Folio ·A

COMMERCIAL IN CONFIDENCE

(Circulate under cover and ... REGISTRY of movement).

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

gins : 21 5/82.
nds : 28/9/82.

PO -CH /GH/0032

PART A

Chancellor's (Howe) Papers:

COMMUNICATIONS BETWEEN WHITEHALL AND THE CLEARING BANKS

Disposal Directions: 25 Years

24/7/95.

PART A

C

SECRETARY OF STATE FOR THE ENVIRONMENT

CH/EXCHEQUER
REC. 21 MAY 1982
ACTION Mr Ritchie
COPIES TO CST
FST
EST
MST(C)
MST(R)
Sir D Wass
Sir A Rawlinson
Mr Barratt
Mr Moncur

Mr Kemp
Mr Ridley

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

21 May 1982

Dear Geoffrey

You will remember that I have been pursuing with the Clearing Banks a proposal from the Financial Institutions Group for the appointment of managers with special responsibility for promoting inner city small businesses, encompassing in particular those in the black communities.

I have received an encouraging response, and now intend to make the attached statement by way of a written Parliamentary Answer. The statement has been agreed with the banks concerned. Two of the new managers have already been appointed, and are being briefed on inner city matters by my officials.

Your support, and that of Mr Governor, has been of great help.

I am sending a copy of this letter to Gordon Richardson and Patrick Jenkin.

Yours ever

MICHAEL HESELTINE

Rt Hon Sir Geoffrey Howe QC

DRAFT STATEMENT

"The Financial Institutions Group of managers working with my Department on inner city problems recommended earlier this year that the major banks should take special measures to encourage and support the development of small businesses in the inner city areas. They pointed to the success of such schemes in the USA, particularly in promoting business development in the black communities."

"I put this recommendation to the banks, and have received an encouraging response".

"I am glad to say that both Barclays Bank and the Midland Bank have recently appointed inner cities business development officers based in London, and Williams and Glyn's intend to make a similar appointment in Liverpool."

"Lloyds Bank are deeply involved in a joint venture with the City of Birmingham to provide finance for new small businesses and are considering how they can broaden their support in the West Midlands."

"In addition the Chairman of the National Westminster Bank has informed me that three new business development officers will be appointed in the inner city areas of Liverpool, Manchester and South London."

"I greatly welcome these initiatives, and believe they will be of significant value in stimulating the economic regeneration of our older urban areas. The other British banks are also considering how they too can help. I believe the banks have a positive role to play here and welcome these latest initiatives as doing yet more to further their involvement."

DRAFT PRESS NOTICE

INN CITY INITIATIVES BY BANKS WELCOMED

Mr Michael Heseltine, Secretary of State for the Environment, today welcomed initiatives being taken by the major banks to encourage business development in Britain's inner cities.

In reply to a Parliamentary Question from [ ] Mr Heseltine said:

"The Financial Institutions Group of managers working with my Department on inner city problems recommended earlier this year that the major banks should take special measures to encourage and support the development of small businesses in the inner city areas. They pointed to the success of such schemes in the USA, particularly in promoting business development in the black communities."

"I put this recommendation to the banks, and have received an encouraging response".

"I am glad to say that both Barclays Bank and the Midland Bank have recently appointed inner cities business development officers based in London and Williams and Glyn's intend to make a similar appointment in Liverpool."

"Lloyds Bank are deeply involved in a joint venture with the City of Birmingham to provide finance for new small businesses and are considering how they can broaden their support in the West Midlands."

"In addition the Chairman of the National Westminster Bank has informed me that three new business development officers will be appointed in the inner city areas of Liverpool, Manchester and South London."

"I greatly welcome these initiatives, and believe they will be of significant value in stimulating the economic regeneration of our older urban areas. The other British banks are also considering how they too can help. I believe the banks have a positive role to play here and welcome these latest initiatives as doing yet more to further their involvement."

Mr French, → to keep PEM got a copy

Ch Mr Monck
Mr Lavelle

91/6

CONFIDENTIAL

27/5/82.

You might like to read this; then we could have a word. Mr Monck and Mr Lavelle might like to join us

MR MIDDLETON

cc Mr Lavelle
Mr Turnbull
Mr Peretz
Mr Pirie
Mr Davies

CHANNELS OF COMMUNICATIONS BETWEEN WHITEHALL AND THE CLEARING BANKS

In his minute of 8 April Mr Kerr reported that the Chancellor attached importance to Mr French's report that National Westminster thought that channels of communication between Whitehall and the clearing banks collectively were inadequate. The Chancellor asked Mr French to discuss the problem with you and me. The Chancellor also said that some difficulties may, perhaps inevitably, arise from the position of the Bank "But this does not preclude efforts at ameliaration".

2. This subject ~~was discussed~~ with Treasury Ministers last July (on 15 and 17 July) at meetings about my paper on Relations with the Bank of England and the Wass Report on Debt Management and Funding Techniques. At the first meeting it was agreed that the Treasury needed to develop contacts with both banks and other financial institutions. It was argued that discussions with the clearing banks should not be confined to lunch-time sessions with the Chief Executive Officers and suggested that the Chancellor should make clear to the Governor his determination that these contacts were to go ahead. It was recognised however that this was likely to remain a problem area since the Bank discouraged direct contact with the Treasury. The Chancellor asked for an aide memoire for a projected talk with the Governor. At the funding meeting it was argued that any approaches to the present Governor would be on specific points about particular contacts rather than on the broader issue of Treasury "freedom of communication" with the banks and other financial institutions. There should be no question of asking the Bank's permission; the Chancellor should tell the Governor what was being done. In September we prepared some speaking notes at the Chancellor's request and the passage on "direct contacts between Treasury and Financial Institutions" is annexed. There has, however, been no record of any such conversation between the Chancellor and the Governor.

Because it hasn't happened - quite rightly - I think

3. At present the Treasury has no regular formal channel of communication with the clearers collectively, though there may be contacts on

12/6

specific subjects with the CLCB and there are semi-social encounters with people from the clearers. At my level and below direct invitations from the clearers individually or collectively are fairly rare. (In my time, since September 1980 I have had two lunches with the CLCB and one lunch and one visit with National Westminster.) I gather that you too do not often lunch with Chief Executives.

4. So much for background. For the future we need to consider:

a. the purpose of direct contacts if we are to have them;

b. the form they should take;

c. what should be said to the Bank and at what level.

I have discussed the first two questions with HF1, HF3 and Mr Peretz, and the rest of this note is pretty much of a consensus.

5. The purpose of the exchanges discussed here would not be to transact business. If we want to do that ourselves - for example on export credit in the past or on tax in the future when your exercise gets going - I do not think there is a problem. The Bank has participated in discussions about export credit but probably would not want to do so on tax. The purpose of the exchanges discussed here would mainly be to get information, though there would also be some expressions of aims and opinions by both sides. If this is the purpose, it should avoid the risk which the Bank reasonably stress of getting wires crossed on operational matters. Moreover there would be positive disadvantage to us if the clearers always felt that on any subject of dispute with the Bank it was worthwhile lobbying us. It was convenient to us not to get involved directly with the clearers about the abolition of MLR and I am very glad we were not involved in the negotiations about the new monetary arrangements which came into force last August.

6. If the basic purpose is information, formal and collective arrangements are probably not the best format. The quarterly meetings

with the Finance Houses and Equipment Leasing Associations which I have inherited are not particularly useful. (This is admittedly partly because we are much less concerned with these institutions, which also incidentally have regular meetings with the Bank, than we are with other institutions such as the clearers and the long term investment funds which we never see.) Formal meetings with the building societies roughly once a quarter in the Joint Advisory Committee chaired by the DOE are also a bit thin. We have yet to see what will come of the meetings in Mr Stanley's new"Mortgage Group" which will be attended by building societies, the clearers, the Bank and me.

7. This all suggests that the best format for pursuing the information purpose wouldbe to avoid a regular collective occasion but for you or me to get in from time to time, say every 4 months or so, a Chief Executive of the individual clearers. Without going through the CLCB we might start with Mr Quinton of Barclays and gradually work through the others (Benson of National Westminster, retiring at the end of 1982, Jones of Lloyds and Taylor who is Stuart Graham's successor at the Midland).

8. The sort of subjects which it might currently be useful to discuss include the following:

a. bank lending to companies;
b. commercial bill round-tripping;
c. competition with building societies;
d. moves to pay interest on current accounts;
e. increasing payment of wages through banks;
f. electronic funds transfer;
g. foreign currency deposits; and
h. overseas lending.

9. If a proposal on these lines seems sensible, we would certainly need authority from Ministers and my own opinion is that the Bank should be told explicitly at some level what we are doing. One possible procedure is the one which has not apparently taken place - for the Chancellor to tell the Governor. An alternative would be to get the Chancellor's

agreement and for Sir Douglas Wass to tell the Deputy Governor that the Chancellor wants us to talk direct to the clearers with the purpose and on the basis described above. If, as is likely, the Governor takes the matter up with the Chancellor, the Chancellor could confirm that he wanted exchanges on these lines to take place and that he had particularly asked Sir Douglas Wass to make sure that Mr McMahon was told.

10. If the Bank are not told they will certainly hear and be in a better position to object even though there can be no question of seeking their agreement.

N MONCK
27 May 1982

FROM: A N RIDLEY
DATE: 27 July 1982

C

CHANCELLOR

cc Economic Secretary
Financial Secretary
Sir Douglas Wass
Mr Middleton
Mr Monck
Mr French

Govt : Mr 83

CONTACT WITH MIDLAND BANK

I went to lunch last Friday with a Mr D G Kitching, a Director and Chief Executive of Midland Bank in charge of corporate finance. Instead of being one of the galère of miscellaneous guests usual on such occasions I found myself on my own with him. During our conversation it appeared that:

(a) Midland are a little uneasy about the past (and present) rather constrained pattern of their relationships and contacts with Whitehall and are keen to widen those with the Treasury in particular;

(b) They were getting in touch with me because they suspected I could be one of a number of possible people it might be worth cultivating.

I gather from Mr Middleton that they have recently been in touch with him to much the same end. I explained that my role did not exclude such contacts, and sought to discover what more specific purpose the Midland might have in mind. Mr Kitching was a little vague about that, but I suspect that Bank taxation was probably the uppermost issue in his mind with, possibly, Gryllsery and BOP as "also-rans".

2. We had a fairly general discussion of a number of specific issues, in which he opined that:

- there could be more significant closures of firms before long, as they "ran out of puff"; though he emphatically did not commend reflation. This was one reason why banks' capital and reserves would need to be beyond doubt in coming months;

- the Cork/Chapter 11 family of proposals for more constructive receivership were not attractive. The major banks and the key accountancy firms involved had learnt a lot, and could carry out the constructive role needed within the existing legal framework;

- he did not see much scope for attracting longer-term deposits at present. It was difficult for clearers to obtain more than minute sums with an original maturity of a year or so;

- on the small business enterprise front equity was really the big problem. He implied that improving the provision of equity should now be the main priority, explained at some length how Midland were involving themselves increasingly and satisfactorily in providing it themselves, and offered to discuss such ideas with us further.

3. It is interesting to note how Midland have joined National Westminster in consciously seeking to open up a dialogue with the Treasury (cf Mr French's recent report about National Westminster). Prima facie it would seen that such initiatives are to be welcomed whether as a way of improving relations generally, facilitating a dialogue on Bank Taxation, or giving us more sources of advise and information about a variety of matters such as Gryllsery. The offer to talk more about BOP and the rest is one which I would recommend Mr French and officials should certainly pursue with the Midland and other banks soon.

AR

A N RIDLEY

X Kerr

ECONOMIC SECRETARY TO THE TREASURY

FROM: C D HARRISON
DATE: 27 JULY 1982

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
Sir D Wass
Mr Middleton
Mr Monck
Mr Pirie
Mr Turnbull

LLOYDS BANK GROUP RESULTS: HALF YEAR ENDED 30 JUNE

X Having seen Lloyds Bank's results which were circulated yesterday, the Economic Secretary has noted with interest that staff costs in the first half of this year are 20% higher than in the first half of last year.

Yes. But so are
- cost of premises + eqpt
- other (28%)

Have they made a major acquisition, or something?

CDH

C D HARRISON

CONFIDENTIAL

From: DOUGLAS FRENCH
28th July 1982

CHANCELLOR OF THE EXCHEQUER

(without attachment)
cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Middleton
Mr Monck
Mr Ridley

We probably do need to ~~[illegible]~~ discuss - @ lunch or some other mtg?

COMMUNICATIONS BETWEEN WHITEHALL AND THE CLEARING BANKS

As a result of your remit earlier in the year, following my contact with the National Westminster Bank, I have been looking at the general subject of contacts between Whitehall and the Clearing Banks. I am sorry not to have reported on this subject earlier, but I did have very useful discussions with Mr Middleton and Mr Monck about it. What follows reflects those discussions although I am here expressing my own conclusions which Mr Middleton and Mr Monck may wish to qualify. I also return to the subject now in the light of Mr Ridley's report of 27th July about his contact with the Midland Bank which appears to be almost exactly on the same lines as my own experience with the National Westminster. This appears to point to a growing wish on the part of the Clearing Banks for a new relationship with Whitehall and to the view that now may be the right time to take some action.

2. As I understand it, this whole subject was discussed at some length last July, in the context of Mr Monck's paper on "Relations with the Bank of England" and the Wass Report on "Debt Management". The attached minute from Mr Monck to Mr Middleton (27th May 1982) gives the full history. An aide-memoire was prepared with a view to your speaking to the Governor about particular points of contact between the Treasury and the Clearing Banks rather than broader freedom of communication which I believe ought to be the thrust of our present considerations.

3. It does not seem to me that there are any overriding reasons why the Bank of England should have traditionally drawn the line at direct formal contacts between the Treasury and the Clearing Banks other than the general feeling that once contact was allowed it would grow and

m[illegible]t eventually lead to an undermining of the Bank of England's role and authority. There is, perhaps, some basis for the belief that such a development would not be in the general interest if it transpired that the Clearing Banks started to enlist the help of the Treasury to strengthen their hand against the Bank of England, or even, on occasions, the reverse.

4. The result, however, is that there exists a severe and artificial restriction on the Treasury's capacity to enter into a useful dialogue with the Clearing Banks, even on the limited basis of exchanging information which stops well short of determining the development of policy on either side.

5. A comparison to illustrate the anomalous nature of this relationship is provided by the building societies. They maintain a direct dialogue with the Bank of England, which is clearly desirable, and which the Treasury, for its part, has never sought to limit. It has been suggested, that Treasury interference in this relationship would be very similar to the Bank of England's role in relation to the Clearing Banks.

6. In my judgment there is a very strong case for initiating direct contact between the Treasury and the Clearing Banks to enable both sides to keep themselves well informed, for Treasury officials to be able to test banking opinion where appropriate and for bankers to feel that they can sound out Whitehall feelings and sometimes express a view without it necessarily going "on the record" or being regarded as an "official line" Indeed, I am very surprised that pressure has not already built up sufficiently to bring this about. In some cases, like bank taxation, it is very difficult to see how progress could ever be made without a direct dialogue although on other matters, especially monetary and prudential ones, there seems a rather better case for preserving the Bank of England's exclusivity.

7. From my discussions with the National Westminster I believe that dialogue would be most beneficial if opened up at the General Manager or senior manager level, or below, not at Chief Executive and Chairman level where any exchanges are likely to be much more formal and less frank. Mr Monck's judgment on this is slightly different.

8. Since the Governor of the Bank of England is known to be unsympathetic to such a development, Treasury officials could hardly

CONFIDENTIAL

steps along this road unless it was agreed that they should. It would be necessary for you to authorise them to do so and then for you to explain to the Governor why you had decided that it was desirable.

I don't think to [illegible] [illegible] at the level of the Governor [illegible] we can then explain [illegible] are already [illegible]

9. I feel sure that now would be the right time to take action and that having had very obvious initiatives taken by two of the Clearers it would be a pity not to respond positively. May I suggest, therefore, that you have a meeting

a. to decide how and when this should be done

b. to agree the form and level of the new dialogue, and

c. to pursue the specific offer from the Midland to talk further about BOP and Gryllsery as mentioned in Mr Ridley's note of 27th July.

You may also wish to test the waters when you have lunch at the National Westminster on Friday.

Douglas French

DOUGLAS FRENCH

PRINCIPAL PRIVATE SECRETARY

FROM: N J ILETT
Date: 29 July 1982

cc Sir D Wass
Mr Middleton
Mr Kemp
Mr Monck
Mr Pirie
Mr Davies

CHANCELLOR'S VISIT TO NATIONAL WESTMINSTER BANK, 30 JULY

I understand that the purpose of this meeting is to allow Natwest to make their case against additional bank taxation to the Chancellor. FP and the Revenue do not think it necessary to trouble the Chancellor (who will be accompanied by Mr Middleton) with any specific briefing on this subject.

2. Mr Leigh-Pemberton was present at Mr Middleton's meeting with the British Bankers Association earlier this week, when Mr Middleton set out the objectives and nature of the review of bank taxation (separate studies of whether the banks ought to pay more tax and how more tax might be raised from them).

3. Natwest announced their interim results on Tuesday; my minute of 28 July to Mr Middleton (copied to you) refers.

4. After falls in the Bank of England's dealing rates earlier this week, the market is expecting a fall in the banks' base rates, but as at mid-afternoon today there is no sign of this happening. There was some press speculation yesterday that Natwest would soon cut its mortgage rate, but this may be unlikely before the building societies shift their rates.

N.J. Ilett

N J ILETT

FROM: N Monck
DATE: 29 July 1982

PRINCIPAL PRIVATE SECRETARY

cc Chief Secretary
Financial Secretary
Economic Secretary
MST(C)
MST(R)
Sir D Wass
Mr Middleton
Mr Ridley
Mr French

COMMUNICATIONS BETWEEN WHITEHALL AND THE CLEARING BANKS

Mr French says that a dialogue between the Treasury and the clearers would be most beneficial if opened up at General Manager or Senior Manager level or below, not at Chief Executive and Chairman level where exchanges are likely to be less frank. He adds that my judgement on this is slightly different. Any difference is very slight indeed. As my note makes clear, which I am attaching for the Economic Secretary and Sir Douglas Wass, I certainly did not envisage exchanges with the Chairmen. The choice between Chief Executive, which I have suggested as a suitable first contact, and General Managers or Senior Managers below that involves a much smaller difference: but which is best probably depends on the subjects to be covered.

N MONCK

CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

FROM: C D HARRISON
DATE: 29 JULY 1982

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Middleton
Mr Monck
Mr Ridley
Mr French

To be discussed

COMMUNICATIONS BETWEEN WHITEHALL AND THE CLEARING BANKS

The Economic Secretary very much agrees with the suggestion in Mr French's minute of 28 July that contacts between the Treasury and the clearing banks should be developed - Bank of England susceptibilities must not be allowed to get in the way.

CDH

C D HARRISON

CONFIDENTIAL

From: N J ILETT
Date: 13 August 1982

83/8

NM 16 Aug

1. MR MONCK
2. CHANCELLOR OF THE EXCHEQUER

61f 28/8

cc CST
FST
EST
MST(C)
MST(R)
Sir D Wass
Mr Burns
Sir K Couzens
Mr Middleton
Mr Quinlan
Mr Pirie o/r
Mr D J Moore
Mr Turnbull
Mr Ridley
Mr French

LONDON CLEARING BANKS: INTERIM RESULTS

This note responds to a number of requests for further information on this subject, especially on staff costs. What follows is mainly drawn from the banks' interim press releases, which I have already circulated (not to all). Unfortunately the quality and presentation of information varies between the banks, and it is not always suitable for presentation in tabular form. The B/E have been able to add some glosses to the published information, but do not have significant additional material.

Profits

2. Pre-tax Group profits for Lloyds were up 10%, NatWest up 9%; Midland down 10%, Barclays down 16% (all on the same period last year). The feeling is growing that the days of high clearing bank profits are over, with difficulties in international business and falling interest rates, as well as a relative decline in non-interest bearing liabilities.

3. Domestic business has generally held up well against international business. Barclay's is the most striking case, with domestic profits up 7.6% and international profits down 44%, mainly in consequence of of a £23½m loss in the USA. Lloyds and NatWest note less startling declines in foreign profits. Midland gives no information. Subsequent bad news about Crocker International, in which Midland took majority control last year, confirms however that they face similar problems.

Bad debts

4. All four banks have greatly increased bad debt provisions. Most of this is now in respect of specific loans. Total provision for bad debts is now £330m, against £167m this time last year. Lloyd's provision has increased by 158%; Midland's by 97%; Barclays' by 92%; and NatWest's by 73%.

CONFIDENTIAL

5. Midland and Barclays (especially North America) and Lloyds (especially South America) note that bad debt provisions have been particularly increased on foreign business.

Support for industry in the recession

6. Midland claims to be maintaining support for a "substantial number" of customers whose business is "basically viable", particularly in the manufacturing sector. Barclays claims to be assisting customers caught by the recession "to the limits of prudence". "Substantial" increases of manpower and financial resources have been devoted to this work, and "thousands" of jobs saved in addition to the 12,000 new jobs created by the various new business loan schemes. No details of the sectors to which these resources are destined are provided.

7. Lloyds and National Westminster do not comment under this heading.

Staff costs

8. Information available varies from bank to bank, and is not complete or consistent as between banks. In particular, we have figures for staff costs (usually worldwide) without full information on staff numbers. There can vary substantially, eg. following acquisitions and we cannot derive reliable figures for increases in average earnings per head . The Bank of England have no more information than the Treasury.

9. Subject to these provisos, the basic figures are as follows:

Staff cost increases

	1st ½ 1982/1st ½ 1981	(1981/1980)
Barclays	14½%	(25% - salary costs)
Lloyds	20%	(19½%)
Midland	10%	(18.5% - remuneration per employee)
NatWest	16¾%	(15.5%)
	Source: interim announcements	Source: latest annual reports

10 Lloyds' high figure for the past year is partly explained by the inclusion of Lloyds and Scottish costs, following Lloyds' increased participation in that finance house. Lloyds' press release says domestic cost controls are "firm". Midland too congratulate themselves in their interim press release on their control of costs and on their branch reorganisation programme.

11. The Bank are not aware of any special factors affecting the Barclays and NatWest staff cost increases. This year's pay increase for most staff was 8.5% from 1 April, with improved holidays. Last year's increase was 10%; but it was agreed later than usual, and backdated. Some of the wage increases paid in respect of April, May and June 1981 may actually have been handed out in the second half of the year, and therefore be included in staff costs for that period. This would inflate the rate of increase obtained by measuring staff costs in the first half of this year against staff costs in the first half of last year.

12. There is also likely to have been some drift. Nor can we disaggregate overseas staff costs.

13. It is for consideration whether we might attempt to get more information from the clearers, direct or via the Bank. A request for information might perhaps be couched in the context of the study of bank taxation. We might argue that it is necessary to establish to what extent, if any, super-normal profits attributable to market conditions in "high street" banking were disguised by excessive wage settlements. But this is pretty tricky ground, for our relations with the B/E as well as the banks.

Prospects for the clearers more generally

14. The B/E report that the clearers are finding it harder to maintain growth than, say 12 months ago, because (contrary to conventional wisdom) the banks consider the growth of their assets depends on the extent to which they can attract deposits. Deposits are becoming harder to get and cost more, with the proportion of non-interest bearing deposits decreasing. There are already firm indications that banks are cutting back on mortgage lending, though this will not show up in the monetary statistics for some months.

Bank of England matters

15. Finally, you commented that we should subject the Bank of England's figures to comparable scrutiny to that given to the other banks and (in a different way) to other nationalised industries, and you asked whether PEAU might look at the Bank's figures.

CONFIDENTIAL

17. This question is closely related to the wider range of issues affecting Treasury/Bank relations, on which Sir Douglas Wass recently minuted the Chancellor. These are to be given further thought after the leave season, and we might perhaps address this particular point then. At present, however, it would probably be HF rather than PEAU that would have the expertise to look at the Bank's figures, but this exercise would be difficult to carry out within present resources.

N.J. Ilett.

N J ILETT

CONFIDENTIAL

Chairman

National Westminster Bank PLC
41 Lothbury, London
EC2P 2BP

Mr Pirie.
cc EST
Sir D. Wass
Mr Middleton
Mr Monck.

19th August, 1982

Dear Geoffrey,

24/viii

You will probably remember drawing my attention to the article by David Fanning which was published in the July issue of 'The Banker' and which alleged that the Clearing Banks were grossly overmanned. I expect the same perceptiveness which drew your eye to the July issue will also take it to this month's issue as well, but just in case this does not happen I venture to enclose a copy of the August article which explains why Mr. Fanning's basis of measurement and his conclusions on the staffing and overmanning of the London Clearing Banks are invalid.

May I add, moreover, a few personal comments based on our own experience in the National Westminster Bank Group which supports Mr. Fraser's reply to David Fanning.

The type of business conducted by a bank - retail or wholesale, and in particular its role in money transmission and cash distribution - has a great bearing on assets and net operating income per employee. We have clear examples of this within National Westminster Group. For example, County Bank, our merchant banking subsidiary, has assets per head of employee more than five times, and net operating income two and a half times as large as that of the Group as a whole.

C.

Continued....

I think you should see this before we minute out your comments on the closures below.

Ta: I have amended my comments, in black

How not to measure bank productivity

trick Frazer
Committee of London Clearing Bankers Research Group

Attempts to measure and compare bank productivity are bedevilled by the absence of any coherent yardstick of output, changing economic conditions, and variations in banks' mix of business. Relying on financial values alone is too simplistic

In November 1981 and again in July 1982 *The Banker* published articles about bank productivity by David Fanning of the University of Wales Institute of Science and Technology. The first article compared British banks with banks in Germany, France and the United States. It concluded, on the basis of a couple of simple calculations, that British banks fell far short of their competitors' standards of productivity and that they could learn valuable lessons in human resource management from American and German banks. The second article offers no further international comparisons but nonetheless concludes that British banking groups are grossly overmanned. It is also claimed that, without exception, banking groups in other countries generate better profits per employee than British groups.

In the case of profits per employee the conclusion in one article is flatly contradicted by the evidence in the other. The other conclusions are equally unsatisfactory — being based on a superficial analysis which is simply not up to the task. The fundamental flaw in the author's argument is the assumption that useful insights into bank productivity can be gained by considering only financial information. It is simply not good enough to ignore important differences between banks and yet go on to make sweeping allegations about British inefficiency.

In his comparison of British banks with other major international banks, Mr Fanning relies upon two ratios — assets per employee and revenue per employee. As it happens, both ratios give much the same result since they are measuring essentially the same thing. This is because the analysis uses gross revenue, a criterion which takes no account of interest paid by banks on their borrowing. So, far from measuring productivity, revenue per employee does little more than reflect the assets of the bank and prevailing interest rates. Certainly, it singularly fails to measure the value that banks add to money — that is the interest margin between deposits and loans

Even the assets per employee ratio can only give a useful measure of staff productivity if they are doing much the same business in much the same environment. This is certainly not the case with the world's leading banks. In some countries the top commercial banks are predominantly engaged in wholesale and international banking, whilst in other cases they also play a major role in retail banking. In some countries the big banks shoulder the lion's share of money transmission activities, which are labour intensive but which generate little in the way of deposits, whilst in other countries money transmission is largely handled by the postal giro or the smaller regional banks.

Similarly, local banking practices have an important impact on the assets of the major banks. Assets will be lower, relatively speaking, in those countries where overdraft lending is the norm, while those banks which require compensating balances will artificially inflate their balance sheets.

Different mix

The problem of ignoring the business mix of individual banks is dramatically demonstrated by the inclusion of Westdeutsche Landesbank in Mr Fanning's analysis. As a central giro institution for savings banks, Westdeutsche Landesbank does practically no retail banking but is a major participant in the wholesale and international banking markets. As a result, its assets per employee ratio is approximately four times higher than the German 'big three'. This erroneous impression of productivity is reinforced by its revenue per employee which is more than twice as high as the big three. In reality Westdeutsche Landesbank has only been able to avoid reporting losses by selling off its industrial shareholdings and making transfers from reserves.

Given this inability of the assets per employee criterion to take account of different business profiles, it is not surprising to find that British banking groups come relatively low down the list. Compared with the

other banking groups cited by Mr Fanning, British banks have a significantly different mix of business. Above all, they have a much larger relative exposure to retail banking and they play a vastly greater role in money transmission services. This not only pulls down the clearing banks' ratio of assets to employees but incidentally pushes up the ratio for building societies to a level more than three times as high. The different ratios simply reflect the fact that building societies play no part in money transmission.

Business profiles

Now that *The Banker* publishes employee numbers as part of its annual analysis of the world's top 500 banks, it is very easy to make international comparisons of assets per employee. The results, shown in table 1, highlight some remarkable differences between countries and an equally remarkable degree of consistency between similar banks within the same country. Where differences exist within a country, they can generally be explained in terms of differing business profiles.

Thus the Bank of America, which is one of the very few banks in the United States with a really substantial branch network, has a lower ratio than other money centre banks. Those banks which have eschewed the retail market altogether, such as J P Morgan and Bankers Trust, have higher than average ratios at $4,182,000 and $2,630,000 per employee respectively. Some of the world's central liquidity institutions for smaller retail banks have, like Westdeutsche Landesbank, huge ratios — for example Norinchukin Bank ($18,705,000) and Deutsche Genossenschaftsbank ($13,043,000). In contrast, small regional banks have ratios which are typically much lower than those of the big commercial banks in the same countries.

The high figures for the Japanese city banks can be explained by a number of factors — absence of overdraft finance, compensating balance requirements, concentration on major corporate clients through a small number of branches and large exposure to the international wholesale markets. Similarly, the high ratios of the Swiss banks can largely be explained by their enormous importance in the international markets in relation to their relatively modest domestic retail banking business.

On the other hand, there are several countries where commercial banks play a similar role to that played by British clearing banks. Thus Australian and Irish banks have ratios which are much the same as those of the clearing banks. It is significant that Standard Chartered and Grindlays, with extensive retail banking operations in less developed countries where labour is cheap and financial wealth is relatively low, have some of the lowest ratios of all. Moreover, Barclays and Lloyds, whose overseas business is closest to that of Standard Chartered and

TABLE 1: RATIO OF ASSETS PER EMPLOYEE FOR LEADING COMMERCIAL BANKING GROUPS

	$'000 per employee
Japan	
Dai-Ichi Kangyo Bank	3,587
Sumitomo Bank	4,313
Fuji Bank	4,019
Switzerland	
Union Bank of Switzerland	3,161
Swiss Bank Corporation	3,494
Crédit Suisse	3,325
Italy	
Banca Nazionale del Lavoro	2,002
Banca Commerciale Italiana	1,832
Banco di Roma	2,338
France	
Banque Nationale de Paris	2,105
Crédit Agricole	1,544
Crédit Lyonnais	2,065
United States	
BankAmerica Corp	1,321
Citicorp	1,936
Chase Manhattan Corp	2,175
Germany	
Deutsche Bank	1,886
Dresdner Bank	1,870
Commerzbank	2,113
Canada	
Royal Bank of Canada	1,803
Canadian Imperial Bank of Commerce	1,368
Bank of Montreal	1,672
Netherlands	
ABN Bank	1,752
Rabobank Nederland	1,601
AMRO Bank	1,823
England	
Barclays Bank	789
National Westminster Bank	984
Midland Bank	945
Lloyds Bank	799
Ireland	
Allied Irish Banks	834
Bank of Ireland	819
Australia	
Commonwealth Banking Corp	684
Bank of New South Wales	805
Australia and New Zealand Banking Corp	805
British Overseas	
Standard Chartered Bank	692
Grindlays Holdings	746

Source: Derived from Top 500 Banks, *The Banker* June 1982.

Grindlays, have the lowest ratios among the clearing banks.

The more one looks at the assets per employee ures, the more one is forced to conclude that they give no useful information about productivity, but indi te the nature of a bank's business.

T problem of productivity measure is, of course, not unique to banking. Even an apparently straightforward comparison of the productivity of Japanese and British car factories can be totally confused if one manufactures its component parts in-house and the other buys them from external suppliers. The difference between wholesale and retail banking is, after all, very much a difference between manufacturing and purchasing the component parts of banking — namely deposits. The measurement of productivity in banking is made particularly difficult by the absence of any coherent yardstick of output. How, for example, does one compare the value of $10 million borrowed on the wholesale market with the processing of 10 million cheques?

Product lines

This is a problem that can never be satisfactorily solved by a measure which relies on financial values only. It is therefore interesting to see that the Bank Administration Institute and the American Productivity Centre have recently established a programme which attempts to measure bank productivity scientifically. The system identifies no less than 31 different product lines that are common to most banks, divided into their two main areas of operation — physical processing of transactions and financial intermediation.

One of the key measures of physical productivity in banking is the processing of payments, and this is one area for which there are reliable long-term statistics. As a result, it is possible to compare money transmission volumes with the number of staff in the London clearing banks. It is thought that something like half the staff effort in the parent banks is absorbed by money transmission, so this is not such a meaningless comparison as might appear at first sight. The results will obviously suffer from changes in the mix of clearing bank business over the period, but this problem is minimised by using parent bank staff figures since most of the banks' significant diversifications have taken place through subsidiaries. Nonetheless, the recent incursion of clearing banks into the mortgage market, which has in most cases been through the parent banks rather than subsidiaries, is an example of how total staff numbers are likely to increase more rapidly than those employed directly in money transmission, thus understating the true improvements in productivity.

The results of comparing average staff numbers against money transmission volumes are shown in table 2 for the last 20 years. During this period the number of payments items handled by the London clearing banks has increased by a factor of four, whilst staff numbers have rather more than doubled. It is quite striking to see how the annual growth rate of productivity, shown in table 3, has picked up from the low figures of the 1960s to the much more respectable values achieved in the 1970s.

In conclusion, it must be stressed that there is no easy way to measure bank productivity. It will be interesting to see how well the Bank Administration Institute succeeds in its attempt to apply a rigorous approach. Bank productivity is undoubtedly an important and interesting subject, and not one that can be satisfactorily dealt with in a simplistic way. Referring to the London clearing banks' own productivity yardsticks, Mr Fanning comments that 'in general terms, the use of volume measures such as deposits per head or loans per head is disingenuous, since volume characteristics are functions of the economy, interest rates, borrowing conditions and so on, rather than of increased employee productivity or effectiveness'. The same is undoubtedly true of value measures and it would be difficult to think of a better epitaph for the author's own efforts.

TABLE 2: PAYMENTS TRANSACTIONS AND STAFF NUMBERS IN THE LONDON CLEARING BANKS

	Payments (millions)	Staff numbers	Payments per staff member
1960	753	109,953	6,848
1961	806	117,105	6,883
1962	836	124,002	6,742
1963	893	129,228	6,910
1964	965	134,831	7,157
1965	1,004	140,874	7,127
1966	1,084	146,008	7,424
1967	1,166	151,209	7,711
1968	1,222	156,828	7,792
1969	1,287	165,067	7,797
1970	1,342	173,045	7,755
1971	1,412	176,590	7,976
1972	1,557	177,784	8,758
1973	1,692	182,284	9,282
1974	1,790	196,175	9,125
1975	1,953	202,066	9,665
1976	2,099	201,235	10,431
1977	2,241	205,427	10,909
1978	2,421	211,285	11,458
1979	2,601	218,645	11,896
1980	2,860	230,925	12,385
1981	2,982	233,598	12,766

Payments include all cheques, credits and pre-authorised payments, except those handled entirely within a single branch. Staff numbers are the average of five dates — end of March, June, September and December for the year in question, together with the end of the previous December.

TABLE 3: GROWTH RATES IN PAYMENTS TRANSACTIONS PER STAFF MEMBER

	Compound annual growth rate %
1960-1965	0·8
1965-1970	1·7
1970-1975	4·5
1975-1980	5·1

CONFIDENTIAL

FROM: C D HARRISON
DATE: 20 AUGUST 1982

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Burns
Sir K Couzens
Mr Middleton
Mr Quinlan
Mr Monck o.r.
Mr D L Moore
Mr Pirie o.r.
Mr Turnbull o.r.
Mr Ilett
Mr Ridley
Mr French

LONDON CLEARING BANKS : INTERIM RESULTS

In paragraph 9 of Mr Ilett's submission of 13 August, there was a table showing recent increases in staff costs in the London Clearing Banks. Mr Ilett says that it is for consideration whether more information on these figures might be sought from the clearers, directly or via the Bank. The Economic Secretary thinks that the table should be put to them, and their comments invited; and that this should be done directly rather than via the Bank. He thinks that a direct approach will put the Treasury on firmer ground in its dealings with the Bank.

CDH

C D HARRISON

I believe I referred to this – [illegible]

1/36

Mr Middleton

FROM: N J ILETT

DATE: 31 August 1982

1. MR PIRIE O/R
2. CHANCELLOR OF THE EXCHEQUER

cc Economic Secretary
Sir D Wass
Mr Middleton
Mr Monck
Mr French

CLEARING BANK STAFFING, AND STAFF COSTS

Mr Kerr's minute of 26 August asked for a draft letter which the Chancellor might send to Mr Leigh-Pemberton. I attach a draft.

N.J. Ilett.

N J ILETT

I am very sorry this was mislaid and has been so long delayed. I have revised the draft to make it clear that you had referred to staff costs as well as productivity when you lunched with Mr Leigh-Pemberton, and attach a retryped version.

AP

A C PIRIE

8/x/82.

20/10

DRAFT LETTER TO:

Robin Leigh-Pemberton Esq
Chairman
National Westminster Bank PLC
41 Lothbury
LONDON
EC2P 2BP

Thank you for your letter of 19 August about the articles about bank productivity which appeared in "The Banker". I have studied Mr Frazer's article with interest, and recognise that Mr Fanning's analysis was inadequate.

When we were talking about productivity over lunch in July, I also mentioned the related issue of increases in staff costs.

A glance at the information given in the clearing banks' latest interim results notices, and in their annual reports, suggests that these costs are rising fast (by nearly 17% over the 12 months to June 1982 in your bank's case). It is not clear to me from the information you and your CLCB colleagues publish to what extent these figures reflect changes in the number of staff employed, acquisitions, changes in the cost of employing staff overseas etc as well as pay increases and productivity improvements in the UK.

I wonder therefore if you and your CLCB colleagues have any estimates of increases in the average earnings per head of your staff employed in the UK in recent years, and of the proportion of these increases which is accounted for by improvements in productivity and by other factors? I would of course treat the information you give me in confidence.

[G H]

PWP

Clerks

FROM: D C FRENCH
23 September 1982

CHANCELLOR

c c
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State(C)
Minister of State(R)
Mr Middleton
Mr Wicks
Mr Ridley
Mr Harris

C.

Sorry – I thought I'd give you this one – in fact I'd sent it back to the Clerks to attach the reference.

2

MIDLAND BANK

As you know the Midland Bank was reported in Sunday and Monday's papers as calling upon the Government to guarantee loans to prevent major companies from failing. Mr Kitchen*, with whom Adam and I had previously been in contact on this and other matters, telephoned to say that the press reports seriously misrepresented the views of the Midland and he wished the record to be set straight in the Treasury. At no time has the Midland thought that Government guarantees were the right way to help major companies in difficulties. Their correct views are as summarised in the note circulated by Adam after we met them.

attach

X

Douglas French

DOUGLAS FRENCH

*A general manager at the Midland

COMMERCIAL IN CONFIDENCE

10/14

From: R J CAPSTICK
Date: 28 September 82

1. MR ~~ILETT~~
MR ~~PIRIE~~ AP 28/9
3. PRINCIPAL PRIVATE SECRETARY

cc Mr Monck

PRIME MINISTER: VISIT TO BANK OF SCOTLAND ON 20 OCTOBER

The Prime Minister has agreed to open the Bank of Scotland's new building in Threadneedle Street on 20 October. No.10 have asked us to provide a short background brief by 6 October. This is attached.

R J CAPSTICK

N.J. Ilett. 28/ix

The Bank of Scotland (not to be confused with the Royal Bank of Scotland) is the 6th largest clearing bank in the UK, accounting for a third of retail banking in Scotland. Barclays have a 35% stake in the Bank of Scotland, but it retains its independence. It is a recognised bank under the Banking Act 1979. Not surprisingly, its performance is to some extent dependent on the Scottish economy. It has a merchant banking subsidiary, the British Linen Bank and a finance house subsidiary, North West Securities. The Bank of Scotland successfully resisted a takeover by the Distillers Company at the end of last year. The full story of the takeover bid is not however public knowledge.

2. The Bank recently announced its interim results. These showed a fall in pre-tax profits from £25.8 million in the six months ending in August 1981 to £22.1 million in the same period in 1982. The Bank attributed the fall to increased bad debt provisions and to the effect of the recession on the Scottish economy. As the Bank of Scotland did particularly well in the first half of last year, a fall in this year's interim profit is really not surprising.

3. The Bank has also begun to widen its network. It recently opened three banks in England, the latest being in Manchester this month. It also has branches in Hong Kong (opened in 1979) and in New York.

4. The Bank of England's view of the Bank of Scotland is that it is sound but unspectacular.

5. Neither the Treasury nor the Bank of England are aware of any matters of controversy affecting the Bank of Scotland which would be likely to arise during a visit of this nature.

6. Copies of the Who's Who entries for the Governor of the Bank of Scotland, Mr Tom Risk and the Treasurer and General Manager, Mr Bruce Pattullo, are attached.

HM TREASURY
28 September 1982

Thomas Risk

Who's Who 1982

RISK, Thomas Neilson; Governor of the Bank of Scotland, since 1981 (Director, 1971; Deputy Governor, 1977–81); *b* 13 Sept. 1922; *s* of late Ralph Risk, CBE, MC, and of Margaret Nelson Robertson; *m* 1949, Suzanne Eiloart; four *s*. *Educ:* Kelvinside Academy; Glasgow Univ. Flight Lieut, RAF, 1941–46; RAFVR, 1946–53. Partner, Maclay Murray & Spens, Solicitors, 1950–81. Director: Standard Life Assurance Co. (Chm., 1969–77); British Linen Bank (Governor, 1977–); Howden Group Ltd; Merchants Trust Ltd; Mine Safety Appliances Co. Ltd. ~~Mem., Scottish~~ Industrial Devélt Bd, 1972–75. Trustee, Hamilton Bequest. *Recreations:* shooting, golf. *Address:* 10 Belford Place, Edinburgh EH4 3DH. *T:* 031-332 9425. *Clubs:* Royal Air Force; New (Edinburgh); Western (Glasgow); Royal and Ancient (St Andrews); Prestwick Golf.

Bruce Pattullo

PATTULLO, (David) Bruce; Treasurer and General Manager, Bank of Scotland, since 1979 (Deputy Treasurer and General Manager, 1978); *b* 2 Jan. 1938; *s* of Colin Arthur Pattullo and Elizabeth Mary Bruce; *m* 1962, Fiona Jane Nicholson; three *s* one *d*. *Educ:* Rugby Sch.; Hertford Coll., Oxford (MA). FIB (Scot.). Commnd Royal Scots and seconded to Queen's Own Nigeria Regt. Gen. Man., Bank of Scotland Finance Co. Ltd, 1973–; Dir and Chief Exec., British Linen Bank Ltd, 1977. Director: Bank of Scotland; Scottish Agricultural Securities Corp. Ltd; Lapid Develts Ltd; Melville Street Investments (Edinburgh) Ltd. Chm., Cttee, Scottish Clearing Bankers; Mem., Council, Inst. of Bankers in Scotland. First Prizeman (Bilsland Prize), Inst. of Bankers in Scotland, 1964. *Recreation:* tennis. *Address:* 6 Cammo Road, Edinburgh EH4 8EB. *T:* 031-339 6012. *Clubs:* Caledonian; New (Edinburgh).

1. Mr [illegible] 1/4

2 Mr Ryrie [illegible] Mr

Contacted on 1/4

I will then contact the Bank

ARB 3/3

10 DOWNING STREET

From the Private Secretary 26 February 1982

Mr Rees

Pl. b/f on 15 September 82. I will then consult Bank.

[illegible]

1/9/82

Dear John,

You should know that the Prime Minister has agreed to open the new building of the Bank of Scotland in Threadneedle Street on Wednesday 20 October. She was asked to do this by Sir William Lithgow, a shipbuilder in Glasgow and a Director of the Bank. The Prime Minister will simply unveil a plaque and meet some of the employees.

Perhaps you would be good enough to send us a short backbround brief, to reach us by Wednesday 6 October.

Yours sincerely,

Caroline Stephens

EXCHEQUER

1 MAR 1982

Mr Ryrie

CST, FST, EST

Sir D Wass, Mr Ryrie, Mr Middleton, Mr Monck, Mr Ridley

John Kerr, Esq.,
HM Treasury.

Mr Moore

Wd you pl. arrange, consulting B/E, at the appropriate time

[illegible]

3/3