BANK *of* ENGLAND

BANKING ACT REPORT

1997/98

BANKING ACT 1987

ANNUAL REPORT UNDER THE BANKING ACT FOR 1997/98

This Report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 28 February 1998 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 the Bank's supervisory priorities during the year under review, including the transfer of responsibility for banking supervision to the Financial Services Authority.

Part II outlines the macroeconomic environment in which banks operated during 1997/98, 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 costs and staffing of Supervision and Surveillance.

1997/98

Part I PRINCIPAL DEVELOPMENTS

THE ESTABLISHMENT OF THE FINANCIAL SERVICES AUTHORITY

In May 1997, the Chancellor of the Exchequer announced Government plans to carry out a major reform of financial regulation, in two stages: first, to transfer responsibility for banking supervision from the Bank to a new and strengthened Securities and Investments Board (SIB), at the same time as giving the Bank operational responsibility for setting interest rates; and, second, to establish a single statutory regulator for all financial services business in the United Kingdom.

This is to be achieved through two pieces of legislation: the Bank of England Act 1998, and a Bill which, it is hoped, will be introduced in autumn this year and will come into force in late 1999 or early 2000. The Government intends to publish this Bill in draft this summer. At the same time, the FSA will set out its regulatory approach in more detail. Further Government announcements have clarified that the new single regulator - the Financial Services Authority (FSA) - will in due course combine the regulatory and registration functions of nine existing bodies.

In announcing his decision, the Chancellor highlighted the increasing blurring of distinctions between different types of financial institution - banks, securities firms and insurance companies. He emphasised the Government's aim of establishing a single statutory regulator to deliver more effective and efficient supervision of all financial business, giving firms and customers better value for money. At the same time he announced that from 1 August 1997, Howard Davies, then Deputy Governor of the Bank, would succeed Sir Andrew Large as Chairman of the SIB (which formally changed its name to the Financial Services Authority in October).

Over the past year the Bank has worked closely with the FSA and the Treasury to implement the Government's decision. The Bank of England Act, transferring to the FSA responsibility for supervising banks, listed money market institutions and related clearing houses, received Royal Assent on 23 April 1998 and will come into force on 1 June. On that date the relevant Bank staff will transfer to contracts of employment with the FSA.

After the transfer of banking supervision, the Bank and the FSA will maintain close working relationships and the agreed framework for co-operation in the field of financial stability is set out in detail in the Memorandum of Understanding, which was published jointly by the Treasury, the FSA and the Bank at the end of October 1997. This explains how the three authorities will work together towards the common objective of financial stability and sets out how their respective responsibilities will be discharged[1].

The FSA will be responsible for the direct supervision of banks, as well as other financial services sector entities, and the supervision of the financial markets and of clearing and settlement systems. It will also be responsible for regulatory policy and will advise on the regulatory implications of market developments and of initiatives such as domestic legislation and EC directives. The Bank will retain its responsibility for the overall stability of the financial system as a whole. This will include achieving monetary stability; seeking to minimise systemic risk through close involvement in the development and strengthening of the financial system infrastructure (e.g. payment systems); taking a broad overview of the system as a whole, with a view to achieving the common objective of systemic stability; and continuing its role in promoting the City of London.

The Deputy Governor of the Bank with responsibility for financial stability will continue to sit on the FSA Board and the FSA Chairman will continue to be a Member of the Bank's Court.

The costs of banking supervision will from 1 June be met by an annual levy on authorised, and certain European authorised, institutions. The FSA consulted the market on its proposals in this area, in a paper published in October. The FSA has now finalised its approach, which is designed to cover the period until the second Bill comes into effect,

(1) This memorandum is reproduced in Appendix 1, together with a list of the constituent parts of the FSA.

taking account of the representations received.

In its October 1997 launch document and its Plan and Budget for 1998/99, published in February, the FSA outlined in some detail its future regulatory approach, including to banking supervision, and set out its work programme, which involves public consultation on a number of key issues. The Plan and Budget also provide details of the FSA organisational structure(1). There will be considerable continuity of management in the transfer of banking supervision from the Bank.

The FSA will seek to maintain the standards of banking supervision currently practised by the Bank and will continue to implement the changes designed to improve overall effectiveness agreed in 1996 following the Arthur Andersen review(2). The FSA will thereby continue to develop the risk-based approach to the supervision of banks (see below). The FSA expects to publish in June a revised version of the Statements of Principles, linked with the publication at the same time of the new Guide to Banking Supervisory Policy. The FSA has already published a consultative paper: "Designing the FSA handbook of rules and guidance". The FSA has also indicated that its approach to the supervision of complex groups is likely to evolve and that it will pilot multi-disciplinary supervisory teams with a limited number of groups. It expects to consult on this issue later this year.

FINANCIAL STABILITY WORLD-WIDE

The economic and financial crises in recent years in Mexico, Japan, and much of South East Asia, together with the increased globalisation of many financial markets, products and institutions, have led to a renewed emphasis on financial stability world-wide, a theme underlined by the 1998 Birmingham Summit. Better financial supervision, especially of vulnerable banking sectors, is an essential element in creating the conditions under which enhanced international capital flows can contribute more positively to economic growth.

The Basle Committee on Banking Supervision has taken a number of initiatives to bolster financial stability. In particular, it has brought many developing and transitional countries in to the formulation, after extensive consultation, of 25 Core Principles of Banking Supervision, designed to provide a minimum framework for governments and supervisors. The Core Principles were launched at the IMF/World Bank Annual Meetings in Hong Kong, and are being followed up by:

- governments and supervisors, who are being encouraged to endorse the Core Principles and more importantly to work for full compliance;
- a self assessment survey conducted by the Basle Committee on the extent of compliance;
- the IMF and World Bank in their programmes and surveillance work; and
- expanded training and technical assistance efforts, including the planned BIS Institute for Financial Stability at Basle.

The Basle Committee over the past year has, in addition:

- developed guidance on risk management, with increasing attention to credit risk;
- published a practical framework for evaluating internal control systems;
- published principles for the management of interest rate risk;
- strengthened international regulatory co-operation; and
- provided leadership on a range of supervisory issues, including Year 2000, disclosure, accounting issues and electronic money.

The 1988 Basle Capital Accord has been updated and extended, most recently to cover market risk. The Basle Committee is continuing to work on further refinements of the Accord, and is considering how best to take account of new developments, particularly in the areas of credit risk

(1) Copies of these documents may be obtained from the FSA's Publications Department, who can be contacted on telephone no:0171-676 1000 or faxno: 0171-676 1099.
(2) In Autumn 1995, the Bank commissioned Arthur Andersen to conduct a review of the operation of its Supervision & Surveillance Divisions (S&S) and to make recommendations for improving the methods, organisation, structure and staffing of S&S.

modelling, securitisation and credit derivatives. The Committee's aim is to build on the achievements of the 1988 Accord in contributing to sounder banking through higher capital ratios.

THE SUPERVISORY RESPONSE TO THE ASIAN CRISES

The causes of the Asian crises are discussed below[1]. There were a number of implications stemming from the Asian crises for UK banking supervision, quite apart from the added impetus for international co-operation outlined above:

- The risk to the solvency of those banks from the affected countries with UK authorisations. As collapsing exchange rates and increasing domestic interest rates began to affect the quality of the banks' loan portfolios, their capital (which may already have been weak) was further impaired and their liquidity tightened. For supervisors, this raised the issue of whether the banks were in breach of the minimum authorisation criteria in Schedule 3 to the Banking Act. Meanwhile, the risk that a withdrawal of funds might affect the ability of the local operations to meet obligations to UK depositors also raised issues under Schedule 3. The Bank worked closely with the banks concerned and with their home country supervisors.

- UK banks with operations in, or exposures to, the countries affected by the crisis. These generally were less of a concern: indeed in a number of cases the regional operations of UK banks benefited from a 'flight to quality' on the part of local depositors away from local banks to foreign banks which were perceived to be stronger. Credit risk has clearly increased and additional modest provisions have been made (see Part III). Economic turbulence, especially the fall in local currencies, also opened up acquisition possibilities in the region.

- Supervisors in London, as a major international financial centre, had to be aware of issues concerning the UK operations of foreign banks not from the affected countries but with significant exposure to them. The Bank monitored and was in close contact with institutions where these exposures were large.

- Inadequate supervisory systems in the region were a contributory factor to the severity of the crises. The remedial programmes being put in place with the help of the international financial agencies include significant elements of restructuring of banking systems.

During the period of turbulence, the Bank has stayed in close contact with the UK operations of banks from the affected countries regarding their liquidity and funding positions. There has also been frequent contact with the banks' Head Offices and their home country supervisors, aided by the contacts the Bank has built up as a result of regular visits to the region. The Bank also liaised closely with the IMF and World Bank.

Although the position of some countries has improved, the crisis is not yet over. Banking supervisors will therefore continue to monitor institutions affected and keep in close touch with other supervisors and international agencies.

THE PROVISIONING MATRIX

The Bank introduced in 1987 a provisioning matrix for country debt in order to give guidance to banks on provisioning levels. Over time, the scoring mechanism in particular has become less useful and increasingly incompatible with risk-based supervision, as evidenced by its limited usefulness in assessing appropriate levels of provisions for exposures to SE Asia at the end of 1997. The Bank has decided that the matrix is to be withdrawn from use as a means of supervisory assessment of provisioning levels. Banks will remain responsible for assessing their own exposures to country risk as part of a new requirement for a provisioning policy statement. The matrix will cease to apply at the point at which a bank provides the FSA with a statement of its provisioning policy, as such statements will then be the main supervisory tool for questioning banks on their provisions for country debt.

THE ECONOMIC CYCLE IN THE UNITED KINGDOM

A further year of above-trend growth took the UK economy to what may well turn out to be a cyclical peak in the rate of growth of output in 1997. Growth in 1998 and 1999 is

(1) See Part II, Macroeconomic Context.

generally expected to slow down significantly from the estimated 3.1% in 1997. Business profitability remains high. Part II, covering the United Kingdom and the world, sets out the economic context within which banks have been operating.

In the past, there have been big cycles in the profitability of banks and these have generally followed, with a lag and with greater amplitude, the general economic cycles in the economy. Swings in banking profitability have been more pronounced because: profits in the economy as a whole have been more variable than output; the way banks have accounted for loan losses meant larger provisions, and hence lower profits, during recessions; and banks have often lent too much too easily during boom times.

By comparison with the boom in the late 1980s, the last few years have seen, for the economy as a whole, a more moderate rate of growth, less tendency for output to exceed significantly its trend level, and fewer imbalances. So far as the banking sector is concerned, there is little evidence of a repeat of the lending activity in the late 1980s which led to heavy loan losses in commercial property and construction in the recession of 1990 to 1992. Moreover, the scale of provisions necessary in 1997 to cover losses in South East Asia has been modest so far; in addition, a positive factor has been the pro-active portfolio management by some large UK banks. Nevertheless, in the past the late stages of the cycle have proved particularly critical for banks: a significant proportion of what ultimately turn out to be bad debts have been put on the book at around that stage. It is therefore important that banks and supervisors remain vigilant.

ECONOMIC AND MONETARY UNION

The European Council decided on 3 May that EMU with 11 participants will start on time in January 1999 and that from that point the wholesale markets and the corporate sector in the United Kingdom will partly switch to the euro and demand euro services from their banks.

The banking supervisors will continue proactively to monitor banks' preparations for the introduction of the euro, with the focus on those banks for which EMU is a material development. If banks are not prepared, not only will new business opportunities be missed, but existing business will also be adversely affected. For example, if a bank's systems cannot cope with the redenomination of securities or changes to market conventions, there will be a severe control problem. If serious shortfalls are identified (particularly in systems and controls), the banking supervisor will take appropriate action, which might ultimately include a restriction of euro-related business.

The Bank is working with the organisations which will make up the FSA, together with industry and consumer groups, to establish the impact of EMU on regulatory requirements. The constituent entities of the FSA are encouraging all regulated firms to conduct thorough audits of all their business processes and product lines; the regulators will be incorporating a review of firms' preparations for EMU into their surveillance and monitoring work during the remainder of the year.

The Bank issued guidance on the implications of the introduction of the euro for the capital adequacy framework in October 1997. Until 31 December 1998, there is exchange rate risk between the participating currencies, so capital charges for foreign exchange rate risk remain in place. From 1 January 1999 no foreign exchange risk will be deemed to exist between the euro and the participating currency units and between participating national currency units themselves. Similarly, interest rate risk on debt instruments should be calculated separately for the participating currencies up to 31 December 1998 and thereafter treated as being in the same currency for capital adequacy purposes.

The Bank has produced a series of papers entitled *Practical Issues Arising from the Introduction of the Euro* which may be viewed on the Bank's website[1] or obtained, free of charge, from the Bank's Public Enquiries Group.

RISK-BASED SUPERVISION

Work is continuing on the Bank's risk-based approach to the supervision of banks, building on the RATE and SCALE frameworks set out in the consultative papers issued last year[2]. This approach involves undertaking an initial risk

(1) The Bank of England's website address in http://www.bankofengland.co.uk. Public Enquiries Group can be contacted on telephone no: 0171 601 4012 or fax no: 0171 601 5460.
(2) RATE (Risk Assessment, Tools of Supervision, Evaluation) for UK incorporated banks and SCALE (Schedule 3 Compliance Assessment Liaison, Evaluation) for banks incorporated in non-EEA countries. Copies of either paper can be obtained from the Public Enquiries Group.

assessment of a bank or banking group, including through on-site visits and liaison with other regulators where appropriate, to identify areas of concern or remedial action, and to draw up a programme of work for the coming period.

The objectives of risk-based supervision of banks are:

- to assess more systematically whether a bank continues to meet the minimum criteria for authorisation, as set out in the Banking Act 1987;

- to gain a better understanding of the quality of management, the characteristics of the business and the risks the banks face;

- to ensure that supervisory action is focused on the main risks in the institutions;

- to use the appropriate tools of supervision (such as reporting accountants' reports on internal controls, Traded Markets Team and Review Team visits) to identify those risks;

- to improve the transparency of supervision through the more explicit linking of the tools of supervision to areas of risk or concern; and

- to allocate resources according to risk - devoting more supervisory effort to those banks that have a high risk profile.

The RATE and SCALE frameworks have been tested on a number of banks during the latter half of 1997. Feedback has been positive and a revised paper on risk based supervision should be published by the FSA in June.

The roll out of RATE and SCALE will be phased over a two-year period. As a result, banks will be subject to a full risk assessment in 1998 or 1999. The Bank has already completed a provisional, 'desktop', RATE assessment of all banks (excluding UK branches of EEA banks) using the new framework, with the objective of developing a supervisory programme for each bank. This, with the provisional risk assessment is being communicated in a letter to each bank.

The Bank is continuing to set capital ratios for banks above the Basle 8% minimum on a bank-by-bank basis, reflecting each bank's risk profile. In setting these ratios, the Bank takes account, in a forward-looking way, of a range of factors relevant to the risk profile of a bank including size, volatility of profits, control systems and risk management, track record and the extent of diversification. In practice, many banks maintain ratios several percent and more above the minima set by the Bank, partly to demonstrate to the market a strong capital position. As the risk-based supervisory approach deepens, it will enhance peer group review and thus the supervisors' ability to judge appropriate capital ratios.

YEAR 2000

The Bank has long recognised the potential for massive disruption which could be caused if banks and others were to fail to ensure systems are year 2000 compliant. The Bank's supervisory programme for the millennium started in late 1996 by asking authorised institutions about their Year 2000 preparations. As supervisor, the Bank does not and could not aim to guarantee that banks will be fully compliant; rather the emphasis is on ensuring that banks' senior management have focused on the scale of the problem facing their institution, are taking responsibility for solving it and have contingency plans in place to rectify any slippage or system failure.

The Bank has also participated in the working group set up by the British Bankers' Association. The key milestones for the banking industry, which supervisors are using to benchmark and monitor banks' progress were published by this group in March 1997 and are set out below.

Much work has been done and most banks are now approaching the key testing phase. Banks should expect closer questioning from banking supervisors as the key milestones in the BBA timetable draw closer. This message has been, and will continue to be, reinforced through letters from the Bank to Chief Executives. The Bank is working closely and actively with other supervisors in the United Kingdom and abroad, including through the Basle Committee. As flagged in its October launch document, the FSA is taking an increasingly proactive role in co-ordinating the supervisory effort across the FSA's constituent bodies. The following division of labour on Year 2000 issues has been agreed:

- All UK-incorporated banks will be the responsibility of the banking supervisor.
- The UK will also adopt the role of lead regulator for overseas branches of UK-incorporated banks, sharing relevant information with the host supervisors.
- For banks incorporated overseas operating in London, the banking supervisor will expect the home supervisor to take the lead. Where this is not the case, the UK will co-ordinate the supervisory approach with the home supervisor as appropriate.

As noted in last year's *Report*, where appropriate, Section 39 Reports will be commissioned to help establish how individual banks are progressing.

Action by the banking supervisors

Should investigations reveal that a bank is not taking appropriate steps and that this poses a material risk to depositors or markets/payments systems, the banking supervisors will use all of the supervisory tools at their disposal ahead of the Year 2000.

- Impose restrictions on some types of activity carried out by a bank.
- Increase a bank's liquidity guidelines where it may be subject to adverse comment and a potential run.
- Increase a bank's capital ratio requirements to reflect these additional risks.
- Revoke a bank's authorisation where the banking supervisor judges that the institution may no longer meet the Schedule 3 minimum authorisation criteria set out in the Banking Act 1987 or the interests of depositors are otherwise at risk. This would be the ultimate sanction.

Any such actions will be co-ordinated under existing arrangements with other supervisors (domestic and international) with an interest in the institution itself or the group of which it is a part. Additionally, the banking supervisors will seek to minimise any changes to regulatory reporting running up to the millennium.

BBA DEADLINES FOR ACTION:

1997	
31 March	Inventory of systems and equipment completed. Issues identified and a plan to address these agreed.
31 December	Relational systems (i.e. those connected or reliant upon other systems) made compliant and made available, with existing compliant systems, for testing.
1998	
30 June	Relational systems tested and made available for testing across organisations. Stand-alone systems made available to test.
31 December	Relational systems' testing across organisations completed and upgrading implemented. Stand-alone systems testing completed and upgrading implemented.
1999	
30 June	All other equipment upgraded and tested.

Part II MACROECONOMIC CONTEXT

OVERVIEW

1997 saw further economic expansion in the United Kingdom. Real GDP grew by an estimated 3.1%, significantly faster than its long-term trend rate of growth. The pace of expansion slackened significantly in the second half of the year. As the Bank's Inflation Report concluded in February 1998, the combination of above-trend growth and falling inflation is unsustainable and has probably already come to an end. The economy may have passed the peak of the cycle in 1997; hence economic conditions for the UK banking sector, which remain highly favourable, may no longer be improving and could be beginning to turn down.

The slowdown in growth towards the end of 1997 - from above trend rates - reflected weakening net exports. The contribution of net trade to GDP growth turned negative during the year, as the impact was felt of sterling appreciation and faster growth than in other major industrial economies. Sterling's effective exchange rate again rose sharply during 1997, and on average over the year was some 15% higher than a year earlier. Surveys of business confidence suggested that the prospects for UK exporters worsened towards the end of the year.

Private consumption was buoyant throughout the year, but grew particularly rapidly in the second quarter, stimulated by windfall gains received by many consumers from the conversion of several mutual societies - building societies and insurance companies - into public limited companies. Investment spending, particularly for business, grew substantially in 1997, but the investment: GDP ratio remains low by the standard of past UK business cycle peaks.

In terms of the sectoral breakdown of GDP, the service sector's output grew much more rapidly than did manufacturing output during 1997, with average rates of growth of 4.3% and 1.5% respectively.

Inflation, as measured by the retail prices index, excluding mortgage interest payments, was a little lower on average in 1997 than in 1996, but was above the government's target of 2.5% in all but two months. The prices charged for services rose faster than those charged for goods; the latter were held back by falls in the prices of raw materials and other imports, partly due to the rise of sterling.

CHART 1

Contributions to GDP growth

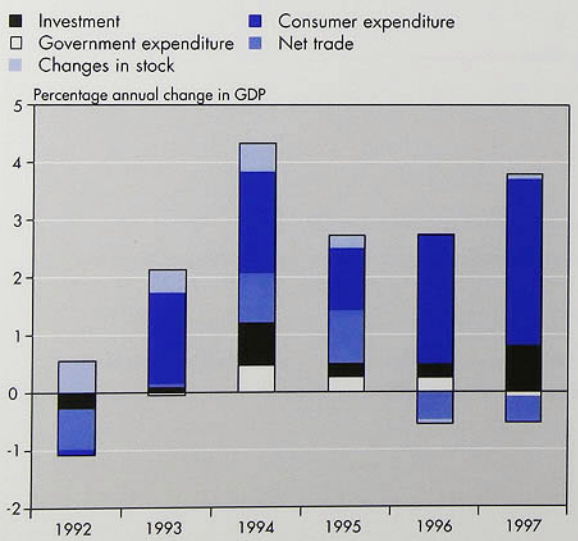
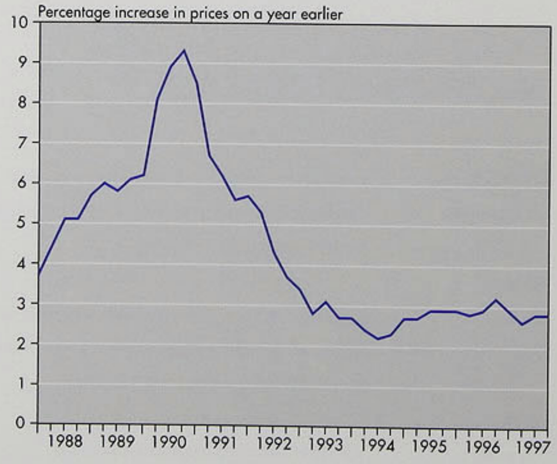


CHART 2

RPIX inflation



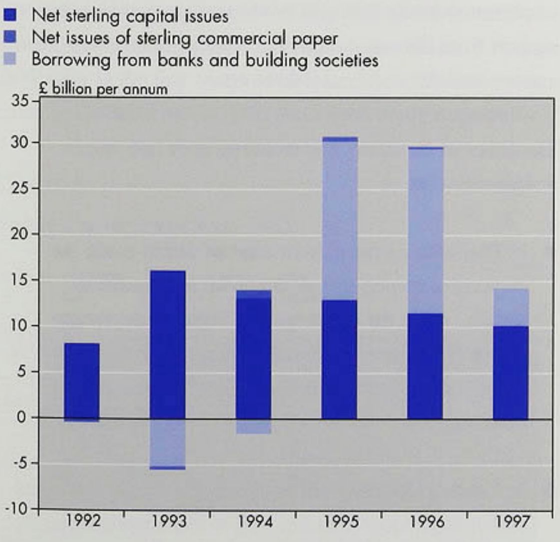
Asset prices continued to rise in 1997. The FT All-Share Index increased by roughly one-quarter over the year, giving a substantial boost to the net financial wealth of consumers. House prices continued to edge up, with activity in the housing market higher in 1997 than in 1996 (particulars delivered increased by nearly one sixth) and the problem of negative equity almost evaporated. Unlike the 1980's, however, house prices nationally did not increase sharply.

CORPORATE SECTOR

Gross trading profits of industrial and commercial companies increased roughly in line with aggregate demand in 1997 and so continued to account for around 14% of GDP. However, dividend payouts, interest payments and UK corporate income taxes (including the 'windfall' tax) increased sharply enough for undistributed income to fall. Company liquidations fell by about 3% but remained relatively high for this stage in the business cycle.

CHART 3

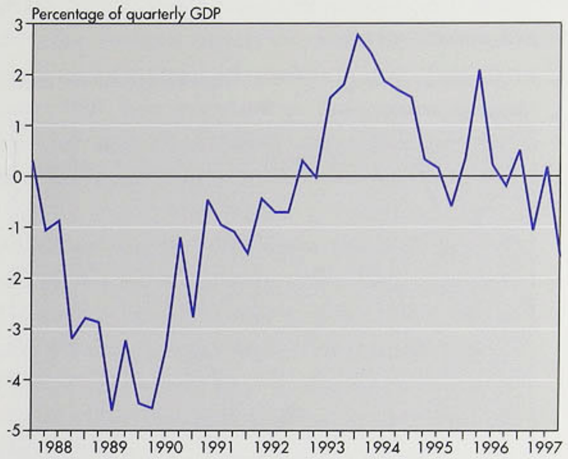
Total annual sterling borrowing by ICCs



Industrial and commercial companies were in financial deficit for 1997 as a whole (the first year in which that had happened since 1992), reflecting the fall in undistributed income. The bank and building society M4 sterling and foreign currency borrowing by ICCs fell to 3.1% in the twelve months to end-1997, from 11.2% in the course of 1996. In contrast, net capital issues remained at a similar level in 1997 as in 1996, despite the strong rise in the stock market.

CHART 4

ICCs' financial balance



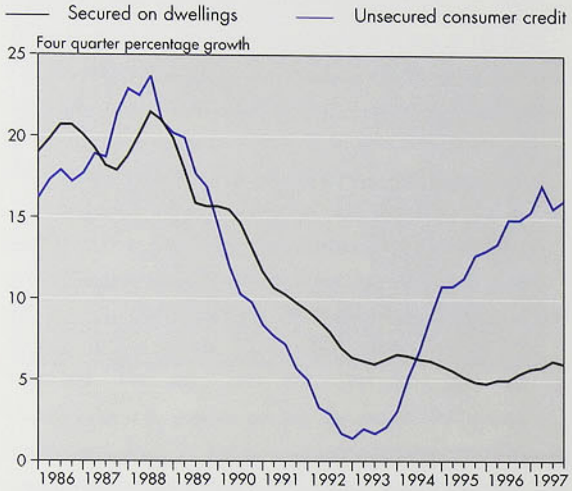
During 1997, there was further recovery in the commercial property market, with rental growth and capital values each showing an improvement of the order of 6%, although again mainly in the prime sector. There remains considerable loan demand which, with an oversupply of funds and greater competition to lend, not just among banks, resulted in a trend to lower pricing and greater loan: value ratios than in 1996. The secondary and tertiary sectors continue to under-perform relative to the prime sector; so banks which are active lenders to the weaker sectors, either for investment or indirectly, as holders of charges against such property as collateral, have a significant exposure in the event of an economic downturn. There is little exposure to speculative development as yet, although the level of London rents suggests such development may be judged economically viable.

PERSONAL SECTOR

The growth rate of credit to the personal sector has slowly increased in the last three years, after slowing in the early 90s. Unsecured lending to persons rose much faster than lending secured on property in the twelve months to December 1997 (by around 16% compared to rates around 6%). Interest rate spreads on unsecured lending fell relative to spreads on mortgage lending, suggesting a supply-side effect on the market for credit derived from increased competition and new entrants amongst suppliers of unsecured credit. Mortgage-equity withdrawal reappeared as a source of consumer finance, but only to a minor extent.

CHART 5

Growth in consumer credit



The increasing demand from consumers for finance from banks probably reflected an increase in expected real incomes. Consumer confidence was significantly higher in 1997 than in 1996, reflecting the windfall gains from demutualisation, increases in net financial and real wealth and increased disposable income. The latter derived from both a moderate increase in annual real wage growth and a continued decline in the rate of unemployment, which also helped reduce job insecurity. Bankruptcies in the personal sector fell sharply, but remain at levels well above those seen at this stage in previous economic cycles.

INTERNATIONAL DEVELOPMENTS

Growth in the European Union as a whole increased to 2.6% in 1997, compared with 1.7% in the previous year. The pattern was the same in all four of the major EU economies. The trend of improved exports and rising domestic confidence as established in the previous year continued, helped by looser monetary conditions across much of Europe as interest rates converged ahead of monetary union.

The economic environment continued to be very benign in the United States with annual GDP growth rising from 2.5% in 1996 to 3.8% in 1997, while prices were broadly stable. Concerns that the pace of growth was unsustainable were at least partially relieved by the dampening effects expected from the Asian crises.

The Japanese economy has suffered from weak growth for some years: more recently activity dipped again following tax rises in the second quarter of 1997. The effects of the Asian crisis in the second half of the year were clearly unwelcome. With deteriorating business and consumer demand, the government has announced reflationary fiscal measures.

THE ASIAN FINANCIAL CRISES

The second half of 1997 saw a spectacular combination of currency collapse and financial crisis in a number of Asian economies. Beginning with the float of the Thai baht in July 1997, and moving on to affect Korea and Indonesia (and to a much lesser extent Malaysia and Hong Kong) the region was affected by a widespread withdrawal of foreign capital. Thailand, Korea and Indonesia received help from a combination of the IMF and World Bank, together with support from the major industrial economies on condition of major economic and financial reforms.

The crises in the three main countries each had certain unique elements.

- In Thailand, a large current account deficit made the exchange rate peg against the dollar impossible to sustain. Once the exchange rate began to depreciate substantially, companies with foreign currency bank debt found it difficult to repay those debts and began to default.

- In Korea, problems were caused by the highly leveraged chaebols, or conglomerates, where bankruptcies created bad debt problems for the banks. This led to a loss of international confidence and a liquidity crisis caused by the withdrawal of short-term interbank funding on which the country was excessively reliant.

- In Indonesia high levels of short-term external debt created a situation where there was general concern about the risk of a default on the part of the corporate sector.

These problems were compounded by falling stock markets and a collapse of property prices. In all cases the local currency lost about half its value - and sometimes more - against the dollar in only a few weeks. The crisis is not yet over, although the position of some countries (e.g. South Korea and Thailand) is improving.

These events had implications world-wide; for banks active in and with exposures to the region, the effects are discussed below[1]. For the implications for banking supervision, see above[2].

FINANCIAL MARKET DEVELOPMENTS

Chart 6 indicates that bond yields on long-dated government debt have fallen across the European Union during 1997. The yield on ten-year German government debt was 5.8% at January 1997, and had fallen to 4.8% by end February 1998. Yields on ten-year government debt issued by countries expected to participate in EMU also fell, with spreads over German yields tightening during the year. Yields on long-dated UK gilts also fell over 1997, but the spread over German yields has widened from October after the announcement that the United Kingdom would not participate in the first round of EMU. The South East Asian crises in the latter part of 1997 have been partly responsible for falling yields across Europe, as expectations for economic growth have dampened.

Gross bond issuance in 1997 was up 13% on that in 1996, despite the surge in issuance in 1996 and the relatively slow end to 1997. Low and falling nominal bond yields across the major developed markets encouraged many companies to use the international debt markets in 1997. Towards the end of 1997, there were also signs that lower rated credits were coming to the bond markets rather than borrowing from banks.

Apart from Japan, the major equity markets all grew strongly during 1997 reflecting strong investor demand. This has continued into the early stages of 1998. The growth rates have been strongly correlated, with the UK's FTSE100 and the US's S&P500 rising by 40% and 42% respectively between January 1997 and end-February 1998. Both markets bounced back quickly from a correction at the end of October following concerns over the Asian situation.

In contrast, Japanese equity prices have been subdued, and fell away in the latter half of 1997 before stabilising again in the first few months of 1998. The fall in the Nikkei over the year from 31 March 1997 was 8.2%.

CHART 6

Ten-year government bond yields

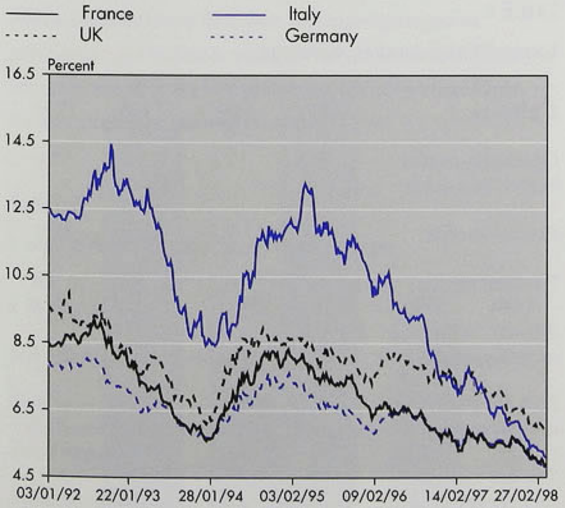
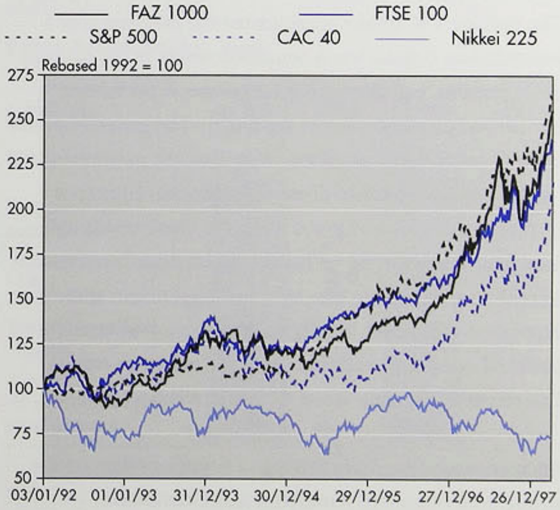


CHART 7

Equity indices



(1) See Part III, Market Developments
(2) See Part I, Principal Developments

Part III MARKET DEVELOPMENTS

OVERVIEW

1997 was another profitable year for the **large UK banks**[1]. Growth in the demand for credit helped boost earnings more than sufficiently to offset the increases in costs while provisions, in the benign economic climate, remained low and the substantial profit growth seen in the previous two years continued, although return on assets remained flat.

Less consolidation was seen in the UK banking sector during 1997 than the previous year, although the conditions remain favourable and there was intense speculation about possible mergers and acquisitions. Several of the large banks have surplus capital and may consider acquisitions in 1998. Share buy-backs have continued. NatWest and Barclays have scaled down their ambitions to be full-service global investment banks, as their projected short and medium-term returns did not appear to justify the dedicated capital and infrastructure costs required to support the business.

The turmoil in SE Asia appears so far to have had a limited effect on the large UK banks. Whilst exposures in some cases are substantial, they are being actively managed and provision levels have been modest.

The **smaller UK banks** consolidated the previous year's performance. Capital levels remained strong in the majority of institutions, and there are good prospects for further growth and efficiency across the board. The general upward trend in profitability persisted. However, the performance of 'niche' players remained diverse. In general, consumer finance businesses performed well. The small residential mortgage lenders could be faced with increased competition from the bancassurers, who have had no problem attracting deposits, but have yet to fully exploit in-roads into, and potential competitive advantage in, the mortgage market. Consequently, lending levels remained relatively low.

Internationally, the Asian crisis had a limited effect on the strong performance of **American** and **Continental European banks** in 1997, assisted by generally improved domestic economic conditions. Trends towards consolidation continued, prompted in Europe largely by the move towards the single currency.

The crisis in the **Japanese** financial sector intensified because of exposure throughout Asia and high domestic non-performing assets. The government has introduced measures aimed at restoring confidence by boosting demand and supporting banks.

UK BANKS

Earnings

Growth in the UK personal sector's income and spending continued in 1997, with increased demand for mortgages and consumer credit. Bank and building society lending to the personal sector increased in 1997, and at a faster rate than in 1996. Secured personal lending grew by 6.2% in 1997 and unsecured lending to the personal sector increased by 16.3% in 1997, or by 20.5% for credit card lending. Bank and building society M4 sterling and foreign currency lending to industrial and commercial companies grew by 3.1% in 1997, after 11.2% in 1996.

TABLE I

Large British banks: earnings

£ billions	*1994*	*1995*	*1996*	*1997*
Operating profits before bad debts	10.5	11.5	12.4	14.4
Pre-tax profits	8.6	9.3	10.6	11.1
Post-tax profits	5.7	6.3	7.0	7.9
Pre-tax % return on average equity	*28.9*	*31.3*	*30.9*	*29.4*
Post-tax % return on average equity	*19.4*	*21.0*	*20.4*	*20.8*
Pre-tax % return on average assets	*1.21*	*1.15*	*1.30*	*1.23*

(1) See the glossary for the definition of this and other terms

Net interest income of the large British banks - the income earned from lending - increased again in 1997, but the annual growth rate slowed slightly, to 6.3% in 1997 from 7.9% in 1996.

Net interest margins were flat for the large British banks, but several different forces were at work. Downward pressure on spreads came from increased competition in the mortgage and savings markets. At the same time, however, spreads were supported by growth in unsecured consumer credit, which, given its riskier nature, is higher margin business. The five one-quarter percentage-point rises in UK base rates in 1997 supported margins through the endowment effect (the amount banks earn from funding interest-earning assets with non-interest bearing liabilities). However, banks would have seen margins squeezed on fixed-rate products.

TABLE II

Large British banks: net interest margins

Percentages	***1994***	***1995***	***1996***	***1997***
Net interest margin	2.79	2.65	2.74	2.72

Non-interest income of the large British banks - the income earned from sources other than direct lending - increased in 1997 by nearly 5%, with more income earned from insurance and long-term savings. As a share of total income, non-interest income was flat. Fixed-rate products, which often attract a first-year fee, also increased in popularity. On balance, volatile exchange-rate conditions in SE Asia, together with cost savings, contributed to higher foreign exchange dealing profits.

TABLE III

Large British banks: sources of income

£ billions	***1994***	***1995***	***1996***	***1997***
Net interest	16.6	17.8	19.2	20.4
Non-interest	13.0	14.0	14.8	15.5
Total income	**29.6**	**31.8**	**34.0**	**35.9**
Non-interest income as a percentage of total	*43.9*	*44.1*	*43.5*	*43.3*

While some banks saw earnings from international business decline, others saw an increase in profits overseas, despite the strength of sterling.

In the smaller banks, delinquency rates were steady and sizeable profits were achieved, particularly in the unsecured lending and credit card markets. Affinity and co-branding products remain popular, although there is some uncertainty as to the effect of an economic downturn on the sustainability of current business positions. Furthermore, a number of affinity relationships have been reconsidered (by either party) or renegotiated. While bancassurers' products have, generally, been fairly standard, there has been some innovation. The flexible mortgage products that some now offer, coupled with their ability to charge mortgage interest on a daily outstanding basis, could significantly increase their market share.

Costs

Costs at the large British banks remained static in 1997. Branch rationalisation and a reduction in staff numbers continued and offset increased spending on IT systems in advance of EMU and Year 2000. At some banks, staff costs increased as a result of diversification into new business areas. Some banks continued to feel the cost of acquisitions made in 1996, while large exceptional costs were incurred for those banks which scaled down their investment banking operations in 1997.

TABLE IV

Large British banks: costs

£ billions	***1994***	***1995***	***1996***	***1997***
Staff	10.4	11.0	11.3	11.6
Premises and equipment	3.5	3.7	3.6	3.7
Other	5.3	4.9	6.3	6.0
Total operating costs	**19.1**	**19.6**	**21.2**	**21.4**
As a percentage of total income	*64.6*	*61.6*	*62.5*	*59.6*

Set against the increase in earnings, however, the cost-to-income ratio for the large British banks fell to 59.6% in

1997 from 62.5% in 1996, continuing the falling trend. The outlook for costs remains one that is likely to see an increase in restructuring changes and IT investments, with spending to make systems Year 2000 compliant and preparations for EMU.

Asset Quality

The stock of bad debt provisions continued to fall in 1997, as banks benefited from benign economic conditions and made substantial releases and recoveries. The bad debt charge increased, however, after reaching a low point in 1996. This can largely be attributed to the Asian crisis: the net bad debt charge to South Korea, Indonesia and Thailand totalled around £200 million in 1997 for the large British banks. In the UK, growth in consumer credit led the large British banks to make higher bad debt charges against unsecured personal lending.

TABLE V

Large British banks: bad debt provisions and charges

£ billions	*1994*	*1995*	*1996*	*1997*
Stock of provisions	12.3	11.4	9.7	9.1
As a percentage of total lending	*3.26*	*2.67*	*2.09*	*1.80*
Charge for bad and doubtful debts	2.2	2.2	1.7	1.9
As a percentage of total lending	*0.59*	*0.53*	*0.38*	*0.39*

The domestic mortgage sector was benign in 1997, with both mortgage arrears and house repossessions down on 1996.

Capital

Retained profits increased slightly in 1997. Combined with slower growth in risk-weighted assets, this left total and Tier one capital ratios at a high level.

Some institutions have significant levels of excess capital, over and above the minimum capital adequacy requirements set by the Bank. As in 1996, some banks have indicated possible share buy-backs or acquisitions. 1998 is likely to see more speculation about take-over activity and talk of pan-European consolidation in the banking industry.

TABLE VI

Large British banks: capital ratios

£ billions	*1994*	*1995*	*1996*	*1997*
Total assets	711	810	855	960
Weighted assets	**424**	**471**	**496**	**515**
Total Tier 1	30.2	33.0	34.9	38.9
Total Tier 2	21.9	23.2	23.4	23.8
Total net capital	**49.0**	**51.1**	**52.5**	**57.0**
Risk Asset Ratio (%)	***11.4***	***10.9***	***10.6***	***11.1***

Building Society Converters

TABLE VII

Building society converters: income, costs and assets

£ billions	*1994*	*1995*	*1996*	*1997*
Net interest	2.71	3.25	3.63	3.92
Non interest	1.06	1.08	1.13	1.20
Total income	**3.77**	**4.34**	**4.81**	**5.24**
Operating costs	1.87	2.15	2.31	2.36
Charge for bad and doubtful debts	0.24	0.17	0.22	0.16
Assets	**130.8**	**160.8**	**171.3**	**187.2**
Risk Asset Ratio (%)	**14.0**	**14.6**	**15.3**	**16.1**

There was fairly strong growth in the converters' total operating income, and despite branch-restructuring and IT investment, costs increased by only 2.3% between 1996 and 1997. The converters, who are already starting from a lower cost base, have therefore further reduced their cost-to-income ratio. Income and asset growth reflects diversification away from traditional mortgage business.

INTERNATIONAL DEVELOPMENTS

Continental Europe

For a majority of Continental European banks the improvement in performance seen in 1996 continued throughout 1997. Fees and commission income rose sharply on the back of the buoyant financial markets during the first half of the year and because of the banks' increasing activities in asset management. Growth in loan demand led to slightly higher net interest income for a number of banks despite continuing pressures on net interest margins. In many cases significant provisions against exposures to South-East Asia had to be made by European banks - aggregate exposure (excluding Swiss banks) accounted for over 40% of total bank claims on Asia. Despite this, many banks reported a sharp increase in net profits and rises in return on equity. Both remain, however, at relatively low levels by comparison with US and UK banks.

Many of the larger European banks continued to develop their activities in investment banking and the capital markets, much of it based in London. The planned merger between SBC and UBS (which will create the largest continental European bank, measured by assets) is an illustration of the European banks' ambitions in this area. At the same time, however, competition and cost pressures have led to an increased focus on restructuring programmes which aim to reduce overheads and streamline operations.

European banks are also focusing increasingly on future strategies following the introduction of the single currency. There has been a significant increase in merger and take-over activity in the European banking sectors, with mergers in Scandinavia, and in the Netherlands and Belgium, seen by many as the first steps in cross-border consolidation of the sector. Although some mergers focus on reducing costs, most seem to be driven more by the belief that it will be necessary to achieve economies of scale and scope in order to face what will be a more competitive environment after the introduction of the single currency.

Despite this, many European banks seem to have had rather limited success so far in cutting costs. Operating costs continued to rise for many large banks as they continued their investments in staff and IT necessary for expansion into new business areas. Preparations for EMU and the Year 2000 problem further increased costs. However there are signs that pressure to increase shareholder value is becoming increasingly important for many banks, and this will in turn intensify the banks' efforts to cut costs.

USA

1997 saw a continuation of the recent strong performance of US commercial banks, with the return on assets of the largest 100 banks rising nine basis points to a new record level of 1.42%. Growth in profitability was largely driven by increased non interest income. High income from securities and trading activities was generated on the back of rising capital markets while retail fee income, bolstered by record net sales of mutual funds by banks, also increased. Loan growth of 8% was unspectacular while net interest margins held up well (falling only 2 basis points to 4.24%). Overall loan quality remained commensurately high given the US economy's strong position in the economic cycle. The main exception was credit card charge-offs, which remain high, although they have levelled off following last year's steep climb. Given liberalised bankruptcy laws (and changing social attitudes towards bankruptcy) concerns remain that a recession would see unprecedented levels of losses on consumer credit portfolios. Eugene Ludwig, the recently retired Comptroller of the Currency, has publicly asked banks to review their credit scoring models to try to avert a loosening in credit standards akin to that of the late 1980s. The US banking industry's loan loss reserves are now, however, twice the level of non-current loans and there is scope for charge-offs to rise before profit and loss or equity levels are affected.

US banks' exposure to SE Asia (excluding trade finance) totals $30.5 billion, or 10.3% of total bank claims. The six money-centre banks account for $24.7 billion of this exposure and these banks are expected to announce increased provisions against the region in 1998 (only J P Morgan having viewed the position as sufficiently clear to have been able to make accurate provisions at the end of 1997).

Industry consolidation continued apace in 1997. First Union's take-over of Corestates and NationsBank's take-over of Barnett Banks were the largest two bank take-overs by deal size ever, up to that point. A number of commercial banks also purchased regional securities houses to take advantage of the Federal Reserve's decision in December 1996 to allow banks' securities affiliates to derive a greater proportion of their revenues from securities activities. Consolidation has accelerated further in the early part of 1998 with the announcement of the three largest ever mergers involving commercial banks (between Citicorp and Travelers; NationsBank and BankAmerica; and First Chicago and Banc One). Consolidation is expected to continue through the rest of 1998.

Attempts at reform of the Glass-Steagall Act continued during the year, but once again proved abortive. The main stumbling blocks proved to be the mixing of banking and commercial activities and the extent of banks' insurance activities. Although it is now clear that Congress will not pass a Reform Bill before the 1998 mid-term elections, the proposed Citicorp-Travelers merger has created a new advocate for change. Congress is likely to revisit the subject in 1999.

US securities firms recorded their most profitable year ever in 1997 as merger and acquisition business and underwriting volumes again rose significantly. A new departure in 1997, the merging of a number of institutional and retail firms, intensified the degree of competition. As a result, many European banks have begun to consider scaling back their commitment to the US investment banking market.

Japan

The crisis in the Japanese banking sector intensified with lower profits, pressure on capital, more insolvencies, police investigations and an economy moving further into recession. In the half year to end September 1997 pre-provision operating profits of the top 19 Japanese banks decreased by 16% over the same period in the previous year. This was largely due to factors specific to the trust bank sector, where operating revenue in the previous year was boosted by a one-off write-back from trust account reserves. Excluding this, operating profits were broadly unchanged from the period in the previous year. Underlying operating profitability has been under pressure from narrowing net interest margins and the sluggish economy. By international standards, Japanese banks remain less profitable than their peers.

Most of the major banks recorded a fall in capital adequacy ratios in the twelve months to end-September, with the average having fallen from 9.4% in September 1996 to 9.1% because of higher provisions for existing bad debts. Banks have been, and plan to continue, rationalising activities to achieve the most effective use of available capital. Some banks have also announced capital raising plans, in a difficult environment.

The Nikkei index has fallen sharply, by 15% from end July to end-February, with weaker banking and securities firms particularly affected. The Nikkei closed at 16,527 at the Japanese fiscal year-end on 31 March 1998, 8.2% below the book close at end-March 1997. The fall in the value of banks' equity holdings had a direct impact on banks' capital adequacy, through the inclusion of 45% of unrealised gains on securities in Tier 2 capital. With effect from end-March 1998, Japanese banks have been allowed to choose whether to value equity holdings at book value or the lower of book and market value. Japan also has the largest exposure to South East Asian countries of BIS members, accounting for 32% of total bank claims on that area; continued problems in the area have also weakened the sector's outlook.

In response, the major credit rating agencies have downgraded Japanese banks over the past few months. In line with the deteriorating operating environment and increasing concerns over the Japanese financial system as a whole, the premium payable by Japanese banks for wholesale funding rose sharply in November - reaching as much as 100 basis points in early December, from almost zero in mid-October. It subsequently fell back to around 40 basis points by end-February 1998. In December the government announced plans to use up to ¥30 trillion (£135 billion) of public money to support the financial system. Of this, ¥17 trillion could be used to protect depositors of insolvent banks and up to ¥13 trillion to buy preferred stocks or subordinated bonds from banks to raise their capital ratios. All of Japan's major banks have applied for the funds to increase their capital bases, with applications so far having been accepted for just under ¥2 trillion, mainly in the form of subordinated bonds. Along with the applications, banks were required to announce restructuring plans, which included staff and wage cuts and branch closures.

GLOSSARY OF TERMS FOR PART III

Sources of data

Audited financial statements for the large British banks and Bank of England statistical returns. Because of rounding, the columns in the tables may not balance.

Large British banks

The definition of large UK banks for the purposes of this section has not changed for this *Report*, even though five building societies converted to banking status during the course of 1997. This is because they have not been banks for a full year and also to allow for comparisons with previous years.

The large UK banks are: Barclays, Lloyds-TSB, Midland, National Westminster, Abbey National, Bank of Scotland, The Royal Bank of Scotland and Standard Chartered. All data for these banks are consolidated. Calendar year-end information except for Bank of Scotland (1997 data are based on interim figures) and the Royal Bank of Scotland (end-September).

Details of the building society converters have been included separately, but analysis of the sector in future years may usefully take account of the clear emergence of two overlapping peer groups, retail and mortgage banks, in comparisons of performance. Three of the converted building societies are now included in the revised BBA definition of the Major British Banks Group which has, with its deletion of Standard Chartered, moved away from the definition used in this *Report*.

Building society converters

The building society converters were Alliance & Leicester, Bristol & West, Halifax, Northern Rock and Woolwich. Group average Risk Asset Ratio figures are estimated (weighted by total, rather than risk-weighted, assets) and pre-conversion figures are based on Solvency Ratios as defined by the Building Societies Commission. Data for Bristol & West are excluded given the different.

Bancassurer

A banking subsidiary of an insurance group.

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.
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 (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.
Net interest margin	Net interest income as a percentage of average interest-earning assets.

Part IV DEVELOPMENTS IN SUPERVISORY POLICY AND PROCEDURE

(1) CHANGES IMPLEMENTED IN THE UNITED KINGDOM

Revision of the Statements of Principles

In last year's *Report*, the Bank stated its intention to publish a revised version of the Statements of Principles later in 1997. The Chancellor's announcement last year transferring banking supervision out of the Bank meant that this project was put on hold; it has now been decided that it will be linked to the publication of the new Guide to Banking Supervisory Policy (see below). The Statements will remove all references to the Policy Notices and Guidance papers and replace them with references to the relevant chapters of the new Guide to Banking Supervisory Policy. The revised Statements of Principles will be issued by FSA soon after 1 June.

The revision contains no material changes to banking supervisory policy. Apart from the references to the new Guide, and references to the FSA rather than the Bank, the amendments mainly focus on consolidating material already published in recent *Reports*. The Statements also contain a brief introduction to risk-based supervision.

Amendments to existing Statements of Principles

The following papers are added to the tables in the existing Statements of Principles have been amended by the issue of three changes to policy:

- Paragraph 2.5 *Letter to UK incorporated authorised institutions clarifying treatment of perpetual non-cumulative preference shares*, issued in January 1998.
- Paragraph 2.6 *Letter to authorised institutions concerning securitisation of revolving credits*, issued in September 1997.
- Paragraph 2.6 *Letter to authorised institutions concerning large exposure considerations for connected investment trusts*, issued in January 1998.

In addition, the supervisory approach has been amended by *A Risk Based Approach to Supervising Foreign Exchange and other Market Risks*, issued in July 1997.

The intention to issue the amendment to the policy on securitisation for revolving credits was explained in last year's *Report*. The effects of the other changes to policy are explained under the relevant paragraphs below. The paper on foreign exchange risk also withdrew two previous notices:

- *Foreign currency exposure*, issued in April 1981
- *Foreign currency options*, issued in April 1984

Guide to Banking Supervisory Policy

During the year, the Bank continued its project to produce a single set of more accessible and user-friendly statements of its banking supervisory policy which it began following the Arthur Andersen review. Its product, the new Guide to Banking Supervisory Policy, was published in draft in May this year and is intended not only to consolidate existing Notices but also to provide much additional explanatory material. From late June, the Guide will operate as the FSA's statement of its detailed prudential policy on banking supervision, replacing the Bank's previous set of Policy Notices.

Foreign Exchange and Other Market Risks

In July 1997 the Bank issued a paper entitled "A Risk Based Approach to Supervising Foreign Exchange and Other Market Risks". Under the new arrangements, institutions will be permitted to set their own internal limits for foreign exchange in a manner appropriate to their business, thereby allowing exposures to be managed in a way which more accurately reflects risk and return than was possible under the old guidelines regime. The role of the Bank, and the FSA in future, will be to seek to ensure the adequacy of internal systems and controls for a proposed level of potential foreign exchange exposure and, if necessary, to seek remedial action where those systems and controls are judged to be inadequate. This approach will be applied to other market risks through the RATE/SCALE process.

Before an institution can make the transition to the new regime the Bank must be satisfied that its exposure to foreign exchange risk will be adequately controlled through a system of internal limits, which may involve on-site review by the Bank's Traded Markets Team. The Bank has therefore put transitional arrangements in place which specify standards to be met before an institution can have its foreign exchange guideline lifted.

Section 39 reports

As part of the process of implementing changes to the s39 framework, following the Bank's February 1997 consultative paper "Banks' internal controls and the s39 process", the Bank has issued two revised Notices on s39 reporting:

- "The Bank of England's Relationship with Auditors and Reporting Accountants"; and
- "Reporting Accountants' Reports on Accounting and Other Records and Internal Control Systems."

The revised Notices (which have been effective since 1 May 1998 and which have been drawn up in the new Policy Guide format) introduced requirements for regular bilateral (Bank - reporting accountant and auditor) meetings, rotation of partners responsible for s39 reports after seven years in a role, and confirmation from the reporting accountants that they have complied with their legal responsibilities to bring certain matters to the Bank's attention.

On the proposals in the February 1997 consultative paper for corporate governance guidance and Directors' attestations the Bank is working, together with the other UK financial services regulators, on a cohesive FSA approach towards the responsibilities of Directors and Senior Managements.

Quality Assurance Unit

The Bank's Quality Assurance (QA) function has continued to develop its remit to assure the quality of banking supervision, and foster best working practices. The S&S-wide (or horizontal) review of the section 39 process has been completed and a number of recommendations are being implemented to promote the more focused use of this supervisory tool. The second horizontal review outlined in last year's *Report* on compliance tools and procedures has been deferred pending the establishment of the FSA. QA has been actively involved in the transition process to the FSA, providing advice and assistance to key executives and implementation groups to promote the incorporation of quality practices into the FSA's operations from inception.

The QA function has also carried out its first vertical review focusing on the supervision of a specific institution. While confirming the effectiveness of the supervision carried out, the review identified a number of issues of general relevance across S&S.

Securitisation

A draft consultative paper on securitisation was issued to practitioners by the Bank in February 1998, in the form of a draft chapter of the Guide to Banking Supervisory Policy discussed above. The paper consolidated the three extant policy notices on securitisation and published for the first time the Bank's policy with respect to conduit and repackaging schemes. The objective of the Bank's policy, to achieve a clean break between the originating bank and the assets securitised, remains unchanged. Comments from the consultative exercise were incorporated in the chapter as it appeared in the published version of the Guide earlier this month.

Preference Shares

The Bank issued a clarificatory memorandum at the end of January on the form of preference shares (or other forms of innovative capital instruments) which are eligible for inclusion in Tier 1 capital. The Bank indicated that, subject to a number of conditions outlined in the memorandum, certain perpetual non-cumulative share issues through a separate issuing entity could provide a bank with Tier 1 capital. It is essential in such cases that any issue should have loss absorbing features which put the bank in an equivalent position to that which would have occurred had it issued the preference shares direct to investors. The Basle Committee is currently examining the whole issue of Tier 1 capital. Banks have been alerted to the possibility that this could result in changes which are less liberal than current interpretations. If so, a key issue will be whether or not issues made prior to that new policy can be grandfathered.

Large Exposures Treatment of Lending to Investment Trusts, etc.

The Bank wrote to all UK-incorporated banks in January to clarify the large exposures treatment of lending to investment trusts, unit trusts and venture funds. This confirmed that exposures to such entities within the same banking group need not normally be treated as "connected" exposures. Similarly, exposures to several different investment trusts within the same third party group need not normally be treated as "related" counterparties.

However, it is important that banks do not take these presumptions for granted; the onus remains on individual banks to examine closely each case on its merits. In doing so banks should consider a number of issues including the ownership of the funds and the degree of independence of control of the funds. Notwithstanding the Bank's acceptance that such funds may be treated as unconnected/unrelated, there remains some aggregate risk, and banks are therefore expected to set limits as part of the process of agreeing their large exposure policy.

(2) IMPLEMENTATION IN PROGRESS

Liquidity

One of the action points set out in the Arthur Andersen Review was to overhaul the present system of collecting data on liquidity. In June 1997 the Bank published a consultative document ('A revised method for measuring liquidity mismatches'), which set out proposals for revising the current set of statistical returns used to measure banks' liquidity mismatches. The Bank's aims in revising the reporting framework were:

- to reduce the number of reporting forms on liquidity measurement to a single form specifically designed for supervisory purposes.
- to improve the scope, coverage and quality of the liquidity data used by the Bank for supervisory purposes.
- to bring the liquidity data collected by the Bank for supervisory purposes further into line with that used by banks for their own day to day management information purposes.

This does not involve any changes to the policy approach set out in the Bank's 1982 Notice 'The measurement of liquidity'.

During the Summer and Autumn of 1997 the Bank participated in a working party of banks set up by the British Bankers' Association to discuss the content of the consultative paper. This resulted in a final set of proposals which were published in February 1998. The key points are as follows:

- Initially, the return will be a cashflow analysis for a minimum period out to one month. Timebands later than those reported on a cashflow basis will be reported in the form of a maturity analysis of assets and liabilities.
- The Bank will consider applications from banks for cashflows not bearing a close resemblance to their contractual maturities to be reported on a behavioural basis.
- Banks will be required to submit one form only covering all the currencies combined. However, management information in individual currencies may be required in exceptional circumstances.
- UK branches of foreign banks with a global liquidity concession may not be required to complete the new return. Prior to granting such an exemption, the Bank will need to be satisfied that appropriate information will be available to the supervisor regarding the UK branch should the need arise.

The Bank also published a draft form and definitions in February 1998 and is currently in the process of discussing the content with the banks through the British Bankers' Association. A final version of the new return will be issued as soon as this process has concluded.

CAD2 and Basle

As noted in last year's *Report*, the Basle Committee on Banking Supervision issued, in January 1996, an amendment to the Accord on Capital Adequacy to cover Market Risks. This enabled banks not only to use a measurement system for market risks similar (but not identical) to that enshrined in the EC Capital Adequacy Directive (CAD), but also to use their own internal Value at Risk (VaR) models as the determinant of supervisory capital for market risks (including commodities). The EU subsequently issued a draft amendment to the CAD - CAD2 - designed also to enable banks, and investment firms, to use internal VaR models.

The Basle amendment was due to be implemented by end-December 1997. The draft EC directive has been progressing through the EU legislative process, including consideration by both the EU Commission and Parliament. It is hoped that the European Parliament will have completed its second reading before the Summer recess, after which the draft directive can go through the final stages of the legislative process. Given this provisional timetable, the Bank has been working towards an implementation deadline of end-September 1998 for both the EU and Basle amendments, which it proposes to implement simultaneously to avoid banks incurring unnecessary changes to systems. Following a series of Practitioners' Group meetings, held jointly with the SFA, consultative documents - both on implementation of VaR models and on changes to the existing CAD regime resulting from the Basle amendment - were issued in January and comments invited by early March. It is hoped to re-issue the documents in final form soon after the CAD2 has been agreed.

Forthcoming EC Directives

Progress on agreeing two amendments to the Solvency Ratio Directive has been slower than expected. The Bank now expects them to be adopted before the end of 1998. These amending Directives are known as the 'Commercial Mortgages Directive' and the 'Expanded Matrix Directive'. The principal benefits of these Directives will be to confirm the 50% risk weighting for mortgage backed securities and to allow for the netting of add-ons, respectively.

(3) LIAISON WITH OTHER SUPERVISORS

The Basle Committee on Banking Supervision

In September 1997 the Basle Committee published the *Core Principles of Banking Supervision*, 25 principles designed to lay the foundation for sound banking supervision. The Basle Committee - on which twelve industrial countries are represented by central banks and, increasingly, by supervisory agencies - consulted world-wide on the text of the principles. A senior Bank official was extensively involved in the drafting. A regular process of consultation has now been set up between the Committee, non-members and the IMF and World Bank: the aim is to work more closely together, especially over the implementation of the Core Principles. This is a task for each country: advice and technical assistance will be available from Basle, from the IMF and multilateral development banks, from the Toronto and BIS Institutes being established, and from many individual central banks and supervisory agencies. Monitoring and implementation of the Core Principles will be mainly the responsibility of the IMF and World Bank, together with a world-wide self assessment survey being conducted by the Basle Committee.

Towards the end of last year the Basle Committee issued a paper on the Year 2000. This set out a timetable for meeting key milestones and stressed to supervisors the importance of monitoring banks against these dates. At the same time, the Committee set up a Year 2000 task force, on which the Bank has a representative. The first action taken by this task force was to issue a questionnaire to all Basle members as well as a number of non-G10 supervisors. The responses highlighted a number of issues and the task force is now considering further work, including methods of raising awareness for both Basle members and non-Basle members alike.

In January 1998, the Basle Committee published a draft *Framework for the Evaluation of Internal Controls* as a guide to supervisors in encouraging sound risk management practices. The framework is built around fourteen principles for evaluating internal controls for banking supervisory authorities to apply and draws lessons from banks' past internal control failures.

Financial Conglomerates

In the field of supervisory co-operation over financial conglomerates, the Joint Forum of Banking, Securities and Insurance Supervision was established in 1996. Recent work has concentrated on establishing principles: for measuring capital adequacy across complex groups, for fit and proper criteria, for the sharing of information and for the conditions under which a supervisory co-ordinator for a group should be appointed. The Joint Forum decided to test the principles in practice over the coming year.

Information sharing among supervisors has become increasingly important with the spread of large multi-national financial institutions. The Joint Forum has developed principles for the exchange of information, both proactively and in response to requests from other supervisors; and, in parallel, G7 countries have worked to identify their legal and administrative obstacles to effective and rapid exchange of information, with a view to improving the position in each of their countries, and disseminating world-wide the key principles of information sharing.

The G7: Financial Crime

As part of the preparation for the Birmingham Summit, co-operation on financial crime and regulatory abuse has been stepped up through a G7 group aiming at improving international co-operation between law enforcement agencies and financial regulators. Each G7 country is reviewing its own laws and procedures to see how the objective of better co-operation on financial crime can be met.

EU Supervisory Bodies

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

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 E-Money, consumer protection issues arising from distance selling, multilateral netting, fair value accounting and outsourcing.

The Groupe de Contact acts 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 in 1997 included a review of the practical operation of Memoranda of Understanding between EEA Member States that were created under the aegis of 2BCD; an investigation of the issues arising from the supervision of EEA banks whose parent undertakings are non-banking or financial entities established outside the EEA; consideration of banks' links with collective investment undertakings; and a review of the supervisory aspects relating to outsourcing by banks.

The EMI Banking Supervisory Sub-Committee

The Sub-Committee considered the role of the European Central Bank in prudential supervision post-EMU and the European Union supervisory regime on liquidity. It also discussed internal controls in credit institutions, E-Money, the use of macroeconomics in the supervisory process and trends in European banking.

Memoranda of Understanding with UK supervisors

The process of review of Memoranda of Understanding (MoUs) has been temporarily postponed as a result of the changes in the UK regulatory structure. The Bank has concluded a new MoU with the FSA and HM Treasury[1] which provides a framework for co-operation once the responsibility for banking supervision moves from the Bank to the FSA. The FSA will be reviewing the MoUs which it will need to put in place with the exchanges and other bodies.

Memoranda of Understanding with Other EEA Supervisors

During the year, the Bank continued to hold regular and ad hoc bilateral meetings with its supervisory counterparts in

(1) The MoU between the Bank, HM Treasury and the FSA is reproduced in Appendix 1.

other EEA Member States under the terms of bilateral MoUs on supervisory co-operation. The principal purposes of these meetings were: 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 the operation of UK banks 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.

MARKET RISK MANAGEMENT

Independent risk management and valuation

Over the last three years, the Bank has observed among the banks it supervises a number of significant trading losses. These variously involved options mispricing, foreign exchange spot settlement losses and fraud, and although none threatened the solvency of the banks concerned, highlighted important issues of management understanding and internal control. These losses confirm the need for all banks with significant trading and treasury operations to have a market risk management (MRM) function with a reporting line to Board level fully independent of the trading function and the need to ensure adequate monitoring and valuation of positions. The Bank issued guidance to banks on the role of the MRM function in February 1998 and on independent valuation and reserving of positions in April 1998. The latter explains that the Bank expects all banks' trading positions to be revalued daily, by a unit independent of the trading function and using prices sourced independently of the traders. When in practice traders' valuations are used, they should be validated by a unit independent of the trading function at end-month and at least once, randomly, intra-month, using independently sourced data.

The MRM function should be tailored to the nature and scale of the trading being undertaken by a bank: less sophisticated trading and treasury operations may not need a separate stand-alone unit, the function instead being performed by another control area which is independent of trading, such as Financial Control. At a minimum, the MRM function should:

- set exposure limits and monitor their utilisation;
- identify, measure and report exposures to senior management and the Board;
- monitor adherence to market risk policies and procedures;
- evaluate market risk exposure in new product proposals;
- validate pricing models;
- evaluate the relationship between P&L and risk to ensure their correlation; and
- design and evaluate stress tests and report results to senior management and the Board.

Stress testing

Banks' stress tests should be appropriate to the size and complexity of their portfolio and the way in which risks are modelled. To use an internal VaR model to calculate market risk capital requirements, banks will have to analyse the effect of a breakdown in one or more of the assumptions underpinning their VaR model as well as the impact of adverse market scenarios. The Bank's Traded Market Team (TMT) has undertaken two informal surveys - in 1997 and 1998 - to assess current market practice in stress testing and found that the approach to, and sophistication of, stress testing varied widely across banks, depending on the size and complexity of portfolios and the way in which risks are modelled. However, the recent period of turbulence in emerging markets was the first since stress testing became widely used by the banks surveyed. This period saw substantial depreciation in some Asian currencies - the Thai baht for example lost more than 50% of its value against the US dollar - and a substantial widening of credit spreads. There were also very large intra-day equity price movements and increased volatilities. Such events led many banks to attach increased importance to stress testing, particularly where they were able to produce sufficiently timely results to manage risks at desk level on a day-to-day basis.

Following this experience, banks indicated that future work was likely to be devoted to incorporating liquidity and credit spread risks in stress testing and scenario analysis and to assessing the impact of counterparty default in addition to market risk. Banks which use internal specific risk models to calculate capital requirements will, of course, be required to include credit spread risk in their stress testing programme.

Options survey

TMT's review of internal models used to calculate capital requirements focuses on systems and controls surrounding the models' use more than the detailed workings of the models themselves. However, TMT has also conducted periodic benchmark surveys of the London OTC options market, in which banks are asked to give values and risk parameters for a standard options portfolio, at a specified time. The results of the last survey were published in autumn 1997 in the Financial Stability Review. The most interesting result was the wide range of values for some of the more exotic products in the foreign exchange options market, notably barrier and digital options. This was surprising given that these products are increasingly widely traded. The implications for the valuation and risk management of these products have been explored with relevant banks and the findings have been reflected in TMT's approach to model recognition and trading and treasury review work.

Part V THE LEGAL FRAMEWORK AND OPERATIONAL SUPERVISION

A DEVELOPMENTS IN THE LEGAL FRAMEWORK

The Bank of England Act

The Bank of England Act 1998, which received Royal Assent on 23 April, inter alia, transfers to the Financial Services Authority the Bank's supervisory functions under the Banking Act 1987 and the Banking Co-ordination (Second Council Directive) Regulations 1992. The Act, which comes into force on 1 June 1998, also makes various consequential amendments to that legislation and other relevant enactments.

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) (Amendment) Regulations 1997[1] which came into force on 21 August 1997. These Regulations amended regulation 14(1) of the Banking Act 1987 (Exempt Transactions) Regulations 1997 to correct an error.

Statements of Principles

A note of revisions to the Statements of Principles is in the previous section.

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 and carry on activities in the United Kingdom under the 2BCD Regulations. **They are not authorised by the Bank and the relevant EEA home state authority retains responsibility for their prudential supervision, except that the Bank has responsibility, in co-operation with that authority, for the supervision of the liquidity of their UK branches.**

The authorised population rose again in 1997/98, from 554 to 579 institutions. The number of institutions permitted to accept deposits in the United Kingdom also rose, from 516 to 538. The difference between the two sets of figures is made up by the increasing number of EAIs that in the United Kingdom are entitled to carry on activities other than deposit-taking, usually by offering services on a cross-border basis only.

TABLE VIII

The 'authorised population'[1]

End-February	*1995*	*1996*	*1997*	*1998*
UK-incorporated	224	220	212	213
Branches of banks incorporated outside the EEA	155	155	149	149
Total authorised under the Banking Act	**379**	**375**	**361**	**362**
EAIs with UK branches entitled to take deposits in the UK	102	103	105	105
EAIs entitled to accept deposits in the UK on a cross-border basis	30	37	50	71
Other EAIs	14	24	38	41
Total EAIs	**146**	**164**	**193**	**217**
Total 'authorised' population	**525**	**539**	**554**	**579**

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

(1) SI 1997 No 1866

Institutions authorised under the Banking Act

There were 362 institutions authorised under the Banking Act at the end of February 1998. Of these, 149 were represented in the United Kingdom by branches of institutions incorporated outside the European Economic Area and 213 were incorporated within the United Kingdom. Of the UK-incorporated institutions, 75 were subsidiaries of overseas companies and seven were joint ventures involving overseas institutions.

European authorised institutions

As at end-February 1998, there were 217 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. A further 71 were entitled to accept deposits on a cross-border basis. Ten EAIs had branches in the United Kingdom which were entitled only to carry on other of the activities listed in Schedule 1 to the 2BCD Regulations and 31 EAIs offered listed services, only on a cross-border basis, which did not include taking deposits.

Applications for authorisation

During 1997/98, 15 applications for authorisation under the Banking Act were granted by the Bank, 11 to UK-incorporated institutions and four to institutions incorporated overseas which wished to open branches in the United Kingdom.

New European authorised institutions

During 1997/98, three new EAIs became entitled to establish branches in the United Kingdom for the purposes of accepting deposits and 23 became entitled to accept deposits on a cross-border basis only. One further EAI established a branch not entitled to accept deposits in the United Kingdom. Eight became entitled to carry on, by the provision of cross-border services only, various listed activities not including deposit taking. Of those providing cross-border services including deposit taking, four EAIs previously provided cross-border services which did not include deposit taking. (As a change of activity, these four do not appear in Table IX).

TABLE IX

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

Year to end-February	*1995*	*1996*	*1997*	*1998*
Banking Act authorisations	6	8	11	15
New EAIs with UK branches entitled to accept deposits in the UK	5	5	4	3
New EAIs entitled to accept deposits in the UK on a cross-border basis	9	8	14	19
Other new EAIs	4	10	16	9

(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.

Surrenders

In 1997/98, 14 authorisations were surrendered, compared with 25 in 1996/97. The majority of surrenders followed mergers, take-overs and group restructurings. Several were also surrendered by overseas institutions as a result of rationalisation of their international activities. Seven institutions ceased to be EAIs during the year.

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. There were 28 such institutions at the end of February 1998. The Bank has the power to give such directions to former authorised institutions as it considers necessary in the interest of depositors. As at the end of February 1998, one bank remains subject to directions issued previously, which have been amended as necessary.

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 if, among other things, it appears to the Bank that any of the minimum criteria for authorisation set down in Schedule 3 of the Act is not or has not been fulfilled. In 1997/98, one bank had such formal restrictions imposed upon it. The Bank also negotiated certain informal restrictions during the year, several of which were upon banks with exposures to regions affected by economic turbulence.

TABLE X

Revocations and restrictions[a]

Year to end-February	*1995*	*1996*	*1997*	*1998*
Revocation of authorisation	-	-	-	-
Restriction of authorisation	1	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.

Appeals

No appeals were lodged in 1997/98 against the Bank's decisions to exercise its powers.

Administration orders and liquidations

No institutions were placed in administration in 1997/98. One institution remained in provisional liquidation and one former authorised institution was placed in liquidation. Two former authorised institutions remained in Members' Voluntary Liquidation during 1997/98.

(ii) Supervision of the authorised population

Interviews, meetings and visits

The Bank held a large number of routine and non-routine meetings with authorised institutions during the year to discuss specific issues and more wide ranging prudential interviews to discuss the institution's performance and any attendant supervisory issues. 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. 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.

The pattern of meetings has already started to change with the introduction of RATE and SCALE and will in future entail fewer routine meetings and more meetings, especially on-site, to address specific identified risks within the authorised institutions.

The Bank's line supervisory staff are complemented by the Review Team and the Traded Markets Team. The Review Team system consists of Bank staff, usually with relevant financial market experience, together with bankers and accountants seconded to the Bank, who visit the premises of authorised institutions to assess the quality of their assets and the adequacy of their systems and controls. Such visits may cover the full range of an institution's activities or concentrate on particular business areas. During the year, 89 full Review Team visits were undertaken, together with 23 non-routine, targeted, visits, which looked at such areas as mortgage business and information technology systems. In accordance with the RATE framework, Review Team visits are increasingly directed to banks where there are specific concerns.

The Bank's Traded Markets Team specialises in the review of banks' trading and treasury risk management and controls, and considers the use by banks of their internal option risk, interest-rate pre-processing and Value at Risk (VaR) models to calculate market risk capital requirements. Visits conducted to review the treasury operations of institutions and assess their systems and controls were also undertaken. Overall, 43 visits to assess models were undertaken during the year and 63 to assess trading and treasury risk management.

Although the working assumption is that the Basle and EU Amendments will not be implemented until September 1998, the length of the model recognition process, which will generally involve three or four visits to each bank, means that the process is now well underway: it has begun for about half a dozen banks, with a further 15 banks having signalled their intention to seek recognition in due course.

The Review Team and Traded Markets Team visits are conducted with the co-operation of the institution and do not involve the use of the Bank's statutory powers.

The Special Investigations Unit (SIU)

The SIU has the primary role of advising line supervisors on matters relating to fraud and other criminal activity involving authorised institutions. That function has expanded over time to include more work on issues relating to systems and controls in place at banks, and overall adherence to the criteria contained in Schedule 3 to the Banking Act.

The Unit is organised into two sections, one dealing with the authorised sector as set out above, the other acting as an intelligence function for all matters related to financial crime. This involves regular and close contacts with other investigation and law enforcement agencies.

In terms of the authorised sector, the Unit has dealt with nearly 500 cases since its inception in 1992 and currently has 80 open. Over the last year, members of the Unit have advised on a number of high-profile cases which have involved extensive liaison with other supervisory bodies, in the UK and overseas. Within a varied caseload, the year has also seen an increasing focus on issues related to anti money laundering systems and 'know your customer' requirements.

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. Eighteen notifications for new or increased control were received in 1997/98. Fifteen have so far been passed without objection and three remained outstanding at the year end.

Representative offices of overseas institutions

In 1997/98, 13 overseas institutions[2] notified the Bank of their intention to establish representative offices in the United Kingdom and one institution notified the Bank of its intention to change the name used by it in the United Kingdom, to which the Bank did not object.

Appendix 4 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.

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 1997/98, 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 228 names submitted during the year by persons who were not authorised under the Banking Act or were not 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 57 of the proposed names would, or might, be likely to breach the Act.

In addition, work is carried out by the SIU Confidential Enquiries group to identify individuals or corporate entities making unauthorised use of the word 'bank' in their name, or use banking descriptions. In the event of any evidence of criminal intent, the Bank will investigate to determine if a criminal prosecution is warranted.

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

Discount houses

Following the money market reforms implemented on 3 March 1997, discount houses were offered transitional arrangements. The number of institutions taking advantage of these (and therefore supervised under the discount house regime) fell from five to three during the year. The business of Seccombe, Marshall & Campion plc was transferred to the London branch of its parent, Banque CPR; although the former's authorisation under the Banking Act was still current at the year end, it was no longer supervised under the discount house regime. Alexanders Discount Ltd surrendered its authorisation during the year following the transfer of its business to the London branch of its parent, Credit Lyonnais. The post-money market reform transitional arrangements remain available to the former discount houses until 31 March 1999.

(iii) Prohibition on unauthorised deposit-taking

The Bank's Enforcement Group deals with unauthorised deposit taking. During the year, they handled some 90 cases (70 in 1996/97) of alleged illegal deposit-taking. New cases referred to the Bank increased to 62 (47), of which 17 (12) were investigated using section 42 powers.

Whilst the Bank may bring a criminal prosecution when there is sufficient evidence to justify it, in the majority of cases it has not been in the public interest to do so. The Bank's primary objective is to protect depositors' interests which can often best be achieved by informal arrangements with the suspect to regularise the position. During the year, voluntary undertakings not to contravene the Act were obtained from individuals in 11 separate cases and, where monies were still owed to depositors, arrangements were agreed for a repayment programme within a given time period.

In the more serious cases the Bank may decide to seek a remedy through civil proceedings. During the year the Bank instigated High Court civil actions in 3 instances of suspected illegal deposit-taking. In July, the Bank served a petition for the winding-up of a company pursuant to section 92(1) to (6) of the Act. The hearing of this petition is currently adjourned as the company is now in creditors' voluntary liquidation.

In September, following a joint investigation with PIA, the Bank obtained injunctions under section 93(1) and (2) of the Act restraining an individual from accepting deposits and from disposing of assets while the investigation continued. This injunction was lifted after the appointment of a trustee in bankruptcy on the petition of creditors. The Bank passed its file to the Police for further investigation.

In December, injunctions under section 93(1) and (2) of the Act were obtained against three individuals and a company prohibiting the use of banking names and descriptions, the taking of deposits and the making of fraudulent inducements contrary to sections 67, 69, 3 and 35 of the Act respectively. The Bank's investigation into the activities of these defendants and others involved in that case continues.

Following an extensive investigation, the Bank decided to prosecute an individual who has now been committed for trial at Crown Court on 19 sample charges under section 3 of the Act (unauthorised deposit-taking); the trial is scheduled to begin in May this year. In another case, the Bank has passed its investigation file to the Crown Office in Edinburgh to consider criminal prosecution (as the Bank may not act as prosecutor in Scotland).

Part VI COSTS, ORGANISATION AND STAFFING OF SUPERVISION AND SURVEILLANCE

Costs

The cost of banking supervision in the Bank of England in the year to February 1998 was approximately £48 million; this includes, in addition to the costs of Supervision & Surveillance, an allowance for the overhead costs including services supplied by central areas of the Bank.

Staff

Staff numbers at the end of February 1998, as shown in Table XI, showed an increase of nine in comparison with the year before, which followed an increase of 41 in the previous year. Following the Arthur Andersen review of supervision, a key focus has been on the recruitment of additional resources to fill the identified gaps and prepare the ground for the wider implementation of risk-based supervision.

While recruitment of new graduates was on target (an additional 35 were taken on in Autumn 1997), it has been more difficult to attract experienced entrants due to a general pick-up in the recruitment market. In addition, the announcement of the transfer of supervision to the FSA has required some alteration to recruitment plans to fit into the FSA's requirements.

Training of Staff

Last year's *Report* mentioned that major changes were being made to the training programme, particularly the introduction of a Core Curriculum defining the mix of knowledge, experience and skills required by both supervisory and surveillance staff at different levels. Based on that work and the training needs that flowed from it, a new programme of training courses has been designed and all staff now have individual training programmes agreed with local management. A number of these courses covered the main technical issues necessary for S&S staff - such as accountancy, capital markets, systems and controls, credit, fraud and surveillance issues - but emphasis has also been placed on developing further some non-technical skills (such

TABLE XI

Allocation of Supervision and Surveillance staff[1]
End February 1998

End-February	*1995*	*1996*	*1997*	*1998*
Senior Managers and Senior Banking Advisors	41	52	55	58
Managers, Analysts and Assistants	199	235	264	272
Inward Secondees/ Review Team	10	10	10	9
Support Services	72	87	96	95
Total	**322**	**384**	**425**	**434**

(1) Staff figures in full time equivalents.

	Staff *1998*	Institutions *1998*
Operational Policy Division	34	-
Major UK Banks Division	37	63
UK Banks & Enforcement Division[1]	48	69
European Division	42	238[2]
Emerging Markets South Division	47	56
Emerging Markets North Division	43	62
North America & Japan Division	40	73
Capital & Wholesale Markets Division[3]	35	18
Operations Division/Deputy & Executive Directors Office[4]	84	-
Quality Assurance	4	-
Change Management Team	5	-
Outward Secondments	4	-
Review Team	9	-
Senior Banking Advsiors	2	-
Total	**434**	**579**

(1) Includes the Deposit Protection Board.
(2) The majority (217) of which are EAIs.
(3) Includes the Traded Markets Team and the section 43 and section 171 regimes. The number of institutions does not include the non Banking Act entities for which CWMD is responsible.
(4) Includes IT, Administration and Training, the Data Analysis Unit, Records Management and local support services.

as meetings, presentation and project management skills) as well as other skills necessary to adjust to the move to the FSA - for example, courses on Change Management and Multiskilling for Support Staff. The intention is to ensure that a minimum of five days' training is undertaken by all staff each year.

There has been close collaboration with trainers in the other parts of the FSA with a view to providing some co-ordination in training across the component parts of the FSA. Although responsibility for running technical training courses will, in the short term, primarily rest with local areas, a number of non-technical courses that will have immediate applicability across the FSA have been allocated to individual areas to run for all FSA staff; and this process of integrating training will progress throughout the next few months.

Training provided by Supervision and Surveillance

As in previous years Supervision and Surveillance provided technical training for bank supervisors in overseas central banks and supervisory authorities. During 1997/98, four courses were held in London at the Bank's Centre for Central Banking Studies, and were attended by participants from a wide range of different countries. A further 14 were provided abroad: in most cases these were directed at supervisors in a single country with content being tailored to meet specific domestic needs.

With regard to recipient countries there was some reduction in the number of courses provided for the countries of Eastern Europe and the former USSR, and a compensating increase in the number of courses held in Commonwealth countries. In addition, the Bank continued to provide lecturers on multinational supervision courses organised by the Basle Committee and other international organisations, and to receive representatives of overseas supervisory authorities on short study visits.

Information Technology

With the decision to create the FSA, the IT strategy being developed following the Arthur Andersen review is being integrated with FSA plans. The target remains to deliver the significant improvements in IT that were agreed to be required. As part of the strategy, significant expenditure was incurred during the year on improvements to existing systems. These will continue so that they can to meet demand prior to merger with other FSA systems.

APPENDIX 1

MEMORANDUM OF UNDERSTANDING BETWEEN HM TREASURY, THE BANK OF ENGLAND AND THE FSA

1. This memorandum of understanding establishes a framework for co-operation between HM Treasury, the Bank of England and the FSA in the field of financial stability. It sets out the role of each institution, and explains how they will work together towards the common objective of financial stability. The division of responsibilities is based on four guiding principles:

- clear *accountability*. Each institution must be accountable for its actions, so each must have unambiguous and well-defined responsibilities;

- *transparency*. Parliament, the markets and the public must know who is responsible for what;

- *no duplication*. Each institution must have a clearly defined role, to avoid second guessing, inefficiency and the duplication of effort. This will help ensure proper accountability;

- regular *information exchange*. This will help each institution to discharge its responsibilities as efficiently and effectively as possible.

The Bank's responsibilities

1. The Bank will be responsible for the overall stability of the financial system as a whole which will involve:

(i) stability of the monetary system. The Bank will monitor this, as part of its monetary policy functions. It will act daily in the markets, to deal with day to day fluctuations in liquidity;

(ii) financial system infrastructure, in particular payments systems at home and abroad. As the bankers' bank, the Bank will stand at the heart of the system. It will fall to the Bank to advise the Chancellor, and answer for its advice, on any major problem inherent in the payments systems. The Bank will also be closely involved in developing and improving the infrastructure, and strengthening the system to help reduce systemic risk;

(iii) broad overview of the system as a whole. The Bank will be uniquely placed to do this: It will be responsible for monetary stability, and will have high level representation at the institution responsible for financial regulation (through the Deputy Governor (financial stability), who will be a member of the FSA Board). Through its involvement in the payments systems it may be the first to spot potential problems. The Bank will be able to advise on the implications for financial stability of developments in the domestic and international markets and payments systems; and it will assess the impact on monetary conditions of events in the financial sector;

(iv) being able in exceptional circumstances to undertake official financial operations, in accordance with the arrangements in paragraphs 11 to 13 of this Memorandum, in order to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system;

(v) the efficiency and effectiveness of the financial sector, with particular regard to international competitiveness. The Bank will continue to play its leading role in promoting the City. Much of this work will be directed towards improving the infrastructure.

The FSA's responsibilities

3. The FSA's powers and responsibilities will be set out in statute. It will be responsible for:

(i) the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and friendly societies;

(ii) the supervision of financial markets and of clearing and settlement systems;

(iii) the conduct of operations in response to problem cases affecting firms, markets and clearing and settlements systems within its responsibilities, where:

a) the nature of the operations has been agreed according to the provisions of paragraphs 11 to 13 of the Memorandum; and

b) the operations do not fall within the ambit of the Bank of England defined in paragraph 2 above. (Such operations by the FSA may include, but would not be restricted to, the changing of capital or other regulatory requirements and the facilitation of a market solution involving, for example, an introduction of new capital into a troubled firm by one or more third parties.)

(iv) regulatory policy in these areas. The FSA will advise on the regulatory implication for firms, markets and clearing systems of developments in domestic and international markets and of initiatives, both domestic and international, such as EC directives.

The Treasury's responsibilities

4. The Treasury is responsible for the overall institutional structure of regulation, and the legislation which governs it. It has no operational responsibility for the activities of the FSA and the Bank, and will not be involved in them. But there are a variety of circumstances where the FSA and the Bank will need to alert the Treasury about possible problems: for example, where a serious problem arises, which could cause wider economic disruption; where there is or could be a need for a support operation; where diplomatic or foreign relations problems might arise; where a problem might suggest the need for a change in the law; or where a case is likely to lead to questions to Ministers in Parliament. This list is not exhaustive, and there will be other relevant situations. In each case it will be for the FSA and the Bank to decide whether the Treasury needs to be alerted.

Information gathering

5. Through the exercise of its statutory responsibilities, the FSA will gather a wide range of information and data on the firms which it authorises and supervises.

6. The FSA and the Bank will work together to avoid separate collection of the same data, to minimise the burden on firms. Where both need access to the same information, they will reach agreement as to who should collect it, and how it should be transmitted to the other.

7. The Bank will collect the data and information which it needs to discharge its responsibilities.

Information exchange

8. This will take place on several levels. The Bank's Deputy Governor (financial stability) will be a member of the FSA Board, and the FSA Chairman will sit on the Court of the Bank of England. At all levels, there will be close and regular contact between the FSA and the Bank. The FSA and the Bank will establish a programme of secondments between the two institutions, to strengthen the links and foster a culture of co-operation.

9. The FSA and the Bank will establish information sharing arrangements, to ensure that all information which is or may be relevant to the discharge of their respective responsibilities will be shared fully and freely. Each will seek to provide the other with relevant information as requested. The institution receiving this information will ensure that it is used only for discharging its responsibilities and that it is not transmitted to third parties except where permitted by law.

Standing Committee

10. In addition to the above arrangements, there will be a Standing Committee of representatives of the Treasury, Bank and the FSA. This will meet on a monthly basis to discuss individual cases of significance and other developments relevant to financial stability. Meetings can be called at other times by one of the participating institutions if it considers there to be an issue which needs to be addressed urgently. Each institution will have nominated representatives who can be contacted, and meet, at short notice.

11. In exceptional circumstances there may be a need for an operation which goes beyond the Bank's routine activity in the money market to implement its interest rate objectives. Such a support operation is expected to happen

very rarely and would normally only be undertaken in the case of a genuine threat to the stability of the financial system to avoid a serious disturbance in the UK economy. If the Bank or the FSA identified a problem where such a support operation might be necessary, they would immediately inform and consult with each other.

12. Each institution (the 'lead institution') would take the lead on all problems arising in its area of responsibility as defined in paragraphs 2 and 3. The lead institution would manage the situation and co-ordinate the authorities' response (including support operations). The form of the response would depend on the nature of the event and would be determined at the time.

13. In all cases the Bank and the FSA would need to work together very closely and they would immediately inform the Treasury, in order to give the Chancellor of the Exchequer the option of refusing support action. Thereafter they would keep it informed about the developing situation, as far as circumstances allowed.

Consultation on policy changes

14. Each institution will inform the other about any major policy changes. It will consult the other in advance on any policy changes which are likely to have a bearing on the responsibilities of the other.

Membership of committees

15. The FSA and the Bank will co-operate fully in their relations with international regulatory groups and committees. They will both be represented on the Basle Supervisors' Committee, the EMI Banking Supervisors' Sub-Committee, and on other international committees where necessary. Where only one institution is represented, it will ensure that the other can contribute information and views in advance of any meeting; and will report fully to the other after the meeting. This will promote co-operation and minimise duplication.

16. The FSA and the Bank will keep HM Treasury informed of developments in the international regulatory community which are relevant to its responsibilities.

17. The FSA and the Bank have agreed the following arrangements for chairing domestic market committees:

- Sterling Markets Joint Standing Committee: the FSA
- Foreign Exchange Joint Standing Committee: Bank
- Derivatives Joint Standing Committee: the FSA
- Stocklending and Repo Committee: Bank

18. The FSA and the Bank will each use best endeavours to facilitate contacts by the other with overseas central banks and/or regulators, where necessary to discharge their respective responsibilities.

Provision of services

19. In some cases it will be more efficient for a service to be provided by the FSA to the Bank, or vice versa, rather than for both institutions to meet their own needs separately. In these cases, service agreements will be established between the two institutions setting out the nature of the service to be provided, together with agreed standards, details of timing, charges (if any), notice periods, and so on. These agreements will in the first instance cover: provision of facilities (premises, IT, etc.) during the transitional phase; the provision of analysis on domestic and overseas financial markets; the provision of research; and the processing of statistical information.

Litigation

20. The Bank will retain responsibility for any liability attributable to its acts or omissions in the discharge of purported discharge of its banking supervisory functions prior to the transfer of these functions to the FSA and shall have the sole conduct of any proceedings relating thereto. The two institutions will co-operate fully where either faces litigation.

Records

21. The FSA will be responsible for the custody of all supervisory records. It will ensure that, within the framework of the relevant legislation, the Bank has free and open access to these records.

CONSTITUENT PARTS OF THE FSA	SUPERVISED BODIES
Building Societies Commission	Building societies
Friendly Societies Commission	Friendly societies
Insurance Directorate of HM Treasury	Insurance, including Lloyd's of London
Investment Management Regulatory Organisation	Investment management
Personal Investment Authority	Retail investment business
Registry of Friendly Societies	Credit unions' supervision (and the registration and public records of building societies, friendly societies, industrial and provident societies and other mutual societies)
Securities and Futures Authority	Securities and derivatives business
Securities and Investments Board	Investment business (including responsibility for supervising exchanges and clearing houses)
Supervision and Surveillance Division of the Bank of England	Banking supervision (including the wholesale money market regimes)

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
Measurement of liquidity	July 1982
Connected lending; accounts; large exposures; fraudulent invitations; floating charges (BSD/1983/1)	April 1983
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
A Risk Based Approach to Supervising Foreign Exchange and other Market Risks	July 1997
Letter to authorised institutions concerning securitisation of revolving credits	September 1997
Letter to UK incorporated authorised institutions clarifying treatment of perpetual non-cumulative preference shares	January 1998
Letter to authorised institutions concerning large exposure considerations for connected investment trusts	January 1998

All the Bank's supervisory notices are to be replaced by the Guide to Banking Supervisory Policy with effect from a date to be advised and likely to be towards the end of June 1998.

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 1998.

Geographical origin of ownership	Branch of an overseas bank[1]	UK incorporated subsidiary of an overseas bank[1]	UK incorporated subsidiary of an overseas non-bank	Controlling (15% or more) stake in a consortium bank	Representative offices	Total
Afghanistan	-	1	-	-	-	1
Argentina	1	-	-	-	1	2
Australia	5	4	-	-	1	10
Austria	4	-	-	-	1	5
Bahamas	-	-	-	-	2	2
Bahrain	2	1	-	-	1	4
Bangladesh	1	-	-	-	1	2
Belgium	5	-	-	-	-	5
Bermuda	-	-	-	-	1	1
Brazil	4	-	-	-	5	9
Bulgaria	-	-	-	-	2	2
Canada	6	5	1	-	-	12
Cayman Islands	-	-	-	-	2	2
China	1	1	-	-	5	7
Colombia	-	-	-	-	1	1
Croatia	-	-	-	-	1	1
Cuba	-	1	-	-	-	1
Cyprus	2	2	-	-	-	4
Czech Republic	1	-	-	-	2	3
Denmark	4	-	-	-	-	4
Ecuador	-	-	-	-	1	1
Egypt	1	1	-	-	-	2
Finland	2	-	-	-	1	3
France	21	6	-	-	23	50
Germany	22	5	-	-	5	32
Ghana	1	-	-	-	-	1
Gibraltar	-	-	-	-	1	1
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	9	2	-	-	-	11
Israel	2	2	-	-	2	6
Italy	15	1	-	-	29	45
Jamaica	-	-	-	-	4	4
Japan	25	5	4	-	14	48
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
Mauritius	-	-	-	-	1	1
Mexico	4	-	-	-	1	5
Netherlands	8	1	-	-	-	9
New Zealand	-	-	-	-	2	2
Nigeria	2	-	-	-	1	3
Norway	3	-	-	-	-	3
Pakistan	4	-	-	-	2	6
Panama	-	-	-	-	1	1
Philippines	1	2	-	-	1	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	-	-	5	10
South Korea	10	3	-	-	4	17
Spain	9	-	-	-	4	13
Sri Lanka	1	-	-	-	-	1
Sweden	3	-	-	-	-	3
Switzerland	8	2	-	-	16	26
Taiwan	2	-	-	-	5	7
Thailand	3	-	-	-	1	4
Turkey	2	1	-	-	7	10
USA	21	7	6	1	8	43
Ukraine	-	-	-	-	1	1
Uruguay	-	-	-	-	1	1
Federal Republic of Yugoslavia	-	-	-	1	3	4
Venezuela	-	-	-	-	1	1
Zambia	1	-	-	-	-	1
Totals	**264**	**65**	**11**	**7** (2)	**209**	**556** (3)
of which						
EEA countries (4)	115	16	-	-	69	200
Other Europe	14	6	-	1	57	78
North America	27	12	7	1	8	55
Japan	25	5	4	-	14	48
Australia & New Zealand	5	4	-	-	3	12
Other Asia	41	11	-	-	22	74
Middle East	22	7	-	5	7	41
Other	15	4	-	-	29	48

(1) Includes institutions authorised to conduct banking business in the country of origin.
(2) Representing 6 institutions.
(3) Representing 555 institutions.
(4) Other than the United Kingdom.

LIST OF INSTITUTIONS AUTHORISED AS AT 28 FEBRUARY 1998

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

European authorised institutions are institutions which are recognised under The Banking Coordination (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 - ie 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[2]

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

AABC International Bank plc
AMC Bank Ltd
AY Bank Ltd
Abbey National plc
Abbey National Treasury Services plc
Adam & Company plc
Afghan National Credit & Finance Ltd
Airdrie Savings Bank
Alliance & Leicester plc
Alliance & Leicester Group Treasury 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
Henry Ansbacher & Co Ltd
Arbuthnot Latham & Co, Ltd
Assemblies of God Property Trust
Associates Capital Corporation Ltd
Avco Trust 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
Bristol & West plc
British Arab Commercial Bank Ltd
The British Bank of the Midde East
The British Linen Bank Ltd
Brown, Shipley & Co Ltd

CIBC Wood Gundy plc
Cafcash Ltd
Capital Bank plc
Cater Allen Ltd
Chartered Trust plc
Charterhouse 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
Crown Agents Financial Services Ltd

Daiwa Europe Bank plc
Dalbeattie Finance Co Ltd
Dao Heng Bank (London) plc
Dexia Municipal Bank plc
Direct Line Financial Services Ltd
The Dorset, Somerset & Wilts Investment Society Ltd
Dryfield Trust plc
Dunbar Bank plc
Duncan Lawrie Ltd

EFG Private Bank Ltd
Eccles Savings and Loans Ltd

FIBI Bank (UK) plc
Fairmount Capital Management Ltd
Financial & General Bank plc
First National Bank plc
First National Commercial Bank plc
Robert Fleming & Co Ltd
Ford Credit Europe plc
Forward Trust Group Ltd
Frizzell Bank Ltd

Gartmore Money Management Ltd
GE Capital Bank Ltd
Gerrard & King 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) including partnerships formed under the law of any part of the UK.

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
Halifax plc
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
Italian International Bank plc

Jordan International Bank plc

Leopold Joseph & Sons Ltd

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

Lazard Brothers & Co Ltd
Legal & General Bank 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
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
Northern Rock plc

PaineWebber International Bank Ltd
Philippine National Bank (Europe) plc
Pointon York 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 Bank Europe 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)
Schroder Leasing Ltd
J Henry Schroder & Co Ltd
Scotiabank Europe plc
Scottish Widows Bank plc
Seccombe Marshall & Campion plc
Secure Trust Bank plc
Singer & Friedlander Ltd
Smith & Williamson Investment Management Ltd
Southsea Mortgage & Investment Co Ltd
Standard Bank London Ltd
Standard Chartered Bank
Standard Life Bank Ltd
Sun Banking Corporation Ltd

TSB Bank plc
TSB Bank Scotland plc
Tesco Personal Finance Ltd
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
United Dominions Trust Ltd

United Trust Bank Ltd
Unity Trust Bank plc

Weatherbys & Co Ltd
Wesleyan Savings Bank Ltd
West Merchant Bank Ltd
Whiteaway Laidlaw Bank Ltd
Wintrust Securities LtdWoolwich plc

Yamaichi Bank (UK) plc
Yorkshire Bank plc

(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 sterling, Ecu or other EEA currencies made with the UK offices of these institutions are covered by the UK Deposit Protection Scheme (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).

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

BSI-Banca della Svizzera Italiana
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
BankBoston,NA
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
Bank of Baroda
Bank of Ceylon
Bank of China
Bank of Cyprus Ltd
The Bank of East Asia Ltd
The Bank of Fukuoka Ltd
Bank of India
Bank of Montreal
The Bank of New York
The Bank of Nova Scotia
The Bank of Tokyo - Mitsubishi, Ltd
The Bank of Yokohama, Ltd
Bank Saderat Iran
Bank Sepah-Iran
Bank Tejarat
Bankers Trust Company
Beirut Riyad Bank SAL

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

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

Emirates Bank International PJSC

First Bank of Nigeria plc
First Commercial Bank
The First National Bank of Chicago
First Union National Bank
The Fuji Bank Ltd

Ghana Commercial Bank
Gulf International Bank BSC

Habib Bank AG Zurich
Habib Bank Ltd
Hanil Bank
The Hiroshima Bank, Ltd
The Hokuriku Bank Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Housing & Commercial Bank, Korea

The Industrial Bank of Japan, Ltd

The Joyo Bank Ltd

KorAm Bank
The Korea Development Bank
Korea Exchange Bank
Korea First Bank

The Long-Term Credit Bank of Japan, Ltd

Macquarie Bank Ltd
Malayan Banking Berhad
MashreqBank PSC
Mellon Bank, NA
The Mitsubishi Trust and Banking Corporation
The Mitsui Trust & Banking Co Ltd
Morgan Guaranty Trust Company of New York

Nacional Financiera SNC
National Australia Bank Ltd
National Bank of Abu Dhabi
National Bank of Canada
The National Bank of Dubai Public Joint Stock Company
National Bank of Pakistan
NationsBank, NA
NationsBank of Texas, NA
Nedcor Bank Ltd
The Norinchukin Bank
The Northern Trust Company

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

People's Bank
Philippine National Bank

Qatar National Bank SAQ

Rafidain Bank (provisional liquidator appointed)
Republic National Bank of New York
Riggs Bank NA
Riyad Bank
Royal Bank of Canada

The Sakura Bank, Ltd
The Sanwa Bank, Ltd
Saudi American Bank
The Saudi British Bank
SEOULBANK
Shanghai Commercial Bank Ltd
Shinhan Bank
The Siam Commercial Bank Public Company Ltd
Sonali Bank
State Bank of India

State Street Bank and Trust Company
The Sumitomo Bank, Ltd
The Sumitomo Trust & Banking Co Ltd
Swiss Bank Corporation
Syndicate Bank

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

Uco Bank
Union Bancaire Privée, CBI-TDB

Union Bank of Nigeria plc
Union Bank of Switzerland
United Bank Ltd
United Mizrahi Bank Ltd
United Overseas Bank Ltd

Wachovia Bank NA
Westpac Banking Corporation

The Yasuda Trust & Banking Co, Ltd

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 UK

The following institutions have exercised their entitlement to provide one or more of the services listed in Schedule 1 of The Banking Coordination (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 intention 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 (1). 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 CPR	France
Banque Française de l'Orient	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

(1) 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.

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
CETELEM	France
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 Agricole Indosuez	France
Crédit Commercial de France	France
Crédit du Nord	France
Crédit Lyonnais	France
Creditanstalt -Aktiengesellschaft	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
Erste Bank der oesterreichischen Sparkassen AG	Austria
FIMAT International Banque	France
First National Building Society	Republic of Ireland
Generale Bank	Belgium
Hamburgische Landesbank Girozentrale	Germany
ICC Bank plc	Republic of Ireland
ING Bank NV	Netherlands
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
Natexis Banque	France
National Bank of Greece SA	Greece
Norddeutsche Landesbank Girozentrale	Germany
Postipankki Ltd	Finland
Rabobank International (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 (FöreningsSparbanken 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 UK

*The following institutions have exercised their entitlement to provide one or more of the services listed in Schedule 1 of The Banking Coordination (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
Carr Futures SNC	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 UK

(i) EAIs which are entitled to accept deposits in the UK 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 Coordination (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
ABN AMRO Lease Holding NV	Netherlands
ACCBank plc	Republic of Ireland
Achmea Hypotheekbank NV	Netherlands
BACOB Bank Luxembourg SA	Luxembourg
BG Bank International SA	Luxembourg
BNP Finance	France
BW Bank Ireland plc	Republic of Ireland
Banca Toscana SpA	Italy
Banco Borges & Irmão SA	Portugal
Banco Chemical (Portugal) SA	Portugal
Banco ESSI, SA	Portugal
Banco Português de Investimento,SA	Portugal
Bank Austria AG	Austria
NV Bank Nederlandse Gemeenten	Netherlands
Bankgesellschaft-Berlin (Ireland) plc	Republic of Ireland
Bankinter SA	Spain
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 Luxembourg	France
Banque Nationale de Paris	France
Banque Nationale de Paris Guyane	France
Banque Nationale de Paris Intercontinentale	Luxembourg
Banque Paribas Luxembourg	France
Banque pour l'Expansion Industrielle	France
Banque Scalbert DupontBear Stearns Bank plc	Republic of Ireland
Bikuben GiroBank A/S	Denmark
Caja de Ahorros de Galicia	
Cedel Bank SA	Spain
Chang Hwa Commercial Bank (Europe) NV	Luxembourg
Chiao Tung Bank Europe NV	Netherlands
Citibank Belgium SA	Netherlands
Commerzbank Europe (Ireland)	Belgium
Compagnie Financière de CIC et de L'Union Européenne	Republic of Ireland

Corporación Bancaria de España, SA	France
Cortal Bank	Spain
Crédit Agricole Indosuez	Luxembourg
Crédit Communal de Belgique SA	Belgium
Crédit Suisse (Luxembourg) SA	Luxembourg
Crédit Universel	France
Crédito Predial Português SA	Portugal
Den Danske Bank International SA	Luxembourg
Den Københavnske Bank A/S	Denmark
Den norske Bank ASA	Norway
DePfa-Bank Europe plc	Republic of Ireland
Deutsche Ausgleichsbank	Germany
Deutsche Bank AG	Germany
Deutsche Bank / DB Ireland plc	Republic of Ireland
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
Dresdner Bank Luxembourg SA	Luxembourg
Eurohypo European Mortgage Bank Ireland plc	Republic of Ireland
Finansbank (Holland) NV	Netherlands
Fokus Bank ASA	Norway
Helaba Dublin Landesbank Hessen-Thüringen International	Republic of Ireland
Helaba Luxembourg Landesbank Hessen-Thüringen International SA	Luxembourg
ING Bank NV	Netherlands
The Investment Bank of Ireland Ltd	Republic of Ireland
Irish Intercontinental Bank Ltd	Republic of Ireland
Irish Nationwide Building Society	Republic of Ireland
Irish Permanent plc	Republic of Ireland
Kredietbank SA Luxembourgeoise	Luxembourg
Landeskreditbank Baden-Württemberg	Germany
Merrill Lynch Capital Markets Bank Ltd	Republic of Ireland
Nordbanken AB (publ)	Sweden
Rabobank Ireland Ltd	Republic of Ireland
Rheinhyp Bank Europe plc	Republic of Ireland
Robeco Bank (Luxembourg) SA	Luxembourg
SGZ-Bank Ireland plc	Republic of Ireland
SNVB Financements	France
Smurfit Paribas Bank Ltd	Republic of Ireland
Société Européenne de Banque	Luxembourg
Société Nancienne Varin-Bernier	France
State Street Banque SA	France
Westdeutsche Landesbank Girozentrale	Germany

(ii) EAIs which are not entitled to accept deposits in the UK 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 Coordination (Second Council Directive) Regulations 1992, ***excluding*** *deposit-taking.*

Name of institution	Country of home state supervisory authority
Anglo Irish Bank Corporation plc	Republic of Ireland
Banco de Fomento e Exterior SA	Portugal
Banco Finantia, SA	Portugal
Bank of America SA	Spain
Banque de Gestion Edmond de Rothschild Luxembourg	Luxembourg
Bayerische Handelsbank AG	Germany
Berlin-Hannoversche Hypothekenbank AG	Germany
Caja Bilbao Bizkaia Kutxa	Spain
Crédit Européen SA	Luxembourg
Credito Italiano	Italy
Delahaye Générale Options SA	France
Deutsche Genossenschafts-Hypothekenbank AG	Germany
Deutsche Hypothekenbank Frankfurt AG	Germany
Deutsche Schiffsbank AG	Germany

EBS Building Society	Republic of Ireland
Europäische Hypothekenbank SA	Luxembourg
FGH Bank NV	Netherlands
Frankfurter Hypothekenbank Centralboden AG	Germany
Garras Bank-Naspa Dublin	Republic of Ireland
Hypothekenbank in Hamburg AG	Germany
IKB Deutsche Industriebank 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
Rheinische Hypothekenbank AG	Germany
S-E-Banken Luxembourg SA	Luxembourg
Salzburger Landeshypothekenbank AG	Austria
Société de Caution Mutuelle des Professions Immobilières et Foncières	France
Sparebanken Nor	Norway
Telia Finans AB	Sweden
Westfälische Hypothekenbank AG	Germany
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

Alliance & Leicester plc
Alliance & Leicester Group Treasury plc
Bristol & West plc
Crown Agents Financial Services Ltd
Halifax plc
Legal & General Bank Ltd
Northern Rock plc
Philippine National Bank (Europe) plc
Standard Life Bank Ltd
Tesco Personal Finance Ltd
Woolwich plc

Deletions

Alexanders Discount plc
Banamex Investment Bank plc
Chase Manhattan plc
Exeter Bank Ltd
King & Shaxson Ltd
LTCB International Ltd
Scottish Amicable Money Managers Ltd
S G Warburg & Co Ltd
Western Trust & Savings Ltd
Woodchester Credit Lyonnais plc

Name changes

CLF Municipal Bank plc to Dexia Municipal Bank plc
Chase Investment Bank Limited to Chase Manhattan plc
Forward Trust Ltd to Forward Trust Group Ltd
NWS Bank plc to Capital Bank plc
Riggs AP Bank Ltd to Riggs Bank Europe Ltd
Scotiabank (UK) Ltd to Scotiabank Europe plc
Smith & Williamson Securities to Smith & Williamson Investment Management Ltd
The First Personal Bank plc to GE Capital Bank Limited
The Private Bank and Trust Company Ltd to EFG Private Bank Ltd

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

Additions

Bank of Cyprus Ltd
The Korea Development Bank
Housing & Commercial Bank, Korea
Wachovia Bank NA

Deletions

Fleet National Bank
The Bank of NT Butterfield & Son Ltd
The Hokkaido Takushoku Bank Ltd
The Nippon Credit Bank Ltd

Name changes

The First National Bank of Boston to BankBoston, NA

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

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

Name of institution	Country of home state supervisory authority
Additions	
CETELEM	France
Banque CPR	France
Erste Bank der oesterreichischen Sparkassen	Austria
Deletions	
GiroCredit Bank Aktiengesellschaft der Sparkassen	Austria
ICS Building Society	Republic of Ireland
Indosuez Carr Futures SNC	France
Name changes	
Banque Française du Commerce Extérieur to Natexis Banque	France
Banque Indosuez to Crédit Agricole Indosuez	France
Creditanstalt-Bankverein to Creditanstalt Aktiengesellschaft	Austria
Rabobank (Coöperatieve Centrale Raiffeisen - Boerenleenbank BA) to Rabobank International (Coöperatieve Centrale Raiffeisen - Boerenleenbank BA)	Netherlands
SwedBank (Sparbanken Sverige AB (publ) to SwedBank (FöreningsSparbanken AB (publ))	Sweden

(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
Addition	
Carr Futures SNC	France
Deletion	
Crédit Agricole Futures	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 UK on a cross-border basis

Additions	
ABN AMRO Leasing Holding NV	Netherlands
Achmea Hypotheekbank NV	Netherlands
BG Bank International SA	Luxembourg
Banca Toscana SpA	Italy
Banco Português de Investimento, SA	Portugal
Bank Austria AG	Austria
Bankinter SA	Spain
Bear Stearns Bank plc	Republic of Ireland
Commerzbank Europe (Ireland)	Republic of Ireland
Corporación Bancaria de España, SA	Spain
Crédit Communal de Belgique	Belgium
Crédito Predial Português SA	Portugal
Den Københavnske Bank A/S	Denmark
Den norske Bank ASA	Norway
Deutsche Bank/DB Ireland plc	Republic of Ireland
Dresdner Bank Luxembourg SA	Luxembourg
Eurohypo European Mortgage Bank Ireland plc	Republic of Ireland
Fokus Bank ASA	Norway
Helaba Luxembourg Landesbank Hessen-Thüringen International SA	Luxembourg
Irish Nationwide Building Society	Republic of Ireland
Landeskreditbank Baden-Württemberg	Germany

Merrill Lynch Capital Markets Bank Limited	Republic of Ireland
Rheinhyp Bank Europe plc	Republic of Ireland
SGZ-Bank Ireland plc	Republic of Ireland
Smurfit Paribas Bank Ltd	Republic of Ireland
State Street Banque SA	France
Westdeutsche Landesbank Girozentrale	Germany

Deletions

Prudential-Bache International Bank SA	Luxembourg
Sydbank Luxembourg SA	Luxembourg

Name Change

Banque Indosuez to Crédit Agricole Indosuez	France

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

Additions

Banco de Fomento e Exterior SA	Portugal
Bayerische Handelsbank AG	Germany
Berlin-Hannoversche Hypothekenbank AG	Germany
Delahaye Générale Options SA	France
Deutsche Genossenschafts-Hypothekenbank AG	Germany
EBS Building Society	Republic of Ireland
IKB Deutsche Industriebank AG	Germany
Westfälische Hypothekenbank AG	Germany

Deletions

Commerzbank Europe (Ireland)	Republic of Ireland
Crédit Communal de Belgique	Belgium
European Mortgage Bank (Ireland) Ltd	Republic of Ireland
Rheinhyp Bank Europe plc	Republic of Ireland
SGZ-Bank Ireland plc	Republic of Ireland

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	IOM
The Agricultural Bank of China	China
Alfa Bank	Russia
Alfa Bank Jersey Ltd	Jersey
Alliance and Leicester (Isle of Man) Ltd	IOM
Al-Rajhi Investment Corporation Ltd	Saudi Arabia
Arab Bangladesh Bank Ltd	Bangladesh
Arjil & Associés Banque	France
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
Banco Bandeirantes SA	Brazil
Banco Boavista SA	Brazil
Banco Bradesco 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 Efisa	Portugal
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 Popular Español	Spain
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:	Bermuda
Bank of Bermuda (Cayman) Ltd	Cayman Is
Bank of Bermuda (Luxembourg) SA	Luxembourg
Bank of Bermuda (Guernsey) Ltd	Guernsey
Bank of Bermuda (Isle of Man) Ltd)	IOM
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 Sarasin & Cie	Switzerland
Bank von Ernst & Co Ltd	Switzerland
Banque Internationale de Commerce	France
Banque Multi Commerciale	Switzerland
(alias: Multi Commercial Bank)	
Banque Privée Edmond de Rothschild	Switzerland
Banque Transatlantique SA	France
Banque Transatlantique (Jersey) Ltd	France
Banque Woolwich SA	France
Bashcredit Bank	Russia
Bilbao Bizkaia Kutxa	Spain
Bradford & Bingley (Isle of Man) Ltd	IOM
Bremer Landesbank	Germany
Birmingham Midshires (Guernsey) Ltd	Guernsey
Bristol & West International Ltd	Guernsey
Britannia International Ltd	IOM

Brown Brothers Harriman Ltd	USA
BULBANK (Bulgarian Foreign Trade Bank) Ltd	Bulgaria
CIC Group (comprising	France
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
Cheshire Guernsey Ltd	Guernsey
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 (alias: CDE)	France
Crédit Foncier de France SA	France
Crédit National	France
Credo Bank	Russia
Delphis Bank - Mauritius	Mauritius
The Derbyshire (Isle of Man) Ltd	IOM
Deutsche Pfandbrief- und Hypothekenbank AG (alias DePfa-Bank)	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 International Merchant Bank	Malta
The First National Bank of Maryland	USA
First Ukrainian International Bank	Ukraine
Fleet Bank NA	USA
Garanti Bank AS	Turkey
Garantia Banking Ltd	Bahamas
Gruppo Arca Nordest (a partnership of:	Italy
Banca Agricola Mantovana	
Banca Antoniana Popolare Veneta	
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 Vicentina)	

The Hachijuni Bank Ltd	Japan
Halifax International (Isle of Man) Ltd	IOM
Halifax International (Jersey) Ltd	Jersey
Harris Trust and Savings Bank	USA
The Hokkoku Bank Ltd	Japan
Hua Nan Commercial Bank Ltd	Taiwan
The Hyakujushi Bank Ltd	Japan
Imperial Bank	Russia
The Industrial & Commercial Bank of China	China
Inkombank	Russia
Investec Bank Ltd	South Africa
Irish Permanent (IOM) Ltd	IOM
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
JSC Kazkommertsbank	Republic of Kazakhstan
Jamaica National Building Society	Jamaica
Jammal Trust Bank SAL	Lebanon
The Japan Development Bank	Japan
Jugobanka AD	Federal Republic of Yugoslavia
The Juroku Bank Ltd	Japan
Kenya Commercial Bank Ltd	Kenya
Komercni Banka AS	Czech Republic
Kookmin Bank	South Korea
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
Moscow Business World Bank of Russia	Russia
Most-Bank	Russia
Muslim Commercial Bank Ltd	Pakistan
NRBank	Russia
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
The Nippon Credit Bank, Ltd	Japan
Northern Rock (Guernsey) Ltd	Guernsey
Nova Ljubljanska Banka DD	Slovenia
Oryx Merchant Bank Ltd	Cayman Is
Osmanli Bankasi AS	Turkey
Osuuspankkien Keskuspankki Oy (alias: 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 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	IOM
The Royal Bank of Scotland Trust Co (Jersey) Ltd	Jersey
SBS Agro Managing Company	Russia
SDM-Bank	Russia
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:	
Standard Bank Isle of Man Ltd	IOM
Standard Bank Jersey Ltd)	Jersey
Stopanska Banka AD	Former Yugoslav Republic of Macedonia
Sumerbank AS	Turkey
TaipeiBank	Taiwan
UAL Merchant Bank Ltd	South Africa
Ueberseebank AG	Switzerland
União de bancos Brasileiros SA (alias: Unibanco)	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
M M Warburg and Co KGaA	Germany
Woolwich SpA	Italy
Woolwich (Guernsey) Ltd	Guernsey
Workers Savings and Loan Bank	Jamaica
(alias Workers Envoy / alias Workers Bank)	
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 1998

Chairman:	E A J George (Governor)	ex-officio
	D Clementi (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
	Howard Davies	independent
	Sir David Scholey CBE	independent

This is the Board's report for the year to 28 February 1998.

Membership

A number of changes took place during the year. Sir Andrew Large retired from the Board on 31 July 1997 upon his retirement as Chairman of the Securities and Investments Board (SIB). Howard Davies became a non-executive member of the Board upon his succeeding Sir Andrew Large as Chairman of the SIB on 1 August 1997. In September 1997, David Clementi became an ex officio member of the Board upon taking up his position as Deputy Governor of the Bank of England. Sir Alan Hardcastle was reappointed to the Board with effect from 4 November 1997.

Meetings

The normal pattern is for the Board to meet monthly. At each meeting, the Board considers papers prepared by Supervision & Surveillance setting out matters both of general supervisory policy and relating to specific institutions. Some matters are discussed at the instigation of the Board, whilst others are reported by Supervision & Surveillance either seeking advice on specific issues or for the Board's information. In particular, the Board is kept informed of cases where Supervision & Surveillance has concerns and where formal action under the Banking Act might be required. 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. This arrangement will cease upon the transfer of banking supervision to the FSA (which is dealt with below).

Matters Considered

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

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

After the Chancellor's announcement in May 1997 concerning the transfer of responsibility for supervision from the Bank of England to the Financial Services Authority, the Board received monthly reports on the transitional issues arising from the transfer of responsibility to the new regulatory authority.

The Board received quarterly reports on progress with the Bank's Review of Supervision, the change programme implemented following publication of Arthur Andersen's Report in July 1996 (see main body of the Banking Act Report). The Board provided advice to S&S on the development of the enhanced framework for risk based supervision (RATE and SCALE) and on proposals for developments in the Section 39 regime (which led to revised notices to reporting accountants being issued in January 1998). The Board received reports on the establishment of the Quality Assurance Unit and commented on the Unit's first horizontal reviews (on the section 39 process) and its first vertical review on the supervision of a specific institution.

With regard to operational matters, the Board received regular reports updating them on specific institutions and matters of concern to Supervision and Surveillance. Amongst other things, the Board considered papers on the performance of different banking sectors, reviewing the key supervisory issues and the strategies adopted for addressing them. Developments in Emerging Markets were considered on several occasions. Towards the end of 1997, the Board in particular focussed on the turbulence in Far Eastern markets and the impact on banks. The Board also discussed the implications of EMU for European banking.

The Board debated a wide range of policy matters during the year, including the adequacy of Millennium Risk preparations; proposed changes to the method for measuring liquidity mismatches; and the Bank's proposals designed to implement the amendment to the Basle Accord to incorporate markets risks and the corresponding changes to the EU Capital Adequacy Directive currently under discussion in Brussels. All of these are covered in more detail in the main body of the Banking Act Report.

The Board received updates on developments in domestic and international regulatory co-operation, including the work of the Basle Committee of Banking Supervisors, 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). The Board discussed a number of papers prepared by the Traded Markets Team which included the lessons to be learnt from trading losses (and unusual profits); guidance for independent risk management functions (subsequently issued to banks in February 1998) and the issues surrounding independent valuation of and reserving for financial instruments.

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

The Board of Banking Supervision post transfer to the FSA

The Board will remain in place at least until the legislation embodying the new financial services regime comes into force, with the same powers and the same advisory relationship with the FSA as it had with the Bank of England. After the transfer to the FSA, the Board will be chaired by one of the independent members and the number of ex officio members will reduce from three to two (the Chairman of the FSA, Howard Davies, and the Managing Director for Financial Supervision, Michael Foot) and the chairman of the Board will be elected by the independent members from among their number.

VRangasamy

Secretary,

by Order of the Board

Bank of England 1998
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