BANK *of* ENGLAND

BANKING ACT REPORT

1996/97

BANKING ACT 1987

ANNUAL REPORT UNDER THE BANKING ACT FOR 1996/97

This Report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 28 February 1997 is presented to the Chancellor of the Exchequer, and by him to Parliament, pursuant to section 1(3) of the Act.

CONTENTS

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 work undertaken following the Bank's Review of Supervision.

Part II outlines the macroeconomic environment in which banks operated during 1996/97, and Part III describes the year's market developments. Part IV summarises policy developments, and Part V gives a description of developments in the legal framework and operational supervision. Part VI reviews the organisation and staffing of Supervision and Surveillance.

1996/97

Part I PRINCIPAL DEVELOPMENTS AND PRIORITIES

THE BANK'S REVIEW OF SUPERVISION

Last year's *Banking Act Report* noted that the Bank had appointed Arthur Andersen to review the appropriateness and effectiveness of the operations of Supervision and Surveillance[1], within the current legislative framework. They were to make recommendations to improve its methods, organisation, structure and staffing. They were also to design and test a Quality Assurance system, the establishment of which had been one of the main recommendations arising from the Board of Banking Supervision's inquiry into the collapse of Barings.

Arthur Andersen's Report was published in July 1996. It concluded that the Bank's supervisory style, where supervisors exercise informed judgements within approved standards and guidelines, should be maintained. However, the Report recommended that:

- the standards and processes of supervision should be linked more explicitly to the objectives of supervision and that the objectives should be promulgated more widely to ensure appropriate internal focus and to promote a better understanding among banks and the public at large;
- a more systematic approach to the supervisory process should be established, including a formal risk assessment of each bank;
- the effectiveness of the existing supervisory tools should be enhanced, in particular the use of prudential information and section 39 (Reporting Accountants') reports;
- more effective use of information technology should be made to capture, manage, analyse and present the wide range of supervisory information;
- the experience and skills of S&S staff should be upgraded through, among other things, increased training based on a core curriculum and the recruitment of more staff with specialist knowledge and skills.

To implement the recommendations, Arthur Andersen considered that a significant increase in the number of staff would be required, with additional expenditure on IT and training.

The Bank concluded that it would take forward all the proposals contained in the Report and established a change management programme to develop and implement the recommendations. The objective is to create an environment in which continuous change is the norm (reflecting reality in the banking system itself), where specialist skills and support facilities are further developed and where supervision is focused on what are identified as the main risks. The programme is designed to enable the Bank to respond to the growing complexity of the banking industry and to meet its aim to be at the leading edge of global best practice in banking supervision. Throughout, the Bank has sought to liaise with the British Bankers' Association (BBA) so that industry thinking can be included, wherever possible, in the development of risk based supervision.

In the period since the launch of its change programme, the bank has made significant progress in implementing the recommendations of the review[2]:

- **Risk based supervision:** A consultative paper on the introduction of a new risk based framework of supervision for UK incorporated institutions (the RATE approach) was issued just before Easter. The paper proposes a revision of the Bank's current supervisory approach to provide for more consistent and better identification of risks in institutions or their wider groups. RATE also seeks to ensure that supervisory action is focused on the main risks and uses the most appropriate tools to deal with those risks. This approach is designed to underpin the flexibility and the application of judgement by individual supervisors which is recognised as a strength of the current arrangements.

(1) The review did not cover the Surveillance function, the Enforcement area, which investigates and prosecutes illegal deposit-taking, or the Deposit Protection Board.
(2) The documents referred to in this section may be obtained by contacting Public Enquiries Group, Bank of England, London, EC2R 8AH.

RISK BASED SUPERVISION

During the review of supervision, Arthur Andersen developed the outline of a risk based approach to supervision, characterised as the 'RATE model'. RATE is an acronym for the three stages of the process: Risk Assessment, Tools of Supervision and Evaluation. The Bank has drawn on this work to develop its proposed approach to risk based supervision, which is summarised here.

The proposed approach introduces the concept of a supervisory period, which is the length of time between undertaking formal risk assessments on a particular bank. This period will usually be a year, but may vary according to the risk profile of the bank concerned, from six months for a bank whose risk profile is classified as very high or for a bank undergoing major change; up to two years, or possibly longer, for a bank whose risk profile is low and whose business and control framework is stable. In each supervisory period, the Bank will perform a risk assessment, take appropriate supervisory action, apply the tools of supervision and undertake a formal evaluation.

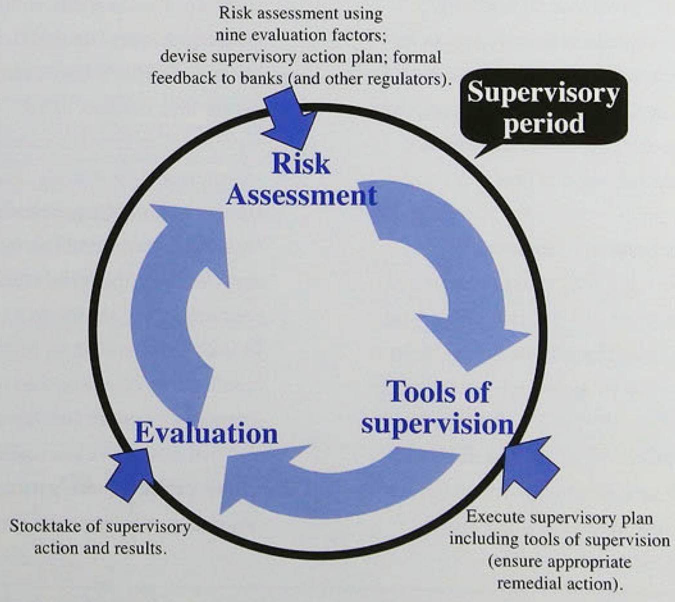
The Bank will undertake the risk assessment using nine evaluation factors (six quantitative—Capital, Assets, Market Risk, Earnings, Liabilities, Business; and three qualitative—Controls, Organisation and Management).

The objective will be to identify the business or inherent risks of a bank and to assess the adequacy and effectiveness of its controls, organisation and management in a systematic manner.

The Bank will also include in its risk assessment control functions, such as internal audit and risk management departments, and other areas of support, including IT and human resource departments.

Where the Bank identifies significant concerns, either from the risk assessment or at any time during the supervisory period, it will seek appropriate remedial action. In addition, after each risk assessment, the Bank will feed back its views on the bank's risk profile to the bank's Board of Directors. The Bank will also outline any remedial action it is seeking or intends to take, and a supervisory programme, setting out the tools of supervision (such as reporting accountants' reports on internal controls, Traded Markets Team and Review Team visits) it intends to use and the likely timing of their application. The tools will be targeted at areas considered to be of higher risk or to follow up issues identified during the risk assessment. The results coming from use of the tools will be examined as they become available, which may require the Bank to reassess the risk profile of the bank or take appropriate supervisory action.

During the course of the supervisory period the Bank will constantly evaluate the information it receives. In addition, at the end of the period, the Bank will undertake a formal evaluation to ensure that it has completed its original work plan, to check that is has acted appropriately on the results of the supervisory tools and generally to assess how effectively it has supervised the bank in question. The conclusions from the evaluation will be a key input into the next risk assessment.



Following the consultation period, the intention is to prototype the new approach on around 20 banks during the remainder of 1997 and to introduce the framework for all UK incorporated banks from next year. (Further information is provided in the text box on page 7.)

- **Banks' internal controls and the section 39 process:** A consultative paper was issued in February 1997, outlining ways to improve the Bank's ability to monitor the effectiveness of banks' internal controls. It looked particularly at the section 39 regime[1], which is one of the Bank's key tools of supervision. Proposals include the provision of annual statements by an institution's Board of Directors to the Bank on the adequacy of systems in place to monitor and control the institution's material risks and formal confirmation from the institution's reporting accountants and auditors that nothing has come to their attention to give them cause to believe that a breach in the minimum criteria for authorisation has occurred. In addition, there are proposals for bilateral meetings between the Bank and the reporting accountants and for a number of changes to the working of the section 39 process. A series of seminars were held in April 1997 to discuss the proposals with interested parties and the Bank will in due course draw up revised proposals, taking into account comments received during the consultation period.

- **Objectives, standards and processes of banking supervision:** The Bank's objectives in carrying out its supervision of banks, the standards the Bank sets itself to ensure that the objectives are met and the main processes used are explained in a booklet published in February 1997. (For further information see text box.)

- **Supervision of non-EEA banks:** A separate consultative paper on how the Bank intends to refine its supervisory approach in respect of UK branches of banks incorporated in non-EEA countries will be issued in the summer.

- **Review of Policy Guidelines:** Work is in hand on the major task of producing a new internal policy guide for line supervisors, which encompasses existing Policy Notices. When the guide is complete, the Bank will produce a similar, but shorter, guide for banks and their advisors so that there is a single, well-organised and easily accessible document covering all major areas of policy.

- **Supervision of liquidity:** Proposals to rationalise the present liquidity reporting requirements for those banks using the mismatch approach are being discussed with the BBA. A new liquidity return is being produced which will both consolidate existing reporting and improve the scope, coverage and quality of liquidity data, to incorporate cash-flows such as interest payments and receipts and off balance sheet items into the analysis. It is hoped to introduce the new arrangements in the Spring of 1998.

- **Review of S3 and use of FX guidelines:** The Bank is reviewing the scope to rationalise and improve the value of other data reported by banks via standard returns. Attention is currently focused on the foreign exchange exposure return (the S3), which is used to monitor foreign exchange exposures against 'guidelines' set by the Bank.

- **Quality Assurance:** The Bank has established a Quality Assurance (QA) function. Its remit is to assure the quality of banking supervision and, through a process of continuous assessment, to foster the development of best working practice. In addition to any individual institution cases it may examine, QA's initial work programme consists of two S&S-wide (or horizontal) reviews. The first is a review of how supervisors use the s39 process (see above). The second is a review of the Bank's own compliance tools and the procedures underlying them, and has the objective of identifying areas where effectiveness and efficiency can be enhanced. The results will feed into the IT strategy Project Team's work by helping to specify the functionality of a proposed upgraded computerised compliance system for Supervision and Surveillance; and will also provide a basis for the production of self review checklists concerning compliance with statutory and policy requirements, for use by supervisors.

(1) S39 of the Banking Act 1987 gives the Bank powers to require an institution to commission reports from accountants to establish, among other things, the adequacy of their systems and controls and the accuracy of their prudential returns.

OBJECTIVES, STANDARDS AND PROCESSES OF BANKING SUPERVISION

Objectives

One of the Bank's core purposes is the maintenance of the stability of the financial system. This involves, among other things, seeking to ensure that the failure of one or more banks does not lead in itself to a failure of others, calling into question the soundness of large parts of the banking system. One way in which the Bank seeks to achieve this is through the discharge of its responsibilities, as set out in the Banking Act 1987, relating to the safety and soundness of individual authorised banks. The primary objective of Supervision and Surveillance is the fulfilment of these responsibilities which strengthens depositor protection and thereby increases confidence in the strength of the banking system as a whole.

The Act accepts the possibility of bank failures and is not aimed at delivering a guarantee of banks' deposit liabilities. To attempt to avoid any bank failing would be unhealthy for the economy (as it would involve limits on competition, innovation and the taking of risk, and increase the costs imposed by supervision); it would also be virtually impossible to achieve. Rather, the intention of the Act is that effective supervision should sufficiently reduce the risk of capital loss to depositors that strong depositor confidence in authorised banks is maintained.

The Act specifies minimum criteria which need to be met by banks at the time of authorisation and on a continuing basis. The Bank's 'Statements of Principles' explain how it interprets the minimum criteria and how it goes about exercising its powers; these general standards are spelled out in more detail in various supervisory Notices. In carrying out its supervisory function, the Bank is required to act in the interest of depositors.

Other objectives of the Bank's supervision are to protect against illegal deposit taking, and to prosecute offences involving unauthorised deposit taking, fraudulent inducement to make deposits and improper use of banking names. The Bank also has specific responsibilities under the Money Laundering Regulations to report to the National Criminal Intelligence Service (NCIS) any information which it considers may be indicative of money laundering. The prime responsibility for tackling financial crime lies with the police and Serious Fraud Office and the Bank liaises closely with them as appropriate.

Standards

The Bank's approach to supervision starts from the recognition that bank management is responsible for its business but that the Act, augmented by the Statements of Principles and other supervisory Notices, creates a framework within which supervision of banks is carried out. In order to achieve its objectives, the Bank has set itself a number of Standards which are summarised below:

- To discharge its legal responsibilities;
- To discharge its policy objectives;
  - —defining and disseminating appropriate supervisory policies and guidelines as a basis for consistent supervisory action;
  - —working to raise international standards of banking supervision and developing effective relations with other regulators, supervisors and market authorities in the United Kingdom and overseas;
- Institution-specific responsibilities;
  - —assessing banks' businesses, their risk profiles and the macroeconomic context;
  - —designing effective supervisory plans and making appropriate use of supervisory tools;
  - —ensuring appropriate reliance is placed on other regulators;
  - —applying policies and taking appropriate supervisory action promptly and consistently;
- Management and communication issues;
  - —ensuring the optimal allocation of supervisory resources based on the risk assessment of individual institutions;
  - —communicating the supervisory framework, approach, policy and decisions.

Processes

The booklet issued by the Bank in February 1997 documented the key elements of the Bank's supervisory structure and processes. This included summarising the responsibility and accountability of particular functions and bodies, such as the Court of Directors, Board of Banking Supervision and the Bank's committee structure, in relation to supervisory matters.

To implement all of the above, Supervision and Surveillance has been building up its staff resources. As recommended by Arthur Andersen, it has also reviewed its approach to training and career development, and its use of information technology. These developments are discussed in more detail in Part VI of this *Report*. The Bank has also recruited three part time senior banking advisers to provide support and advice to line supervisors. These individuals have wide financial experience at senior levels as well as specialist expertise. They are being used to assist Supervision and Surveillance in planning for the implementation of RATE (the new risk based framework of supervision) and the improvements to the section 39 regime. Several similar individuals have been employed as short-term consultants.

Much remains to be done to implement the proposals set out last summer by the Bank and, in the meantime, the financial sector continues to evolve. The Bank will regularly review its programme in that light and in due course will conduct a formal re-evaluation of key elements with the help of outside consultants. Changes of the size and nature described above cannot, however, be implemented in full immediately. Staff increases, training programmes, IT support, the office lay-out and other changes being put in place to underpin the desired culture changes are all now in hand; but many will not come to full fruition within the next couple of years.

OTHER DEVELOPMENTS

In December 1996, the Treasury Select Committee published a Report on 'Barings Bank and International Regulation'. As the Report acknowledged the main recommendations relating to the Bank's supervisory work (for example, on the importance of encouraging international regulatory co-operation and on improving some of the key tools of supervision) were being taken up in the changes now underway.

RELATIONS WITH OTHER SUPERVISORS

For many years the Bank has played a leading part in international banking supervisory circles, both in formulating policy and developing practical arrangements to develop and enhance co-operation in the supervision of individual banks. This role in part reflects London's position as a financial centre; it has become increasingly important given the trend towards management and control of risk on a global, rather than legal entity, basis. Moreover, the continuing diversification of banks into 'non-traditional' businesses has necessitated close contact with supervisors in other financial industries, such as securities and insurance, both within the United Kingdom and overseas.

Over the last year the Bank has continued this work, in the process visiting the overseas operations of UK authorised institutions in 45 countries, including for the first time reviews by the Traded Markets Team (see page 12). This has been combined with a detailed series of meetings with most of the EU banking supervisors, at many of which the Bank has been accompanied by one or more of the financial services regulators from the United Kingdom, and by extensive contact with banking and securities supervisors in all the non-EU G10 countries. The Bank has signed Memoranda of Understanding (MOUs) and other forms of agreement with a number of banking and securities supervisors overseas, in addition to those previously agreed under the EU's Second Banking Co-ordination Directive (2BCD), and has more under negotiation. These should underpin the already good co-operation with these various regulators. Within the United Kingdom the Bank has continued to work closely with the regulators responsible for significant parts of the UK banks' non-banking businesses, notably the Securities and Investments Board (SIB), the Self Regulating Organisations (SROs) and the Department of Trade and Industry (DTI); and with the Building soceties Commission (BSC) in connection with the conversion to banking status of a number of large building societies. In addition to work on individual cases, there has been extensive discussion of problems of mutual interest such as how risk assessments can be carried out (and information shared) as effectively and efficiently as possible, from the viewpoint both of regulators and the regulated.

As well as these steps to enhance co-operation on a bilateral basis, the Bank is also actively engaged in a number of multilateral initiatives:

- In January 1996 the Joint Forum of banking, securities and insurance supervisors was established to pursue practical means to facilitate information exchange on financial conglomerates (including the possibility of establishing criteria to identify a 'co-ordinator' or 'lead regulator' for this purpose) and to examine other issues relevant to their supervision including ways of measuring capital adequacy on a group wide basis. G7 heads of Government meeting in Lyon in June 1996, urged 'maximum progress' in the following twelve months to enhance co-operation among international supervisory authorities, 'importantly by clarifying their roles and responsibilities'. Since then the Joint Forum has identified certain legal obstacles to information exchange which it advocates should be removed and has set up a task force which has carried out detailed work on around a dozen conglomerates, looking at operational and risk management issues and their interaction with supervisory arrangements. The Bank has made a major contribution to this work, particularly in respect of the need to define and put into effect an agreed role for the 'co-ordinator', both in emergencies and normal circumstances.

- Throughout the period, the Bank has held regular discussions with other UK and US banking and securities supervisors, to examine ways of understanding and supervising better the operations of complex financial groups. These discussions have on occasions involved regulators from third countries.

- In June 1996 the International Conference of Banking Supervisors—attended by supervisors from 140 countries—endorsed new guidelines (to which the Bank had contributed extensively) on the responsibilities of home and host country supervisors dealing with the Supervision of Cross-Border Banking. This paper sets out practical means to enhance the ability of supervisors to carry out effective consolidated supervision, and to overcome impediments to information flows to enable this to happen while respecting legitimate customer confidentiality concerns.

- Between October 1996 and April 1997 when it was published, the Bank contributed to the work of the Basle Committee, together with supervisors from a variety of emerging markets and other non-G10 countries, on a set of Core Principles for Effective Banking Supervision. These are designed to establish an internationally recognised and universally applicable set of sound practices to safeguard financial stability; they are likely to be used extensively by the International Monetary Fund and the International Bank for Reconstruction and Development as well as individual countries.

A common objective of these initiatives is to address the issues raised by the globalisation and diversification of banking groups, identify problems early, provide flexiblity to respond to local conditions and avoid unnecessary duplication. (Further detail on the Bank's work with other regulators is provided in Part IV of this *Report*.)

AMENDMENT TO THE EU CAPITAL ADEQUACY DIRECTIVE (CAD)

The European Commission has now proposed to the Council of Ministers that the existing CAD should be amended to take account of two important provisions in the Basle Market Risk papers—the capital requirements for commodities and the ability to use Value at Risk (VAR) models to determine capital requirements for part or all of a bank's trading risks.

While the Basle framework applies to internationally active banks in G10 countries, the CAD applies to investment firms as well as to banks. However, the 'broad brush' charges for commodities risk in the Basle proposals were designed for major banks (for whom commodities business is, in proportional terms, relatively small); they were not intended for investment firms conducting significant commodities business to which CAD applies, for whom a more precise method of capital charge is appropriate.

This proposed amendment to CAD was adopted by the EU Commisssioners in mid-April 1997. It is, therefore, unlikely that the amending directive will have been agreed by the Council of Ministers or by the European Parliament in time for it to be implemented by the end of 1997. If so the results of the models testing work carried out by the Basle Committee would suggest that British and other European banks will be at something of a competitive disadvantage compared with their competitiors from non-EU G10 countries until the changes are introduced. Nevertheless, this disadvantage is likely to be rather less than at present, where in general there are no market risk charges applied to non-EU banks.

So far as the capital requirements for commodities are concerned, the text adopted by the European Commission permits investment firms, until the end of 1999, to use capital requirements which are lower than those set out in the amendment to the Basle Accord. The UK authorities will continue to press the case for a prudent and proportionate capital regime, now that the European Commission have noted their concerns. It is hoped that the proposal will form a useful basis for further discussion

THE ROLE OF THE TRADED MARKETS TEAM

The Traded Markets Team (TMT) specialises in the supervision of banks' trading operations. It grew from five people in 1995 to nine at end February 1997 and is staffed by a mixture of individuals with market experience, secondees from other regulators and Bank staff who have been given a detailed training programme including secondments to risk management departments at major banks.

In the course of its visits in 1996/97, the TMT found improvements in the quality of systems and controls surrounding the derivatives trading operations of the banks visited. The implementation of the CAD and the associated model recognition process has undoubtedly contributed to this improvement. However, several banks were found still to be having problems in integrating their IT systems to produce accurate, consistent and timely risk management data; this is recognised as an issue by many of the banks, which are working on improvements while introducing VAR methodology.

The team has also had discussions with a number of banks who are using VAR models about their approach to stress testing, backtesting and to modelling specific risk. These discussions have aided our understanding of recent developments in these complex areas and have helped formulate our views on the nature of the qualitative controls which banks using VAR models might adopt.

TMT's contacts with the banks suggest that fewer new highly structured interest rate derivative products are being developed, although there has been increasing interest in trading derivatives based on South East Asian and other less widely used currencies, including emerging market products. In the foreign exchange market, more barrier and digital options were traded by the banks visited, especially during the period of relatively low FX volatility in mid-1996; such instruments raise a number of questions, for example the need for appropriate independent monitoring of the timing of when barriers are breached.

RISK AND REMUNERATION

It is not the job of the supervisor to lay down the remuneration policies of banks. Nevertheless, as has been underlined by several incidents during the year, there are a number of legitimate questions which the supervisor can and should ask. For example:

- Does the level and variability of the resulting cost base match the level and variability of the income available to meet these costs?

- Is remuneration policy (especially on bonuses) likely to provide an incentive to employees to behave in a manner consistent with the objectives of the Bank?

- What controls are in place to ensure that any incentive to take excessive risks is adequately countered?

An analysis of the issues was provided in an article in the Spring 1997 issue of the Bank's *Financial Stability Review*[1]. The Bank's supervisors are pursuing the resulting questions with banks individually.

INTERNET BANKING

Remote access to banking services has already been well established in the form of home and telephone banking. More recently, institutions have offered such services on the Internet. The Bank welcomes this widening of choice for retail and corporate customers. The vast majority of Internet usage for banking services is of no supervisory concern. Banking on the Internet or through other remote access channels may, however, lead to breaches of the Banking Act's rules on advertising and deposit taking.

It is not always possible to establish the country of operation of a bank that offers its services on the Internet. It may also be difficult for an individual to determine whether the bank is an authorised institution, either in the United Kingdom or

(1) Last October the Bank and the SIB launched the Financial Stability Review. The second issue of the Financial Stability Review was released in March and single copies/subscriptions can be obtained from the Bank at a cost of £10 for a single issue (£5 for students) and £18 for a year's subscription (£9 for students) by calling 0171-601 5191 or by writing to: Subscriptions, Financial Stability Review, Bank of England, Threadneedle Street, London, EC2R 8AH.

abroad. Deposit protection schemes may not apply in the event of failure. The Bank recommends that depositors should conduct due diligence on all names before using the Internet for banking and, more generally, depositing money with entities off-shore. The Bank advises anyone responding to advertisements for deposits placed on the Internet to check whether or not the bank or company concerned is properly authorised. While the Bank is able to say whether an institution with a UK presence is authorised to accept deposits in the United Kingdom, potential depositors should consult the relevant regulator in the country concerned in the case of banking services offered from overseas. The Bank provides further guidance to the public in its leaflet *Money in the Bank*, which is also available on the Bank's website (which is at http://www.bankofengland.co.uk).

IT DEVELOPMENTS

Planning for the Euro and how to address the issues associated with the Year 2000 has been, and remains, a major priority in terms of the IT developments facing banks. During the year, the Bank has sought to establish from the banks what their preparations are and how these are to be monitored internally.

So far as preparations for the Millennium are concerned, the Bank has also co-operated with the BBA in establishing a timetable to assist banks determine if their own plans and progress are broadly in line with the industry norm.

To date our supervisory discussions on this topic suggest that banks are confident their systems development is proceeding according to plan. Nevertheless, given the potential supervisory risk if these plans falter, the Bank will continue to raise these issues with Chief Executives and their senior management teams over the coming year. If, as a result, the Bank uncovers any doubts about the adequacy of a bank's preparations it is likely that a S39 report will be commissioned. This will help the Bank establish the facts so that we can judge the extent of any supervisory risk and decide an appropriate supervisory response.

A broadly similar exercise is underway in relation to banks' preparations for the introduction of the Euro.

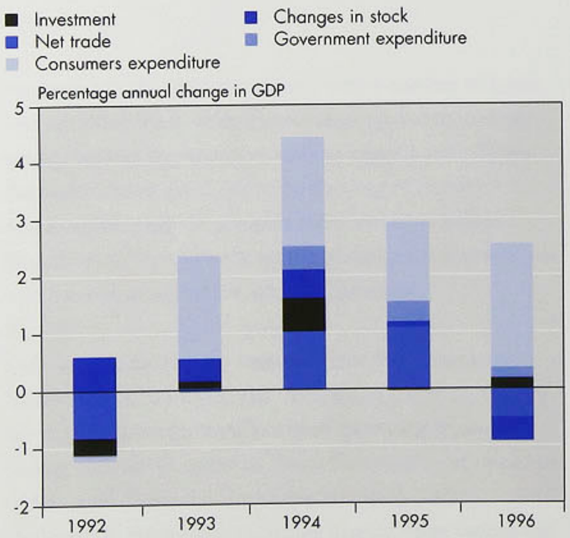
Part II MACROECONOMIC CONTEXT

OVERVIEW

Economic conditions remained favourable for the UK banking sector throughout 1996. GDP growth during 1996 was 2.4%, much the same as in 1995, and is around the long term trend. GDP growth was constrained at the beginning of 1996, partly as a result of de-stocking (particularly in the manufacturing sector). The weakness in some of the UK's major export markets in the first half of 1996 also offset the strong growth in domestic demand. However, the strength of service exports in the second half of 1996 (despite the appreciation in sterling) resulted in net external trade making only a small negative contribution to GDP growth during the year. Towards the end of 1996, there was a clear acceleration in GDP and by the fourth quarter of 1996 the economy was growing at an annualised rate of 3¼%. This was partly due to the increase in service sector output, 3.5% over the year, with the finance and business sector estimated to have grown most strongly.

CHART 1

Contributions to GDP growth

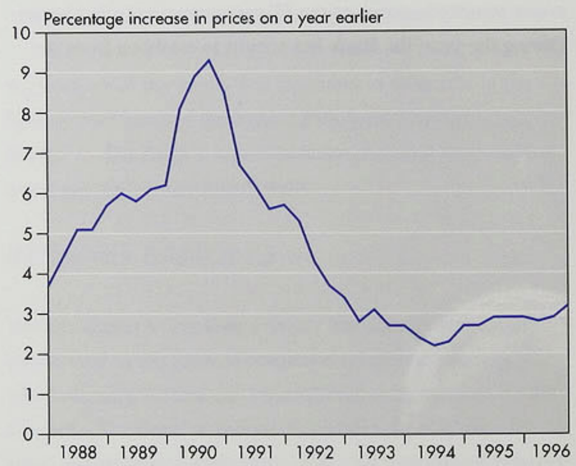


Consumption continued to grow above trend during 1996, with expenditure on durables increasing faster than that on services and non-durables. Manufacturing output remained weak in the first six months of 1996, although there was some recovery in the second half of the year, partly offset by the impact of the appreciation in sterling. Despite a strong rise in the fourth quarter, investment growth is far weaker at this point in the cycle than in comparable periods albeit that the level of investment is comparatively high. Investment in manufacturing was relatively weaker than investment in the service sector, despite the declared intentions of manufacturing firms to invest more than in previous years.

Inflation, as measured using the Government's target measure—the retail prices index excluding mortgage interest payments (RPIX)—rose slightly in 1996 (see Chart 2). This was partly due to strong demand in the service sector and also the 8% increase in petrol prices in the second half of 1996.

CHART 2

RPIX inflation



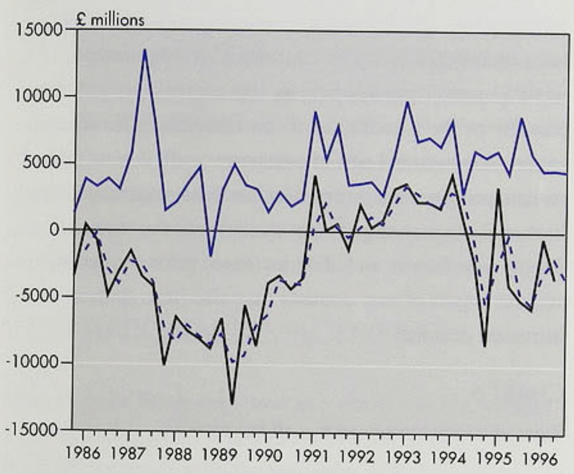
Meanwhile, the housing market saw the most sustained recovery in house prices since the downturn in 1990. House prices, as measured by the Halifax price index, increased by 8.3% during 1996, compared with a fall of 1.3% during 1995 (although house prices remained relatively low compared to earnings). Rising house prices reduced the number of households with negative equity and improved the prospects for lenders' asset quality, both by lessening the incentive for a borrower with payment difficulties to default and by increasing lenders' recovery rates in the event of default. Housing turnover increased by over 30% during 1996 but it remains at historically low levels.

CORPORATE SECTOR

Internally generated income remained industrial and commercial companies' (ICCs) most important source of funds (over 60%) during 1996, although there was an underlying increase in borrowing from banks and building societies in the first half of this year. One reason for the return to bank borrowing was the financing of mergers and acquisitions (M&A), which tended to concentrate bank lending in the hands of the bankers of acquiror companies. Although the actual number of M&A deals was not high in 1996, the level of expenditure on M&A increased sharply.

CHART 3

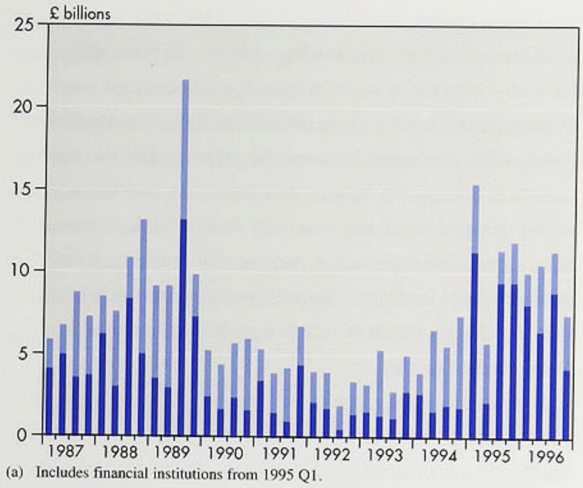
Capital market issues and bank borrowing



Gross trading profits grew more than expected in 1996, although a significant amount of this can be attributed to particularly strong profits of North Sea companies (due to the increase in oil prices as well as an expansion in capacity). Profits earned by UK companies during 1996 returned to the highest levels since the start of the recession in 1991. This strengthened the capital base of ICCs and increased the potential for investment. ICCs' dividend payout ratio (approximately 30%) continued the upward trend that began at the end of 1994, although the rate of growth is not as high as in the late 1980s. Interest cover on companies' bank debt was around 13 times (compared to a recessional low, 5.0 and a late 1980s peak, 13.4). During 1996, ICCs' financial balance[1] fluctuated between deficit and surplus. However, for 1996 as a whole, ICCs ran a financial surplus of £2.7 billion. This return to financial surplus appears to be primarily due to a large, one off, reduction in expenditure on stocks. The rate of decline of insolvencies moderated during 1996, consistent with the rate of GDP growth.

CHART 4

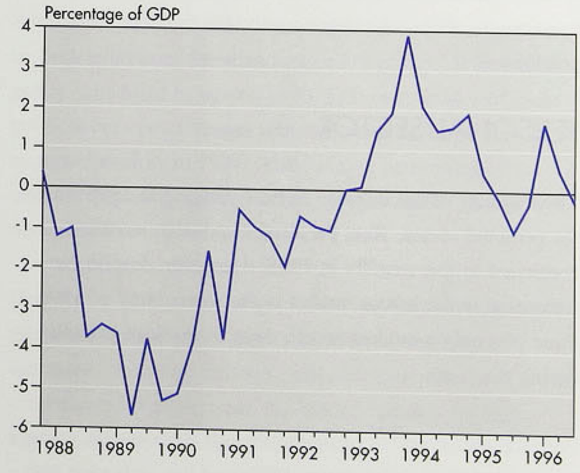
Acquisitions and mergers in the corporate sector



(a) Includes financial institutions from 1995 Q1.

CHART 5

ICCs' financial balance



(1) Financial balance is the difference between undistributed income and gross domestic fixed capital formation. It is a fairly volatile series and this should be taken into account in any analysis.

During 1996, the recovery in the commercial property market continued and there was some patchy rental growth across all sectors. Despite continued growth in loan demand, lenders are facing increasing competition as the number of lenders rose during 1996. This could lead to pressure on margins and lending criteria. In particular, loan–to–value ratios have increased, even amongst cautious lenders (rising from a norm of 70%, to 75% or even 80%). Polarisation continued between the prime end of the market (which is leading the upturn) and secondary and tertiary where demand remained relatively weak. Banks continue to have significant exposure to commercial property, either through direct lending or through security taken via a floating charge, much of which may be concentrated in these weaker sectors.

The overall level of capitalisation and the strong competition within the market continued to impose downward pressure on lending margins to corporates. However, despite historically low lending rates, demand remained relatively weak. Evidence suggests that such lending did not open the door to new business but was instead being used by corporates to refinance existing debt.

Institutional cash deposits continued to rise during 1996 as markets performed strongly. The effect of market performance meant that some institutions preferred to keep their holdings in cash, rather than the securities market, in anticipation of a fall in that market. The strong rise in the securities market during 1996 also meant an increase in cash balances, in order for institutions to maintain a balanced portfolio.

PERSONAL SECTOR

The majority of the increase in bank lending in 1996 was to the personal sector. Real personal disposable income continued to rise steadily in 1996. However, despite the tightening in the labour market in the second half of 1996 there was only a modest acceleration in earnings growth during the year.

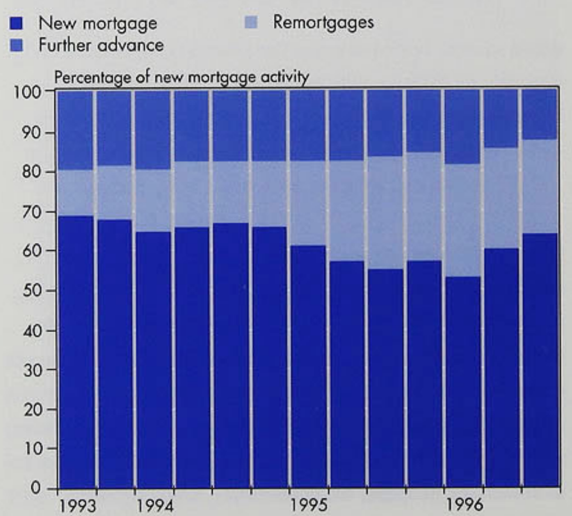
Personal sector saving increased during 1996 mainly going into bank deposits, unit trusts, PEPs and life assurance and pension funds. Despite falling deposit rates, banks have increased their share of retail deposits.

Unemployment fell during 1996, on average by 29,000 per month. This included a fall of 95,400 in November, the largest monthly decline in claimant unemployment on record although comparisons are made more difficult by the introduction of the Jobseekers' Allowance in October.

There was strong growth in consumer credit during 1996, reflecting macro-economic factors such as falling unemployment and growth in incomes and personal consumption. The growth in consumer credit could have been encouraged partly by consumers' anticipation of windfall gains from building society conversions and also possibly by the substitution of consumer credit for secured credit. A substantial part of consumer credit is now offered on deferred payment terms, which will have introduced an increased element of payment shock(1) into the sector. Supply-side factors including increased price competition and the impact of new entrants may also have further increased demand.

CHART 6

Type of mortgage advance—all buyers

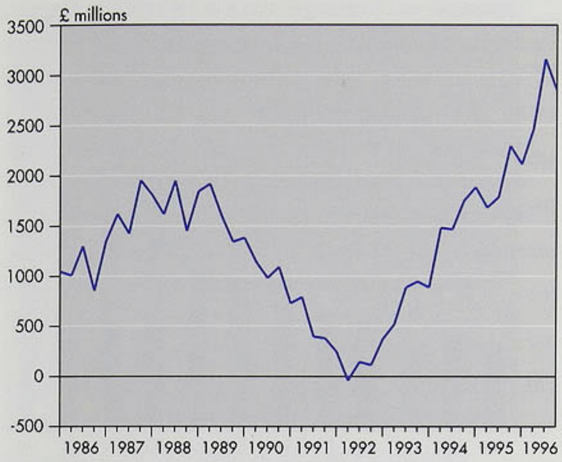


The economic environment of rising house prices, falling unemployment and stable interest rates indicate a decline in the financial fragility of the personal sector. However, the

(1) Payment shock is a term used to describe the phenomenon of a customer becoming used to budgeting to meet a reduced payment over the deferred or discounted period and then being unprepared to meet the full payment when the deferral or discount ends. The resultant 'shock' tends to make the lending riskier, all else being equal.

CHART 7

Net consumer credit lending



increase in the personal sector debt to income ratio could make the sector more sensitive to a downturn in economic conditions.

INTERNATIONAL DEVELOPMENTS

Growth in the European Union as a whole was below trend in 1996, falling to 1.7% compared to 2.5% in 1995. The large EU countries, with the exception of the United Kingdom, had lower growth than the smaller EU countries. In Germany, France, and Italy GDP growth in 1996 was less than 1.5%. In the second half of the year, exports strengthened and business confidence picked up. Domestic demand growth was more modest, with unemployment continuing to rise during the last quarter.

The Netherlands, Finland, Greece, Portugal, Ireland and Luxembourg all had GDP growth above 2.5% in 1996 with domestic demand as well as exports sustaining growth.

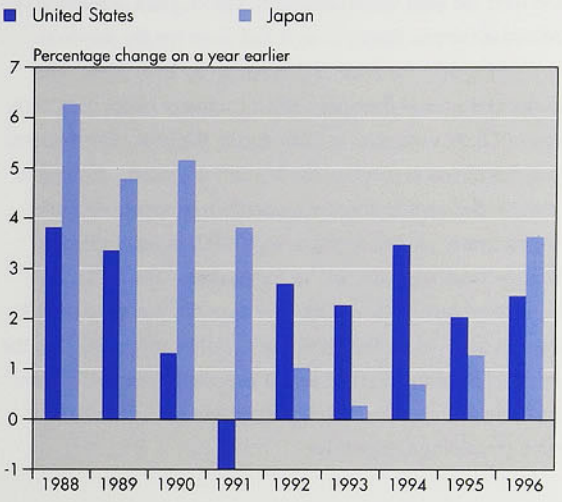
Annual GDP growth in the United States rose from 2% in 1995 to 2.5% in 1996. But, moderate wage rises, increased productivity and exchange rate appreciation restrained inflationary pressures; core inflation and the GDP deflator exhibited a declining trend throughout 1996.

This lack of inflationary pressure allowed the Federal Reserve to keep official interest rates constant throughout 1996, following a 25 bp cut in January. This was despite periodic concerns in financial markets that the above trend rate of activity, coupled with a tight labour market and high capacity utilisation would lead to a pre-emptive tightening. Wage pressure began to increase towards the end of 1996, however, and a 25 bp rise was announced at the end of March 1997, following evidence of further labour market tightening.

The benign environment of robust activity and low inflation was also one factor behind the continued rally in US equity markets.

CHART 8

United States & Japanese GDP growth



The Japanese economy grew at the fastest rate of any G7 economy in 1996 (3.6%). As in 1995, growth was boosted by both expansive fiscal and monetary policy. With fiscal policy scheduled to tighten in the first quarter of 1997, and public works programmes nearing completion, growth is expected to slow in 1997. Following a weakening of the yen, the export sector may offset a resultant fall in domestic demand.

Despite the pick up in the growth of the economy the stock market remained weak and the number of bankruptcies increased. Although property prices appeared to have consolidated over the year, the market remains far from active, so further falls are possible.

In the emerging markets, private capital inflows continue to be an important feature. Total inflows to the major emerging markets in 1996 are estimated at about

US$ 240 billion, with private flows over 95% of the total. Most of the private flows went to Latin America and the Asia/Pacific region. Moderate international interest rates and continuing economic reform in emerging markets are key factors in increasing investor interest in the region.

FINANCIAL MARKET DEVELOPMENTS

Equity prices on most of the major exchanges rose during 1996, despite falls during the middle part of the year. The Japanese equity market was the main exception, despite starting the year very strongly. Following significant falls towards the end of 1996 the Nikkei 225 declined by over 8% over the year to end February 1997. The US market continued to rise strongly, as it had done for the previous two years, with the S&P 500 index up by over 20%. The major continental European stock exchanges kept pace with rises of their own of over 20% during the year. Government policies aimed at meeting the Maastricht criteria, leading to lower inflation and economic conditions more favourable for company profits, together with a fall in bond yields in Europe were seen as positive for equities. The FTSE 100 performed less well—rising 12% over the year—held back later in the year by the view that a further appreciation in the value of Sterling, on the back of expected rises in UK base rates could mean that UK exporters would have a difficult time remaining competitive.

CHART 9

Equity indices

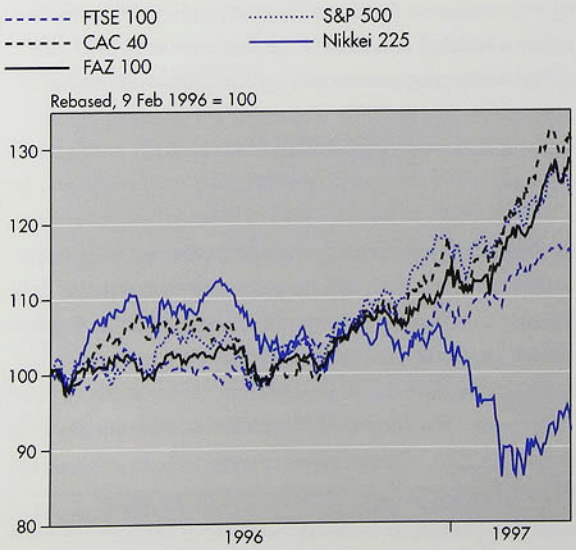
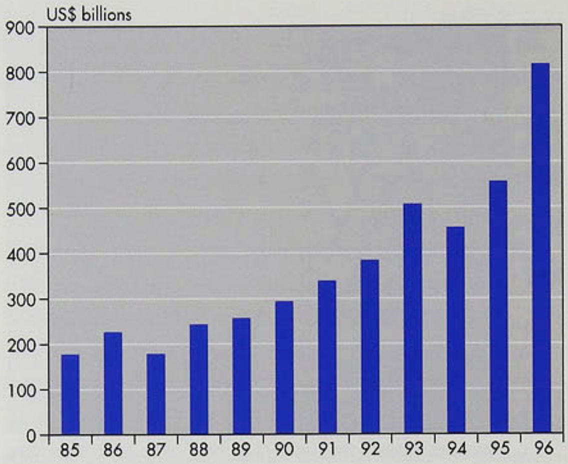


CHART 10

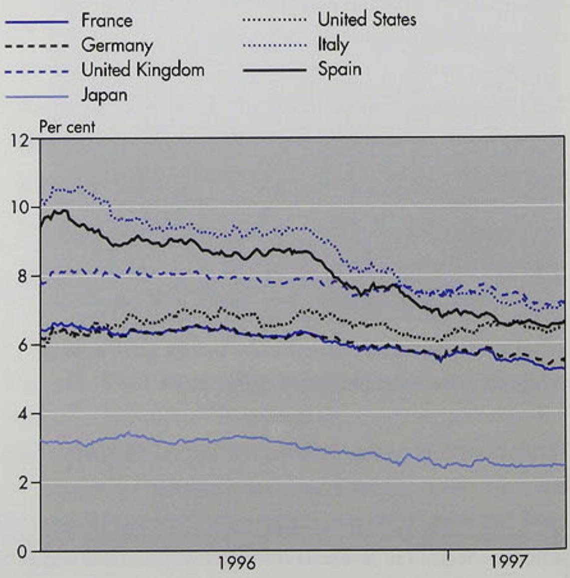
Gross international bond issuance



1996 proved to be a record year for international bond issuance. Gross international issues in the year to end February 1997 totalled $US 810 billion, a 46% increase over the $US 554 billion total for the previous year. Redemptions were high during 1996, reflecting relatively high levels of issuance in 1986, 1991 and 1993 (ten, five and three years being the most common maturities for bonds); so some of the increase reflected the refinancing of maturing debt. Spreads were driven down by asset-hungry investors such that market conditions were very favourable for issuers.

CHART 11

Ten-year government bond yields



Bond yields generally finished the year lower than they started, despite, in most cases, rising in the first quarter. The prospect of EMU led to a convergence of rates amongst countries expected to participate. For countries such as Italy and Spain this led to sharp falls as rates moved closer to German rates. This reflected not only the anticipation of the single currency (and, therefore, more similar yield curves), but also the convergence of economic policies in order to meet the criteria for participation. The yield on UK Gilts showed no tendency to close with German bund yields even though the United Kingdom may well meet the EMU criteria.

US treasury yields ended the year higher than they started, rising over 60 basis points. Japanese treasury yields remained by far the lowest of the major economies, dropping by over 60 basis points.

Low nominal yields in most of the major markets meant that demand for emerging market debt increased during the year. Investors "searching for yield" were attracted by the higher returns available on this paper. Favourable global economic conditions also encouraged investors to see the emerging markets as less risky.

Competition in the international syndicated loan market continued to compress spreads over the year, albeit at a slower rate. Some lenders, in the search for higher yield, pursued lower quality credits. This resulted in a 'flattening' of the curve, which suggests that there is less differentiation between lower and high quality credits and, therefore, lower quality credits are getting a relatively better deal.

Part III MARKET DEVELOPMENTS

OVERVIEW

1996 has been another profitable year for the large UK banks, which have continued to benefit from a favourable economic environment. Mounting consumer confidence has driven loan demand, leading to rises in net and non interest income, while asset quality remains strong, resulting in a repeat of the 1995 pattern of lower bad debt charges and improving operating profits.

The process of structural change in the sector continues, with further consolidation in 1996. As competition threatens to become more intense in personal financial services, banks have sought to expand market share and diversify into other areas of personal finance, and so acquisitions and integration (with the associated up-front expense) were again a theme in 1996. For example: the business of National & Provincial was transferred to Abbey National; Lloyds-TSB benefited from its first full year of Cheltenham & Gloucester's earnings and acquired the remaining 38% share in Lloyds Abbey Life; and NatWest also made several acquisitions. As supermarkets and other non-traditional players prepared to enter the retail financial services market, pressure increased to cut costs, whilst maintaining and increasing the client base.

The performance of smaller UK banks also improved further as lending volumes increased, costs were curtailed and profitability increased. While performance has always been diverse among such 'niche' players there appears to have been a general upward trend during 1996. Strong growth was particularly evident for those institutions engaged in consumer finance and was seen across a wide range of products. The proliferation of 0% finance deals for the household appliances sector continued, while lending for car finance remained strong. Profitability among the smaller banks was also helped by their ability to write back lending written off during the last recession.

Despite cost pressures on European banks, 1996/97 saw little domestic restructuring. In the United States, on the other hand, consolidation continued in 1996, with a 4% reduction in the number of banks covered by deposit insurance to around 9,500 at year end. Amongst the large banks though, there were fewer merger deals in 1996 than in 1995. In Japan, Bank of Tokyo and Mitsubishi Bank merged on 1 April 1996 to form the largest bank in the world, when measured by size of assets.

As part of economic reform, in recent years a number of emerging market economies have privatised banks either by floating a tranche of equity or by selling a strategic stake along with management control. In addition, banking systems have been liberalised (for example, by allowing greater foreign ownership of domestic banks). 1996 saw this trend towards liberalisation continuing in Latin America and Southern Asia, with further liberalisation expected in these areas, and parts of the Middle East, in 1997.

EARNINGS

The pick-up in mortgage and consumer credit fed through to increases in interest income and overall earnings of large British banks (see Table 1). In contrast, lending to the corporate sector remained more subdued, although some banks did report increased activity in this area.

Despite price competition in some product areas, such as mortgages and credit card funding, net interest margins have shown a slight improvement overall for the big four retail

TABLE 1

Large British banks: earnings

£ billions	***1993***	***1994***	***1995***	***1996***
Operating profits before bad debts	11.33	10.47	11.47	12.44
Pre-tax profits	5.45	8.58	9.29	10.64
Post-tax profits	3.57	5.74	6.22	6.99
Pre-tax return on equity (%)	*19.47*	*28.93*	*31.32*	*30.82*
Post-tax return on equity (%)	*12.75*	*19.35*	*20.96*	*20.26*
Return on total assets (%)	*0.80*	*1.21*	*1.15*	*1.3*

banks. This was due in part to improved spreads in other areas—notably retail deposits, which were boosted by strong retail inflows and, possibly, a distortionary effect arising from building society conversions which may have resulted in a less competitive retail deposit market—but also changes in the mix of business in some banks to products with higher spreads.

TABLE II

The 'big four' retail banks: net interest margins

Percentages	*1993*	*1994*	*1995*	*1996*
Domestic	3.6	3.6	3.7	3.5
International	2.0	1.9	1.8	1.6
Overall	**2.9**	**2.9**	**2.9**	**2.9**

Income from sources other than direct lending also increased, reflecting the income mix of acquisitions (which tended to earn proportionally more from non-interest income). There were also increases in some existing sources with a particularly large increase in fees and commissions—boosted by such items as fees from increased levels of credit card lending. Income from insurance businesses partly offset these increases as a number of companies made large payments in respect of bad-weather claims. Income from dealing, historically volatile, came in lower than in 1995.

TABLE III

Large British banks: sources of income

£ billions	*1993*	*1994*	*1995*	*1996*
Net interest	16.40	16.61	17.78	19.19
Non-interest	13.40	12.98	14.01	14.76
Total income	**29.79**	**29.59**	**31.79**	**33.95**
Non-interest income as a percentage of total income	*45.0*	*43.9*	*44.1*	*43.5*

Among the smaller banks, several institutions have expanded in the credit card market, and others were extremely active in the supply of affinity and co-branding products. Others chose to take up joint ventures with those already established in the market. The strong growth in consumer lending has not been without cost. Despite lending volumes being sufficiently strong to maintain profitability, margins have been squeezed for the smaller banks and delinquency levels have begun to pick up from the very low levels seen in 1994 and 1995. In spite of a positive response in terms of tightening underwriting criteria it appears that the full effects have yet to feed through. For those smaller banks engaged in lending for commercial and residential building, the pick-up in the housing market, and to a lesser extent a resurgence in commercial property values, led to a turnaround.

COSTS

The large banks are following strategies of maintaining downward pressure on costs through rationalisation of branch and staff numbers. As part of this process, further investment is being made in new technology and staff training in order to equip the large banks to compete more effectively against existing rivals and new entrants. Restructuring costs, therefore, continue to play a large part in the sector's overall expenses (and off-set the effect of declining staff and branch numbers), although they have declined compared to 1995.

TABLE IV

Large British banks: costs

£ billions	*1993*	*1994*	*1995*	*1996*
Staff	10.15	10.40	11.03	11.26
Premises and equipment	3.23	3.46	3.65	2.93
Other	4.52	5.26	4.89	6.35
Total operating costs	**17.90**	**19.12**	**19.57**	**20.54**
As a percentage of total income	*60.1*	*64.6*	*61.6*	*60.5*

The combined effect of the above, added to by acquisition-related expenses, has been an increase in overall costs of around 5%. However, growth in income has once again outstripped growth in costs, leading to a decline in the sector's cost to income ratio from 61.6% to 60.5%.

ASSET QUALITY

Asset quality continues to benefit from low inflation and low interest rates, although there are signs that the bottom of the bad debt cycle may finally have been reached. The domestic bad debt charge remained at last year's levels, halting a decline of the last three years. At some of the large banks, increased credit card business and personal lending required increased provisions in personal banking businesses, but these have been largely offset by the significant number of releases from provisions and recoveries from other areas of business, like emerging market debt.

TABLE V

Large British banks: domestic bad debt provisions and charges

£ billions	*1993*	*1994*	*1995*	*1996*
Stock of domestic commercial provisions[(a)]	7.5	6.3	5.8	4.9
As a percentage of total lending	*3.5*	*2.0*	*1.5*	*1.3*
Charge for domestic bad and doubtful debts	4.7	2.1	1.7	1.7
As a percentage of total lending	*2.0*	*0.7*	*0.5*	*0.4*

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

CAPITAL

The capital bases of the large banks remain strong, reflected in the number of share buybacks and acquisitions over the last year, with some banks promising the return of further capital to shareholders over 1997, and speculation rife as to others following suit. Increases in retained profits compared to 1995 and further capital and debt issues have more than offset the effect of the past year's capital outflows and, despite continuing and steady growth in assets, capital ratios remain at historically high levels.

TABLE VI

Large British banks: capital ratios

Convergence basis

£ billions	*1993*	*1994*	*1995*	*1996*
Total assets	676.8	711.4	809.7	854.6
Weighted assets	417.3	424.4	471.1	496.0
Total net capital	45.0	48.5	51.1	52.5
Risk Asset Ratio (%)	***10.8***	***11.4***	***10.9***	***10.6***

TABLE VII

Large British banks: capital constituents

Convergence basis

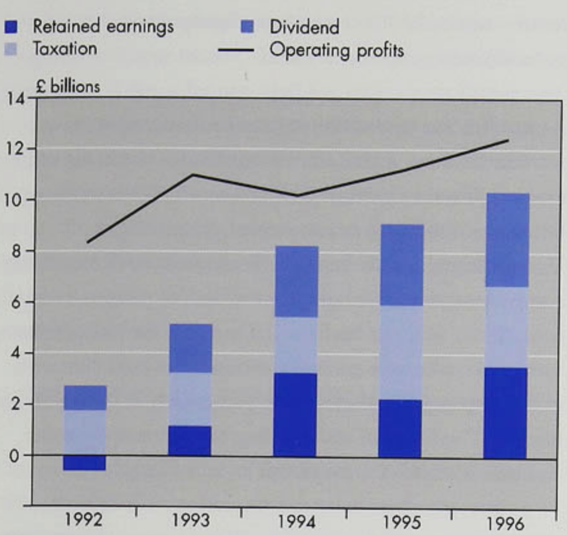
£ billions	*1993*	*1994*	*1995*	*1996*
Tier 1				
Ordinary shares	7.49	7.57	6.35	6.25
Preference shares	0.78	0.76	1.39	1.13
Reserves	17.27	20.65	23.58	26.21
Minorities	1.66	1.26	1.67	1.32
Total Tier 1	**27.18**	**30.24**	**32.99**	**34.91**
Tier 2				
Property revaluation reserves	0.16	0.12	0.11	0.12
Hybrid capital	8.89	8.82	9.33	9.43
General provisions	2.21	2.25	2.53	2.38
Tier 2 minorities	0.01	0.01	0.02	0.01
Subordinated loan stock	10.19	10.68	11.17	11.50
Headroom deduction	-0.19	—	—	-0.01
Total Tier 2	**21.27**	**21.88**	**23.16**	**23.43**
Deductions	-3.46	-3.18	-5.02	-5.85
Total net capital	**44.98**	**48.95**	**51.13**	**52.49**

OVERSEAS PERFORMANCE OF LARGE BRITISH BANKS

The large UK banks' international operations had a profitable year once again. The banking groups with large presences in Hong Kong and the Asia Pacific region showed profitable growth in personal and corporate lending, reflecting the growth in that region. Mortgage and credit card growth featured strongly in these areas, although, mirroring trends in the United Kingdom, Hong Kong

CHART 12

Large British banks: retained earnings



business was also subject to pressures on mortgage margins. Personal banking in the rest of Asia also performed well, reflecting the strategic concentration of those banks with retail operations there to grow their business in areas which are not yet 'banked' to their full potential. Further acquisitions and mergers in the United States contributed positively to income, while European operations, on the other hand, did not fare quite so well, reflecting underlying trends in those economies.

BUILDING SOCIETY CONVERSIONS

Last year's *Report* noted the conversion plans of the Halifax, Alliance & Leicester and Woolwich building societies to banking status as well as the transfer of the business of National & Provincial Building Society to Abbey National which was completed during 1996/97. During the year Northern Rock Building Society also announced its plans to convert into an independent bank; a further society, Bristol & West, intends to convert and be acquired by Bank of Ireland. After due consideration the Bank indicated, as evidenced in each of these five institutions' Transfer Statements, that it is minded to authorise the successor companies and, where appropriate, their treasury bank subsidiaries. Alliance & Leicester converted in April; Halifax, Woolwich and Bristol and West plan to conclude conversion in mid-1997 and Northern Rock in autumn 1997.

In the event of conversion of these societies into banks, some £190 billion of assets and liabilities will be added to the banking sector or around 10% of the current total. Some £130 billion of retail deposits will accrue to the sector, roughly 25% of the current level of sterling UK private sector deposits. These conversions, once completed, will transfer about 65% of the building society sector to the banking sector which would then account for some 70% of the stock of mortgage loans, which is double its previous share.

The building societies planning to convert had a satisfactory year in 1996 based upon buoyant retail margins (despite continued competition and discounting on the mortgage side) and continued low bad debts. Against both historical comparisons and banking sector competitors they are well capitalised.

New building society legislation enacted in March 1997 will impact on societies planning to convert, as follows:

(i) the abolition of the Priority Liquidation Distribution Reserve (PLDR) will release capital, which would otherwise have had to be held in a special reserve;

(ii) the successor company to a converting society will lose its five year protection from takeover if it makes an acquisition of a financial services company, operating in the United Kingdom, or if 75% of voting shareholders vote for it; and

(iii) it will no longer be necessary for a separate treasury bank to be established.

Halifax and Bristol & West have chosen conversion to an existing company (as opposed to a specially formed successor company) which involves, under current and previous legislation, neither PLDR nor protection provisions nor the need for a separate treasury bank.

REFORM OF THE BANK'S OPERATIONS IN THE STERLING MONEY MARKETS

In February 1997, the Bank announced a number of reforms to its operations in the sterling money markets, effective from 3 March 1997. Gilt repo—essentially a modern form of secured money lending—was added to the list of high-quality instruments in which the Bank conducts its daily open market operations. This move reflected the scale and depth of gilt repo trading which has developed since the start of the market at the beginning of 1996; the value of gilt repo contracts outstanding increased from around £36 billion in February 1996 to around £65 billion in November of that year. Various technical changes to the Bank's operations were also announced, and the arrangements for providing funds to the market late in the day were simplified.

The Bank also decided to broaden the range of counterparties able to participate in its sterling market operations, beyond its traditional specialist counterparties, the discount houses. From March 1997, banks, building societies and securities firms which are subject to appropriate prudential supervision and are able to meet certain functional requirements may be counterparties in the Bank's money market operations. Five discount houses opted to remain as counterparties and to take advantage of temporary provisions to facilitate their transition to the new arrangements.

MERCHANT BANKS

One focus of last year's review was consolidation within the merchant bank sector, which had just experienced three significant acquisitions. Some external commentators expected further rationalisation within the sector, but these expectations were not realised.

The focus for many merchant banks has instead been on ensuring that their management, businesses and control structures are organised so as to allow them to operate most efficiently in an increasingly competitive environment. In the case of those banks recently acquired by overseas banks, this process has involved the incorporation of the UK banks into global investment banking operations under a common brand name. Similar processes are underway elsewhere within the sector, although on a smaller scale, as managements recognise the importance of internal integration and (global) co-ordination of single businesses with a view to greater specialisation. Part of this process has seen the creation of complex matrix management arrangements, where business lines cut across legal entities and national boundaries. The banks have recognised that this in turn requires changes in, and in some cases a strengthening of, their underlying control structures.

In a diverse grouping such as the merchant banks, it is difficult to generalise about performance but—in very broad terms—results for the sector were slightly up on the generally strong figures of 1995.

As in 1995, the 'global' investment banks dominated the markets for more capital-intensive activities and at the same time continued to increase their presence in advisory businesses and in asset management, both in the United Kingdom and overseas. However, despite this strong competition, the published league tables for mergers and acquisitions advisory business indicate that the independent merchant banks have generally continued to hold their own in the corporate advisory sphere, particularly in the domestic market. The future of underwriting arrangements remains an important issue for the sector.

Asset management remains a significant source of income for a number of the merchant banking groups. The strength of equity markets worldwide in 1996 provided a favourable background for this type of business, but competition is very strong. This is reflected in more frequent reviews of mandates and in the introduction of more flexible fee structures, including increasing use of performance-related fees. It remains to be seen whether the adverse publicity generated by problems which came to light in several asset management groups during the year will have any wider or longer-term impact on the sector, but at this stage it seems unlikely.

Although the contribution of trading activities to overall results has diminished for a number of banks in recent years, as they have sought to concentrate more on fee-based advisory work, they remain a significant profit-centre. Trading performance in 1996 was mixed, with some banks being able to take advantage of the strength of capital markets in the second half of the year and a generally high level of activity in the emerging markets, particularly of Eastern Europe. Concerns about the cost and availability of funding for the independent constituents of the sector, which were evident in the immediate aftermath of the Barings collapse, diminished. The tightness of margins continues to render more traditional balance sheet activities unattractive and the past year has seen a further move by the sector into the provision of structured finance advice and into niche financing areas.

Some of the merchant banks have experienced a considerable increase in costs, predominantly for staff, as they have sought to acquire and retain staff in a very competitive labour market. In some cases the provision of guaranteed bonuses for new staff has raised costs further and it remains to be seen to what extent discretionary bonuses will be genuinely flexible in less successful years. Expenditure on IT also remains high, although there should be (staff cost) savings in future years as the benefit of this investment flows through. These factors have inevitably limited operating profits, even though income streams have generally held up well.

INTERNATIONAL DEVELOPMENTS

Despite the sluggish state of the domestic economies during 1996, most of the Continental European banks enjoyed an improvement on their 1995 performance. The main cause of growth was commission and trading income (particularly from international business), while a continued squeeze on margins left net interest income fairly flat, despite some growth in business volume. Many banks continued to focus on expanding their fee based business (such as investment banking and private banking), accounting for the increasing share of income which this type of business generated. Provisioning across Continental Europe was rather mixed: early indications are that, although the stock of provisions remained fairly high, some banks were able to reduce their net additions to provisions in 1996. This was the case in the Scandinavian countries (following the banking sector crisis of the early 1990s) and also for some of the French banks. In contrast, all three of the big Swiss banks made significant one off charges to provisions in 1996, mainly against their domestic lending.

The aim of reducing cost income ratios has proved a considerable challenge to the European banks. Costs during 1996 were boosted by heavy investment in IT, by preparations for EMU and by the growing expense of specialised staff (particularly in the investment banking field). Despite these increasing costs, many European banks have failed to address the domestic overcapacity to which their comprehensive branch networks contribute. Strict labour laws and working practices discourage banks from radically altering their costly domestic banking networks. However, it is unlikely that cost pressures will ease and it will be some years before investment in technology such as direct banking will break even. The banks are also facing a period of uncertainty regarding the introduction of the single currency and its impact on their business.

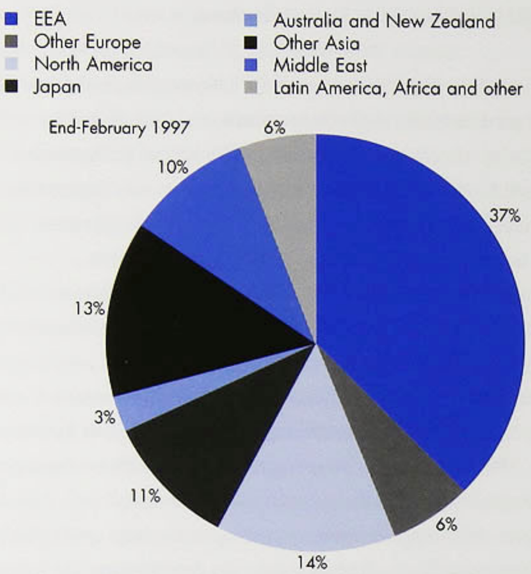
The very strong performance of the US commercial banks continued in 1996, with return on assets at around 1.2% remaining almost as strong as in 1995's record performance. Income from securities and trading activities was boosted by the rising stock market and has taken price-to-book ratios (but not price earnings ratios) and dividend yields to respective highs and lows. Revenues from non-interest sources such as fee income were buoyant while net interest margins also held up well. Costs were cut further (especially as a result of mergers) and deposit insurance costs reduced. However, although still lower than in the early 1990s, provisions were higher than in 1995; consumer credit quality, especially in credit cards, continued to decline. After improvements in recent years, loan quality in aggregate stabilised. Recent signs of a deterioration in credit quality in some areas (anecdotal evidence suggests this may include the real estate sector) may intensify if a greater than envisaged tightening of monetary policy results in a marked slowdown in economic growth later this year. However, the US banking industry overall continues to be well reserved, with an average of $1.82 in reserves for every $1.00 of non-current loans at the end of December 1996. Although the largest banks have been reducing their reserves, on average there is scope for charge offs to rise substantially before losses begin to dent equity.

In the half year to end September 1996 the top 20 Japanese banks reported operating profits of ¥ 2.2 trillion, down 10% from the corresponding period of the previous year when profits had benefited from the impact of falling interest rates on net interest receipts and capital gains on bonds.

Bank loans outstanding fell marginally during 1996 due to weak demand, increased disintermediation and a reduced willingness on the part of banks to lend as a result of both capital constraints and an emphasis on asset quality. Japanese banks made substantial write offs of bad debts during the year to end March 1996, a considerable proportion of which were largely due to property related lending during the 'bubble' period. As a consequence many banks declared losses. While write offs in the half year to end September 1996 were much lower than for the corresponding period a year earlier, there remains a

CHART 13

Geographical representation of overseas institutions[(a)]



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

considerable bad debt overhang; non-performing loans of the top 20 banks at end September 1996 were reported to amount to 4% of loans outstanding, and this figure only includes loans to companies in bankruptcy or in arrears for over six months. Meanwhile bankruptcies continue to increase. On the other side of the balance sheet, the 'Japan premium' on short term deposits taken in major financial centres outside Japan has remained modest for the strongest banks, although there is evidence of more 'tiering'.

The capital ratios of the top 20 banks at end September 1996 averaged 9.4%, with some having little safety margin above the internationally accepted BIS 8% minimum. Tier 2 capital includes 45% of unrealised gains on equities, and thus many banks' capital ratios are vulnerable to any weakness in the Nikkei. In response, banks have liquidated assets—including overseas assets where substantial capital gains have been made—and attempted to raise new capital. Against this background, market concerns over the capital adequacy, and even solvency, of some Japanese banks have increased, and the rating agencies have downgraded some banks and placed others on their watchlists. On 1 April 1997, a major restructuring of one of the top 20 banks and the proposed merger of another with a major regional bank was announced. Both are to withdraw from international business.

SUPERMARKET BANKING

Several joint venture alliances between authorised institutions and supermarkets have been launched to provide retail financial services. These ventures typically involve a bank providing operational and processing facilities and the supermarket providing marketing and distributional skills.

The initial products offered by the joint ventures have been standard retail products, including instant access savings accounts and credit cards, although most plan to extend the range of products they offer in due course. Some of the joint ventures are also offering 'budget cards' whereby customers deposit regular amounts into their account to cover their monthly shopping bill and have the option of obtaining limited credit on this account. In general, such products, especially the budget accounts, are aimed at increasing customer loyalty by 'locking in' customers to the store. From the point of view of banks, a co-branding alliance with a supermarket provides the opportunity to generate more revenue through access to a new customer base including those who would not normally visit a traditional branch.

The first issue for supervisors to consider is the legal structure of the arrangements. In some of the ventures so far announced, a separate Banking Act authorisation has not been sought and the joint venture uses the partner bank's existing authorisation to take deposits. It is important that under these arrangements it is made clear to the depositor that it is the bank and not the supermarket which is taking the deposit. Where the joint venture takes the form of a newly authorised bank, it is important that its customers have a clear view of the ownership of that company.

Second, there is the challenge arising from the different nature of selling banking products as opposed to other consumer products in that not all potential customers for the former may be suitable on normal credit grounds. Supervisors must ensure that the different business ethic in supermarkets does not result in any diminution of the 'know your customer' checks or those on money laundering and that the normal focus on credit aspects of a banking business is maintained.

Third, there are systems and controls considerations. The supervisors will need to ensure that the banks, who provide the systems for the joint ventures, have sufficient capacity to cope with the level of business generated by the venture. Business levels could be fairly difficult to predict given that the concept is new but has already received heavy publicity. Further, as with any business line, there are reputational risk issues for both partners in the event that a joint venture does not work out as planned.

Finally, these ventures are likely to be affected by a general trend in banking which involves banks outsourcing more of their functions than previously. The Bank permits outsourcing arrangements provided they are properly established and controlled.

GLOSSARY OF TERMS FOR PART III

Sources of data	Audited financial statements for the large British banks and Bank of England statistical returns. The table on interest margins is based on several estimated figures. Because of rounding, the columns in the tables may not balance.
Large British banks	Barclays, Lloyds-TSB, Midland, National Westminster, Abbey National, Bank of Scotland, The Royal Bank of Scotland, Standard Chartered. All data for these banks are consolidated. Calendar year-end information except for Bank of Scotland (1996 data are based on interim figures) and the Royal Bank of Scotland (end-September). Lloyds-TSB figures prior to 1995 are estimated using the combined figures for the separate banks.
Four large 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 but 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) for banking activites and *Implementation in the United Kingdom of the Capital Adequacy Directive (S&S/1995/2)* (as amended) for trading activites.

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 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.
Priority Liquidation Distribution Reserve	A priority right in liquidation conferred upon former members of a building society which has transferred its business to a specially formed successor company.

Part IV POLICY DEVELOPMENTS

As discussed in Part I of this *Report*, the Bank's principal priorities for 1996/97 have been those arising from the Bank's Review of Supervision. Given the coverage earlier in the *Report*, this work is not discussed further.

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

Post-BCCI Directive

The Post-BCCI Directive (EC Directive 95/26/EC), which was implemented in the United Kingdom on 18 July 1996, applies to EEA credit institutions, investment firms, insurance companies and UCITS. The Regulations[2], which implemented the Directive, made various amendments to the Banking Act with respect to credit institutions. The Bank's Notice S&S/1996/9 sets out the administrative arrangements for credit institutions with respect to the 'close links' provision of the Directive and imposed a new notification obligation upon institutions which relates to the 'close links' they have with other entities.

The Directive contains four main provisions: first, the relevant supervisory authorities are obliged to refuse applications from financial undertakings[3] for authorisation, and have the power to revoke authorisation, where the existence of a close link between the undertaking and another entity or individual prevents effective supervision; second, financial undertakings are required to have their head office in the same Member State as their registered office; third, the Directive allows for the creation or widening of certain 'gateways' for the disclosure of confidential supervisory information; and fourth, auditors and accountants performing statutory tasks in relation to financial undertakings and closely linked undertakings are required to report material breaches of relevant laws and certain other concerns to the relevant supervisor.

Amendment to the implementation of the Solvency Ratio Directive

The Bank's Notice S&S/1996/10, issued in December 1996, implemented an amendment to the implementation in the United Kingdom of the Solvency Ratio Directive to include Korea in the group of Zone A countries.

Work of other bodies

Following Financial Reporting Exposure Draft (FRED) 10, the Accounting Standards Board (ASB) issued a revised version of Financial Reporting Standard (FRS) 1, 'Cash flow statements', in October 1996. Cash flows will now be reported on a strict cash basis. In addition, banks are now permitted to report under a slightly different format in recognition of the specialised nature of their business. The standard became effective for periods ending on or after 23 March 1997.

In March 1996, the ASB issued FRED 11 'Associates and Joint Ventures' which concentrates on the definition of 'significant influence'. A key point is the ending of the presumption of significant influence if 20% of voting rights are held if a number of other conditions are not fulfiled. Equity accounting will continue to be the main method used.

FRED 11 was followed in June by FRED 12 'Goodwill and Intangible Assets'. After what has been a long running debate, it recommends the inclusion of acquired goodwill as an asset amortised over a maximum of 20 years, although this presumption is rebuttable and annual impairment tests will be required. This approach would put the United Kingdom in line with international accounting standards, which do not permit the current UK practice of writing off goodwill against reserves.

The ASB has also issued a number of discussion papers during the year including, a paper on 'Derivatives and Other Financial Instruments' (see page 34).

(1) A list of the policy and practice notices issued by Supervision and Surveillance currently in force is included at Appendix 2.
(2) Statutory instrument 1996 No 1669.
(3) As defined in Article 1 of EC Directive 95/26/EC.

Of particular interest, given its topical nature, is the Urgent Issues Task Force's (UITF) conclusion on the accounting treatment of software costs incurred because of the Year 2000. The UITF have stated that they regard such costs as rectification expenditure rather than enhancement and these should therefore be written off as incurred, rather than capitalised.

The BBA, in conjunction with the Irish Bankers' Association, issued an exposure draft of their revised Statement of Recommended Accounting Practice (SORP) on 'Advances'. The draft SORP provides additional guidance on the treatment of mortgage incentives and their disclosure; the relationship between specific and general provisions; the disclosure of non-performing loans; and the implications of FRS 5 'Reporting the Substance of Transactions'.

Regulatory developments abroad

Representative Leach's 1995 bill, which aimed to increase the powers of commercial banks to engage in securities and insurance business, stalled in the US legislative process and was finally abandoned in June 1996. Subsequently, regulatory actions increased the scope of banks to engage in non-banking business. First, the Federal Reserve Board amended the conditions under which Section 20 subsidiaries of bank holding companies are allowed to underwrite and deal in securities. The proportion of its total revenue that a Section 20 subsidiary could derive from 'ineligible' securities activities (such as corporate debt and equity) was raised from 10% to 25%. The Fed also eliminated certain firewalls between a bank and its affiliate and has now proposed to eliminate most of the remaining firewalls in an effort to reflect the change in emphasis from a regulatory to a risk-based approach. Second, in November 1996 the Comptroller of the Currency, Eugene Ludwig, ruled that national banks would be allowed to conduct non-banking operations in main (or lead) bank subsidiaries, rather than having to conduct them in separate affiliates of the bank holding company. Legislative reform is now being proposed again for the new Congress, with four regulatory reform bills, including one from Representative Leach.

In November 1996 Japanese Prime Minister Hashimoto announced the intention to introduce a 'big bang' of reforms in the financial sector. The first step was the establishment of working groups to examine various aspects of the reforms which are all due to report by the middle of 1997. It is expected that the first major reform will be the abolition of controls on foreign exchange transactions by April 1998. The ultimate objective is a substantial liberalisation of Japanese financial markets by 2001. In parallel with this, consideration is being given to a new Bank of Japan law, reducing the legal powers of the Government over the operations of the Bank, and a reform of the Ministry of Finance, including the transfer of banking supervision to a separate agency.

(2) IMPLEMENTATION IN PROGRESS

Amendment to the Basle Capital Accord to cover market risks

Last year's *Report* noted that the Basle Committee on Banking Supervision had issued an amendment to the Accord on Capital Adequacy to cover Market Risk (including commodities). The amendment proposed two basic systems for measuring such risks; the first, the so-called standardised method, follows very closely (although not precisely) the system adopted in the EU Capital Adequacy Directive. This directive became operational in January 1996 and applies both to credit institutions and investment firms established in the European Union.

The second system adopted in the Basle amendment to the Accord is based on banks' own value at risk (VAR) models as the determinant of supervisory capital requirements. The Basle amendment to the Accord is due for implementation by end-December 1997. As noted in Part I of this *Report*, the European Commission has recently adopted an amendment to the CAD to bring the existing Directive broadly into line with the revised Basle Accord. The timing of its implementation, however, remains uncertain as the amending directive has yet to be discussed in a European Council working party or debated by the European Parliament.

Securitisation of revolving credits

Following consultation on the one issue requiring further review identified in the Bank's Notice S&S/1996/8, 'Securitisation of revolving credits'—the setting of a minimum period for the scheduled amortisation of aggregated schemes—the Bank plans to issue an amending

Notice in the summer. The Bank continues to believe that a minimum amortisation period is required, given the fundamental principle underlying the policy that securitisation arrangements should ensure the full sharing of risk and reward by investors. However, the requirement for 90% repayment of total debt outstanding at the start of the amortisation period has been relaxed. Principal and interest (as opposed to just principal) may now be used to make repayments.

(3) AREAS UNDER DISCUSSION

Consultation notice on banks' holdings of credit and financial institutions' and non-financial companies' capital instruments

As noted in the Spring 1997 edition of the *Financial Stability Review*, the Bank issued a draft Policy Notice in December 1996 for consultation prompted by banks' growing equities businesses. The Notice sought to clarify and update the existing policy on the deductions from capital which must be made when banks hold other companies' capital instruments. These rules apply both to holdings in companies within and outside a bank's consolidated group. Under existing policy, banks' physical holdings of credit institutions' and investment firms' capital instruments may only be held without deduction from capital when banks have demonstrated that they make markets in such instruments; these so-called 'market-maker's concessions' were introduced in 1986 to facilitate the market in bank capital instruments, while at the same time limiting the extent to which the capital of one bank is used to support another. Under the proposals in the draft Notice, holdings taken by a bank and included in its trading book—essentially those held for trading purposes—need not be deducted from capital, as long as they do not exceed the limits set out in the Own Funds Directive. This relaxation reflects the contribution to liquidity of the market in capital instruments which banks, which hold such instruments in their trading book, make even when they are not designated market-makers. The Bank is currently reviewing comments received on the draft Notice.

Credit derivatives

The Bank issued a discussion paper on 'Developing a supervisory approach to credit derivatives', in November 1996, intended to initiate a wider debate on the appropriate risk management of these products and to invite comments on the possible capital adequacy treatment. Further information is provided in the text box on page 33.

Interest rate risk management

As noted in the Spring 1997 edition of the *Financial Stability Review*, the Basle Supervisors Committee issued a consultative paper on 22 January entitled 'Principles for the management of interest rate risk'. It sets out twelve principles as sound practices for interest rate risk management, falling into five broad categories:

(a) **The role of the board and senior management:** noting the importance of the board in setting the strategy, policies and procedures, and of senior management in managing, controlling and limiting the risks via an appropriate independent risk management function.

(b) **Policies and procedures:** noting the importance of clear and appropriate policies and adequate procedures, controls and risk assessment for new financial products or trading strategies with senior management approval.

(c) **Measurement and monitoring systems:** noting the need for comprehensive, timely and accurate exposure monitoring systems where the underlying assumptions are clearly understood by management and vulnerability to loss is tested under stressed conditions.

(d) **Independent controls:** noting the need for adequate controls and periodic independent reviews of controls and risk management processes.

(e) **Information for supervisory authorities:** noting that G10 supervisors will seek information from banks to gauge their exposure to interest rate risk, for example, by maturity and currency.

There are two annexes to the paper; the first considers techniques for interest rate risk measurement, while the second discusses methods of interest rate risk exposure monitoring by supervisory authorities.

CREDIT DERIVATIVES

As noted in the Spring 1997 edition of the *Financial Stability Review*, many commentators are predicting a significant expansion in the market for credit derivatives—a new range of financial products being pioneered by larger banks and securities firms, mainly in London and New York. The issues raised by some forms of credit derivative are complex and the Bank has consulted market practitioners and other banking and securities regulators in Europe and the United States in an effort to develop a broadly consistent approach to them.

In November the Bank issued a discussion paper, 'Developing a Supervisory Approach to Credit Derivatives'. The paper had several purposes:

- to initiate a wider debate on the appropriate risk management of credit derivatives;
- to set out how they currently fit into the Bank's capital adequacy rules; and
- to invite comments on how this interim capital treatment might be developed in the future.

As noted above, credit derivatives are a relatively new range of financial products. Estimates of the market size vary considerably, but it is clear that the value of deals outstanding is still very small in comparison with interest rate and foreign exchange derivatives. However, many banks and other financial institutions are actively exploring the possibility of using credit derivatives. For some, this may be part of a larger move towards managing credit risks more actively.

Credit derivatives are designed to transfer the credit risk on loans and other assets from one party to another, in exchange for either interest payments or a one-off fee. They can take the form of a swap or option contract or a note issue. They offer banks and other institutions the possibility of adjusting their credit risks by hedging individual exposures (for example, to a relationship borrower) or by diversifying their portfolio of credit risks (for example, by reducing concentrations in particular countries). Credit derivatives can also allow non-banks (such as insurance companies and pension funds) to assume the economic role of lenders without the need to acquire the infrastructure necessary to service loans.

While credit derivatives offer potential benefits to banks and other institutions, they also raise the same important questions of documentation, risk management and control associated with most new products. Credit derivatives do not fit into the established regulatory capital adequacy regimes in a straightforward manner because the current capital framework was devised before banks began to develop techniques for active hedging and diversification of credit risks. Banking regulators are, therefore, discussing their treatment in the appropriate sub-committees of the Basle Committee on Banking Supervision and in Brussels in an effort to establish sensible risk management guidelines and a broadly consistent framework of capital charges. To increase its understanding of the new instruments and trading strategies, the Bank has co-operated closely with the SFA in a series of fact-finding meetings with active market participants and their trade associations and has also met with the various US banking regulators and the main market players in New York.

The paper issued by the Bank in November was an important component of this open and collaborative approach and has been welcomed by market commentators and other regulators as a constructive way of developing policy. The International Swap Dealers' Association, the London Investment Banking Association, and the British Bankers' Association helped to co-ordinate discussion of the issues raised in the paper, and responded in detail to the Bank. Individual banks have also responded in detail, as have accountants and academics.

The responses reveal a variety of views in some areas, but there is agreement on a number of important issues, particularly with respect to aspects of the proposed interim capital charges. This is helpful in taking forward the debate, and the Bank will be discussing the implications with other regulators internationally before giving feedback to the market and to respondents.

The paper invited comments not only on alternative approaches which would be consistent with the relevant European Directives and the Basle Accord, but also on more forward looking solutions which might require the capital framework to be changed. Several respondents who were unable to make comprehensive suggestions on the way forward within the time period for comments (by end January 1997), have indicated they will do so later. The debate about how the regulatory capital framework should reflect active management of credit risk will continue as banks develop more sophisticated strategies, and the Bank continues to extend an open invitation for comments and suggestions.

The Bank believes the proposals represent a sound basis for discussion of the principles of managing and supervising interest rate risk.

The paper was issued as a consultative proposal and comments on all aspects from banks and other interested parties were requested by the Bank by end March 1997. Comments received have been forwarded to Basle.

Financial conglomerates

As noted in Part I of the *Report*, the Joint Forum on Financial Conglomerates was established in early 1996. The Joint Forum took forward the work of the Tripartite Group. This predecessor group was comprised of some twenty-five individuals from the banking, securities and insurance supervisory sectors who acted in a personal capacity in examining supervisory issues relating to financial conglomerates. Its report was released in July 1995. The Joint Forum is comprised of nine senior supervisors for each of the banking, insurance and securities sectors. Thirteen countries are represented in the Joint Forum: Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States. The EU Commission is attending in an observer capacity to liaise with similar work undertaken in the EU.

In accordance with the mandate agreed by the three constituting Committees, the Joint Forum is pursuing practical means at domestic and international levels to facilitate the exchange of information between supervisors both within their own sectors and between different sectors, and investigating any legal or other barriers which could impede the exchange of supervisory information. It is also examining the possibility of establishing criteria to identify and define the responsibilities of a 'co-ordinator' or 'lead regulator' and is working on developing principles for the supervision of financial conglomerates.

The growing emergence of financial conglomerates, where legal entities are often not a good guide to how businesses are managed and risks taken, and the blurring of distinctions between the activities of firms in each financial sector has heightened the need for co-operative efforts to improve the effectiveness of supervisory methods and approaches. The focus is, primarily, those diversified financial firms whose large scale activities straddle national borders and cross sectoral boundaries.

Accounting and disclosure of financial instruments

A survey published in November 1996 by the Basle Committee and the Technical Committee of the International Organisation of Securities Commissions (IOSCO) showed that in general the largest banks and securities houses in the G10 involved in derivatives continued to enhance the disclosure of their trading and derivatives activities in their 1995 annual reports. The improvement in quantitative disclosure, especially of market risk, was particularly marked, with the proportion of the sample providing value-at-risk based information doubling to slightly less than a half. Nevertheless, there remained substantial variations in the quality of disclosure both between and within countries.

Work continued in the United Kingdom and at European Union and international levels to develop improved accounting and disclosure standards for financial instruments. In the United Kingdom the Accounting Standards Board (ASB) published a Discussion Paper 'Derivatives and Other Financial Instruments' which addresses both accounting and disclosure issues. The ASB issued an exposure draft dealing with the disclosure issues in April, with a further exposure draft on measurement issues to follow.

In Europe, the Commission decided to aim for a non–mandatory recommendation on disclosure of information on financial instruments in banks' accounts. A first draft was considered by the Joint Working Group on Accounting and Disclosure of Financial Instruments in February.

At the international level the International Accounting Standards Committee (IASC) continued work on the second phase of its financial instruments project. The goal of the second phase is to issue a standard on accounting for financial instruments which will complement the standard on disclosure (IAS 32) which became effective for accounting periods beginning on or after 1 January 1996. The IASC issued a discussion paper on accounting for financial assets and financial liabilities in March 1997. This paper proposed that market value accounting for financial instruments should be adopted, with limited exceptions. Comments on the Discussion Paper's proposals are to be submitted by 15 July 1997.

Emerging market financial stability

Following the crisis in Mexico, the international community is examining how financial stability in emerging markets might be enhanced. The Bank is actively involved in this effort through its participation in a Working Party on emerging market financial stability, which will report to the 1997 G7 Summit in Denver, and as noted in Part I is also co-operating in the Basle Committee's work on guidelines on minimum standards for effective banking supervision, which were published on 9 April 1997.

(4) LIAISON WITH OTHER SUPERVISORS

The Basle Committee on Banking Supervision

Many of the issues which have involved the Basle Committee over the last year have already been discussed elsewhere in this *Report* and are not, therefore, described further in this section.

The Committee, under the chairmanship of Tommaso Padoa-Schioppa of the Banca D'Italia (recently succeeded by Tom de Swaan of de Nederlandsche Bank), met four times during 1996. As discussed above, a supplement to the 1988 Capital Accord to cover market risks incurred by banks was published in January 1996. During the year the Committee considered two aspects of the supplement in further detail—the difference in capital requirements stemming from use of internal models as opposed to the standardised approach and the steps being taken by the industry to model specific risk. In December it discussed the quantitative parameters laid down for models users, following further empirical tests, while concluding that further work was needed before any changes were made to the arrangements for specific risk.

In addition, the Committee's work on multilateral netting schemes culminated in publication of an interpretation note in April 1996. The Committee's work on interest rate risk is discussed on page 32.

It was also agreed that the future work of the Committee would be divided into three main areas: (i) capital adequacy including both credit and market risk; (ii) risk management including operational risk and internal controls; and (iii) information flows and disclosure, assisted by a task force on accounting issues.

EU supervisory bodies

The Banking Advisory Committee (BAC) and the Contact Group of EU Supervisory Authorities ('Groupe de Contact') met regularly during 1996 to discuss supervisory questions at EU level.

The BAC met three times in 1996. The BAC's main work is to assist the European Commission in the preparation, application and interpretation of EU banking legislation, and to approve technical amendments to existing EU legislation. Subjects discussed included the revision of the CAD following the amendment to the Basle Capital Accord to incorporate market risk (including the amendment of CAD in respect of models), the regulatory consequences of the introduction of the Euro, the regulatory aspects of electronic money (including the Internet), and the treatment of mortgage finance and investment firms under the Solvency Ratio Directive.

The Groupe de Contact has continued to act as a forum for confidential exchange of information on matters of mutual interest, for reviewing developments in Member States' supervisory systems and for conducting comparative studies of different aspects of these systems. Subjects covered by the Groupe de Contact during 1996 included: the relationship between banking supervisory authorities and external auditors; Member States' supervisory policies with respect to country risk provisioning; and the host Member State's regimes with respect to the supervision of the liquidity of branches of credit institutions which are authorised in other EEA Member States. As in previous years, much of the Groupe de Contact's work was made available to the BAC and/or the European Monetary Institute's Banking Supervisory Sub-Committee.

The EMI Banking Supervisory Sub-Committee

The Sub-Committee, under the Chairmanship of Tom de Swaan of de Nederlandsche Bank, met four times in 1996.

The work of the Sub-Committee concentrated mainly on the prudential consequences of the introduction of the single currency and the process for co-operation between supervisory authorities in the European Union post-EMU. In this area, the Sub-Committee considered the contribution of any future European Central Bank to the 'smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system'. It also discussed the flows of information between supervisory authorities, the European Central Bank and National Central Banks both in and out of EMU. Other subjects discussed included regulatory co-operation, macro-economic influences on the banking system, electronic money, financial fragility, internal controls, credit registers and general banking developments.

Memoranda of Understanding with UK supervisors

Memoranda of Understanding (MoUs) in place with Financial Services Act regulators are currently under review and possible amendment, following the implementation of the Investment Services Directive and the Bank's Review of Supervision in 1996. MoUs were finalised with the London International Finance Futures and Options Exchange and the London Clearing House. The Bank hopes to finalise a similar MOU with the London Metal Exchange soon.

Memoranda of Understanding with other EEA supervisors

During the year, the Bank continued to hold routine and ad hoc bilateral meetings with its supervisory counterparts in other EEA Member States under the terms of bilateral MoUs on supervisory co-operation. The principal purpose of these meetings was: to exchange information on credit institutions with physical presences in both countries; to address bilateral concerns or supervisory issues arising from the administration of EU Directives; and, more generally, to exchange views on supervisory developments and other issues of mutual interest. The Bank places considerable emphasis on co-operation and co-ordination with supervisors in other EEA Member States.

Contact with non-EEA supervisors

The Bank has continued to develop its programme of formal and informal contacts with non-EEA supervisors to improve its understanding of the nature and scope of their supervision and to exchange information, both about UK banks' operations within their jurisdictions and about banks from their countries which have operations in the United Kingdom. During the year the Bank has formalised its contacts with other supervisors in a number of cases by concluding MoUs or exchanging letters concerning supervisory arrangements.

THE SINGLE MARKET IN BANKING—THE ROLE OF THE BANK OF ENGLAND

The Second Banking Co-ordination Directive (2BCD) was implemented in the United Kingdom on 1 January 1993. It allows, among other things, a bank incorporated and authorised in one EEA[1] country (the 'home' country) to provide certain banking and financial services in another EEA country (the 'host' country) without needing prior authorisation from the host country supervisor. This can be done either on a cross-border basis or through opening a branch in the host country. Banks which have used the 2BCD passport to provide such services in the United Kingdom are known as European Authorised Institutions (EAIs). Banks authorised in any one EEA country are subject to a range of EU directives which provide a common regulatory framework for their prudential supervision throughout the EEA. In the United Kingdom there are at present 115 branches of EAIs which, with their 14 UK subsidiaries account for about a quarter of the UK's banking sector balance sheet. The largest 10 EAIs in London account for around half of this figure.

The leading European banks continue to focus on expanding their investment banking capabilities, consolidating recent acquisitions, and restructuring their operations to suit the global stage on which they perform. The importance of London as a financial centre means that this often involves a strengthening of their UK presences.

Under the 2BCD, responsibility for the prudential supervision of UK branches of EAIs was, with the exception of that for the supervision of liquidity (responsibility for which is shared between home and host country supervisors), passed from the Bank to that institution's home supervisory authority. This means that, for example, the prudential supervision of the UK branches of French banks is the responsibility of the Commission Bancaire: similarly, that of the UK branches of Italian banks is the responsibility of the Banca D'Italia. Conversely, the Bank of England is now solely responsible for the prudential supervision of branches of UK incorporated banks in other EEA countries.

As a result of these changes the Bank has very limited supervisory powers and responsibilities for EAIs. In particular, the Bank has virtually none of the legal powers over UK branches of EAIs that it has over institutions authorised under the Banking Act 1987: for example, the Bank has no authorisation powers, no powers to set capital requirements and no powers to require information on large exposures, provisioning or profitability. No 'fit and proper' tests are carried out by the Bank on EAIs or their shareholders, controllers and management: no significant prudential information systematically passes from a UK branch of an EAI to the Bank, and no reports on systems and controls from reporting accountants and no Review Team Visits are undertaken.

To achieve its limited supervisory responsibility for liquidity, the Bank generally holds one meeting a year with UK branches of EAIs. This meeting typically consists of a very general discussion of strategy, business environment, and the liquidity of its UK operations.

Overarching these arrangements, the bank has signed formal agreements—'Memoranda of Understanding'—with other EEA supervisors. These Memoranda provide a framework for the exchange of information between home and host supervisors. They also make clear the home country responsibility for prudential supervision.

Beyond this very limited supervisory role, the Bank has a wider interest in the activities of major EAIs' UK operations. As the central bank of the United Kingdom the Bank has, as one of its core purposes, the maintenance of the stability of the UK financial system. Although the Bank does not have a supervisory responsibility for the soundness of individual EAIs, the larger and more complex UK branches of EAIs could pose secondary supervisory risk, for example due to the size of their exposures to other, particularly smaller, UK banks. These banks may, therefore, be of interest to the Bank as part of its wider central bank task. In relation to these large and complex EAIs the Bank hopes to build up a relatively fuller (but still necessarily highly impressionistic) picture of the scale and nature of their business and a high-level impression of their control systems.

This allows the Bank to be better informed about the possible implications of the operations of major European banks in the United Kingdom for London markets. The Bank also ensures that this information is communicated to the home supervisors so that their ability to carry out their supervisory responsibilities is increased.

Under 2BCD the supervision of liquidity remains a responsibility shared between the home and host supervisor. Where the bank manages its liquidity on a global basis (and is monitored as such by its home supervisor), the Bank's policy is to look to Head Office to ensure that the UK branch has appropriate liquidity. Once the Bank is able to agree with the home supervisor that supervisory monitoring by the Bank of liquidity of a UK branch of an EAI would not be of value, we seek to agree a 'global liquidity arrangement' with the home supervisor. This allows the Bank to meet its host responsibilities under 2BCD, without imposing quantitative local liquidity requirements on the branch. The Bank has raised the possibility of agreeing such arrangements with a number of EEA supervisors and has already reached agreement, in principle, in some cases. The Bank hopes to reach agreement on such arrangements with as many other EEA supervisory authorities as possible over the coming year.

(1) The EEA (European Economic Area) comprises Norway, Iceland and Liechtenstein as well as the members of the European Union.

Part V THE LEGAL FRAMEWORK AND OPERATIONAL SUPERVISION

A. DEVELOPMENTS IN THE LEGAL FRAMEWORK

Statutory instruments

One statutory instrument was made under the Banking Act 1987 since last year's *Report* was published. This was The Banking Act 1987 (Exempt Transactions) Regulations 1997[1] which came into force on 3 April 1997. The regulations, among other things, set out the circumstances in which the acceptance of a deposit involving the issue of a debt security is an exempt transaction.

One statutory instrument[2] amending the Banking Act was made, on 27 June 1996, under the European Communities Act 1972. This gave effect to the Post BCCI Directive, which came into force on 18 July 1996. The regulations among other things also amended The Accountants (Banking Act 1987) Regulations 1994[3] to widen the scope of the requirement for auditors and reporting accountants to notify relevant information to the Bank. (The changes made by the Directive are described more fully in Part IV of this *Report*.)

Statements of Principles

A notice relating to the principles in accordance with which the Bank is acting in exercising its power to grant, revoke or restrict an authorisation, as set out in sections 4,5 and 6 of the Statement of Principles (published in May 1993 by the Bank under section 16 of the Act) was issued in November 1996: *United Kingdom arrangements for the implementation of the close links provision of the Post-BCCI Directive (S&S/1996/9).*

In addition, the following paper is added to the table in paragraph 2.5 of the Statement of Principles— 'The Bank's general approach to the assessment of capital adequacy': *Amendment to the Bank's notice on the implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3) (S&S/1996/10).*

Revision of the Statements of Principles

The Statements of Principles were last published in 1993. In subsequent years any changes to the Statements have been set out, annually, in the *Banking Act Report*. A number of significant changes have taken place since 1993, such as implementation of the Capital Adequacy Directive. The Bank intends to publish a revised version later in the year.

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.** (This approach is set out in more detail in the text box on page 37.)

The authorised population rose again in 1996/97, from 539 to 554 (see table I). The number of institutions permitted to accept deposits in the United Kingdom also rose from 515 to 516. 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.

(1) SI 1997 No 817
(2) SI 1996 No 1669
(3) SI 1994 No 524

Institutions authorised under the Banking Act

There were 361 institutions authorised under the Banking Act at the end of February 1997. Of these, 149 were represented in the United Kingdom by branches of institutions incorporated outside the European Economic Area and 212 were incorporated in the United Kingdom. Of the UK-incorporated institutions, 79 were subsidiaries of overseas companies and seven were joint ventures involving overseas institutions.

TABLE VIII

The 'authorised population'[1]

End-February	*1994*	*1995*	*1996*	*1997*
UK-incorporated	232	224	220	212
Incorporated outside the UK	286	301	319	342
Total	**518**	**525**	**539**	**554**
of which:				
EAIs with UK branches entitled to take deposits in the UK	97	102	103	105
EAIs which are entitled to take deposits in the UK on a cross-border basis	21	30	37	50
Other EAIs	11	14	24	38

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

European authorised institutions

As at end-February 1997, there were 193 institutions recognised under the 2BCD Regulations as EAIs. Of these, 105 had branches in the United Kingdom which were entitled (among other things) to accept deposits in the United Kingdom, and ten 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 78 EAIs did not have branches but offered services on a cross-border basis only (of which 50 were entitled to take deposits).

TABLE IX

New authorisations under the Banking Act and new EAIs[1]

Year to end-February	*1994*	*1995*	*1996*	*1997*
Banking Act authorisations	5	6	8	11
New EAIs with UK branches entitled to accept deposits in the UK	5	5	5	4
New EAIs entitled to accept deposits in the UK on a cross-border basis	21	9	8	14
Other new EAIs	11	4	10	16

(1) Where the nature of an institution's business has changed, for example, from taking deposits cross-border to having a branch, it is not treated as a new authorisation and is not recorded in Table II. In addition, where a bank is authorised to do more than one activity it is recorded as only one authorisation.

Applications for Authorisation

In the year to end-February 1997, eleven applications for authorisation under the Banking Act were granted by the Bank—nine to UK-incorporated institutions and two to institutions incorporated overseas which wished to open branches in the United Kingdom.

New European authorised institutions

During 1996/97, four new EAIs became entitled to establish branches in the United Kingdom for the purpose of accepting deposits. Another five EAIs established branches not entitled to accept deposits in the United Kingdom. A further 25 EAIs became entitled to carry on, by the provision of cross-border services only, various listed activities (14 of which included deposit-taking).

Surrenders

In 1996/97, 25 authorisations were surrendered compared with twelve in 1995/96. The majority of surrenders were due to a change in the activities of the institution resulting in the authorisation no longer being required. Several were also surrendered as a result of mergers, acquisitions and group restructurings, while a number of overseas institutions opted for a single UK presence.

In cases where an institution surrenders its authorisation but retains Banking Act 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 33 such institutions as at the end of February 1997. The Bank has the power to give such directions to former authorised institutions as it considers necessary in the interests of depositors. As at end February 1997 only one FAI remains subject to directions issued previously and which have been amended as necessary.

Five institutions ceased to be European authorised institutions during the year.

TABLE X

Revocations and restrictions[(a)]

Year to end-February	*1994*	*1995*	*1996*	*1997*
Revocation of authorisation[(b)]	1	—	—	—
Restriction of authorisation	7	1	1	—
Revocation of restricted authorisation	—	—	—	1

(a) The table only relates to institutions authorised under the Banking Act. It records cases in the year that the Bank's formal notice of revocation or restriction was given. In some cases the revocation did not take effect until the following year and in a few cases the institution surrendered its authorisation, or a conditional authorisation expired, before the revocation took effect. It is not therefore a record of authorisations revoked or restricted but of the use of the Bank's powers.

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

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, among other things, 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 fulfiled, or may not be or may not have been fulfiled, in respect of the institution. In 1996/97, one institution had its restricted authorisation revoked. The Bank also agreed certain informal restrictions during the year.

Appeals

One appeal was lodged in 1996/97 against the Bank's decision to exercise its powers. The appeal was later withdrawn by agreement.

Administration orders and liquidations

No institutions were placed in administration in 1996/97. A Members' Voluntary Liquidation (MVL) was put into effect in the case of one institution and a further institution remained subject to a MVL in 1996/97. One institution remained in provisional liquidation.

(ii) Supervision of the 'authorised population'

Interviews, meetings and visits

As customary, the Bank held a large number of meetings with authorised institutions throughout the year, the majority of which were of a non-routine nature 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 1996/97, there were 671 routine prudential interviews with UK authorised institutions and 390 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. Visits range from a day or two at one location to longer and more complex visits which may extend into weeks and cover many locations. Review teams typically comprise two to three people. Increasingly the Review Team visits are being directed to banks where there are specific concerns. This increasing focus has resulted in a reduction in the number of unscheduled visits and is likely to continue once the RATE process is fully operational.

During the year, 119 full review team visits were carried out, along with a further seven 'special' visits.

As discussed in Part 1 of this *Report*, the Bank's Traded Markets Team continued to visit banks to examine the models that banks may use when calculating their market risk capital requirement under the CAD for options and derivatives portfolios. 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 and general reviews of the systems and controls in Treasury operations were also undertaken. Overall, 70 visits, of one or two days, were undertaken to some 60 UK institutions during the year. The Traded Markets Team also made 12 visits to institutions overseas.

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 banks; they also hold wide ranging discussions with overseas supervisors. Surveillance staff regularly undertake visits to overseas countries to assess the economic and regulatory environment through discussions with banks, exchanges, regulators and other relevant bodies. Supervision and Surveillance visits extended to 71 countries during 1996/97 and over 370 meetings were held, at home and abroad, with overseas supervisors, compared with some 200 meetings with 68 countries in 1995/96.

Use of powers to obtain information

Section 39 of the Banking Act gives the Bank powers to require an authorised 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 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 1996/97 689 section 39 reports were commissioned (332 of them on overseas branches) including 25 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. No such reports were commissioned during 1996/97.

The Bank's supervisory response to events depends on the specific circumstances prevailing at the individual institution. On a number of occasions, where a matter is raised by a bank, the Bank has agreed to institutions initiating their own independent enquiries. Typically the scope of the work will be agreed with the Bank, and a full copy of the resultant report will be submitted. The results of these enquiries, and management response and actions, are discussed in a similar manner to formal reports under the Banking Act.

The Special Investigations Unit (SIU)

The SIU was formed in December 1992 to improve the Bank's ability to react to fraud both within and on the authorised community. Since that time the Unit has dealt with over 400 cases ranging from frauds by junior employees within banks to major incidents, such as the Board of Banking Supervision enquiry into Barings. The SIU is primarily an advisory body to assist the supervisors, but has a wider Bank remit when necessary.

During the year 83 cases were referred to the Unit, from across all the S&S Divisions, ranging from discrete single issue cases to more complex issues dealing with fraud, malpractice and problems with systems and controls. The SIU's primary responsibility remains to investigate fraud or malpractice. However, as supervisors' focus on systems and controls increases, the Unit is spending increasing amounts of time in these areas. Often this requires an assessment of the issues relating to adherence to the 'fit and proper' criteria in Schedule 3 of the Banking Act, as set out in the recently published paper on the objectives of supervision.

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, a person's fitness and properness to become a shareholder controller at the proposed threshold. 43 notifications for new or increased control were received in 1996/97. 38 have so far been passed without objection; five remained outstanding as at the end of February 1997.

Representative offices of overseas institutions

In 1996/97, 25 overseas institutions(1) notified the Bank of their intention to establish representative offices in the United Kingdom, one of which was withdrawn, and seven 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 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 1987 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 does not specify any 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 authorise, or supervise, representative offices and has no powers to do so.

Banking names and descriptions

In 1996/97, 15 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 184 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 58 of the proposed names would, or might be likely to, breach the Act.

In addition, work is carried out to identify individuals or corporate entities who do not seek permission to use the word 'bank' in their name, or to use banking descriptions. In the event of any evidence of criminal intent the Bank will investigate to determine if a criminal prosecution is warranted.

Discount houses

The number of discount houses fell from seven to five during the year: The business of King & Shaxson Limited was transferred to Gerrard & King Limited (formerly Gerrard & National Limited) on 6 January. Union Discount Company Limited decided not to take advantage of the transitional arrangements offered to the discount houses at the time of money market reform and to cease to act as the Bank's counterparty. Instead, the Union group is refocusing its business towards its other financial services companies.

(1) The terms 'overseas institution', 'representative office', and 'establishment' are formally defined in Section 74 of the Banking Act 1987.

(iii) Prohibition on unauthorised deposit-taking

The Bank's Enforcement Group investigated some 70 cases of alleged unauthorised deposit-taking during the year. New cases referred to the Bank held steady at 47. There were 12 new investigations using powers under section 42 of the Act, lower than in recent years but continuing the pattern of getting to grips with a series of demanding cases founded on complex and ingenious schemes for taking money from the public.

In October 1996 Peter Charles Carlton Lennon and Roger Allen Charlesworth each pleaded guilty to four charges under Section 35 of the Banking Act (fraudulent inducement to make a deposit); Lennon pleaded guilty to two charges under Section 1 of the Forgery and Counterfeiting Act 1981 (making a false instrument) and Charlesworth pleaded guilty to one charge under Section 3 of the Forgery and Counterfeiting Act 1981 (using a false instrument). Paul Anthony Hyans pleaded guilty to two charges under Section 35 of the Banking Act. The contraventions were made in the operation of the Heritage Bond scheme; the forged documents were discovered during the investigation of the case. Lennon was sentenced to a total of 21 months imprisonment and Charlesworth to a total of 18 months imprisonment. Hyans received a sentence of 200 hours community service. The Judge commended the speed and efficiency of the Bank's investigation which, in nipping the scheme in the bud, had ensured that no losses were suffered by depositors.

In another case involving false and misleading statements in advertisements the Bank decided to administer a formal caution to a young offender in accordance with Home Office Guidelines for Cautions. The caution will be recorded centrally in a similar way to criminal records.

Although no civil proceedings were undertaken in the High Court during the year, 10 undertakings not to contravene the Act were obtained.

Discussions have taken place with other enforcement agencies to assist preparation for the implementation, in 1997, of the Code of Practice issued under the Criminal Procedure and Investigations Act 1996.

Following the Bank's July 1996 letter to banks on vigilance against fraud and illegal deposit-taking the Enforcement Group commenced discussions with several large British banks offering guidance on how to identify signs of illegal deposit taking activity undertaken by their customers.

Part VI ORGANISATION AND STAFFING OF SUPERVISION AND SURVEILLANCE

The reorganisation of Supervision and Surveillance

The Bank's Review of Supervision concluded that a key element of the change programme should be the reorganisation of Supervision and Surveillance into a larger number of line divisions. Appendix 1 depicts this new structure which includes these new divisions: the Emerging Markets North and South Divisions (previously Developing World Division), the European Division and North America and Japan Division (previously Industrial World Division) and the newly formed Operations Division encompassing training, IT and other support functions. In addition, the formation of the Capital and Wholesale Markets Division brought together three separate areas in Supervision and Surveillance which have a strong capital and wholesale market content: the UK Investment Banks Group, the Traded Markets Team and the Wholesale Markets area. A Quality Assurance function reporting direct to the Executive Director responsible for Supervision and Surveillance and a Data Analysis Unit specialising in "intelligent data analysis" were also created along with the establishment of a Change Management Team to take forward the change programme. All these changes took effect on 1 September 1996.

It was recognised by the Bank that in order to implement the wide-ranging recommendations of the Review, Supervision and Surveillance would require a significant increase in resources to carry it through, as well as substantial additional expenditure on information technology and training (see below).

Staff

Staff numbers at the end of February 1997, as shown on in Table 1, showed an increase of 41 compared with a year earlier. This reflects the Bank's recruitment drive over recent months which included a number of specialists (for example in training and IT), the experienced banking advisers, six individuals with previous experience in banking and related sectors and ten additional graduate entrants, in addition to our Autumn graduate/support staff recruitment

TABLE XI

Allocation of Supervision and Surveillance staff

End-February	*1994*	*1995*[1]	*1996*	*1997*
Senior Managers	29	41	52	55
Managers, Analysts and Assistants	152	199	235	264
Inward Secondees/ Review Team	11	10	10	10
Support Services	57	72	87	96
Total	**249**	**322**	**384**	**425**

(1) Includes 42 Surveillance staff previously working in the Bank's former International Divisions.

Following the restructuring of Supervision and Surveillance, 1996 data is not shown on the table below

	Staff	Institutions
	1997	*1997*
Regulatory & Supervisory Policy Division[1]	30	–
Major UK Banks Division	42	56
UK Banks & Enforcement Division[2]	53	69
European Division	42	216[3]
Emerging Markets South Division	44	57
Emerging Markets North Division	43	58
North America & Japan Division	37	80
Capital & Wholesale Markets Division[4]	40	20
Operations Division/Deputy & Executive Directors Office[5]	73	–
Quality Assurance	4	–
Change Management Team	3	–
Staff on Secondment	4	–
Review Team	10	–
Total	425	556

(1) Banking Supervisory Policy Group (Regulatory Policy Group are excluded from this figure).
(2) Includes the Deposit Protection Board.
(3) The majority (193) of which are EAI's.
(4) Includes UK Investment Banks Group, Traded Markets Team and the Wholesale Markets areas. The number of institutions does not include the non Banking Act entities which CWMD is responsible for.
(5) Includes IT, Administration and Training, the Data Analysis Unit, Records Management and local support services.

round. The majority of the initial increase in staff requirements arose from the reorganisation of Supervision and Surveillance and the creation of a number of specific new functions (as outlined above). Over the forthcoming year, Supervision and Surveillance will continue to build up its staff resources in preparation for the introduction of the RATE process. The Autumn graduate recruitment round, together with the recruitment of further experienced hires and additional support staff should raise staff numbers closer to the longer term staffing (an increase of 100 to around 485) which AA suggested were likely to be needed.

Training of staff

The Review has prompted a major re-examination of training, recruitment and career development policies in Supervision and Surveillance. One of the central planks of this will be the setting out of a Core Curriculum, which will define the mix of knowledge, experience and skills that are required by staff at different levels in Supervision and Surveillance. The Core Curriculum will cover both the supervision and surveillance functions. This task is already well under way and has already resulted in changes to the S&S training programme as well as proposals for improving career development through measures such as secondments and more structured delegation. These changes will help to drive forward the introduction of new supervisory practices such as the RATE process. To help implement these changes, a specialist training manager (who started in early March) has been recruited.

Meanwhile the existing training programme has been further extended. A wide range of training has been delivered throughout the year particularly for those who have recently joined Supervision and Surveillance. Two three-week courses, covering the fundamentals of S&S work and attended by over 70 people, have been built on by further courses on more advanced supervisory and surveillance issues. A number of seminars on capital markets, risk management, money laundering, topical supervisory issues and detailed policy subjects have also been held.

Training provided by Supervision and Surveillance

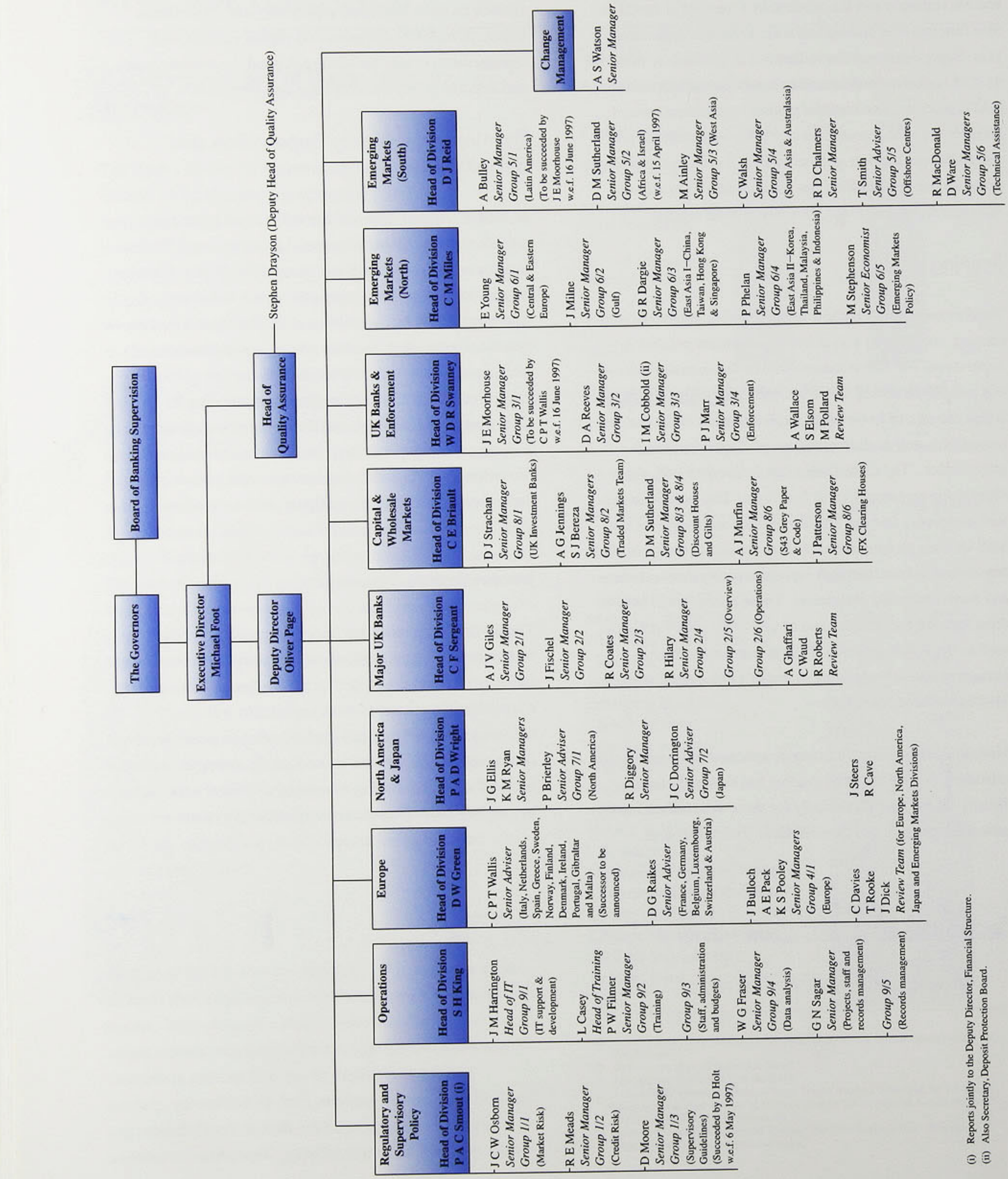
In 1996/97 Supervision and Surveillance continued to provide training for overseas banking supervisors. Four courses were held at the Bank's Centre for Central Banking Studies in London for participants from a wide range of countries. Sixteen courses were delivered abroad for the benefit of individual countries. As in recent years, these were mainly held in the transitional economies of Eastern Europe and Central Asia, though some took place in Commonwealth countries and a certain amount of technical assistance was given abroad. In addition, Supervision and Surveillance continued to receive representatives of overseas supervisory authorities generally on short-term educational visits.

Information technology

The Review concluded that Supervision and Surveillance needed to make significant additional investments in IT. In taking this forward, a project group has been established and a considerable amount of work undertaken with the objective of developing and implementing a comprehensive IT strategy. As part of this process, an IT strategist has been recruited and a substantial amount of additional expenditure has already taken place to improve existing systems.

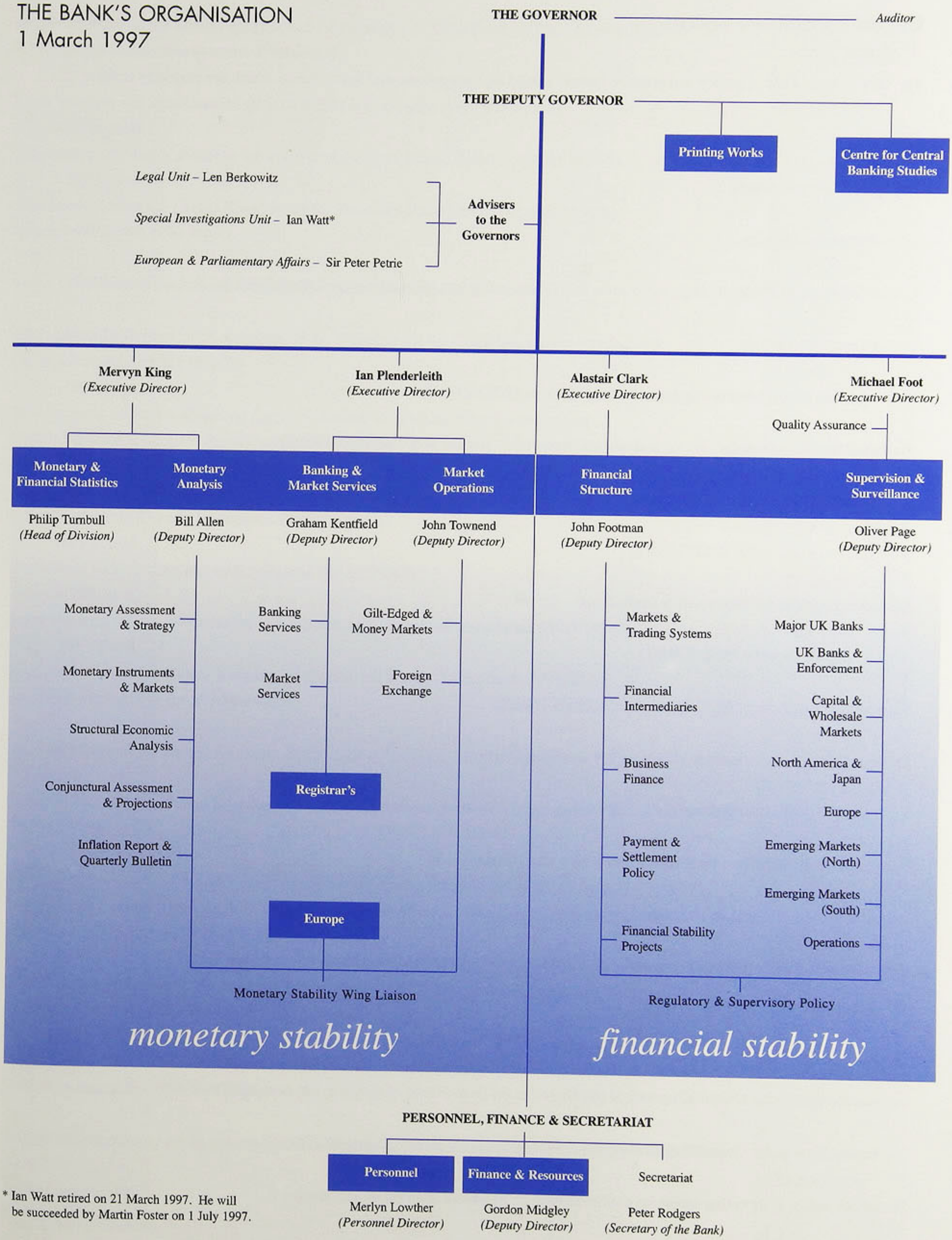
APPENDIX 1

SUPERVISION AND SURVEILLANCE ORGANOGRAM
1 March 1997



(i) Reports jointly to the Deputy Director, Financial Structure.
(ii) Also Secretary, Deposit Protection Board.

THE BANK'S ORGANISATION
1 March 1997



* Ian Watt retired on 21 March 1997. He will be succeeded by Martin Foster on 1 July 1997.

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
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	December 1990
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
Letter to authorised institutions concerning vigilance against fraud and illegal deposit-taking	July 1996
United Kingdom administrative arrangements for implementation of the close links provision of the Post-BCCI Directive (S&S/1996/9)	October 1996
Further amendment to the implementation in the United Kingdom of the Solvency Ratio Directive (BSD/1990/3) (S&S/1996/10)	December 1996

APPENDIX 3

GEOGRAPHICAL REPRESENTATION OF OVERSEAS INSTITUTIONS

The following table shows the geographical origins and status of foreign institutions represented in the United Kingdom at end-February 1997.

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	-	-	-	2	3
Australia	5	4	-	-	2	11
Austria	4	-	-	-	1	5
Bahamas	-	-	-	-	1	1
Bahrain	2	1	-	-	1	4
Bangladesh	1	-	-	-	1	2
Belgium	5	-	-	-	-	5
Bermuda	1	-	-	-	-	1
Brazil	4	-	-	-	7	11
Bulgaria	-	-	-	-	3	3
Canada	6	5	1	-	-	12
Cayman Islands	-	-	-	-	2	2
China	1	1	-	-	5	7
Colombia	-	-	-	-	1	1
Croatia	-	-	-	-	1	1
Cuba	-	1	-	-	-	1
Cyprus	1	2	-	-	-	3
Czech Republic	1	-	-	-	2	3
Denmark	4	-	-	-	-	4
Ecuador	-	-	-	-	1	1
Egypt	1	1	-	-	-	2
Finland	2	-	-	-	1	3
France	20	6	1	-	23	50
Germany	22	5	-	-	4	31
Ghana	1	-	-	-	-	1
Gibraltar	-	-	-	-	2	2
Greece	4	1	-	-	2	7
Hong Kong	4	2	-	-	-	6
India	6	1	-	-	-	7
Indonesia	2	-	-	-	1	3
Iran	5	-	-	1	-	6
Iraq	1	-	-	-	-	1
Republic of Ireland	10	2	-	-	-	12
Israel	2	2	-	-	2	6
Italy	15	1	-	-	29	45
Jamaica	-	-	-	-	4	4
Japan	27	6	4	-	12	49
Jordan	1	-	-	1	-	2
Kenya	-	-	-	-	1	1
Kuwait	-	1	-	1	1	3
Lebanon	1	-	-	-	1	2
Libya	-	-	-	1	-	1
Luxembourg	2	-	-	-	2	4
Former Yugoslav Republic of Macedonia	-	-	-	-	1	1

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

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
Malaysia	2	-	-	-	2	4
Malta	-	-	-	-	2	2
Mexico	4	1	-	-	2	7
Netherlands	8	1	-	-	-	9
New Zealand	-	-	-	-	2	2
Nigeria	2	-	-	-	1	3
Norway	3	-	-	-	-	3
Pakistan	4	-	-	-	2	6
Panama	-	-	-	-	1	1
Philippines	1	1	-	-	2	4
Poland	1	-	-	-	-	1
Portugal	4	-	-	-	2	6
Qatar	1	-	-	-	-	1
Romania	-	-	-	1	-	1
Russia	-	1	-	-	18	19
Saudi Arabia	4	2	-	1	2	9
Singapore	4	-	-	-	-	4
Slovak Republic	-	-	-	-	1	1
Slovenia	-	-	-	-	2	2
South Africa	2	3	-	-	4	9
South Korea	8	3	-	-	6	17
Spain	9	-	-	-	3	12
Sri Lanka	1	-	-	-	-	1
Sweden	3	-	-	-	-	3
Switzerland	8	3	-	-	17	28
Taiwan	2	-	-	-	4	6
Thailand	3	-	-	-	1	4
Turkey	2	1	-	-	7	10
UAE	4	-	-	-	-	4
USA	21	8	6	2	12	49
Ukraine	-	-	-	-	1	1
Uruguay	-	-	-	-	1	1
Federal Republic of Yugoslavia	-	-	-	1	3	4
Venezuela	-	-	-	-	1	1
Zambia	1	-	-	-	-	1
Totals	**264**	**67**	**12**	**9** (2)	**215**	**567** (3)
of which						
EEA countries (4)	115	16	1	-	67	199
Other Europe	13	7	-	2	60	82
North America	27	13	7	2	12	61
Japan	27	6	4	-	12	49
Australia & New Zealand	5	4	-	-	4	13
Other Asia	39	9	-	-	24	72
Middle East	22	7	-	5	7	41
Other	16	5	-	-	29	50

(1) Includes institutions authorised to conduct banking business in the country of origin.
(2) Representing 7 institutions.
(3) Representing 565 institutions.
(4) Other than the United Kingdom.

LIST OF INSTITUTIONS AUTHORISED AS AT 28 FEBRUARY 1997

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 (EEA) 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 by the Bank of England 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
AMC Bank Ltd
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 Irish Bank (GB)/First Trust Bank - (AIB Group (UK) plc)
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 China International (UK) Ltd
Bank of Cyprus (London) Ltd
Bank of Montreal Europe Ltd
Bank of Scotland
Bank of Scotland Treasury Services plc
Bank of Tokyo - Mitsubishi (UK) 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 Bank Trust Company Ltd
Barclays de Zoete Wedd Ltd
Barclays Private Bank Ltd
Baring Brothers Ltd
Beneficial Bank plc
British Arab Commercial Bank Ltd (3)
The British Bank of the Midde East
The British Linen Bank Ltd
Brown, Shipley & Co Ltd

CIBC Wood Gundy plc
CLF Municipal Bank plc
Cafcash Ltd
Cater Allen Ltd
Chartered Trust plc
Charterhouse Bank Ltd
Chase Investment Bank Ltd
Chase Manhattan International Ltd
Cheltenham & Gloucester plc
Citibank International plc
Clive Discount Company Ltd
Close Brothers Ltd
Clydesdale Bank plc
Consolidated Credits Bank Ltd
The Co-operative Bank plc
Coutts & Co
Crédit Agricole Lazard Financial Products Bank
Credit Suisse Financial Products

Daiwa Europe Bank plc
Dalbeattie Finance Co Ltd
Dao Heng Bank (London) 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
First National Bank plc
First National Commercial Bank plc
The First Personal Bank plc
Robert Fleming & Co Ltd
Ford Credit Europe plc
Forward Trust Ltd
Frizzell Bank Ltd

Gartmore Money Management Ltd
Gerrard & King 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 20,000 if greater).
(3) Consortium banks.

Girobank plc
Goldman Sachs International Bank
Granville Bank Ltd
Gresham Trust plc
Guinness Mahon & Co Ltd

HFC Bank plc
HSBC Equator Bank plc
HSBC Investment Bank plc
Habibsons Bank Ltd
Hambros Bank Ltd
Hampshire Trust plc
The Hardware Federation Finance Co Ltd
Harrods Bank Ltd
Harton Securities Ltd
Havana International Bank Ltd
The Heritable and General Investment Bank Ltd
Hill Samuel Bank Ltd
C Hoare & Co
Julian Hodge Bank Ltd
Humberclyde Finance Group Ltd

3i plc
3i Group plc
IBJ International plc
Investec Bank (UK) Ltd
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

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
Merrill Lynch International Bank Ltd
The Methodist Chapel Aid Association Ltd
Midland Bank plc
Midland Bank Trust Company 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
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
Prudential-Bache International Bank Ltd
Prudential Banking plc

RBS Trust Bank Ltd
R Raphael & Sons plc
Rathbone Bros & Co Ltd
Rea Brothers Ltd
Reliance Bank Ltd
Riggs AP 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
Ruffler Bank plc

SBI European Bank plc
Sabanci Bank plc
Sainsbury's 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 plc
Toronto Dominion Bank Europe Ltd
Turkish Bank (UK) Ltd

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

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 Mercantil de São Paulo SA-Finasa
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) Tbk
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 - Mitsubishi, Ltd (2)
The Bank of Yokohama, Ltd (2)
Bank Saderat Iran
Bank Sepah-Iran
Bank Tejarat
Bankers Trust Company (2)
Beirut Riyad Bank SAL

Canadian Imperial Bank of Commerce (2)
Canara Bank
Capital One Bank (2)
Chang Hwa Commercial Bank Ltd
The Chase Manhattan Bank (2)
The Chiba Bank Ltd (2)
Cho Hung Bank (2)
The Chuo Trust & Banking Co, Ltd (2)
Citibank NA (2)
Commercial Bank of Korea Ltd (2)
Commonwealth Bank of Australia (2)
CoreStates Bank NA (2)
Credit Suisse First Boston (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 PJSC

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 National Bank (2)
The Fuji Bank, Ltd (2)

Ghana Commercial Bank
Gulf International Bank BSC

Habib Bank AG Zurich (2)
Habib Bank Ltd
Hanil 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 (2)
Korea Exchange Bank (2)
Korea First Bank (2)

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

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

Qatar National Bank SAQ

Rafidain Bank (provisional liquidator appointed)
Republic National Bank of New York (2)
Riggs Bank NA (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

(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 20,000 if greater).
(2) Non-EEA OECD institutions.

Shinhan Bank (1)
The Siam Commercial Bank Public Company Ltd
Sonali Bank
State Bank of India
State Street Bank and Trust Company (1)
The Sumitomo Bank, Ltd (1)
The Sumitomo Trust & Banking Co Ltd (1)
Swiss Bank Corporation (1)
Syndicate Bank

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)

Turkiye 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

2 European authorised institutions (EAIs) entitled to establish UK branches

(i) EAIs which are entitled to accept deposits through a branch in the United Kingdom

The following institutions have exercised their entitlement to provide one or more of the services listed in Schedule 1 of The Banking Co-ordination (Second Council Directive) Regulations 1992, ***including*** *deposit-taking. EAIs may appear under both sections 2 and 3 of this list. This occurs when institutions notify the Bank under 2BCD of their intentions to provide services both through a branch and on a cross-border basis. Qualifying deposits made with 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. Those institutions that have joined the UK scheme are marked with an asterisk.*

Name of institution	Country of home state supervisory authority
ABN AMRO Bank NV	Netherlands
Allied Irish Banks plc	Republic of Ireland
Alpha Credit Bank AE	Greece
Anglo Irish Bank Corporation plc	Republic of Ireland
BfG Bank AG	Germany
BHF 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 AIG	France
Banque Arabe et Internationale d'Investissement	France
Banque Banorabe	France
Banque Française de l'Orient	France
Banque Française du Commerce Extérieur	France

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

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
Byblos Bank Belgium SA	Belgium
CARIPLO - Cassa di Risparmio delle Provincie Lombarde SpA	Italy
Caisse Nationale de Crédit Agricole	France
Cariverona Banca 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 ASA	Norway
Deutsche Bank AG	Germany
Deutsche Bau- und Bodenbank AG	Germany
Deutsche Genossenschaftsbank	Germany
Dresdner Bank AG	Germany
Equity Bank Ltd	Republic of Ireland
Ergobank SA	Greece
FIMAT International Banque	France
First National Building Society	Republic of Ireland
Generale Bank	Belgium
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
Lehman Brothers Bankhaus AG	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 Bank Markets Ltd	Republic of Ireland
Unibank A/S	Denmark
Westdeutsche Landesbank Girozentrale	Germany

(ii) EAIs which are not entitled to accept deposits through a branch in the United Kingdom

The following institutions have exercised their entitlement to provide one or more of the services listed in Schedule 1 of The Banking Co-ordination (Second Council Directive) Regulations 1992, ***excluding*** *deposit taking.*

Name of Institution	Country of home state supervisory authority
Bank Labouchere NV	Netherlands
Bikuben GiroBank A/S	Denmark
Crédit Agricole Futures	France
International Finance Futures SNC	France
LGT Bank in Liechtenstein (Deutschland) GmbH	Germany
Schröder Münchmeyer Hengst & Co	Germany
Société de Transaction et d'Arbitrage sur Futurs Financiers	France
Sparebanken Nor (trading as UBN Securities)	Norway
Transoptions Finance	France
Westdeutsche ImmobilienBank	Germany

3 European authorised institutions entitled to provide services on a cross-border basis in the United Kingdom

(i) EAIs which are entitled to accept deposits in the United Kingdom on a cross-border basis

The following institutions have exercised their entitlement to provide on a cross-border basis one or more of the services listed in Schedule 1 of The Banking Co-ordination (Second Council Directive) Regulations 1992, ***including*** *deposit-taking. 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
ACCBank plc	Republic of Ireland
BACOB Bank Luxembourg SA	Luxembourg
BNP Finance	France
BW Bank Ireland plc	Republic of Ireland
Banco Borges & Irmão SA	Portugal
Banco Chemical (Portugal) SA	Portugal
Banco ESSI, SA	Portugal
NV Bank Nederlandse Gemeenten	Netherlands
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 Indosuez	France
Banque Indosuez Luxembourg	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
Bikuben GiroBank A/S	Denmark
Caja de Ahorros de Galicia	Spain
Cedel Bank SA	Luxembourg
Chang Hwa Commercial Bank (Europe) NV	Netherlands
Chiao Tung Bank Europe NV	Netherlands
Citibank Belgium SA	Belgium
Compagnie Financière de CIC et de L'Union Européenne	France
Cortal Bank	Luxembourg
Crédit Suisse (Luxembourg) SA	Luxembourg
Crédit Universel	France
Den Danske Bank International SA	Luxembourg
DePfa-Bank Europe plc	Republic of Ireland
Deutsche Ausgleichsbank	Germany
Deutsche Bank AG	Germany
Deutsche Bank Luxembourg SA	Luxembourg
Deutsche Bau- und Bodenbank AG	Germany
Deutsche Handelsbank AG	Germany
Deutsche Hypothekenbank AG	Germany

Deutsche Siedlungs- und Landesrentenbank	Germany
Dornbirner Sparkasse	Austria
Finansbank (Holland) NV	Netherlands
Helaba Dublin Landesbank Hessen-Thüringen International	Republic of Ireland
ING Bank NV	Netherlands
The Investment Bank of Ireland Ltd	Republic of Ireland
Irish Intercontinental Bank Ltd	Republic of Ireland
Irish Permanent plc	Republic of Ireland
Kredietbank SA Luxembourgeoise	Luxembourg
Nordbanken AB (publ)	Sweden
Prudential-Bache International Bank SA	Luxembourg
Rabobank Ireland Ltd	Republic of Ireland
Robeco Bank (Luxembourg) SA	Luxembourg
SNVB Financements	France
Société Européenne de Banque	Luxembourg
Société Nancienne Varin-Bernier	France
Sydbank Luxembourg SA	Luxembourg

(ii) EAIs which are not entitled to accept deposits in the United Kingdom on a cross-border basis

The following institutions have exercised their entitlement to provide one or more of the services listed in Schedule 1 of The Banking Co-ordination (Second Council Directive) Regulations 1992, ***excluding*** *deposit-taking.*

Name of institution	Country of home state supervisory authority
Anglo Irish Bank Corporation	Republic of Ireland
Banco Finantia, SA	Portugal
Bank of America SA	Spain
Banque de Gestion Edmond de Rothschild Luxembourg	Luxembourg
Caja Bilbao Bizkaia Kutxa	Spain
Commerzbank Europe (Ireland)	Republic of Ireland
Crédit Communal de Belgique SA	Belgium
Crédit Européen SA	Luxembourg
Credito Italiano	Italy
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 Centralboden AG	Germany
Garras Bank-Naspa Dublin	Republic of Ireland
Hypothekenbank in Hamburg AG	Germany
Incentive Credit AB	Sweden
Investmentbank Austria AG	Austria
Irish Nationwide Building Society	Republic of Ireland
LGT Bank in Liechtenstein (Deutschland) GmbH	Germany
Nedship Bank (Nederlandse Scheepshypotheekbank NV)	Netherlands
Realkredit Danmark A/S	Denmark
Republic National Bank of New York (Luxembourg) SA	Luxembourg
Rheinboden Hypothekenbank AG	Germany
Rheinhyp Bank Europe plc	Republic of Ireland
Rheinische Hypothekenbank AG	Germany
S-E-Banken Luxembourg SA	Luxembourg
SGZ-Bank Ireland plc	Republic of Ireland
Salzburger Landeshypothekenbank AG	Austria
Société de Caution Mutuelle des Professions Immobilières et Foncières	France
Sparebanken Nor	Norway
Telia Finans AB	Sweden
Württembergische Hypothekenbank AG	Germany

CHANGES TO THE LIST OF INSTITUTIONS

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

1 Institutions authorised by the Bank of England to accept deposits in the United Kingdom

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

Additions

AMC Bank Ltd
Bank of China International (UK) Ltd
Barclays Private Bank Ltd
HSBC Equator Bank plc
HSBC Investment Bank plc
Prudential-Bache International Bank Ltd
Prudential Banking plc
RBS Trust Bank Ltd
Sainsbury's Bank plc

Deletions

ANZ Grindlays Bank plc
Bishopscourt (BB & Co) Ltd (in administration)
Belmont Bank Ltd
British Railways Savings Company Ltd
Caledonian Bank plc
Central Hispano Bank (UK) Ltd
Cyprus Credit Bank (UK) Ltd
Davenham Trust plc
James Finlay Bank Ltd
Foreign & Colonial Management Ltd
Forward Trust Personal Finance Ltd
HSBC Investment Bank Ltd
Hungarian International Bank Ltd
Mellon Europe Ltd
Minories Finance Ltd
The National Mortgage Bank plc
Wagon Finance Ltd

Name changes

Allied Trust Bank Ltd to Investec Bank (UK) Ltd
Bank of Tokyo International Ltd to Bank of Tokyo-Mitsubishi (UK) Ltd
Chemical Investment Bank Ltd to Chase Manhattan International Ltd
First Trust Bank (AIB Group Northern Ireland plc) to Allied Irish Bank (GB)/First Trust Bank - (AIB Group (UK) plc)
Gerrard & National Ltd to Gerrard & King Ltd
Lordsvale Finance plc to Ruffler Bank plc
SBI European Bank Ltd to SBI European Bank plc
UBAF Bank Ltd to British Arab Commercial Bank Ltd

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

Additions

Capital One Bank
NationsBank of Texas NA

Deletions

Banco Inverlat SA
The Bank of Tokyo, Ltd
Bank von Ernst & Co Ltd
The Chase Manhattan Bank, NA
French Bank of Southern Africa Ltd
Harris Trust and Savings Bank
Merchants National Bank & Trust Company of Indianapolis (National City Bank, Indiana)
NBD Bank

Name changes

Banco Mercantil de São Paulo SA to Banco Mercantil de São Paulo SA - Finasa
Chemical Bank to The Chase Manhattan Bank
Crédit Suisse to Credit Suisse First Boston
PT Bank Negara Indonesia (Persero) to PT Bank Negara Indonesia (Persero) Tbk
Fleet Bank of Massachusetts, NA to Fleet National Bank
The Mitsubishi Bank, Ltd to The Bank of Tokyo-Mitsubishi, Ltd
The Riggs National Bank of Washington, DC to Riggs Bank NA

2 European authorised institutions (EAIs) entitled to establish UK branches

(i) EAIs which are entitled to accept deposits through a branch in the United Kingdom

Name of institution	Country of home state supervisory authority
Additions	
Banque AIG	France
Deutsche Bau- und Bodenbank AG	Germany
Equity Bank Ltd	Republic of Ireland
FIMAT International Banque	France
Lehman Brothers Bankhaus AG	Germany
Deletions	
AIB Capital Markets plc	Republic of Ireland
AIB Finance Ltd	Republic of Ireland
Generale Bank Nederland NV	Netherlands
Name changes	
Berliner Handels-und Frankfurter Bank to BHF BANK AG	Germany
Cassa di Risparmio di Verona Vicenza Belluno e Ancona SpA to Cariverona Banca SpA	Italy
Den norske Bank A/S to Den norske Bank ASA	Norway
Ulster Investment Bank Ltd to Ulster Bank Markets Ltd	Republic of Ireland

(ii) EAIs which are not entitled to accept deposits through a branch in the United Kingdom

Name of institution	Country of home state supervisory authority
Additions	
Bank Labouchere NV	Netherlands
International Finance Futures SNC	France
LGT Bank in Liechtenstein (Deutschland) GmbH	Germany
Société de Transaction et d'Arbitrage sur Futurs Financiers	France
Sparebanken Nor (trading as UBN Securities)	Norway
Transoptions Finance	France

3 European authorised institutions entitled to provide services on a cross-border basis in the United Kingdom

(i) EAIs which are entitled to accept deposits in the United Kingdom on a cross-border basis

Additions	
ACCBank plc	Republic of Ireland
BW Bank Ireland plc	Republic of Ireland
Banco ESSI, SA	Portugal
Banque Indosuez	France
Banque Indosuez Luxembourg	Luxembourg
Citibank Belgium SA	Belgium
Crédit Suisse (Luxembourg) SA	Luxembourg
Deutsche Ausgleichsbank	Germany
Deutsche Bank Luxembourg SA	Luxembourg
Deutsche Handelsbank AG	Germany

Helaba Dublin Landesbank Hessen-Thüringen International	Republic of Ireland
The Investment Bank of Ireland Ltd	Republic of Ireland
Irish Intercontinental Bank Ltd	Republic of Ireland
NV Bank Nederlandse Gemeenten	Netherlands
Rabobank Ireland Ltd	Republic of Ireland

Name Change

Sparekassen Bikuben A/S to Bikuben GiroBank A/S	Denmark

(ii) EAIs which are not entitled to accept deposits in the United Kingdom on a cross-border basis

Additions

Anglo Irish Bank Corporation plc	Republic of Ireland
Banco Finantia, SA	Portugal
Banque de Gestion Edmond de Rothschild Luxembourg	Luxembourg
Commerzbank Europe (Ireland)	Republic of Ireland
Garras Bank-Naspa Dublin	Republic of Ireland
Investmentbank Austria AG	Austria
LGT Bank in Liechtenstein (Deutschland) GmbH	Germany
Nedship Bank (Nederlandse ScheepshypotheekbankNV)	Netherlands
Rheinhyp Bank Europe plc	Republic of Ireland
S-E-Banken Luxembourg SA	Luxembourg
SGZ-Bank Ireland plc	Republic of Ireland
Société de Caution Mutuelle des Professions Immobilières et Foncières	France
Sparebanken NOR	Norway
Telia Finans AB	Sweden

Deletions

Bear Stearns Bank GmbH	Germany
Deutsche Centralbodenkredit AG	Germany

Name Change

Frankfurter Hypothekenbank AG to Frankfurter Hypothekenbank Centralboden 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
Abbey National Treasury International (IOM) Ltd	Isle Of Man
The Agricultural Bank of China	China
Alliance and Leicester (Isle of Man) Ltd	Isle Of Man
Allied Banking Corporation	Philippines
Alfa Bank	Russia
Al-Rajhi Investment Corporation Ltd	Saudi Arabia
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 del Cambi)	Italy
Banca Toscana SpA	Italy
Banco Bamerindus do Brasil SA	Brazil
Banco Bandeirantes SA	Brazil
Banco Boavista SA	Brazil
Banco Bradesco SA	Brazil
Banco de Crédito Nacional SA	Brazil
Banco de Galicia	Argentina
Banco de la Republica Oriental del Uruguay	Uruguay
Banco del Pacifico Group (representing:	
Banco del Pacifico SA	Ecuador
Banco del Pacifico SA	Colombia
Banco del Pacifico (Panama) SA	Panama
Pacific National Bank)	USA
Banco di Sardegna SpA	Italy
Banco Excel Economico SA	Brazil
Banco Mello Comercial SA	Portugal
Banco Mercantil CA SACA	Venezuela
Banco Nacional de Comercio Exterior SNC	Mexico
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
Bank Edouard Constant Ltd	Switzerland
Bank Ekspres AS	Turkey
Bank Indonesia	Indonesia
Bank Morgan Stanley AG	Switzerland
Bank Negara Malaysia	Malaysia
Bank of Bermuda (also representing:	
Bank of Bermuda (Cayman) Ltd	Cayman Islands
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
Bank of Cyprus (Channel Islands) Ltd	Guernsey
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
Bank von Ernst & Co Ltd	Switzerland
Banpais SA	Mexico
Banque Arjil & Compagnie	France
Banque Internationale de Commerce	France
Banque Multi Commerciale	Switzerland
Banque Privée Edmond de Rothschild	Switzerland
Banque Transatlantique SA	France
Banque Transatlantique (Jersey) Ltd	France
Banque Woolwich SA	France
Bashcredit Bank	Russia
Bradford & Bingley (Isle of Man) Ltd	Isle Of Man

Bremer Landesbank	Germany
Birmingham Midshires (Guernsey) Ltd	Guernsey
Bristol & West International Ltd	Guernsey
Britannia International Ltd	Isle Of Man
Brown Brothers Harriman Ltd	USA
BULBANK (Bulgarian Foreign Trade Bank) Ltd	Bulgaria
Bulgarian Trade and Savings Bank	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 SA	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 Obchodnl Banka AS	Czech Republic
China Construction Bank	China
Chinatrust Commercial Bank	Taiwan
The Chugoku Bank Ltd	Japan
Commercial Bank of Greece	Greece
Commercial Bank "Stroyinvest"	Russia
Compagnie Bancaire	France
Compagnie Bancaire Geneve	Switzerland
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
Elbim Bank	Russia
Energomashbank	Russia
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 Ukrainian International Bank	Ukraine
Fleet Bank NA	USA
Garanti Bank AS	Turkey
Gruppo Arca Nordest (a partnership of:	Italy
Banca Agricola Mantovana	
Banca Antoniana	
Banca Popolare Commercio e Industria	
Banco Popolare dell'Emilia Romagna	
Banca Popolare di Ancona	
Banca Popolare di Bergamo-Creditor 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 Ltd	Japan
Halifax International (Isle of Man) Ltd	Isle Of Man
Halifax International (Jersey) Ltd	Jersey
Harris Trust and Savings Bank	USA
The Hokkoku Bank Ltd	Japan
Housing and Commercial Bank Korea	South Korea
Hua Nan Commercial Bank Ltd	Taiwan
The Hyakujushi Bank Ltd	Japan
Imperial Bank	Russia
The Industrial & Commercial Bank of China	China
Inkombank	Russia
Irish Permanent (IOM) Ltd	Isle Of Man
Israel Discount Bank Ltd	Israel
Israel Discount Bank of New York	Israel
Istituto Centrale delle Banche Popolari Italiane SpA	Italy
The Iyo Bank Ltd	Japan
JSB Toribank	Russia
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
Kenya Commercial Bank Ltd	Kenya
Komercní Banka AS	Czech Republic
Kookmin Bank	South Korea
The Korea Development Bank	South Korea
Kredietbank SA Luxembourgeoise	Luxembourg
Landesbank Schleswig- Holstein Girozentrale	Germany
Maritime Joint Stock Bank	Russia
Merrill Lynch Bank (Suisse) SA	Switzerland
Metropolitan Bank and Trust Company	Philippines
Mezhcombank	Russia
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
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
The Navy Federal Credit Union	USA
Northern Rock (Guernsey) Ltd	Guernsey
Nova Ljubljanska Banka DD	Slovenia
Oryx Merchant Bank Ltd	Cayman Islands
Osmanli Bankasi AS	Turkey
Osuuspankkien Keskuspankki Oy (Okobank)	Finland
Parva Chastna Banka AD	Bulgaria
People's Bank of China	China
Pramex Britannica Ltd (representing: Caisse Centrale des Banques Populaires)	France
Privredna Banka Zagreb DD	Croatia
Promstroybank	Russia
Rand Merchant Bank Ltd	South Africa
Republic National Bank of New York (Suisse) SA	USA
Reserve Bank of Australia	Australia
Robeco UK Ltd (representing: Banque Robeco (Suisse) SA)	Switzerland
Rosestbank	Russia
Rossiyskiy Kredit Bank	Russia
Royal Bank of Canada (Jersey) Ltd	Jersey
The Royal Bank of Scotland AG	Switzerland
The Royal Bank of Scotland International (Gibraltar) Ltd	Gibraltar
The Royal Bank of Scotland (Guernsey) Ltd	Guernsey
The Royal Bank of Scotland International Ltd	Jersey
The Royal Bank of Scotland (Nassau) Ltd	Bahamas
The Royal Bank of Scotland Trust Co (Guernsey) Ltd	Guernsey
The Royal Bank of Scotland Trust Co (IOM) Ltd	Isle Of Man
The Royal Bank of Scotland Trust Co (Jersey) Ltd	Jersey
SKB Banka DD	Slovenia

The 77 Bank Ltd	Japan
The Shoko Chukin Bank	Japan
Siberian International Investment Bank	Russia
Sime Bank Berhad	Malaysia
Skipton Guernsey Ltd	Guernsey
Standard Bank of South Africa Ltd	South Africa
Standard Bank Offshore (representing:	South Africa
Standard Bank Isle of Man Ltd,	Isle Of Man
Standard Bank Jersey Ltd)	Jersey
Stopanska Banka AD	Former Yugoslav Republic of Macedonia
Sumerbank AS	Turkey
Taipei Bank	Taiwan
Texas Commerce Bank NA	USA
UAL Merchant Bank Ltd	South Africa
Ueberseebank AG	Switzerland
Unibanco - União de bancos Brasileiros SA	Brazil
Union Bank Ltd	Pakistan
United Overseas Bank, Geneva	Switzerland
Victoria Mutual Finance Ltd (representing Victoria Mutual Building Society)	Jamaica
Vojvodjanska Banka DD	Federal Republic of Yugoslavia
Všeobecná Úverová Banka AS	Slovak Republic
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 28 February 1997

Chairman:	E A J George (Governor)	ex-officio
	H Davies (Deputy Governor)	ex-officio
	M D K W Foot (Executive Director)	ex-officio
	Sir Alan Hardcastle	independent
	Harry Taylor CBE	independent
	Peter Gerrard CBE	independent
	Sir Dennis Weatherstone KBE	independent
	Sir Andrew Large	independent
	Sir David Scholey CBE	independent

This is the Board's report for the year to 28 February 1997.

Membership

A number of changes took place during the year.
Mr Michael Foot became an ex-officio member of the Board on 1 March 1996 (on his appointment as Executive Director responsible for Supervision and Surveillance). On 30 June 1996 Lord Swaythling retired and was replaced by Sir Andrew Large (the Chairman of the Securities and Investments Board (SIB)), with effect from 1 July 1996. On the same date, Mr Howard Davies, (Deputy Governor of the Bank of England and ex officio member of the Board of Banking Supervision), was appointed to the SIB Board. On 31 August 1996, Mr Jon Foulds retired and was replaced by Sir David Scholey, a non-Executive Director of the Bank of England, with effect from 1 September 1996.
Mr Harry Taylor was reappointed to the Board with effect from 4 November 1996.

Meetings

The normal pattern is for the Board to meet monthly. At each meeting, the Board considers papers prepared by Supervision and 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 and Surveillance either seeking advice on specific issues or for the Board's information. In particular, the Board is kept informed of cases where Supervision and Surveillance has concerns and where formal action under the Banking Act might be required or is in progress. In consultation with the Board, Supervision and Surveillance prepares a six month forward agenda of items to be discussed.

The Board meets Members of Court annually in the context of the Court's responsibility for the management of the Bank.

Matters Considered

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

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

The Board received regular reports on progress with the Bank's Review of Supervision. Following publication of Arthur Andersen's Report in July 1996, and the reorganisation of Supervision and Surveillance in September 1996, the Board was provided with regular reports on progress in implementing the recommendations arising from the Review, covering such issues as recruitment, IT, training and progress with the various projects (see main body of *Banking Act Report* for details). The Board debated a number of subjects arising from the Review, including papers on the objectives, standards and processes of supervision and proposals for developments in the application of Section 39. The Board also advised on the framework for the RATE model.

With regard to operational matters, the Board received regular reports on specific institutions and matters of concern to Supervision and Surveillance. The Board considered the performance of different banking sectors, looking at the key supervisory issues and the strategies adopted for addressing them. The Board discussed the impact of the Bank's money market reforms on banks and considered the implications of 'cash backs' and other incentive schemes for UK mortgage lending margins.

The Board debated a wide range of policy matters, including issues raised by custody, credit derivatives, the Post-BCCI Directive and deductions from bank capital in respect of holdings of other banks' capital instruments. The Board also discussed Supervision and Surveillance's supervisory approach to 2BCD branches and the Bank's obligations in respect of systems and controls in the light of EU Money Laundering Regulations. The Board also considered Supervision and Surveillance's proposed approach to the treatment of institutions using the Internet. In line with the recommendation set out in paragraph 14.58 of the Board's Report into the Collapse of Barings, the Board received regular reports on the operation of the Bank's large exposure rules.

The Board received regular reports on developments in domestic and international regulatory co-operation, including the work of the Joint Forum; the Basle/IOSCO Joint Initiative; and progress in establishing Memoranda of Understanding with other supervisors.

Regular reports from the Special Investigations Unit were reviewed by the Board, as were reports on the work of Supervision and Surveillance's Enforcement Group (dealing with instances of illegal deposit taking). Papers on the work of the Legal Unit and the work of the Traded Markets Team were also reviewed by the Board.

Further details are provided in the main body of the *Banking Act Report*.

VRangasamy

Secretary,
by Order of the Board

Bank of England 1997
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