfers less investment, the increase in value of stocks and work in progress.
(2) Defined as interest payments as a percentage of operating profits.

CHART 3

ICCs' financial balance

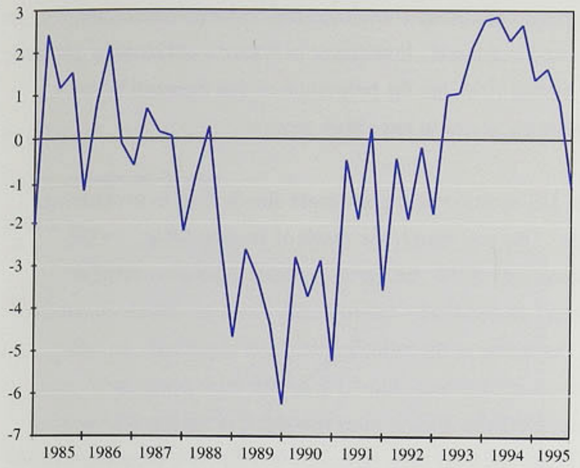
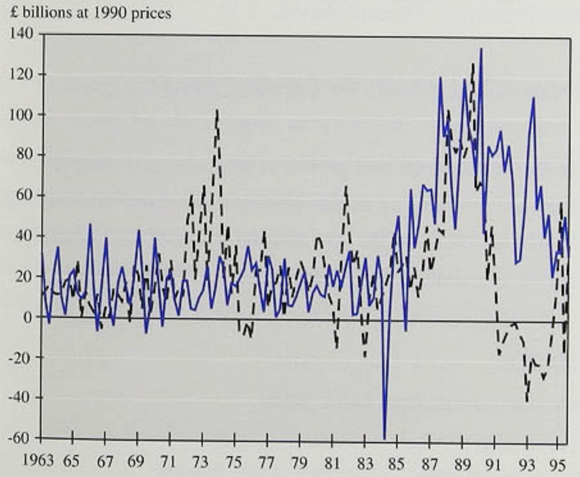


CHART 4

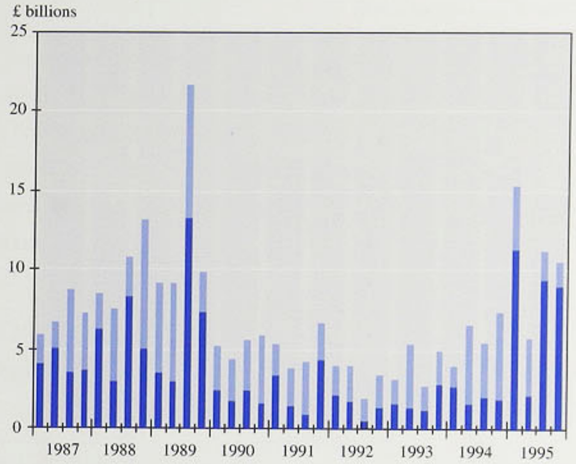
External finance



The value of corporate take-over activity increased significantly in 1995 (see Chart 5). The increase was linked in part to a more liberal regime towards merger and acquisition in certain regulated industries—but also reflected the desire of some companies with a strong financial position to grow their businesses by acquisition. Such activity provided a boost both to bank lending (although this is to some extent temporary, since such borrowing is often refinanced in the capital markets) and to fee income for those banks with corporate finance operations.

CHART 5

Acquisitions and mergers in the corporate sector



(a) Includes financial institutions from 1995 Q1.

PERSONAL SECTOR

Deposits with the banking sector increased by nearly 15% in the year to September 1995, although this was partly accounted for by Lloyds Bank's acquisition of the Cheltenham and Gloucester Building Society (the adjusted figure was closer to 7%). The rise may also have reflected some increase in precautionary savings, perhaps in response to continued uncertainty about employment prospects.

The stock of loans secured on dwellings grew far more slowly than retail deposits, as net lending fell sharply. In addition, there was increased remortgage activity, as customers took advantage of both the economic conditions and fierce competition to refinance mortgages at some of the lowest interest rates seen for decades. New mortgage lending remained sluggish because of the continued weakness of the housing market (Charts 6 and 7 overleaf).

In contrast to previous recoveries, consumer credit continued to grow rapidly, with the stock of such lending increasing by 12% during 1995. Of the various factors which may have contributed to this, important ones seem to have been that consumers may have anticipated a pick up in the growth of real disposable income as well as a variety of windfall gains, including from maturing TESSAs, building society conversions and electricity rebates; and that they may have used consumer

CHART 6

Type of mortgage advance—all buyers

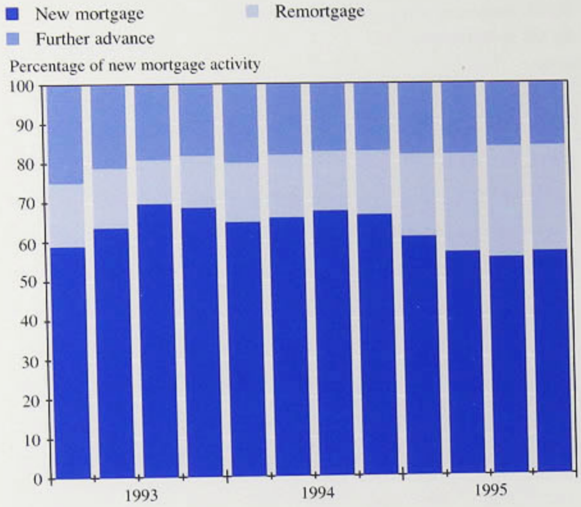
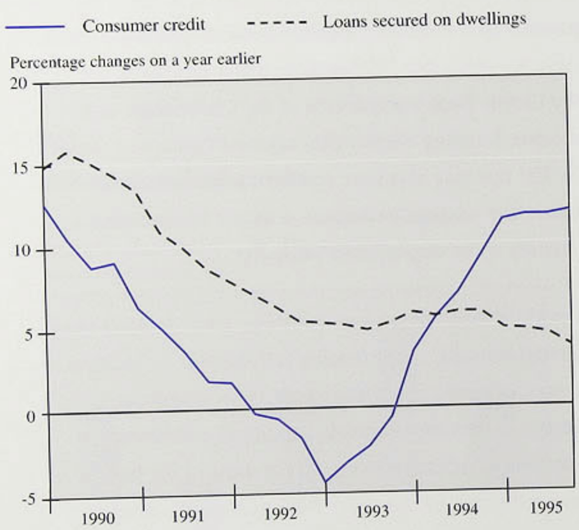


CHART 7

Secured and consumer credit lending



credit to make improvements to their existing homes, rather than move house.

INTERNATIONAL DEVELOPMENTS

Economic activity in the major overseas economies as a group slowed somewhat during 1995. Despite marked reductions in interest rates in Germany, output growth there and in France showed a definite pause towards the end of the year, and year on year growth was lower than widely forecast. One important factor explaining the fragility of economic activity in Europe has been the high rate of unemployment—around 11% of the workforce in the European Union as a whole—which has depressed consumer confidence and hence private sector demand in general. Investment in France and Germany picked up during 1995, but the proportion of this financed by bank borrowing seems to have been modest.

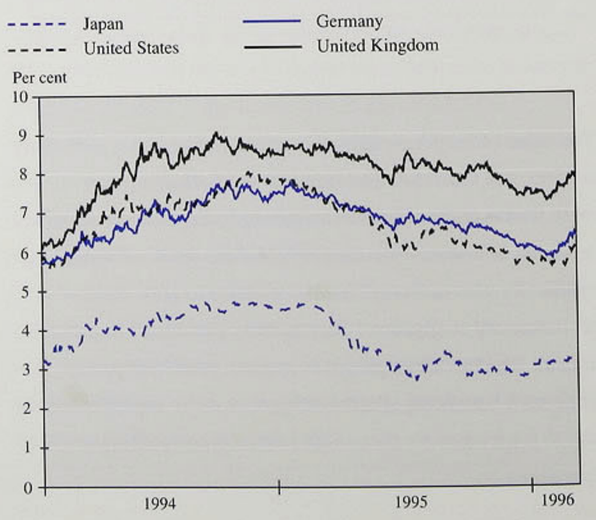
The US economy also grew more slowly than in the previous year. This was mainly the result of stockbuilding; by the second half of the year, growth seems to have resumed at around its trend rate. Interest rates were, nevertheless, reduced in December as the inflation prospects improved. In Japan, growth in 1995 was below 1% for the third consecutive year, despite official interest rates remaining at the record low level of 0.5%. Activity was, however, boosted by a substantial fiscal package introduced in September, and the conditions appear to be in place for the long-awaited recovery in private sector demand. The yen has depreciated substantially from the high levels seen in the first half of 1995 and the stock market has strengthened over the same period.

FINANCIAL MARKET DEVELOPMENTS

The slower-than-expected growth in the major economies, downward revisions by market participants to their expectations of future inflation and the downward trend in official interest rates led to a strong rally in the international bond markets

CHART 8

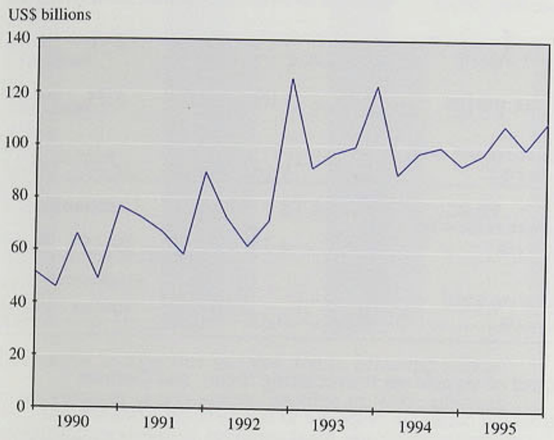
Ten-year government bond yields



during 1995, with yields declining in most of the main markets (see Chart 8). The rise in yields in the first months of this year reflected uncertainty about the strength of economic recoveries and a feeling that interest rates might have reached their lowest point.

CHART 9

Gross eurobond issues

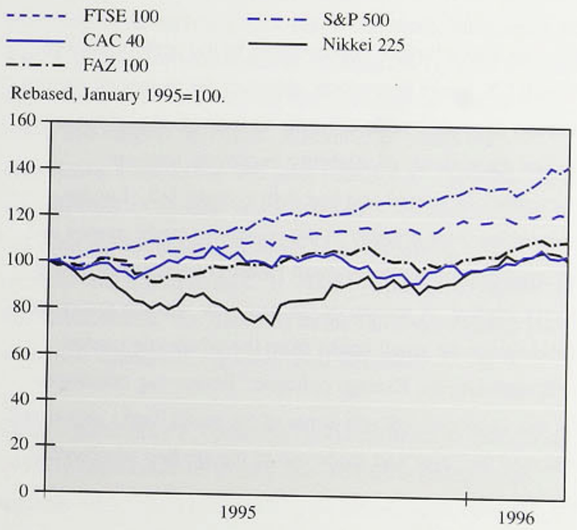


In response to the lower yields, investors seemed increasingly willing to take on riskier paper, with nominal yields appearing sometimes to be more important than risk-adjusted yields. This partly accounted for the successful re-entry into the international markets of emerging-market borrowers after the Mexican crisis. Japanese retail investors were major providers of funds, particularly in the international markets. There was strong growth in international bond market issues during the year, with quarterly gross eurobond issuance at its third highest ever level in the first quarter of 1996, and issues in 1995 as a whole the second highest ever (Chart 9).

Expectations of interest rate reductions also underpinned advances in the major equity markets during 1995 (Chart 10). The US market grew most strongly, rising by 28%; rises in European markets were generally more muted. Following a decline during 1994, Japanese equity prices recovered in the latter part of 1995.

CHART 10

Equity indices



Part III MARKET DEVELOPMENTS

OVERVIEW

Against the favourable economic background, the large UK banks improved their profitability in 1995, consolidating the gains of the previous year (Table I). However, in contrast to 1994, when the recovery in profits was almost entirely attributable to lower net bad debt charges, last year's improvement was mainly a result of a better operating performance. Most of the large banks recorded increases in both net interest and non-interest income, with the latter largely the result of a recovery in dealing profits.

There was also a further improvement in the performance of the small UK banks as a group, although the aggregate picture continued to mask a wide diversity in individual performance. With few exceptions, profitability improved, lending opportunities increased and bad debt charges fell. Lending opportunities were greatest in the consumer credit market and most subdued among those small banks concentrating on the property market. A feature of the past year was the resurgence of funding for the small banks from the wholesale market, notwithstanding the Barings collapse. Borrowing conditions from this source eased, and some of the small banks negotiated syndicated facilities and made use of the sterling commercial paper market.

Competition in the UK banking sector has remained intense, particularly in the market for personal savings and mortgages, and a process of consolidation is underway. There was a high level of merger and acquisition activity in 1995/96: Lloyds Bank acquired the Cheltenham and Gloucester Building Society and merged with TSB, while Abbey National and the National and Provincial Building Society announced a merger. The Halifax and Leeds Permanent Building Societies merged and the merged entity is seeking banking status. In addition, during the year both the Alliance and Leicester and Woolwich Building Societies announced plans to seek banking status.

In most of the major overseas economies, cost pressures, deregulation and overcapacity have similarly focused attention on consolidation and restructuring. The privatisation of a number of small and medium-sized banks in France offers the prospect of significant restructuring there; and German commercial banks, in response to competition from US and other large European banks, are raising their global investment banking profile through organic growth and acquisition. Consolidation in the US commercial banking industry has continued at a brisk pace: in the two years to the end of 1995, over 1,000 small institutions have been absorbed through merger. In Japan, further consolidation in the banking system is in prospect, as the largest city banks deal with their bad debt problems and consider new business strategies; the merger agreed during 1995 between Bank of Tokyo and Mitsubishi provided an example of this. And in a number of developing world countries, the terms of IMF restructuring programmes have included requirements to privatise publicly owned banks. The box on page 20 looks at some of the factors prompting banking consolidation.

TABLE I

Large British banks: earnings

£ billions	***1991***	***1992***	***1993***	***1994***	***1995***
Operating profits before bad debts	9.05	10.14	11.33	10.47	11.47
Pre-tax profits	2.34	2.12	5.45	8.58	9.29
Post-tax profits	1.38	1.09	3.57	5.74	6.22
Pre-tax return on equity (%)	*8.76*	*8.16*	*19.47*	*28.93*	*31.32*
Post-tax return on equity (%)	*5.42*	*4.18*	*12.75*	*19.35*	*20.96*
Return on total assets (%)	*0.42*	*0.35*	*0.80*	*1.21*	*1.15*

EARNINGS

The large UK banks benefited from the recovery in loan demand in 1995, with an increase in net interest income. Lending growth, although higher than in the previous year, showed no signs of returning to the rates of the late 1980s. With deposit growth continuing to outstrip the growth of commercial lending opportunities, the large banks invested a large part of their surplus funds in low-yielding, lower risk weighted government securities.

Loan growth among the large banks was more pronounced in the personal than in the corporate sector, although there were significant variations between individual banks. Consumer credit proved more buoyant than mortgage lending, perhaps reflecting the general reluctance of consumers to take on longer-term commitments.

TABLE II

Large British banks: sources of income

£ billions	*1991*	*1992*	*1993*	*1994*	*1995*
Net interest	15.59	16.09	16.40	16.61	17.78
Non-interest	10.69	11.86	13.40	12.98	14.01
Total income	**26.28**	**27.94**	**29.79**	**29.59**	**31.79**
Non-interest income as a percentage of total income	*40.1*	*42.4*	*45.0*	*43.9*	*44.1*

In contrast to a decline in 1994, banks achieved steady improvements in non-interest income in 1995, although sustaining increases in earnings from this source remains a major challenge (Table II). The recovery in non-interest income was almost entirely attributable to increased dealing profits. Fee and commission income remained under pressure, but benefited from renewed growth in credit-card activity. Earnings from life assurance continued to be depressed, as a result of low consumer confidence and a reassessment of regulatory requirements.

Among the smaller banks, the expansion of credit-card lending has been a feature, and a number of institutions have become players in the growing affinity card market. Competition in the consumer credit market—as in others—has been intense, and business has been transacted at very fine margins. Some niche operators in the property market have found opportunities for expansion—typically only from a very small base—but generally new business in this sector has been scarce. Small banks have in the main adopted a cautious approach to property lending; many are still managing out portfolios of non-performing loans written in the late 1980s.

Despite some narrowing of loan spreads in certain business areas, banks were generally able to maintain overall interest margins by using readily available retail funds to widen deposit spreads (Table III).

TABLE III

The 'big four' retail banks: interest margins

Percentages	*1991*	*1992*	*1993*	*1994*	*1995*
Domestic	4.0	3.8	3.6	3.6	3.7
International	2.1	2.3	2.0	1.9	1.8
Overall	**3.3**	**3.3**	**2.9**	**2.9**	**2.9**

COSTS

The increasingly competitive environment and limited opportunities for developing new sources of income have reinforced the need for effective cost control in retail banking. The banks have continued to rationalise their operations, including by centralising back office functions, integrating sales forces, developing management information systems to exploit opportunities for cross-selling and reducing the size of head office and support functions. A number of banks are considering outsourcing and joint ventures as a possible further way forward. Although individual banks' strategies differ, there has been a general trend towards more devolved decision-making structures. It will be important to ensure, in this environment, that banks' systems and controls keep pace with their changes in organisational structure.

Despite these efforts, operating costs continued to rise during 1995, in most cases reflecting one-off restructuring costs together with increased spending on information technology (Table IV). At some banks, the savings achieved by further reductions in staff numbers were offset in part by the cost of

TABLE IV

Large British banks: costs

£ billions	*1991*	*1992*	*1993*	*1994*	*1995*
Staff	9.55	9.83	10.15	10.40	11.03(a)
Premises and equipment	3.49	3.67	3.23	3.46	3.65
Other	4.20	4.27	4.52	5.26	4.89
Total operating costs	**17.24**	**17.77**	**17.90**	**19.12**	**19.57**
As a percentage of total income	*65.6*	*63.6*	*60.1*	*64.6*	*61.6*

(a) See text.

CONSOLIDATION IN THE BANKING SECTOR

During 1995/96, there were a number of high-profile mergers between banks in both the retail and merchant banking sectors. The detailed rationale for a merger is different in each case. There have, however, been a number of common underlying economic and financial motives behind recent mergers; this box outlines some of them and suggests some of the different factors that may be at work in the retail and merchant banking sectors.

Retail banking

At present, the key motive for change in the UK retail banking sector is the need to control costs while income generation remains difficult. This is in the context not only of intense competition within the sector, for products such as mortgages, but also of the low-inflation environment, which has reduced nominal loan and income growth. In addition, the investment programmes in information technology (IT) already embarked upon by most of the large banks to improve delivery channels, risk management and data processing involve significant initial costs which are expected to yield savings over the longer term.

Indeed IT expenditure generally is a manifestation of another motive for mergers, namely that the 'critical mass' required by banks if they are to compete successfully might be increasing. High IT expenditure thus becomes a barrier to entry, which may marginalise smaller institutions, providing an incentive for further consolidation.

A merger between two retail banks also affords an opportunity to reduce overall head office, systems and administration costs. In addition, the overlaps resulting from a merger may make it possible to reduce the branch and other network infrastructure beyond any existing plans for the single entity. Studies in the United States, where bank mergers of this type have been more common, suggest that the potential savings can be as high as 30% of total expenditure, although 20% seems more typical. They suggest that the majority of the increase in overall profitability following a merger is derived from a reduction in costs rather than an increase in revenue.

In terms of revenue enhancement, a merger should also provide growth opportunities, by extending the product range and the potential market for the combined bank and hence increasing the opportunity for cross-selling. In the longer term, it may also allow the bank to develop new products that combine the expertise of each partner. And it may create a more diversified business, which could lead to a greater stability of earnings.

Merchant banking

Whereas the motives in the retail sector might be described as 'internal' factors, essentially concerning banks' operational efficiencies, consolidation in the merchant banking sector has been largely driven by longer-term external factors. The two most important would seem to be: first, a gradual shift away from traditional 'banking' methods of financial intermediation towards greater use of the securities market; and second, the increasing globalisation of that market. To some extent the process of consolidation may have been accelerated and highlighted in the short term by the failure of Barings, but the motives underlying it pre-dated that failure and are likely in the longer term to have a greater effect on the structure of the industry than any event in isolation.

In recent years, both borrowers, in the form of large companies, and savers have used the securities market increasingly. Securities issuance has accounted for an increasing proportion of finance in international markets since the mid-1980s. Meanwhile the proportion of UK personal sector wealth invested through life assurance and pension funds has doubled to a third of the total.

Divergent patterns of economic growth, capital investment and savings around the world, accompanied by further reductions in capital controls, have also increased cross-border activity in securities markets and corporate finance. This growing globalisation has been facilitated by the rapid growth in the range of financial instruments and hedging techniques available to banks, including derivative products, which have allowed investors to exploit differential returns in different markets and further to diversify their portfolios by including international assets.

Mergers in the merchant banking sector have, therefore, been more concerned with safeguarding or increasing income than reducing costs. The aim is to combine product expertise in the growing markets with capital strength. For the acquired merchant banks, the need for capital has been driven not only by the desire to compete with larger more global banks in more capital-intensive products, such as securities distribution and trading in their chosen geographical areas, but also—for some—the desire to join the global players. For the acquiring banks, the merger can be seen both as a defence against losing some of their traditional franchise, and as a way of expanding their product range which may afford more opportunities for growth in one of the most important financial centres.

A note of caution

Mergers can provide the opportunity for growth, greater efficiency and increases in profitability. They are, however, only opportunities, which need to be carefully managed if they are to be translated into results. The merged bank's management must find solutions to the problems created in combining different cultures into the same organisation, while developing the systems needed to provide management information sufficient to manage the combined entity. If these problems are ignored, a merger may increase inefficiencies rather than reduce them.

training staff to operate new IT systems. Nevertheless, the growth in costs was exceeded by the growth in income to leave the cost-income ratio significantly down in 1995.

ASSET QUALITY

Bad debt charges fell again in 1995, both in absolute terms and as a proportion of lending, consolidating the improvement in asset quality that began in 1992 (Table V). The perception that the cycle of bad debt charges may now have reached its lowest point is widely held among the large banks, suggesting that further strengthening of headline profitability will require improvements in operating performance. The steadiness of lending growth, together with the lack of an upward trend in receiverships, suggests that, in the short term at least, the level of bad debts may remain stable. However, a number of the large UK banks made provisions against problem corporate exposures during the year and several also made additional provisions against pensions mis-selling. Some banks made further write-backs in respect of problem country debt, but these were significantly lower than in the previous year.

TABLE V

Large British banks: domestic bad debt provisions and charges

£ billions	*1991*	*1992*	*1993*	*1994*	*1995*
Stock of domestic commercial provisions(a)	7.0	8.2	7.5	6.3	5.8
As a percentage of total lending	*2.9*	*4.2*	*3.5*	*2.0*	*1.5*
Charge for domestic bad and doubtful debts	5.9	6.7	4.7	2.1	1.7
As a percentage of total lending	*2.4*	*3.0*	*2.0*	*0.7*	*0.5*

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

The large banks have continued to develop measures to enhance credit assessment. The measures adopted vary between individual banks, but include risk-adjusted pricing, the more systematic use of credit scoring and the development of default provisioning methodologies, based on quantifying the probability of default for different categories of loan at the time loans are made.

CAPITAL

Steady asset growth led to a slight reduction in the large banks' capital ratios in 1995, although they remained comfortably above the 8% Basle minimum. As a consequence both of restructurings and continued high retentions, there was a change in the composition of Tier 1 capital among the large banks, with a fall in ordinary share capital offset by an increase in reserves. Nevertheless, some of the large banks issued new share capital during the year to maintain capital ratios following acquisitions.

Some large banks now believe their levels of capital may be more than is needed to support organic growth, and are

TABLE VI

Large British banks: capital constituents

Convergence basis

£ billions	*1991*	*1992*	*1993*	*1994*	*1995*
Tier 1					
Ordinary shares	7.37	7.43	7.49	7.57	6.35
Preference shares	0.47	0.50	0.78	0.76	1.39
Reserves	15.64	15.66	17.27	20.65	23.58
Minorities	1.11	1.22	1.66	1.26	1.67
Total Tier 1	**24.59**	**24.82**	**27.18**	**30.24**	**32.99**
Tier 2					
Property revaluation reserves	0.75	0.27	0.16	0.12	0.11
Hybrid capital	6.11	7.33	8.89	8.82	9.33
General provisions	1.72	2.06	2.21	2.25	2.53
Tier 2 minorities	—	0.01	0.01	0.01	0.02
Subordinated loan stock	8.70	9.93	10.19	10.68	11.17
Headroom deduction	-0.57	-0.49	-0.19	—	—
Total Tier 2	**16.87**	**19.18**	**21.27**	**21.88**	**23.16**
Deductions	-2.65	-3.11	-3.46	-3.18	-5.02
Total net capital	**38.83**	**40.88**	**44.98**	**48.95**	**51.13**

considering a number of options to enhance shareholder value. These include further acquisitions, increased dividend streams and further share buy-backs (Tables VI and VII).

TABLE VII

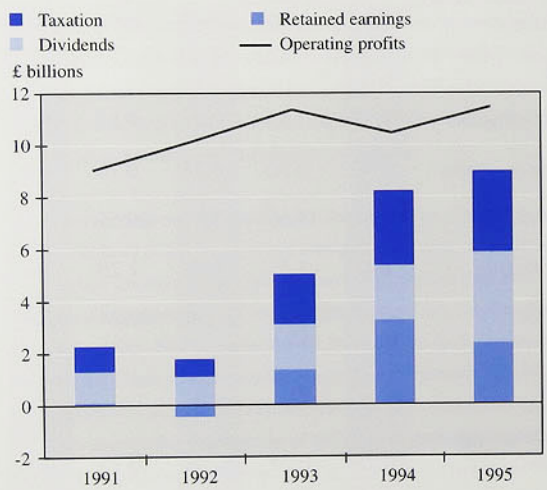
Large British banks: capital ratios

Convergence basis

£ billions	*1991*	*1992*	*1993*	*1994*	*1995*
Total assets	529.2	607.8	676.8	711.4	809.7
Weighted assets	391.5	411.2	417.3	424.4	471.1
Total net capital	38.8	40.9	45.0	48.5	51.1
Risk asset ratio (%)	**9.9**	**9.9**	**10.8**	**11.4**	**10.9**

CHART 11

Large British banks: retained earnings



MERCHANT BANKING

Reviews of the activities of the UK merchant banks in 1995 have inevitably focused on the Barings collapse. Commentators have been inclined to regard this specific event as having broader consequences for the UK merchant banks as a group. They have pointed to the acquisition of three UK merchant banks, including Barings, by large international banks as evidence that the broad group of UK merchants might lose their independence in an industry undergoing a significant process of consolidation. These issues are discussed in the box on page 20.

In terms of results, however, 1995 was a good year for many of the merchant banks. Although the small rise in funding costs which a number of banks experienced after the Barings collapse had an adverse effect, it was offset by increased revenue from various sources. In particular, income from advising on mergers and acquisitions was generally high, as a result of the increased activity. This is evident from published league tables for both UK and cross-border take-overs where, in the provision of advice, the independent merchant banks competed successfully with their 'global' counterparts. At the same time, the 'global' banks dominated those activities which are more capital and balance sheet intensive, including the lead management of bond and equity issues.

The more buoyant conditions in the major securities markets during 1995 contributed to the improved overall trading profits of the merchant banks compared with 1994. A number of these banks also performed well in the area of asset management, in which some are significant participants, and recorded improvements compared with the previous year.

INTERNATIONAL DEVELOPMENTS

Despite the slowdown in activity in much of Europe, the performance of banks in the major continental European countries improved, compared with the disappointing results in 1994. Although loan demand remained subdued in most countries, placing pressure on banks' interest margins, this was offset by a recovery in trading income, which reflected the strengthening conditions in capital markets.

Generally in Europe, rates of new provisioning declined from their previous high levels; in Germany, this reflected a stabilisation of commercial property prices. The decline in new provisions was, however, less pronounced in France, where banks still have some significant corporate problems and commercial property prices have yet to stabilise. And Italy was an exception to the trend, with many banks increasing their provisions in response to new problem debts.

US commercial banks enjoyed record profitability in 1995, reflecting improvements in most categories of income, but particularly in trading revenues as capital market conditions improved markedly compared with 1994. Overall, net interest earnings held up despite intense competitive pressure in corporate lending. Asset quality continued to improve in all areas except consumer lending; high personal sector indebtedness resulted in an increase in losses on consumer portfolios.

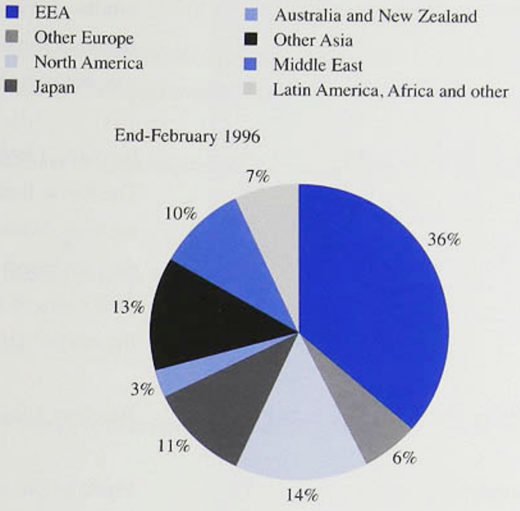
The Japanese banks continued to face difficult domestic conditions. Despite an accommodating domestic monetary policy, growth in the Japanese economy remained subdued and the commercial property sector remained particularly depressed. And although falls in market interest rates led to a marked improvement in profits at an operating level, the banks continued to be burdened by high levels of bad debt—officially estimated at around 7½% of gross domestic product. The banks wrote off extensive bad debts in 1995, including a significant proportion of those to the seven housing loan companies (the *jusen*). This will result in the majority of the major 20 banks reporting losses for 1995.

Concerns about the fragility of the Japanese banking system, compounded by the failure of a regional bank and of several small domestic credit institutions, led to Japanese banks facing a margin over market rates for borrowings during 1995—the 'Japan premium'. Concerns came to a head last October when the premium briefly exceeded 50 basis points for the larger Japanese banks. Since then, a number of developments—including official statements of support for the financial system and a number of proposals for dealing with the financial sector's problems—have led to a marked reduction in the premium.

In the wake of the economic turbulence in Mexico at the end of 1994, the Mexican banking sector suffered a severe liquidity crisis and a sharp deterioration in asset quality which necessitated a significant number of bank recapitalisations. In

CHART 12

Geographical representation of overseas institutions[(a)]



(a) Branches, subsidiaries and other controlling stakes in consortium banks.

response, the authorities implemented a number of short-term measures to support capital and liquidity, and a broader restructuring of the sector is underway, including an increase in foreign bank participation.

The large UK banks' international operations had another profitable year. The Far East remained a focus of expansion for some, particularly in corporate finance. Elsewhere, in contrast, a number of loss-making overseas operations were sold during the year. The large banks continued to adopt a selective approach to the EU Single Market. A number of acquisitions and joint ventures were announced with continental European banks during the year, but some banks incurred substantial costs as a result of restructuring unprofitable European operations. Major merger and acquisition activity elsewhere included the NatWest Group's sale of its US retail banking operation Bancorp, and Barclays' purchase of Wells Fargo Nikko Investment Advisers.

Sources of data	Audited financial statements for the large British banks and Bank of England statistical returns. Because the data considered are primarily for the 1995 calendar year, the impact of the CAD is not considered. 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 (1995 data are based on interim figures) and the Royal Bank of Scotland (end-September). TSB changed its financial year end following the merger with Lloyds and the data for the merged group are for the twelve months ending in December 1995.
The 'big four' retail banks	Barclays, Lloyds-TSB, Midland and National Westminster.
Operating 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 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.

Part IV POLICY DEVELOPMENTS

(1) CHANGES IMPLEMENTED IN THE UNITED KINGDOM[1]

Barings Report recommendations

The Board of Banking Supervision's Report on Barings included 17 recommendations, all of which were accepted immediately by the Bank. The implementation of these recommendations has given rise to a number of policy changes covering the areas of consolidated supervision, statistical returns, solo consolidation, regulatory co-operation, internal audit and audit committees, the scope of section 39 reporting and large exposures. Detailed discussion of most of these is included in Part I of this *Report*; the Bank's Policy Notices on reporting accountants are discussed below.

Post-Barings Notices on Reporting Accountants

The Bank reissued in revised form its three Notices on reporting accountants, 'The Bank of England's relationship with Auditors and Reporting Accountants' (S&S/1996/5), 'Guidance Note on Reporting Accountants' Reports on accounting and other records and internal control systems' (S&S/1996/6) and 'Guidance Note on Reporting Accountants' Reports on Bank of England Returns used for prudential purposes' (S&S/1996/7) to update them, *inter alia*, to take account of the recommendations made by the Barings Inquiry. The main changes are that reporting accountants may now be commissioned to form an opinion on the systems of controls over the accuracy of the information contained in an institution's records and its transfer to prudential returns; that the Bank may use section 39 reviews more flexibly, to cover group operations other than the institution itself; and that reporting accountants will be required to state the extent of the work performed for each section 39 review.

Capital Adequacy Directive

The EU Capital Adequacy Directive (CAD), which sets minimum capital requirements for market risks in the trading books of banks and investment firms, came into effect in the United Kingdom on 1 January; the Bank was required to provide a framework for its implementation by July 1995. Following a consultative period, including the issue of a detailed consultation document in December 1994, and an exercise with the SIB and the SFA to ensure that their views were fully taken into account in the Bank's implementation, a Policy Notice (S&S/1995/2) was issued in April 1995. A second Policy Notice (S&S/1995/4) was issued in late 1995 to clarify areas of the new policy where necessary. Further information about the implementation of the CAD is contained in Part I of this *Report*.

Investment Services Directive

The Investment Services Directive became effective from 1 January 1996. It was implemented in the United Kingdom via the Investment Services Regulations 1995, made in December 1995, which, *inter alia*, amended the Financial Services Act 1986. Its primary purposes are to provide a single European 'passport' to investment firms and to make some changes in the access to regulated markets. Its impact on credit institutions is limited, but as the scope of the Financial Services Act has been broadened slightly, some credit institutions may be subject to that legislation for the first time. Where the requirements of the Directive specifically apply to credit institutions, any changes will have been reflected in the relevant SRO rules and the wholesale markets supervisory regime. Any issues arising from the ISD will be discussed as part of the Bank's on-going discussions with the SIB and the SROs.

Amendments to the implementation of the Solvency Ratio and Own Funds Directives

The Bank's Notice S&S/1995/5, issued in December 1995, implemented amendments to the Solvency Ratio Directive and the Own Funds Directive, respectively to lower the risk weighting for the European Investment Fund from 100% to 20%, and to exclude internally audited interim profits from institutions' own funds.

(1) A list of the policy and practice notices issued by Supervision and Surveillance currently in force is included in Appendix 2.

The Bank's Notice S&S/1996/2, issued in March 1996, added the Inter-American Investment Corporation to the list of Multilateral Development Banks and confirmed that under the terms of S&S/1995/1 the Czech Republic had acquired Zone A status from 21 December 1995.

Netting of counterparty risk on repos/reverse repos and OTC derivatives

In December 1995, the Bank issued Policy Notice S&S/1995/3 on the netting of counterparty risk associated with sale and repo agreements, and draft rules on over the counter (OTC) derivatives. The Notice supplemented the Bank's Notice BSD/1990/3 ('Implementation in the UK of the Solvency Ratio Directive'). It set out the legal and systems requirements that authorised institutions are required to meet before the Bank is prepared to treat the counterparty credit risk arising from such transactions on a net basis for capital adequacy and large exposures reporting purposes. The legal requirements derive from the Basle rules for netting counterparty risk on OTC derivatives; for prudential reasons, the Bank has extended these to cover repos and reverse repos. While the Basle recommendations for OTC derivatives have been in place since September 1994, EEA member states have had to await adoption of the Contractual Netting Directive before they could recognise these netting agreements. The Directive came into force on 23 April 1996 and the Bank issued a Notice (S&S/1996/3) confirming the final rules to take effect from 30 April, which replaced S&S/1995/3.

In order to gain recognition of netting agreements, banks are required to write to the Bank setting out the agreement, jurisdictions, counterparty types and product types involved and to confirm that they have obtained legal opinions which satisfy the terms of the Notice. They are also required to maintain detailed records of their due diligence so that compliance with the Notice may subsequently be examined, either via supervisory visits or the section 39 process, and to manage their resulting exposures on a net basis.

Treatment of potential future exposure for off balance sheet contracts

In March 1996, the Bank issued Policy Notice S&S/1996/4, which introduced new arrangements for those banks employing the replacement cost method for calculating the credit exposure arising from off balance sheet contracts. The Notice takes effect from 1 July 1996. The new figures—in the form of an expanded matrix which reflects work in Basle—apply to the potential future exposure on contracts concerning equities, precious metals other than gold, and other commodities, and also to contracts of greater than five years' residual maturity. The use of the alternative original exposure method is limited to interest rate, foreign exchange and gold contracts in the banking book only.

Liquidity

The Bank's approach to the measurement of liquidity of large UK retail banks under the 'sterling stock' regime was finalised during the year, and is discussed in the box on page 28. For those banks not subject to this approach, in January the Bank issued a Policy Notice (S&S/1996/1) amending its 1982 Notice ('The measurement of liquidity') and extending the range of marketable securities which can be regarded as sight assets for the purposes of calculating liquidity mismatches. The changes recognised the fact that assets other than those explicitly permitted to be included by the 1982 Notice could, at a range of discounts, prudently be considered readily marketable. Institutions wishing to take advantage of this wider range of marketable assets may report from May 1996 on part 2 of a new liquidity return, Form L1.

The securitisation of revolving credits

Following a consultation process begun last September, in April the Bank issued a Policy Notice [('Securitisation of revolving credits' (S&S/1996/8)], amending its supervisory treatment of these securitisations. The securitisation of revolving credits, such as credit-card receivables, raises particular supervisory issues as a result of a number of features common to the schemes: the shared interest of the originating bank and the securitisation's investors in the accounts that are transferred; the possibility of increased legal risk and moral pressure arising from the complexity of the arrangements; and the eventual reversion in full to the originating bank of the pool of accounts transferred. Because of these concerns, the Bank's previous policy on these securitisations limited the amount of outstanding revolving credits that a bank could securitise at any one time. This general limit has now been lifted, with the

STERLING STOCK LIQUIDITY

In January, the Bank implemented a new system for measuring the sterling liquidity of the large UK banks. The approach is based on the four key principles of prudent liquidity management set out in the Bank's 1982 Policy Notice 'The measurement of liquidity', which underlie the Bank's approach to liquidity policy. These require that a bank:

(i) Should be able to meet its obligations as and when they fall due;

(ii) Should maintain sufficient immediately available cash or liquid assets to meet its obligations ('adequate stock');

(iii) Should have a profile of cash flows arising from maturing assets sufficient to fulfil its obligations ('adequate cash flow'); and

(iv) Should have an adequately diversified deposit base in terms of both maturities and range of counterparties.

Most banks in the United Kingdom are supervised on what is known as the 'mismatch' approach, whereby assets and liabilities are allocated on a maturity ladder and limits are set on the size of the mismatch in various time bands. This approach is less suitable for very large banks whose balance sheets are characterised by a highly diversified retail deposit base. For these banks, it is more important that they hold an adequate stock of liquid assets.

The Bank's objective in developing the new system for sterling stock liquidity has been to establish a framework that directly addresses the liquidity needs of the major UK retail banks and introduces a common minimum standard. It is designed to ensure that at all times a bank maintains a stock of highly liquid assets which it can mobilise quickly and discreetly to replace funding that has been withdrawn because of a perceived problem in the institution. The aim is to provide a breathing space during which the institution can try to arrange more permanent funding solutions.

The Bank has decided that, in order to provide adequate time to investigate various forms of remedial action, a bank should, as a minimum, be able to meet its obligations without any renewal of maturing wholesale funding (on a net basis) for a period of five working days, after allowing for the loss of a proportion of its retail deposit base. To prevent stock holdings from becoming excessively volatile, institutions will also be expected to hold sufficient sterling stock to meet a minimum 'floor' requirement agreed with the Bank.

An institution will thus be expected to hold a stock of sterling liquid assets sufficient to cover the higher of:

(i) Its wholesale sterling net outflow 'floor' over five working days, as agreed with the Bank. Unless otherwise agreed, the floor will normally be set at 50% of the institution's internal wholesale sterling net outflow limit over five working days, as agreed with the Bank; or

(ii) 100% of the actual wholesale sterling net outflow over five working days, plus 5% of sterling retail deposits falling due in the same period.

The stock of sterling liquidity comprises assets which carry a low credit risk, are traded in sizable amounts in deep and liquid markets, and which the Bank is prepared, by convention, to lend against in the course of its money-market operations. These comprise:

- Cash and operational balances with the Bank;
- UK Treasury bills and gilts;
- UK bank bills eligible for rediscount at the Bank;
- UK local authority bills eligible for rediscount at the Bank;
- Secured overnight and callable deposits with money-market dealing counterparties of the Bank which are authorised institutions under the Banking Act;
- Secured overnight and callable deposits (including secured callable fixtures) with Stock Exchange Money Brokers and Gilt Edged Market Makers, including money-market dealing counterparties of the Bank which are not authorised institutions under the Banking Act.

When considering the adequacy of a bank's stock of liquid assets, the Bank will also consider the diversification of the assets held and the bank's ability to mobilise them quickly and discreetly. The Bank has taken the view that certificates of deposit (CDs) do not meet the requirements for inclusion in the sterling liquidity stock because of the absence of any lender of last resort facility and the consequent risk that this may make the CD market unpredictable in the event of a problem in a major bank. However, it recognises that CDs do have a role to play in liquidity management; so although CDs cannot be included in the sterling liquidity stock, institutions are permitted to offset their holdings of CDs against a maximum of 50% of the wholesale sterling actual net outflow over five working days. For this purpose, CDs will be subject to a 15% discount to reflect the cost of a forced sale in a troubled market.

concerns it was put in place to address met in other ways. The Bank has consulted further on one detailed aspect of the policy—the setting of a minimum period for the scheduled amortisation of schemes using the aggregated approach.

Deposit Protection Scheme

The Credit Institutions (Protection of Depositors) Regulations 1995 came into effect on 1 July 1995. The Regulations amended the UK Deposit Protection Scheme to meet the requirements of the EU Deposit Guarantee Schemes Directive. They made a number of changes to the level and scope of the protection provided: in particular, the maximum level of protection for an individual depositor was increased from 75% of £20,000 to 90% of £20,000 (or ECU 22,222 if higher). These changes brought the Deposit Protection Scheme into line with the Building Societies' Investor Protection Scheme.

The Scheme now covers deposits in Ecu and the currencies of all EEA states (rather than just sterling deposits), and covers the branches of UK-incorporated banks throughout the EEA, where coverage was previously limited to their UK offices. Deposits with UK offices of banks incorporated in other EEA states should now be primarily covered by the scheme established in their home state, although where the UK scheme offers more favourable protection, the Regulations allow a bank to 'top up' into the UK scheme. Deposits with UK offices of banks from outside the EEA continue to be protected under the Scheme unless the Deposit Protection Board is satisfied that they are at least as well protected under other arrangements in the bank's home country.

The Regulations also extended the categories of depositor and deposit which are not protected under the Scheme. Deposits by all credit and other financial institutions and insurance undertakings are excluded, as are those that form part of a bank's own funds and deposits which the Deposit Protection Board is satisfied were made in connection with a money-laundering transaction. Banks are now required to provide depositors with details of deposit protection arrangements.

Work of other bodies

The Accounting Standards Board (ASB) issued a number of exposure drafts and discussion papers during the year. A discussion paper on taxation was the first step to the development of a new Financial Reporting Standard (FRS) to replace Statement of Standard Accounting Practice (SSAP) 15 and some of the disclosure requirements of SSAP 8. It recommends adoption of the 'full provision' method as more consistent with international practice and the ASB's draft Statement of Principles. To counter the problem of the build-up of large liabilities, the paper introduces the concept of discounting. In June, the ASB issued a paper on pension costs, which continued to favour the methodology in SSAP 24, but narrowed the available measurement options to make disclosure more relevant. In addition, a working paper was issued with proposals on the depreciation of goodwill and intangibles.

An exposure draft of the ASB's Statement of Principles for Financial Reporting was issued in November. This was intended to codify the concepts and principles developed by the ASB to guide it in setting new accounting standards. A paper discussing issues of recognition, measurement and disclosure of provisions was issued in November. Financial Reporting Exposure Draft (FRED) 10, 'Cash flow statements', issued in December, proposed changes to the format and basis of cash-flow statements.

FRS 8, 'Related party disclosures', became effective for all accounting periods from 23 December.

The British Bankers' Association, in conjunction with the Irish Bankers' Federation, issued two new Statements of Recommended Accounting Practice (SORP)—'Derivatives' and 'Contingent liabilities and commitments'—both of which applied to accounting periods beginning on or after 23 December. The preferred approach of the SORP on derivatives remained to require derivatives held for trading purposes to be measured at fair value and to allow them to be accounted for on an accruals basis only where they are held as part of the bank's non-trading risk management strategy. The SORP clarified the valuation and income recognition provisions and expanded the existing disclosure requirements.

The Royal Institution of Chartered Surveyors issued its appraisal and valuation manual, which replaced the 'Red Book'. This updated guidance to valuers on the bases and methods to be used in preparing valuations of fixed assets.

The Greenbury Report, issued in July 1995, contained a code of best practice for listed companies covering remuneration committees, disclosure and approval provisions, remuneration policy and service contracts and compensation. The Stock Exchange has adopted large parts of the Greenbury Report, and various disclosures and statements have been included in the Listing Rules.

(2) IMPLEMENTATION IN PROGRESS

Post-BCCI Directive

This Directive ('Directive to Reinforce Prudential Supervision within the European Union following the Collapse of BCCI') was adopted in June 1995 following conciliation proceedings between the Council of Ministers and the European Parliament. It must be implemented by Member States by 18 July 1996 and the Bank is working with H M Treasury and other UK supervisors to decide what changes to UK legislation will be needed.

The Directive covers not only EEA 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, among 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.

Market risk

During 1995, the Basle Committee considered responses from banks and other interested parties to its proposed market risk package, which contained a proposal to allow banks to use 'value-at-risk' (or VAR) models to measure these risks for supervisory capital adequacy purposes. The final amendment to the Basle Accord was published in January 1996 for implementation by the G10 supervisory authorities before the end of 1997.[1]

Several changes were made to the proposals as a result of the consultation, mainly to the detailed quantitative standards to be applied when using internal models. By contrast, there was little further comment on the 'standardised method' (or 'building block' approach) and market participants expressed strong support for the strict qualitative standards proposed for the risk management process to be applied by VAR model users. The Committee also confirmed that, subject to national discretion, banks could issue short-term subordinated debt subject to a lock-in clause ('Tier 3 capital') to meet part of their capital requirement for market risks; limits on the amounts allowed will be a matter for national discretion.

The most significant change to the quantitative standards gave banks more flexibility in specifying model parameters, including the possibility of recognising correlation effects between, as well as within, broad risk factor categories (for example between interest rates and exchange rates); this change should ensure that banks which have diversified trading activities, and thus fewer risk concentrations, are not penalised. The quantitative parameters set in the final package were: that the value at risk should be calculated daily, using a 99th percentile, one-tailed confidence interval and a minimum price shock equivalent to ten trading days (i.e. a ten-day holding period); and that the model should incorporate at least one year of historical data. The capital charge will be the higher of the previous day's value at risk and three times the average of the daily value at risk during the preceding 60 business days.

The models approach was developed as an alternative to the standardised approach for general market risk, but no consensus emerged by the end of the consultation period on how to model specific risk (i.e. the risk associated with individual securities). The final package therefore retained a minimum charge for specific risk, set at 50% of that in the standardised approach, while allowing banks that have developed specific risk models

(1) 'Amendment to the Capital Accord to incorporate market risks', Basle Committee on Banking Supervision.

to use them (subject to the minimum). The Committee invited banks to devise a methodology to improve on this approach.

In recent years, there has been close collaboration between the Basle Committee and IOSCO, with the objective of achieving more consistent regulatory treatments for similar activities across different types of institution. Following the G7 Summit in Halifax in June, the two committees agreed to establish a co-ordination group to extend joint work on existing projects and to review possible new initiatives. In the area of market risk, the group is working to understand better the relative implications of VAR models for banks and securities firms, and to assess the extent to which there is scope for further collaboration.

Derivatives disclosure

Developments during the year—including the implementation of the CAD and the amendment of the SRD to allow the netting of OTC derivatives—led to significant changes in banks' prudential reporting of derivatives activity. Further details can be found in Part I of this *Report*.

Discussion of derivatives disclosure in published financial statements has continued and a paper was issued jointly by the Basle Committee and the Technical Committee of IOSCO discussing relative levels of disclosure among G10 countries in 1994 compared with 1993. It concluded that, although disclosure had improved, significant differences remained in the type and usefulness of information disclosed.

Other bodies, including industry groups as well as national and international accounting authorities, have also launched initiatives to improve public disclosure. For example, the International Swaps and Derivatives Association in a survey found that institutions were planning additional disclosure in 1995.

The treatment of derivatives has been influenced significantly by accounting developments. During 1995, the International Accounting Standards Committee (IASC) issued IAS 32, 'Financial Instruments: Presentation and Disclosure'. The British Bankers' Association, with the Irish Bankers' Federation, issued a SORP on derivatives (see 'Work of other bodies' above). The ASB is examining derivatives issues and is undertaking a project on financial instruments; it anticipates publishing a discussion paper during 1996. In addition, the Basle Committee and the European Commission are turning their attention to accounting and disclosure issues.

(3) AREAS UNDER DISCUSSION

Amendment to the CAD

Since the publication of the Basle Committee's final amendment to the 1988 Basle Accord in January of this year, EU Member States have commenced deliberations on amendments to the Capital Adequacy Directive. Article 14 of the CAD allows for it to be revised within three years of implementation if there are 'developments in international fora of regulatory authorities'.

The main departures from the CAD approach in the Basle framework are the scope it allows supervisors to allow the use of VAR models and the introduction of a framework for the measurement of commodities risk. At this stage, it is not possible to determine the likely scope of the amending Directive or the timetable for its introduction.

Supervision of financial conglomerates

In July 1995, an informal tripartite group of bank, securities and insurance supervisors, established at the initiative of the Basle Committee, produced a discussion document on issues relating to the supervision of financial conglomerates—defined, broadly, as predominantly financial groupings involved in two or more of the three business areas covered by the supervisors. The report examined the measurement of capital on a group-wide basis, group structures, the possible establishment of lead supervisors or 'convenors', the contagion effect of intragroup exposures and several other issues. Following it, the Basle Committee, IOSCO and the International Association of Insurance Supervisors agreed to reconstitute the group as a Joint Forum formally representing the parent Committees. This has now begun to pursue the mandate given to it, which includes reviewing the means of facilitating information exchanges between supervisors, examining how criteria to identify a lead supervisor might be established, and developing a set of principles to govern the future supervision of financial conglomerates.

(4) LIAISON WITH OTHER SUPERVISORS

The Basle Committee on Banking Supervision

The Committee met four times during 1995. The centrepiece of its work over the year was the publication of the supplement to the 1988 Capital Accord to cover market risks, which was issued in draft in April 1995 and published in final form in January (see above). The G10 supervisory authorities are due to implement the proposals by the end of 1997.

Work carried out in conjunction with IOSCO led to the publication of two joint reports concerning the derivatives activities of banks and securities firms. The first, published in May, presented a framework for supervisors to assess information on derivatives activity. The second, released in November, surveyed public disclosure practice among internationally active G10 banks and securities firms, and included recommendations for further improvements in public disclosure (see above).

The treatment of potential future exposure for off balance sheet items under the Capital Accord was amended with effect from the end of 1995 to recognise the effects of netting in the calculation of potential future exposure and to expand the matrix of add-on factors (see above).

Further work was carried out on interest rate exposure measurement, multilateral netting schemes and the development of a minimum standards framework for the supervision of international banking groups.

EU supervisory bodies

The Banking Advisory Committee (BAC) and the Contact Group of EU Supervisory Authorities ('Groupe de Contact') met regularly during 1995 to discuss supervisory questions at EU level. In addition to the exercise of its 'comitological' function (i.e. approving technical amendments to existing EU legislation), the BAC continued to work alongside the European Commission in the preparation, application and interpretation of EU banking legislation. Subjects discussed over the course of the year included: the use of VAR models for the calculation of banks' capital requirements for market risks under the CAD; the supervision of financial conglomerates; the supervisory implications of the transition to a single currency; restrictions imposed by host countries in the interest of the 'general good'; the treatment of mortgage credit under the Solvency Ratio Directive; and the impact of the General Agreement on Trade in Services on the third-country provisions of the Second Banking Co-ordination Directive. The BAC was assisted in its work by a Technical Working Group on Interpretation.

The Groupe de Contact continued to act as a forum for reviewing developments in Member States' banking supervisory systems and for holding confidential exchanges of information on issues of mutual interest (for example, instances of cross-border fraud). As in the past, the Groupe also carried out comparative studies of particular aspects of Member States' supervisory systems. Subjects covered by these studies included: the supervisory treatment of off balance sheet securitisation transactions; the use made to date of the 'passport' provisions of the 2BCD; and the instruments, short of liquidation proceedings, available to supervisory authorities when managing crises affecting individual credit institutions. Much of the Groupe de Contact's work was submitted to—and discussed by—the Banking Advisory Committee and/or the EMI Banking Supervisory Sub-Committee.

The EMI Banking Supervisory Sub-Committee

The Sub-Committee, under the Chairmanship of Mr Quinn, then an Executive Director of the Bank, met three times last year. When Mr Quinn retired from the Bank on 29 February, its Chairmanship passed to Mr Tom de Swaan of De Nederlandsche Bank.

The Sub-Committee conducted a survey into the way in which banks manage their credit risk. Its main finding was that banks have continued to enhance their approach in the area, and the report identified a number of general principles on which supervisors could draw to ensure that banks maintain adequate processes. Work on central registers has continued, with the aim of promoting co-operation among those central banks which manage such systems (i.e. those in Austria, Belgium, France, Germany, Italy, Portugal and Spain). In September, the Sub-Committee set up a working party to examine best practice in banks' internal control systems. In the first stage of this work, specific consideration was given to the role of banks' directors and management committees in devising and implementing effective internal control mechanisms. The Sub-Committee has also given thought to the supervisory implications of the move to Stage 3.

Memoranda of Understanding with UK supervisors

During the year, a review was begun of the Memoranda of Understanding (MoUs) agreed with Financial Services Act regulators. This is aimed at updating existing MoUs in the light of the Barings Inquiry and the Investment Services Directive. At the same time, MoUs have been, or are being, negotiated for the first time with the London International Financial Futures and Options Exchange, the London Metal Exchange and the London Clearing House, aimed at ensuring an adequate information flow.

Memoranda of Understanding with other EEA supervisors

During the year, the Bank continued to hold bilateral meetings with supervisory authorities in other EEA Member States. The principal purpose of these meetings was to exchange information on credit institutions with physical presences in both countries; to address bilateral difficulties or supervisory concerns arising from the administration of the Second Banking Co-ordination Directive; and, more generally, to exchange views on supervisory developments and other issues of mutual interest. The terms of such co-operation are set out in bilateral MoUs which the Bank has negotiated with its supervisory counterparts in other EEA countries. The Bank places considerable emphasis on co-operation and co-ordination with supervisors in other EEA Member States to try to ensure a good exchange of information.

Contact with non-EEA supervisors

The Bank has continued to develop its programme of contacts with non-EEA supervisors to improve its understanding of the nature and scope of their supervision, to exchange information about UK banks' operations within their jurisdictions and about their banks where they have UK authorisations. In the latter case, the Bank has discussed prudential issues arising from the UK operations of these banks having regard to the criteria for authorisation in the United Kingdom.

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.

Two statutory instruments affecting the Banking Act were made under the European Communities Act 1972. The first, made on 6 June 1995, gave effect to the EU Directive (94/19/EC) on deposit guarantee schemes, and came into force on 1 July 1995.(1) The changes it made are outlined in Part IV. The second, which, among other things, gave effect to the EU Investment Services Directive (ISD) was made on 18 December 1995, with most of its provisions coming into force on 1 January 1996.(2) The regulations amended sections 11 (1A) and 12A of the Act, which set out the circumstances in which the Bank has the power to revoke or restrict the authorisation of an institution, so as to include where a UK-incorporated credit institution has failed to comply with any rule of law in force in another EEA state for purposes connected with the implementation of the ISD. Section 84 (which deals with restrictions on the disclosure of information) was also amended to allow the Bank to disclose information to the SIB and the SROs so that they can carry out their functions as a competent authority under the ISD and the CAD.

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:

- Implementation in the United Kingdom of the Capital Adequacy Directive (Amendments to S&S/1995/2) (S&S/1995/4, December 1995).
- Amendments to the Bank's notices on: (i) The Verification of Interim Profits in the context of the Own Funds Directive (BSD/1992/5); and (ii) The Implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3) (S&S/1995/5, December 1995).
- Implementation in the United Kingdom of the Solvency Ratio Directive (S&S/1996/2, March 1996) (further amendment to the 1990 paper).
- Netting of counterparty credit risk associated with sale and repurchase agreements and OTC derivatives (S&S/1996/3, March 1996).
- Treatment of potential future exposure for off balance sheet contracts; implementation in the United Kingdom of the Solvency Ratio Directive (S&S/1996/4, March 1996) (further amendments to the 1990 paper).

The following paper is added to paragraph 2.6 of the Statement of Principles:

- Securitisation of revolving credits (amended annex to BSD/1989/1, replacing Part C of BSD/1992/3) (S&S/1996/8, April 1996).

The following paper is added to paragraph 2.22 of the Statement of Principles:

- Definition of Marketable Assets for Liquidity Purposes (Amendment to July 1982 Policy Notice: 'The Measurement of Liquidity') (S&S/1996/1, January 1996).

The following papers are added to paragraph 2.26 of the Statement of Principles:

- The Bank of England's relationship with auditors and reporting accountants (S&S/1996/5, April 1996, replaces BSD/1994/1).
- Guidance note on reporting accountants' reports on accounting and other records and internal control systems (S&S/1996/6, April 1996, replaces BSD/1994/2).

(1) The Credit Institutions (Protection of Depositors) Regulations 1995 (SI 1995 No 1442).
(2) The Investment Services Regulations 1995 (SI 1995 No 3275).

- Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes (S&S/1996/7, replaces BSD/1987/3).

In addition, paragraph 2.26 of the Statement of Principles discusses the requirement for an institution to maintain adequate accounting and other records and adequate systems of control for its business and records. Following the implementation of the ISD on 1 January 1996, the Bank has reviewed its policy regarding the records and systems that authorised institutions should maintain with regard to their investment business. Where institutions conduct investment business (as defined by the ISD) under the review of an SRO, this paragraph is amended to state that they can demonstrate to the Bank the adequacy of their controls over their investment business by compliance with the relevant rules issued by their SRO.

Further, paragraphs 3.1 and 3.2 of the Statement of Principles are amended to reflect the introduction of new arrangements, which are based on the CAD, for supervision of the capital adequacy of the discount houses (see below).

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, and the relevant home state authority retains responsibility for their prudential supervision, except that the Bank retains responsibility, in co-operation with that authority, for the supervision of the liquidity of their UK branches.**

The authorised population rose again in 1995/96, from 525 to 539 (see Table VIII). The number of institutions permitted to accept deposits in the United Kingdom also rose, from 511 to 515. The difference between the two sets of figures is made up by the increasing number of EAIs that 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.

TABLE VIII

The 'authorised population'(a)

End-February	*1992*	*1993*	*1994*	*1995*	*1996*
UK-incorporated	263	253	232	224	220
Incorporated outside the United Kingdom	255	255	286	301	319
Total	**518**	**508**	**518**	**525**	**539**
of which:					
EAIs with UK branches entitled to take deposits in the United Kingdom		*79*	*97*	*102*	*103*
Other EAIs		*—*	*32*	*44*	*61*

(a) Includes European authorised institutions, which are not authorised under the Banking Act.

Institutions authorised under the Banking Act

There were 375 institutions authorised under the Banking Act at the end of February 1996. Of these, 155 were represented in the United Kingdom by branches of institutions incorporated outside the European Economic Area and 220 were incorporated in the United Kingdom. Of the UK-incorporated institutions, 80 were subsidiaries of overseas companies and seven were joint ventures involving overseas institutions.

European authorised institutions

As at end-February 1996, there were 164 institutions recognised under the 2BCD Regulations as EAIs. Of these, 103 had branches in the United Kingdom which were entitled (among other things) to accept deposits in the United Kingdom, and five had branches in the United Kingdom which were entitled only to carry on other of the activities listed in Schedule 1 of the 2BCD Regulations. The remaining 56 EAIs did not have branches but offered services on a cross-border basis only (which may or may not have included deposit-taking).

Applications for authorisation

In the year to end-February 1996, eight applications for authorisation under the Banking Act were granted by the

Bank—six to UK-incorporated institutions and two to institutions incorporated overseas which wished to open branches in the United Kingdom.

New European authorised institutions

During 1995/96, five new EAIs became entitled to establish branches in the United Kingdom for the purpose of accepting deposits. Another two EAIs established branches not entitled to accept deposits in the United Kingdom. A further 16 EAIs became entitled to carry on, by the provision of cross-border services only, various listed activities.

TABLE IX

New authorisations under the Banking Act and new EAIs

Year to end-February	*1992*	*1993*	*1994*	*1995*	*1996*
Banking Act authorisations	25	26	5	6	8
New EAIs with UK branches entitled to accept deposits in the United Kingdom			5	5	5
Other new EAIs			32	13	18

Surrenders

In 1995/96, twelve authorisations were surrendered, compared with 16 in 1994/95. Of these, five followed group re-organisations and three occurred following take-overs. One institution surrendered after a change in its activities meant that authorisation was no longer required and two surrendered having wound down activities. The last, an overseas incorporated institution, surrendered in order to focus activities in its domestic 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 36 former authorised institutions as at the end of February 1996. 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 one former authorised institution in 1995/96 and directions previously issued remained in force over one other.

Five institutions ceased to be European authorised institutions 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 1995/96, 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 X

Revocations and restrictions[(a)]

Year to end-February	*1992*	*1993*	*1994*	*1995*	*1996*
Revocation of authorisation[(b)]	1	3	1	—	—
Restriction of authorisation	4	12	7	1	1
Revocation of restricted authorisation	—	2	—	—	—

(a) The table relates only 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.

(b) Including the expiry of a time-limited authorisation.

Appeals

No appeals were lodged against the Bank's decision to exercise its powers in 1995/96.

Administration orders and liquidations

No institutions were placed in administration in 1995/96; one institution continued in administration and one institution remained in provisional liquidation.

(ii) Supervision of the 'authorised population'

Interviews, meetings and visits

Some 3,600 meetings were held during 1995/96, a significant increase on the level in the previous year. The majority—over 2,500—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 focused on reports produced by the reporting accountants under section 39 of the Act. In 1995/96, there were 652 routine prudential interviews with UK authorised institutions and 347 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 assets 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; these 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 to three people. During the year, 113 full review team visits were carried out, along with a further 18 'special' visits.

The Bank's separate Traded Markets Team continued to visit banks to examine the models that banks may use when reporting foreign exchange risk under the CAD and when calculating the risks in derivatives portfolios before reporting under the standard CAD format. The visits involve a review of the operating environment as well as of the mathematics backing the models. Visits conducted to review the foreign exchange operations of institutions and assess them against the guidelines for foreign exchange position-taking set by the Bank are now usually combined with model review visits. Overall, such visits were undertaken to some 45 institutions during the year. In some instances, only one full-day visit was required, while in other instances a number of full-day and half-day visits were undertaken.

The review team 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.

Supervision staff regularly undertake visits to the head offices of foreign banks with branches in the United Kingdom, parent banks with UK-authorised subsidiaries and overseas offices of UK-incorporated institutions; they also engage in discussions with overseas supervisors. And Surveillance staff regularly undertake visits to overseas countries to assess the economic and regulatory environment through discussions with, for example, banks, exchanges, regulators and other relevant bodies. Supervision and Surveillance visits extended to 68 countries during 1995/96 and more than 200 meetings were held, at home and abroad, with overseas supervisors—a significant increase on previous years.

Use of powers to obtain information

Section 39 of the Banking 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 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 1995/96, 647 section 39 reports were commissioned (268 of them on branches of overseas banks), including 15 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. Two such reports were commissioned during 1995/96.

The Bank is able to use its investigatory powers under sections 39 and 41 of the Act in relation to European authorised institutions in order to carry out its limited functions under the 2BCD Regulations in relation to such institutions and to assist the relevant home state authority. The Bank used these powers in 1995/96 only to undertake routine examinations of the accuracy of statistical returns submitted to the Bank.

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. 54 notifications for new or increased control were received in 1994/95. 43 were passed without objection and two were withdrawn. Nine remained outstanding as at the end of February.

Representative offices of overseas institutions

In 1995/96, 33 overseas institutions notified the Bank of their intention to establish representative offices in the United Kingdom, and five institutions notified the Bank of their intention to change the name used by them in the United Kingdom. In no case did the Bank object 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.

Overseas institutions[1] are required under section 75 of the Banking Act 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. Overseas institutions that established representative offices before the Act 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 1995/96, eleven 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 173 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 48 of the proposed names would, or might be likely to, breach the Act.

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 market with seven discount houses authorised under the Banking Act. The gilt-edged market-maker HSBC Greenwell relinquished its status as a money-market dealing counterparty of the Bank with effect from 2 January.

In May, the Bank set out new arrangements for the supervision of the discount houses' capital adequacy based on the CAD. The new capital adequacy arrangements were finalised in September and were introduced on 2 January. The Bank has also introduced a new reporting system which allows the houses to fulfil their reporting obligations electronically. In addition, the Bank has continued to monitor the houses'

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

positions under, *inter alia*, the terms of the 2BCD and the Second Consolidated Supervision Directive. The Bank also monitored the houses' compliance with the terms of their exemption from the Solvency Ratio Directive until that exemption ended on 2 January.

In January, when the open gilt repo market was established, four discount houses merged their businesses with those of Stock Exchange Money Brokers (SEMBs). Three of these mergers were with a SEMB from the same group as the discount house. The merged houses' balance sheets were significantly expanded by the addition of the former SEMBs' stock-lending and money-market balances. It is anticipated that all of the houses' balance sheets will expand as the gilt repo market develops.

(iii) Prohibition on unauthorised deposit-taking

With increased manpower resources, the Bank has been able to respond more rapidly to potential cases of unauthorised deposit-taking referred to it and to investigate more cases simultaneously. During the year, 45 new cases were referred to the Bank and investigators were involved in investigating 72 separate cases.

In October, John William Alexander Dennison of Jackson & Co Financial Services pleaded guilty to offences under section 3 of the Act (unauthorised deposit-taking); he was sentenced to a total of two and a half years' imprisonment, reduced on appeal to twelve months, and disqualified from directorship for seven years. In November, Derek Robert Hartshorne, a director of Macmillan Stewart Securities plc, was convicted of one offence under section 35 of the Act (fraudulent inducement to make a deposit) and specimen counts under section 3. He was sentenced respectively to twelve months' and six months' concurrent terms of imprisonment; an appeal is pending. In December, Craig David Harris, trading as Wealthmaster and a director of Personal & Corporate Financial Planning (South East) Limited, pleaded guilty to two offences under section 35 of the Act and was sentenced in March to concurrent terms of imprisonment of twelve months and six months. In two further cases, the Bank successfully sought High Court injunctions, in one instance restraining various persons from breaches of section 35 of the Act, and in the other, restraining contraventions under sections 3 and 35 and also restricting the disposal of assets pending completion of the Bank's investigation.

In June, the Bank sought the appointment of provisional liquidators to a partnership which had been taking deposits contrary to the Act. It was subsequently wound up under section 92 of the Act on the Bank's petition, on the grounds that it was just and equitable to do so.

The Bank's powers under section 42 of the Act (requiring provision of relevant documents and information to investigators) were exercised in 24 cases with 93 individual notices being served.

The Bank passed one case concerning illegal deposit-taking to the Serious Fraud Office during the year; in due course, the Bank's investigators may be required to assist with any prosecution that ensues.

Part VI ORGANISATION AND STAFFING OF SUPERVISION AND SURVEILLANCE

The new arrangements for the Financial Stability Wing

During the year, the Bank announced changes to the structure of its Financial Stability Wing, which includes Supervision and Surveillance. In particular, the Division within Supervision and Surveillance that dealt specifically with banking supervisory policy issues merged with those working on broader regulatory policy subjects outside S&S, to form the Regulatory and Supervisory Policy Division. The new Division embraces both operational and analytical aspects of banking and financial regulation and reports jointly to the Deputy Directors for Supervision and Surveillance and Financial Structure. This change is intended to enhance the integration of analytical and operational work across the Wing as a whole. In addition, the Wholesale Markets Supervision Division now reports to the Deputy Director for Supervision and Surveillance, bringing all supervisory operations together in one part of the Wing.

Staff

Staff numbers at the end of February 1996, as shown in Table XI, showed an increase of 62 compared with a year earlier, accounted for by 23 extra Supervision and Surveillance staff and the inclusion of 39 staff formerly accounted for separately as the Wholesale Markets Supervision Division. For the year to end-February 1997, provision has been made for a total of 391 staff. The S&S staff establishment is maintained by staff moves within the Bank together with an annual graduate intake and recruitment of individuals with existing experience in commercial banking and other relevant areas.

Training of staff

The technical training programme for supervisors has continued and been revised and extended following a review of training needs by a firm of external consultants. Under the revised arrangements, a wider range of training is being delivered at an earlier stage to staff joining Supervision and Surveillance, with further training subsequently being delivered on a structured basis to cover specific areas such as capital markets, lending

TABLE XI

Allocation of Supervision and Surveillance staff

End-February	*1992*	*1993(a)*	*1994*	*1995(b)*	*1996(c)*
Senior Managers	32	30	29	41	52
Managers, Analysts and Assistants	147	146	152	199	235
Inward Secondees/ Review Team	10	10	11	10	10
Support Services (d)	—	—	57	72	87
Total	**189**	**186**	**249**	**322**	**384**

(a) Figures include 3 managers, 7 analysts and assistants, and 2 secondees who subsequently transferred to the Legal Unit or the Special Investigations Unit.
(b) Includes 42 Surveillance staff previously working in the Bank's former International Divisions.
(c) Includes 24 Wholesale Markets Supervision Division staff and 15 support staff.
(d) Until May 1993, support services staff were budgeted for centrally in the Bank.

	Staff		Institutions	
	1995	*1996*	*1995*	*1996*
Major UK banks division (a)	31	41	73	74
Medium & smaller UK institutions & enforcement (b)	47	45	75	69
Industrial world division (c)	56	65	252	271
Developing world division (d)	60	66	118	118
Wholesale markets supervision division	—	24	—	7(h)
Regulatory & supervisory policy division (e)	28	28	—	—
Support services	72	87	—	—
Central Services (f)	28	28	—	—
Total	**322**	**384**	**518(g)**	**539**

(a) Groups 3-5.
(b) Groups 6-10.
(c) Groups 11-15.
(d) Groups 16-20.
(e) Traded Markets Team, Banking Supervisory Policy Group and staff working for the Deposit Protection Board; Regulatory Policy Unit is excluded from this figure.
(f) Including IT and administration.
(g) Excluding the seven discount houses.
(h) Including the seven discount houses but excluding other, non Banking Act authorised, entities supervised by the division.

and fraud awareness. These further courses have been designed specifically for banking supervisors and are supported by relevant case studies and simulations. The first of these new courses were run last autumn for nearly 50 staff, and plans for others are in hand. Specialist courses are also in place for staff on the surveillance side and additionally graduate recruits also participate in a Bank-wide graduate training programme; an abbreviated version of this is provided for staff employed on short-term contracts.

Several staff have again been released on secondment. Overseas, staff are working in Hong Kong, the Cayman Islands, Gibraltar and at the European Commission. Within the United Kingdom, a limited number of short-term secondments to banks have enabled members of staff to gain first-hand experience of areas of finance, for example risk management in trading products such as derivatives.

Training provided by Supervision and Surveillance

In 1995/96, Supervision and Surveillance's provision of training for overseas supervisory authorities increased markedly, through courses held both in the Bank's Centre for Central Banking Studies and abroad. 14 courses (some of them multinational) were held in eleven countries. In contrast to previous years, when the majority related to the states of the former Soviet Union and the other formerly centrally planned economies, work in the year under review was much more evenly balanced between those and other countries.

Short visits from overseas supervisors seeking to familiarise themselves with the Bank's supervisory approach continued. In addition, there was an increase in the number of longer programmes although, overall, resource constraints meant that those remained few in number.

Information technology

The introduction in the spring of 1995 of a more powerful central processor, coupled with improvements to the local area network infrastructure, generally supported the expanded IT needs of Supervision and Surveillance during 1995/96. The changes enabled the completion of the project to provide each member of staff with a PC and also allow some flexibility for future expansion.

The transition to 'Windows'™ -based desktop software has continued. The introduction of new and revised statistical returns has necessitated a major upgrade to the software used for forms-processing and analysis. Work here is now focusing on provision of analysis software following the changes to liquidity reporting.

The Bank continues to investigate electronic document archiving and interrogation facilities. Product development in this area is extremely rapid and a project group is reviewing options about how best to take this forward. Supervision and Surveillance is currently reviewing IT-skills utilisation and training as part of the Arthur Andersen review.

APPENDIX 1

Supervision and Surveillance organogram

As at 29 February 1996

The Governors — **Board of Banking Supervision**

Brian Quinn
Executive Director
(Replaced by M D K W Foot w.e.f. 1 March 1996)

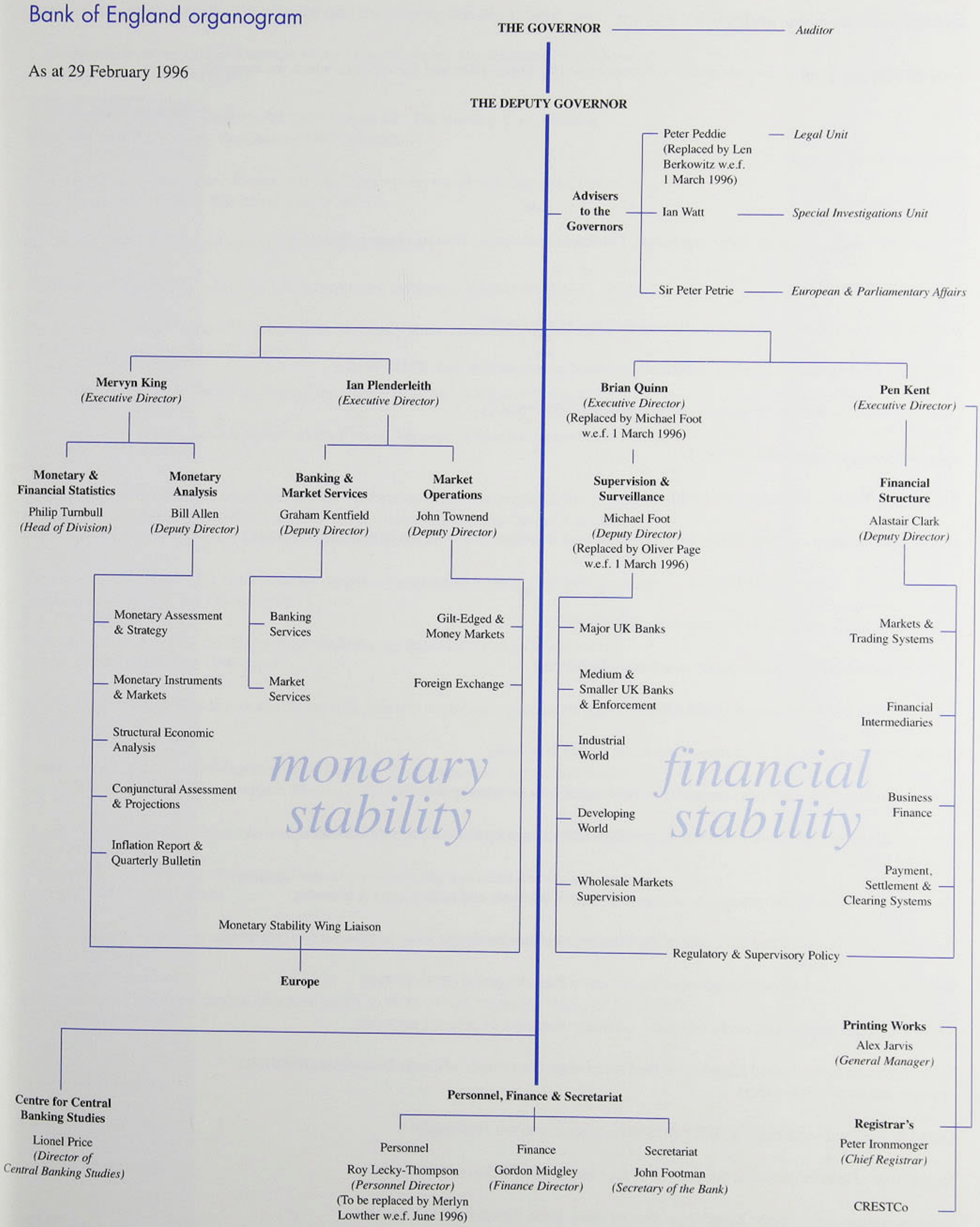
M D K W Foot
Deputy Director
(Replaced by O Page w.e.f. 1 March 1996)

- **P A C Smout (i)** *Head of Division Regulatory & Supervisory Policy*
  - A G Jennings *Senior Manager Group 1 Traded Markets Team*
  - R E Meads, J C W Osborn, J A Hoskins *Senior Managers Banking Supervisory Policy Group*
- **C F Sergeant** *Head of Division Major UK Retail & Merchant Banks*
  - A J V Giles *Senior Manager Group 3*
  - J Fischel *Senior Manager Group 3A*
  - R B Coates *Senior Manager Group 4*
  - A S Watson *Senior Manager Group 4A*
  - D J Strachan *Senior Manager Group 5*
  - K Ryan *Senior Manager Overview Group*
  - A Ghaffari *Review team*
- **W D R Swanney** *Head of Division Medium & Smaller UK Banks & Enforcement*
  - J E Moorhouse *Senior Manager Group 6*
  - D A Reeves *Senior Manager Group 7*
  - I M Cobbold *Senior Manager Group 9 (ii)*
  - P J Marr *Senior Manager Group 10 Enforcement*
  - C Armstrong, S Elsom, V Patel, S French *Review Team*
- **D W Green** *Head of Division Industrial World*
  - J Bulloch, A E Pack *Senior Managers*
  - D G Raikes *Senior Adviser Group 11 Europe A*
  - J G Ellis *Senior Manager*
  - P G Brierley *Senior Adviser Group 12 USA, Canada*
  - K S Pooley *Senior Manager*
  - C P T Wallis *Senior Adviser Group 14 Europe B*
  - R E P Diggory *Senior Manager*
  - P A D Wright *Senior Adviser Group 15 Japan*
  - E Bialkowska, E F Hill, C J Davies, R J Hands, P J Phelan *Review Team (iv)*
- **D J Reid** *Head of Division Developing World*
  - S J Bereza *Senior Manager*
  - E Young *Senior Adviser Group 16 Eastern Europe, and Eastern Mediterranean*
  - E M Ainley *Senior Manager*
  - L F T Smith *Senior Adviser Group 17 Middle East*
  - M J Fuggle *Senior Manager*
  - C M Miles *Senior Adviser Group 18 Far East Asia*
  - J W Milne *Senior Manager*
  - P C Hayward *Senior Adviser Group 19 Africa and Latin America*
  - C H Walsh *Senior Manager*
  - M J Stephenson *Senior Economist Group 20 Indian sub-continent and Australasia*
- **O Page** *Head of Division Wholesale Markets (Mr Page's successor to be announced)*
  - S J Drayson *Senior Manager Discount Houses*
  - A J Murfin *Senior Manager S43 listing, brokers, non-bank principals, banks*
  - D M Sutherland *Senior Manager Policy issues, SEMBs and IDBs*
  - S H King *Senior Manager GEMMs*
  - W Hyde *Senior Manager FX clearing houses*
- P W Filmer *Senior Manager Training & Development*
- G N Sagar *Senior Manager Information Technology*
- *Deposit Protection Board*
- R D Chalmers *Senior Manager Offshore Financial Centres (iii)*
- R J MacDonald, D A Ware *Senior Managers Technical Assistance*

(i) Reports jointly to the Deputy Director, Financial Structure.
(ii) Also Secretary, Deposit Protection Board.
(iii) Responsible also for centralised work on review teams.
(iv) Review team for Industrial World and Developing World Divisions.

Bank of England organogram

As at 29 February 1996



APPENDIX 2

Current supervisory notices

The following is a list of policy and practice notices issued by Supervision and Surveillance 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 BSD/1985/2)	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
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 Co-ordination (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
Subordinated loan capital issued by UK-incorporated authorised institutions (BSD/1994/3)	May 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
Implementation in the United Kingdom of the Capital Adequacy Directive (amendments to S&S/1995/2) (S&S/1995/4)	December 1995
Amendments to the Bank's notices on: (i) the verification of interim profits in the context of the Own Funds Directive (BSD/1992/5) and (ii) the implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3) (S&S/1995/5)	December 1995
Definition of marketable assets for liquidity purposes (amendment to July 1982 policy notice: 'Measurement of liquidity') (S&S/1996/1)	January 1996
Implementation in the United Kingdom of the Solvency Ratio Directive (S&S/1996/2) (further amendment to the 1990 paper)	March 1996
Netting of counterparty credit risk associated with sale and repurchase agreements and OTC derivatives (S&S/1996/3)	March 1996
Treatment of potential future exposure for off balance sheet contracts; implementation in the United Kingdom of the Solvency Ratio Directive (S&S/1996/4) (further amendments to the 1990 paper)	March 1996
The Bank of England's relationship with auditors and reporting accountants (S&S/1996/5)	April 1996
Guidance note on reporting accountants' reports on accounting and other records and internal control systems (S&S/1996/6)	April 1996
Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes (S&S/1996/7)	April 1996
Securitisation of revolving credits (amended annex to BSD/1989/1, replacing Part C of BSD/1992/3) (S&S/1996/8)	April 1996

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 1996.

Geographical origin of ownership	Branch of an overseas bank(1)	UK incorporated subsidiary of an overseas bank(1)	UK incorporated subsidiary of an overseas non-bank	Controlling (15% or more) stake in a consortium bank	Representative offices	Total
Afghanistan	–	1	–	–	–	1
Argentina	1	–	–	–	1	2
Australia	5	5	–	–	2	12
Austria	4	–	–	–	1	5
Bahamas	–	–	–	–	3	3
Bahrain	2	1	–	–	1	4
Bangladesh	1	–	–	–	1	2
Belgium	5	–	–	–	–	5
Bermuda	1	–	–	–	–	1
Brazil	4	–	–	–	6	10
Bulgaria	–	–	–	–	2	2
Canada	6	5	–	–	–	11
Cayman Islands	–	–	–	–	2	2
China	1	–	–	–	5	6
Colombia	–	–	–	–	1	1
Croatia	–	–	–	–	1	1
Cuba	–	1	–	–	–	1
Cyprus	1	3	–	–	–	4
Czech Republic	1	–	–	–	2	3
Denmark	4	–	–	–	–	4
Ecuador	–	–	–	–	1	1
Egypt	1	1	–	–	–	2
Finland	2	–	–	–	1	3
France	16	8	–	–	23	47
Germany	19	5	–	–	4	28
Ghana	1	–	–	–	–	1
Gibraltar	–	–	–	–	1	1
Greece	4	1	–	–	2	7
Hong Kong	4	2	–	–	1	7
Hungary	–	1	–	–	–	1
India	6	1	–	–	–	7
Indonesia	2	–	–	–	2	4
Iran	5	–	–	1	–	6
Iraq	1 (2)	–	–	–	–	1
Ireland	11	2	–	–	1	14
Israel	2	2	–	–	2	6
Italy	15	1	–	–	28	44
Jamaica	–	–	–	–	4	4
Japan	28	6	4	–	15	53
Jordan	1	–	–	1	–	2
Kenya	–	–	–	–	1	1
Kuwait	–	1	–	1	1	3
Lebanon	1	–	–	–	2	3
Libya	–	–	–	1	–	1
Luxembourg	2	–	–	–	3	5

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

Geographical origin of ownership	Branch of an overseas bank[1]	UK incorporated subsidiary of an overseas bank[1]	UK incorporated subsidiary of an overseas non-bank	Controlling (15% or more) stake in a consortium bank	Representative offices	Total
Former Yugoslav Republic of Macedonia	–	–	–	–	1	1
Malaysia	2	–	–	–	2	4
Malta	–	–	–	–	2	2
Mexico	5	1	–	–	3	9
Montenegro	–	–	–	–	1	1
Netherlands	8	1	–	–	–	9
New Zealand	–	–	–	–	2	2
Nigeria	2	–	–	–	1	3
Norway	2	–	–	–	–	2
Pakistan	4	–	–	–	2	6
Panama	–	–	–	–	1	1
Philippines	1	1	–	–	1	3
Poland	1	–	–	–	–	1
Portugal	4	–	–	–	1	5
Qatar	1	–	–	–	–	1
Romania	–	–	–	1	–	1
Russia	–	1	–	–	10	11
Saudi Arabia	4	2	–	1	2	9
Serbia	–	–	–	1	2	3
Singapore	4	–	–	–	–	4
Slovenia	–	–	–	–	2	2
South Africa	3	3	–	–	3	9
South Korea	8	3	–	–	7	18
Spain	9	1	–	–	5	15
Sri Lanka	1	–	–	–	–	1
Sweden	3	–	–	–	–	3
Switzerland	9	2	–	–	17	28
Taiwan	2	–	–	–	5	7
Thailand	3	–	–	–	1	4
Turkey	2	1	–	–	5	8
UAE	4	–	–	–	–	4
USA	23	9	4	2	11	49
Ukraine	–	–	–	–	1	1
Venezuela	–	–	–	–	1	1
Zambia	1	–	–	–	–	1
Totals	**263**	**72**	**8**	**9** (2)	**209**	**561** (3)
of which						
EEA countries (4)	108	19	–	–	69	196
Other Europe	14	8	–	2	47	71
North America	29	14	4	2	11	60
Japan	28	6	4	–	15	53
Australia & New Zealand	5	5	–	–	4	14
Other Asia	39	8	–	–	27	74
Middle East	22	7	–	5	8	42
Other	18	5	–	–	28	51

(1) Includes institutions authorised to conduct banking business in the country of origin.
(2) Representing 7 institutions.
(3) Representing 559 institutions.
(4) Other than the United Kingdom.

APPENDIX 4

LIST OF INSTITUTIONS AUTHORISED AS AT 29 FEBRUARY 1996

This list is made available pursuant to section 17(2) of the Banking Act 1987 as amended by The Banking Co-ordination (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.

European authorised institutions are institutions which are recognised under The Banking Co-ordination (Second Council Directive) Regulations 1992. The European authorised institutions included in the list are those in respect of which the Bank of England has received a notification from the relevant supervisory authority in the home State—i.e. the country in the European Economic Area in which they are incorporated or formed—entitling them to establish a branch or provide services on a cross border basis in the United Kingdom. European authorised institutions are authorised by the relevant home State supervisory authority. They are not authorised by the Bank of England.

1 Institutions authorised or entitled to accept deposits in the United Kingdom

(i) UK-incorporated institutions authorised by the Bank of England(1)

The following UK-incorporated institutions are authorised by the Bank of England under the Banking Act 1987 to accept deposits in the United Kingdom. Qualifying deposits in sterling, Ecu or other EEA currencies made with these institutions in the United Kingdom or other EEA countries are covered by the UK Deposit Protection Scheme.(2)

ABC International Bank plc
ANZ Grindlays Bank plc
AY Bank Ltd(3)
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(3)
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
Bankgesellschaft Berlin (UK) 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
Bishopscourt (BB & Co) Ltd (in administration)
The British Bank of the Middle East
The British Linen Bank Ltd
British Railways Savings Company Ltd
Brown, Shipley & Co Ltd

CIBC Wood Gundy plc
CLF Municipal Bank plc
Cafcash Ltd
Caledonian Bank plc
Cater Allen Ltd
Central Hispano Bank (UK) Ltd
Chartered Trust plc
Charterhouse Bank Ltd
Chase Investment Bank Ltd
Chemical Investment Bank Ltd
Citibank International plc
Clive Discount Company Ltd
Close Brothers Ltd
Clydesdale Bank plc
Consolidated Credits Bank Ltd
The Co-operative Bank plc
County NatWest Ltd
Coutts & Co
Crédit Agricole Lazard Financial Products Bank
Credit Suisse Financial Products
Cyprus Credit Bank (UK) Ltd

Daiwa Europe Bank plc
Dalbeattie Finance Co Ltd
Dao Heng Bank (London) plc
Davenham Trust plc
Direct Line Financial Services Ltd
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

(1) Including partnerships formed under the law of any part of the United Kingdom.
(2) Cover is limited to 90% of a depositor's total qualifying deposits subject to a maximum payment to any one depositor of £18,000 (or ECU 22,222 if greater).
(3) Consortium banks.

Forward Trust Personal Finance Ltd
Frizzell Bank Ltd

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

HFC Bank plc
HSBC Investment Bank Ltd
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(1)
Italian International Bank plc

Jordan International Bank plc(1)
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

PaineWebber International Bank Ltd
Pointon York Ltd
The Private Bank & Trust 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)(1)
Schroder Leasing Ltd
J Henry Schroder & 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

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

UBAF Bank Ltd(1)
UCB Bank plc
Ulster Bank Ltd
Union Discount Company Ltd
The United Bank of Kuwait plc(1)
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
Wintrust Securities Ltd
Woodchester Credit Lyonnais plc

Yamaichi Bank (UK) plc
Yorkshire Bank plc

(1) Consortium banks.

(ii) Institutions incorporated outside the European Economic Area authorised by the Bank of England

The following institutions incorporated outside the EEA are authorised by the Bank of England under the Banking Act 1987 to accept deposits in the United Kingdom. Qualifying deposits in sterling, Ecu or other EEA currencies made with the UK offices of these institutions are covered by the UK Deposit Protection Scheme.[1]

ABSA Bank Ltd
Allied Bank of Pakistan Ltd
American Express Bank Ltd(2)
Arab African International Bank
Arab Bank plc
Arab Banking Corporation BSC
Arab National Bank
The Asahi Bank, Ltd(2)
The Ashikaga Bank Ltd(2)
Australia & New Zealand Banking Group Ltd(2)

BSI-Banca della Svizzera Italiana(2)
Banca Serfin SA
Banco de la Nación Argentina
Banco do Brasil SA
Banco do Estado de São Paulo SA
Banco Inverlat 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(2)
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(2)
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(2)
Bank of India
Bank of Montreal(2)
The Bank of New York(2)
The Bank of Nova Scotia(2)
The Bank of Tokyo, Ltd(2)
The Bank of Yokohama, Ltd(2)
Bank Saderat Iran
Bank Sepah-Iran
Bank Tejarat
Bank von Ernst & Co Ltd(2)
Bankers Trust Company(2)
Beirut Riyad Bank SAL

Canadian Imperial Bank of Commerce(2)
Canara Bank
Chang Hwa Commercial Bank Ltd
The Chase Manhattan Bank, NA(2)
Chemical Bank(2)
The Chiba Bank Ltd(2)
Cho Hung Bank
The Chuo Trust & Banking Co, Ltd(2)
Citibank NA(2)
Commercial Bank of Korea Ltd
Commonwealth Bank of Australia(2)
CoreStates Bank NA(2)
Crédit Suisse(2)
The Cyprus Popular Bank Ltd

The Dai-Ichi Kangyo Bank, Ltd(2)
The Daiwa Bank, Ltd(2)
The Development Bank of Singapore Ltd
Discount Bank and Trust Company(2)

Emirates Bank International Ltd

First Bank of Nigeria plc
First Commercial Bank
The First National Bank of Boston(2)
The First National Bank of Chicago(2)
First Union National Bank
Fleet Bank of Massachusetts, NA(2)
French Bank of Southern Africa Ltd
The Fuji Bank, Ltd(2)
Ghana Commercial Bank
Gulf International Bank BSC
Habib Bank AG Zurich(2)
Habib Bank Ltd
Hanil Bank
Harris Trust and Savings Bank(2)
The Hiroshima Bank, Ltd(2)
The Hokkaido Takushoku Bank, Ltd(2)
The Hokuriku Bank Ltd(2)
The Hongkong and Shanghai Banking Corporation Ltd

The Industrial Bank of Japan, Ltd(2)

The Joyo Bank Ltd(2)

KorAm Bank
Korea Exchange Bank
Korea First Bank

The Long-Term Credit Bank of Japan, Ltd(2)

Macquarie Bank Ltd
Malayan Banking Berhad
MashreqBank PSC
Mellon Bank, NA(2)
Merchants National Bank & Trust Company of Indianapolis (National City Bank, Indiana(2)
The Mitsubishi Bank, Ltd(2)
The Mitsubishi Trust and Banking Corporation(2)
The Mitsui Trust & Banking Co Ltd(2)
Morgan Guaranty Trust Company of New York(2)

NBD Bank(2)
Nacional Financiera SNC
National Australia Bank Ltd(2)
National Bank of Abu Dhabi
National Bank of Canada(2)
The National Bank of Dubai Public Joint Stock Company
National Bank of Pakistan
NationsBank, NA(2)
Nedcor Bank Ltd
The Nippon Credit Bank, Ltd(2)
The Norinchukin Bank(2)
The Northern Trust Company(2)

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

People's Bank
Philippine National Bank

Qatar National Bank SAQ

Rafidain Bank (provisional liquidator appointed)
Republic National Bank of New York(2)
The Riggs National Bank of Washington, DC(2)
Riyad Bank
Royal Bank of Canada(2)

The Sakura Bank, Ltd(2)
The Sanwa Bank, Ltd(2)
Saudi American Bank
The Saudi British Bank
SEOULBANK
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(2)
The Sumitomo Bank, Ltd(2)
The Sumitomo Trust & Banking Co Ltd(2)
Swiss Bank Corporation(2)
Syndicate Bank

(1) Cover is limited to 90% of a depositor's total qualifying deposits subject to a maximum payment to any one depositor of £18,000 (or ECU 22,222 if greater).
(2) Non-EEA OECD institutions.

TC Ziraat Bankasi(1)
The Thai Farmers Bank Public Company Ltd
The Tokai Bank, Ltd(1)
The Toronto-Dominion Bank(1)
The Toyo Trust & Banking Company, Ltd(1)
Türkiye Is Bankasi AS(1)

Uco Bank
Union Bancaire Privée, CBI-TDB(1)
Union Bank of Nigeria plc

Union Bank of Switzerland(1)
United Bank Ltd
United Mizrahi Bank Ltd
United Overseas Bank Ltd(1)

Westpac Banking Corporation(1)

The Yasuda Trust & Banking Co, Ltd(1)

Zambia National Commercial Bank Ltd
Zivnostenská Banka AS

(iii) European authorised institutions entitled to establish UK branches

The following European authorised institutions are entitled to establish branches in the United Kingdom for the purpose of accepting deposits in the United Kingdom. Qualifying deposits made with the UK offices of these institutions are covered by the deposit protection scheme established in the institution's home State.(2) Such institutions have the right to join the UK scheme to supplement the cover available from their home State scheme if that is less generous than the UK scheme.

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
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 Monte dei Paschi di Siena SpA	Italy
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 Portugês 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

(1) Non-EEA OECD institutions.
(2) The level and/or scope of the cover provided by the home State scheme for deposits with UK offices may not be greater than is available under the UK scheme.

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
Creditanstalt - Bankverein	Austria
Credito Italiano	Italy
De Nationale Investeringsbank NV	Netherlands
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
Generale Bank Nederland NV	Netherlands
GiroCredit Bank Aktiengesellschaft der Sparkassen	Austria
Hamburgische Landesbank Girozentrale	Germany
ICC Bank plc	Republic of Ireland
ICS Building Society	Republic of Ireland
ING Bank NV	Netherlands
Indosuez Carr Futures SNC	France
Industrial Bank of Korea Europe SA	Luxembourg
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
Kas-Associatie NV	Netherlands
Kredietbank NV	Belgium
Landesbank Berlin Girozentrale	Germany
Landesbank Hessen-Thüringen Girozentrale	Germany
MeesPierson NV	Netherlands
Merita Bank Ltd	Finland
National Bank of Greece SA	Greece
Norddeutsche Landesbank Girozentrale	Germany
Postipankki Ltd	Finland
Rabobank (Coöperatieve Centrale Raiffeisen-Boerenleenbank BA)	Netherlands
Raiffeisen Zentralbank Osterreich AG	Austria
Skandinaviska Enskilda Banken AB (publ)	Sweden
Société Générale	France
Südwestdeutsche Landesbank Girozentrale	Germany
Svenska Handelsbanken AB (publ)	Sweden
SwedBank (Sparbanken Sverige AB (publ))	Sweden
Triodosbank NV	Netherlands
Ulster Investment Bank Ltd	Republic of Ireland
Unibank A/S	Denmark
Westdeutsche Landesbank Girozentrale	Germany

2 European authorised institutions entitled to accept deposits in the United Kingdom without establishing a branch in the United Kingdom

A European authorised institution may be entitled to accept deposits in the United Kingdom without establishing a branch in the United Kingdom (i.e. by the provision of services on a cross border basis). Where an institution's name appears in this section and in section 1(iii) of this list that 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. Qualifying deposits with these institutions are covered by the deposit protection scheme in the institution's home State.

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
Bankgesellschaft-Berlin (Ireland) plc	Republic of Ireland
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 Générale du Luxembourg SA	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 Financière de CIC et de L'Union Européenne	France
Cortal Bank	Luxembourg
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
Deutsche Siedlungs- und Landesrentenbank	Germany
Dornbirner Sparkasse	Austria
Finansbank (Holland) NV	Netherlands
ING Bank NV	Netherlands
Irish Permanent plc	Republic of Ireland
Kredietbank SA Luxembourgeoise	Luxembourg
Nordbanken AB (publ)	Sweden
Prudential-Bache International Bank SA	Luxembourg
Robeco Bank (Luxembourg) SA	Luxembourg
SNVB Financements	France
Société Européenne de Banque	Luxembourg
Société Nancienne Varin-Bernier	France
Sparekassen Bikuben A/S(1)	Denmark
Sydbank Luxembourg SA	Luxembourg

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 activities other than the acceptance of deposits.(1)

(i) 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
Schröder Münchmeyer Hengst & Co	Germany
Transoptions Finance	France
Westdeutsche ImmobilienBank	Germany

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

Name of institution	Country of home state supervisory authority
Bank of America SA	Spain
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
Deutsche Schiffsbank AG	Germany
Europäische Hypothekenbank SA	Luxembourg
European Mortgage Bank (Ireland) Ltd	Republic of Ireland
FGH Bank NV	Netherlands
Frankfurter Hypothekenbank AG	Germany
Hypothekenbank in Hamburg AG	Germany
Incentive Credit AB	Sweden
Realkredit Danmark A/S	Denmark
Republic National Bank of New York (Luxembourg) SA	Luxembourg
Rheinboden Hypothekenbank AG	Germany
Rheinische Hypothekenbank AG	Germany
Salzburger Landeshypothekenbank AG	Austria
Württembergische Hypothekenbank AG	Germany

(1) I.e. one or more of the activities listed in Schedule 1 to The Banking Co-ordination (Second Council Directive) Regulations 1992.

CHANGES TO THE LIST OF INSTITUTIONS

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

1 Institutions authorised or entitled to accept deposits in the United Kingdom

(i) UK-incorporated institutions authorised by the Bank of England

Additions

Bankgesellschaft Berlin (UK) plc
Baring Brothers Ltd
Cheltenham & Gloucester plc
Crédit Agricole Lazard Financial Products Bank
Cyprus Credit Bank (UK) Ltd
Direct Line Financial Services Ltd

Deletions

City Trust Ltd
Commercial Bank Trust plc
County NatWest Ltd
Mercury Provident plc
Nykredit Mortgage Bank plc
Omega Trust Co Ltd
Ralli Investment Company Ltd
Svenska International plc
Tyndall Bank plc
Wimbledon & South West Finance plc (in administration)

Name changes

Baring Brothers & Co Ltd (in administration) to Bishopscourt (BB & Co) Ltd (in administration)
CIBC Bank plc to CIBC Wood Gundy plc
The Charities Aid Foundation Money Management Company Ltd to Cafcash Ltd
Goldman Sachs Ltd to Goldman Sachs International Bank
J Henry Schroder Wagg & Co Ltd to J Henry Schroder & Co Ltd
Tokai Bank Europe Ltd to Tokai Bank Europe plc

(ii) Institutions incorporated outside the EEA authorised by the Bank of England

Additions

People's Bank
KorAm Bank

Deletions

Bank of America Illinois
Cyprus Credit Bank Ltd

Name changes

Bank of Seoul to SEOULBANK
Emirates Bank International Ltd to Emirates Bank International PJSC
First Fidelity Bank, NA to First Union National Bank
Multibanco Comermex SA to Banco Inverlat SA
NationsBank NA (Carolinas) to NationsBank NA

(iii) European authorised institutions entitled to establish UK branches

Name of institution	Country of home state supervisory authority
Additions	
Banca Monte dei Paschi di Siena SpA	Italy
De Nationale Investeringsbank NV	Netherlands

ICC Bank plc	Republic of Ireland
Industrial Bank of Korea Europe SA	Luxembourg
Triodosbank NV	Netherlands

Deletions

ASLK-CGER Bank NV SA	Belgium
Kansallis-Osake-Pankki	Finland
Monte dei Paschi di Siena	Italy
Nordbanken AB (publ)	Sweden

Name changes

Crédit Lyonnais Bank Nederland NV to Generale Bank Nederland NV	Netherlands
Internationale Nederlanden Bank NV to ING Bank NV	Netherlands
Nordbanken to Nordbanken AB (publ)	Sweden
Skandinaviska Enskilda Banken to Skandinaviska Enskilda Banken AB (publ)	Sweden
Svenska Handelsbanken to Svenska Handelsbanken AB (publ)	Sweden
Union Bank of Finland Ltd to Merita Bank Ltd	Finland

2 European authorised institutions entitled to accept deposits in the United Kingdom without establishing a branch in the United Kingdom

Name of institution	Country of home state supervisory authority
Additions	
Bankgesellschaft-Berlin (Ireland) plc	Republic of Ireland
Banque Général du Luxembourg SA	Luxembourg
Cortal Bank	Luxembourg
Deutsche Siedlungs-und Landesrentenbank	Germany
Dornbirner Sparkasse	Austria
Kredietbank SA Luxembourgoise	Luxembourg
Nordbanken AB (publ)	Sweden
Société Européenne de Banque	Luxembourg
Deletion	
Compagnie du Crédit Universel	France

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

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

Additions

Schröder Münchmeyer Hengst & Co	Germany
Westdeutsche ImmobilienBank	Germany

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

Additions

Bank of America SA	Spain
Deutsche Schiffsbank AG	Germany
European Mortgage Bank (Ireland) Ltd	Republic of Ireland
FGH Bank NV	Netherlands
Incentive Credit AB	Sweden
Republic National Bank of New York (Luxembourg) SA	Luxembourg
Salzburger Landeshypothekenbank AG	Austria
Württembergische Hypothekenbank AG	Germany

APPENDIX 5

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.***

Name of institution	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
Alfa Bank	Russia
Al-Rajhi Investment Corporation Ltd	Saudi Arabia
Arab Bangladesh Bank Ltd	Bangladesh
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 Toscana SpA	Italy
Banco Bamerindus do Brasil SA	Brazil
Banco Bandeirantes SA	Brazil
Banco Bradesco SA	Brazil
Banco de Crédito Nacional SA	Brazil
Banco del Pacifico Group (also representing:	
Banco del Pacifico SA	Colombia
Banco del Pacifico SA	Ecuador
Banco del Pacifico (Panama) SA	Panama
Pacific National Bank)	USA
Banco di Sardegna SpA	Italy
Banco Economico SA	Brazil
Banco Gallego SA	Spain
Banco Internacional SA	Mexico
Banco Mercantil CA SACA	Venezuela
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 Santander Guernsey Ltd	Guernsey
Banco Urquijo	Spain
PT Bank Bumi Daya (Persero)	Indonesia
Bank Indonesia	Indonesia
Bank Morgan Stanley AG	Switzerland
Bank Negara Malaysia	Malaysia
Bank of Bermuda (also representing:	
Bank of Bermuda (Cayman) Ltd	Cayman Is
Bank of Bermuda (Luxembourg) SA	Luxembourg
Bank of Bermuda (Guernsey) Ltd	Guernsey
Bank of Bermuda (Isle of Man) Ltd	Isle of Man
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 Ltd	Australia
Bank Sarasin & Cie	Switzerland
Banpais SA	Mexico
Banque Arjil & Compagnie	France
Banque Internationale de Commerce	France
Banque Multi Commerciale	Switzerland
Banque Privée Edmond de Rothschild	Switzerland
Banque Scandinave en Suisse	Switzerland
Banque Transatlantique SA	France
Banque Transatlantique (Jersey) Ltd	France
Banque Woolwich SA	France
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
BULBANK (Bulgarian Foreign Trade Bank) Ltd	Bulgaria

CIC Banks (representing:	
Banque Bonnasse	France
Banque CIAL	France
Banque CIN	France
Banque CIO	France
Banque Régionale de l'Ain	France
Banque Régionale de l'Ouest	France
Banque Scalbert Dupont	France
Banque SNVB	France
CIC Paris	France
Lyonnaise de Banque	France
Société Bordelaise	France
Union Européenne de CIC)	France
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
The Central Bank of China, Taipei	Taiwan
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 of Greece	Greece
Commercial Bank "Stroyinvest"	Russia
Compagnie Bancaire	France
Comptoir des Entrepreneurs	France
Crédit Foncier de France SA	France
Crédit National	France
Credo Bank	Russia
The Derbyshire (Isle of Man) Ltd	Isle of Man
Deutsche Pfandbrief-und Hypothekenbank AG	Germany
Deutsche Schiffsbank AG	Germany
Donghwa Bank	South Korea
East-West Investment Bank	Russia
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
The 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
First International Merchant Bank	Malta
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
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	
Banca Popolare di Lodi	
Banca Popolare di Sondrio	
Banca Popolare di Verona	
Banca Popolare Veneta	
Banca Popolare Vicentina)	
The Hachijuni Bank	Japan
Halifax International (Isle of Man) Ltd	Isle of Man
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
The Industrial and Commercial Bank of China	China
Industrial Bank of Korea	South Korea
Inkombank	Russia
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	Federal Republic of Yugoslavia
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
The Korea Development Bank	South Korea
Korea Housing Bank	South Korea
Kredietbank SA Luxembourgeoise	Luxembourg
Landesbank Schleswig-Holstein Girozentrale	Germany
Litex Bank SAL	Lebanon
Maritime Joint Stock Bank	Russia
Merrill Lynch Bank (Suisse) SA	Switzerland
Metropolitan Bank and Trust Company	Philippines
Mid-Med Bank Ltd	Malta
Montenegro Banka DD Podgorica	Federal Republic of Yugoslavia
Morval & Cie SA, Banque	Switzerland
Most-Bank	Russia
Muslim Commercial Bank Ltd	Pakistan
N & P Overseas Ltd	Isle of Man
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
NatWest Bank NA	USA
The Navy Federal Credit Union	USA
Northern Rock (Guernsey) Ltd	Guernsey
Nova Ljubljanska Banka DD	Slovenia
Oryx Merchant Bank Ltd	Cayman Island
Osmanli Bankasi AS	Turkey
Osuuspankkien Keskuspankki Oy (Okobank)	Finland
Parva Chastna Banka AD	Bulgaria
People's Bank of China	China
The People's Construction Bank of China (now called China Construction Bank)	China
Pramex Britannica Ltd (representing: Caisse Centrale des Banques Populaires)	France
Privredna Banka Zagreb DD	Croatia
Promstroybank	Russia
Republic National Bank of New York (Suisse) SA	USA
Reserve Bank of Australia	Australia
Robeco UK Ltd (representing: Banque Robeco (Suisse) SA)	Switzerland
Rossiyskiy Kredit Bank	Russia
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 (IOM) Ltd	Isle of Man
The Royal Bank of Scotland (Jersey) Ltd	Jersey
The Royal Bank of Scotland (Nassau) Ltd	Bahamas
SE Banken Luxembourg SA	Luxembourg
SKB Banka DD	Slovenia
The 77 Bank Ltd	Japan
The Shoko Chukin Bank	Japan
Skipton Guernsey Ltd	Guernsey
Standard Bank of South Africa Ltd	South Africa

Stopanska Banka AD	Former Yugoslav Republic of Macedonia
Swiss Cantobank (International)	Switzerland
TaipeiBank	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 Malayan Banking Corporation Berhad	Malaysia
United Overseas Bank, Geneva	Switzerland
Victoria Mutual Finance Ltd (representing Victoria Mutual Building Society)	Jamaica
Vojvodjanska Banka DD	Federal Republic of Yugoslavia
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
Workers Savings and Loan Bank	Jamaica
Yapi ve Kredi Bankasi AS	Turkey
Yorkshire Guernsey Ltd	Guernsey
The Zenshinren Bank	Japan

ANNUAL REPORT BY THE BOARD OF BANKING SUPERVISION

Membership as at 29 February 1996

Chairman:	E A J George	ex-officio
	H Davies	ex-officio
	B Quinn	ex-officio
	Jon Foulds	
	Peter Gerrard CBE	
	Sir Alan Hardcastle	
	Lord Swaythling	
	Harry Taylor	
	Sir Dennis Weatherstone KBE	

This is the Board's report for the year to 29 February 1996.

Membership

Mr Peter Gerrard was reappointed to the Board with effect from 1 October 1995 for a five year term. On 22 March 1995, Mr Rupert Pennant-Rea resigned as Deputy Governor of the Bank and as an ex-officio member of the Board. Mr Howard Davies was appointed Deputy Governor and as an ex-officio member of the Board with effect from 11 September 1995. Mr Brian Quinn retired as Executive Director responsible for Banking Supervision and as an ex-officio member of the Board on 29 February 1996.

Meetings

The Board usually meets monthly to carry out its normal business. (See below for the conduct of the Inquiry into the collapse of Barings.)

In consultation with the Board, Supervision & Surveillance prepares a six month forward agenda of items to be discussed. At each meeting, the Board considers papers prepared by Supervision & Surveillance setting out matters both of general supervisory policy and relating to specific institutions. Some matters are discussed at the instigation of the Board, whilst others are reported by Supervision & Surveillance either seeking advice on specific issues or for the Board's information. 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.

During the course of the year, the Board met twice with the Bank's Court of Directors to discuss supervisory matters.

Matters Considered

The Board maintained under its 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 implementation of the Capital Adequacy Directive, the Deposit Guarantee Directive and the Investment Services Directive, as well as issues arising from amendments to the Basle Capital Accord to cover market risks and the Basle agreement to net counterparty risk arising from repo/reverse repo and OTC derivatives. In addition, the Board considered proposed developments in Supervision & Surveillance's policy on the securitisation of revolving credits (such as credit cards), as well as reviewing various papers relating to implementation of the post-Barings recommendations, including the framework for consolidated supervision, regulatory co-operation and proposals for the quality assurance function.

With regard to operational matters, in addition to receiving reports on specific institutions and matters of concern to Supervision & Surveillance, the Board reviewed papers on the regulatory burden on the small banking sector; the treatment of building societies converting to banking status; developments in electronic money; and regular reports on offshore banking centres.

Regular reports from the Special Investigations Unit were reviewed by the Board, as were reports on the work of Supervision & Surveillance's Enforcement Group (dealing with the instances of illegal deposit taking). Further details on some of the matters considered during the year are provided in the main body of the Banking Act Report.

Inquiry into the Collapse of Barings

On 2 March 1995, at the instigation of the Chancellor of the Exchequer, the Board commenced its Inquiry into the events that led to the collapse of Barings, with the following aims: to establish in detail the events that led to the collapse; to reach any immediately applicable conclusions; 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 duly conducted its investigation with the assistance of the Bank's Special Investigations Unit and lawyers, accountants and derivatives experts drawn from outside the Bank. Where the investigation concerned the supervision of Barings by the Bank and other regulators, it was conducted on behalf of the independent members of the Board only and the views expressed were theirs alone. Members of the investigation team held meetings and discussions with directors and employees of the Barings Group, and with representatives of regulators, supervisors and others both in the United Kingdom and elsewhere and obtained documentation from those sources. Interviews were conducted in London and Tokyo with Barings Group directors and employees past and present, the auditors of Barings plc and employees of the Bank and the SFA. The Inquiry was not able to speak to Mr Nick Leeson, formerly General Manager and Head Trader of Baring Futures (Singapore) Pte Limited ("BFS"), the Singapore subsidiary in which the losses were incurred. The Board was unable to get full access to information in Singapore or to conduct formal interviews with BFS's management, employees and staff or to interview BFS's auditors.

The Board's report was provided to the Chancellor on 13 July 1995 and published by order of the House of Commons on 18 July. It concluded, in summary, that:

(a) the losses were incurred by reason of unauthorised and concealed trading activities within BFS;

(b) the true position was not noticed earlier by reason of a serious failure of controls and managerial confusion within Barings; and

(c) the true position had not been detected by the external auditors, supervisors or regulators of Barings prior to the collapse.

In September, subsequent to publication of the Board's report, a report was published by inspectors appointed by the Singaporean Minister of Finance to investigate the affairs of BFS. On 1 December, Mr Leeson pleaded guilty in a Singapore court to two offences of deceiving the auditors of Barings and to cheating the Singapore International Monetary Exchange. He was sentenced to six and a half years' imprisonment.

The Board's report into the collapse of Barings identified 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.

Some of the key recommendations for the Bank are outlined below:

- Extending consolidated supervision: the Board recommended that the Bank should seek to understand better the significant risks in a group containing an authorised bank including, in particular, how these risks are managed and controlled.

- Developing regulatory co-operation: the Board recommended that the Bank should strengthen supervisory co-operation, signing Memoranda of Understanding with other regulators both in the United Kingdom and overseas where possible.

- Quality Assurance: the Board recommended the introduction of an independent quality assurance review of the Bank's supervision of banks.

Further details on the Report's recommendations are provided in the main body of the Banking Act Report.

VRangasamy

Secretary,
by Order of the Board