PO-CH/NL/0089

PART A

Part A -

SECRET

(Circulate under cover and notify REGISTRY of movement)

Begins: 26/11/86
Ends: 21/7/87

MARKET SENSITIVE

Chancellor's (Lawson) Papers:

MONOPOLIES AND MERGERS COMMISSION REVIEW OF RESTRICTIVE TRADE PRACTICES

Disposal Directions: 25 Years

31/7/95

PO -CH /NL/0089
PART A

DEPARTMENT OF TRADE AND INDUSTRY
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From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

Michael Howard QC MP

Note
Passed this on to Mr Howard's office
AA 27/11

Personal copies to:
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax

CONFIDENTIAL & MARKET SENSITIVE

David Norgrove Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON SW1

I don't like the form of words @ all. ACSA
Better, surely, as I have

26 November 1986

Ch
Announcement (x overleaf) is phrased v oddly. No mention here of Morgan Grenfell (or Cazenoves)
AA

Dear David,

GUINNESS

You will wish to know that as a result of new information received in confidence my Minister, as the responsible Minister in this case, has decided to appoint inspectors under the Companies Act to investigate Guinness plc. The announcement will be made as soon as suitable inspectors can be appointed; we are aiming for tomorrow or Friday. (The Secretary of State has not seen the papers because of his family connections with Guinness.)

The Secretary of State signed in September a Memorandum of Understanding with the Securities and Exchange Commission on exchange of information. The SEC have informed us that Mr Ivan Boesky has told them of a deal done during the Guinness takeover bid for Distillers between him and certain directors of Guinness. Boesky was asked to buy Guinness stock in order to ensure that the Guinness share price held firm during the bid. He bought $100 million as instructed by Guinness directors. After the bid Boesky sold his shares. He was paid for his trouble by Guinness investing $100 million in shares in his limited partnership, which carried rights of only 45 per cent to the profits and 90% of the losses.

Mr Howard has confirmed with the Chairman of the SEC personally that they regard this information as reliable. It amounts to prima facie evidence of three criminal offences under the Companies Act and the Prevention of Fraud (Investments) Act.

RH3AQA

999-9

In essence the MoU requires us to keep information provided under it confidential and to use that information solely for the purpose of investigation and enforcement. In this case the SEC are particularly anxious about publicity because of the effect it could have on Boesky's co-operation with them, on the further press speculation it would create on top of what is already major press criticism of the SEC and the unnecessary warnings it would give about the extent of co-operation under the MoU. Co-operation with the SEC is of major importance to the Department in its vigorous enforcement of the law against insider dealing and other securities frauds.

We have, however, agreed a suitably guarded reference to the purpose of the appointment. It is our practice always to announce the appointment of inspectors under sections 432 and 442 of the Companies Act 1985; we must also do so in this case both because of the dangers of a false market developing in Guinness's shares and because we should differentiate this appointment from Opposition pressure (which is continuing) to appoint inspectors when Guinness resiled on their commitments in the bid documents on several points including the appointment of a non-executive Chairman (Sir Thomas Risk).

We would therefore be announcing the appointment of inspectors in order to "examine circumstances suggesting misconduct [of the affairs of the company in connection with its membership".]

Mr Howard has informed the Chancellor of the Exchequer, the Attorney General, the Minister of Agriculture and the Governor of the Bank of England.

I am copying this letter to their respective private secretaries and to Sir Robert Armstrong's office. The Department of Energy have been informed at official level in relation to the British Gas privatisation.

Yours sincerely,

David Roe

DAVID ROE
Private Secretary to Michael Howard

RH3AQA

pup

Express 27/11.

Widening the insider net

THE GOVERNMENT'S probe into the City's insider dealing scandal is about to take a dramatic new turn. Trade Secretary Paul Channon is expected to announce tomorrow that the investigation is to be widened to include other City figures.

So far the DTI's inspectors, and a nine-man team, have concentrated on Geoffrey Collier, the 35-year-old share dealer forced to resign from merchant bankers Morgan Grenfell for trying to profit from priviledged information.

New tougher measures, introduced two weeks ago, gave inspectors the power to take evidence under oath and compel witnesses to talk.

C10/2

SECRET AND PERSONAL

pup

FROM: A C S ALLAN
DATE: 28 NOVEMBER 1986

NOTE FOR THE RECORD

cc Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr Robson

SECTION 432 INVESTIGATION INTO GUINNESS

Mr Howard rang the Chancellor last night (Thursday 27 November) just after 7.00pm. He said he would be appointing inspectors at 8.30am on Monday, the inspectors would go in at 9.00am and an announcement would be made at 9.30 am. The announcement would now incorporate a reference to the Financial Services Act.

2. The Chancellor asked whether Mr Howard had satisfied himself that these procedures were in accordance with the Government's disclosure obligations for the British Gas sale. Mr Howard said that his officials had been in touch with Department of Energy and these points had been considered. It was not clear whether the information was 'material', but even if it was, it was all being disclosed in a public announcement before the offer closed. The Chancellor said it was important make sure about this, and Mr Howard agreed to check again.

3. Mr Howard's office rang me again today to report that, for technical reasons, the inspectors would be appointed today but with the announcement on Monday. He told me that officials had confirmed that these procedures were fully consistent with the Government's obligations towards the British Gas sale.

ACSA

A C S ALLAN

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From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs
Michael Howard QC MP

CH/EXCHEQUER
REC. 01 DEC 1986 1/12.
ACTION ~~Action~~ Sir
COPIES TO Sir P Middleton
Sir G Littler
Mr Cassell, Ms Lomax.

pmp

CONFIDENTIAL

David Norgrove Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON SW1

1 December 1986

Dear David,

GUINNESS

Further to my letter of 26 November, the Prime Minister will wish to be aware that inspectors were due to visit the company at 9.00 am this morning, Monday 1 December. The attached press notice is to be released to the Stock Exchange and the media at 9.30 am.

I am copying this letter to the private secretaries to the Chancellor of the Exchequer, the Attorney General and the Minister for Agriculture, to the Governor of the Bank of England and to Sir Robert Armstrong's office.

Yours sincerely,
David Roe

DAVID ROE
Private Secretary to Michael Howard

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4471
Out of hours: 01-215 7877

Number: 86/850

Date: 1 December 1986

INSPECTORS APPOINTED UNDER COMPANIES ACT 1985

Michael Howard, Minister for Corporate and Consumer Affairs, has today (1 December) announced that inspectors and have been appointed under sections 432 and 442 of the Companies Act 1985 to report on Guinness plc.

The inspectors are Mr David Torrance Donaldson QC and Mr Ian Glendinning Watt, Chartered Accountant, of Messrs KMG Thomas McLintock.

The purpose of the investigation is to examine circumstances suggesting misconduct of the affairs of Guinness plc in connection with its membership.

ENDS

NOTES TO EDITORS

1. On 26 and 27 November Mr Howard made two Orders which came into operation on 27 and 28 November respectively. They were the Financial Services Act 1986 (Commencement No 2) Order 1986 and the Financial Services (Disclosure of Information) (Designated Authorities) Order 1986.

2. These Orders enable information obtained by inspectors appointed under the Companies Act and under the Financial Services Act to be disclosed to other regulatory organisations.

3. The registered office of the Guinness plc is Bodiam House, Twyford, Abbey Road, London NW10 7ES.

Sir Gordon White K.B.E.
Chairman

Hanson Industries
410 Park Avenue
New York, NY 10022
Telephone (212) 759-8477
Telex 96.17.75

January 21, 1987

Dear Nigel Lawson

In view of the current debate on mergers which has been in the news so much recently and the conflicting views being expressed, I thought you would be interested to see the opinions of the Antitrust Division, the regulatory division of the United States Department of Justice.

What is interesting, especially in view of the current review of competition policy in Britain, is the careful appraisal of the facts leading up to the Department's conclusion. Furthermore, the effects on the economy are based on a dynamic perception of the economy rather than the static approach which seems to find more favour in Britain.

As a believer in the freedom of the market place and the beneficial effects of mergers on the essential process of industrial restructuring, I hope you will find this forthright and clear analysis helpful.

Yours sincerely,

pp

Dictated by
SIR GORDON WHITE
and signed in his absence.

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Secretary of State for Trade and Industry

29 January 1987

Ian Stewart Esq MP
Economic Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

ECONOMIC SECRETARY
PPS
Sir P Middleton
Mr Monck
Mrs Lomax
Mr Hall
Mr Board
Mr D Jones
Mr Croft - Tsol
Mr Nicolle - BoE

Thank you for your letter of 19 January about the Banking Bill Committee's interest in bank takeovers and the current review of mergers policy.

I am grateful to you for drawing the debate to my attention. I firmly support the view that it would be wrong to separate treatment of bank takeovers from takeovers in other sectors. But, as you told the Committee, the current policy review can certainly take into account the anxieties expressed in the debate.

PAUL CHANNON

DW4BYE

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CONFIDENTIAL

cc: Chancellor
Mr Cassell
Mrs Lomax
Mr Hall
Mr Jones
Mr Hoskel TSC

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

11 February 1987

Dear Paul,

BANKING BILL

Thank you for your letter of 29 January. I share your view that we should resist the pressure for a national interest power to block bank takeovers and this is the position I shall be taking at Report stage of the Bill, which is to be held on Thursday 19 February.

However, as you will have seen from the debate in Committee, Members on both sides are concerned that the current review of mergers policy might result in the removal of the exisiting provisions allowing for the scrutiny of takeovers on grounds of public interest. Without resting on this, I think I should have lost the vote in Committee.

Because of this, unless I am able to give a firm assurance that the review will not have this result, there is a real risk of having an unwanted national interest provision forced upon us, if not in the Commons, in the Lords. I think it important that the argument is fully established before the Bill leaves the Commons, otherwise we would I think be inviting trouble in the House of Lords.

I should therefore like to be in a position to say not only that the anxieties expressed about bank takeovers will be taken into account in the current review, but also that the Government will retain a power for the investigation of mergers on general public interest grounds. I would be grateful if you could let me know

that you are content for such an assurance to be given at Report stage.

On a related point, you may also have noticed that the Banking Bill has been criticised for not dealing with the question of bank takeovers that would be objectionable on grounds of reciprocity, and that the Financial Services Act's powers in this area are inadequate. I propose to address this problem by bringing forward an amendment to the Bill that will allow potential takeovers of UK banks to be blocked on grounds of absence of reciprocity in the 'predator's' home country, using the same principles of reciprocity as contained in Section 183 of the Financial Services Act. This too should help to draw the string from pressure for a generalised national interest power.

I am copying this letter to the Prime Minister, Geoffrey Howe, Malcolm Rifkind and the Governor of the Bank of England.

yours ever

Ian

IAN STEWART

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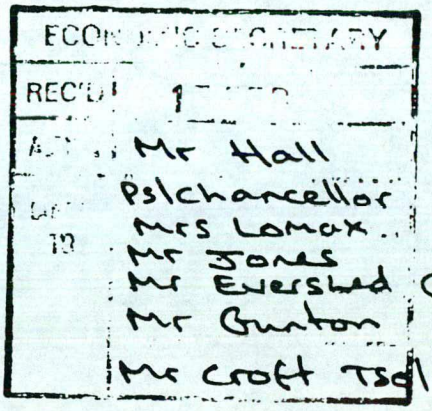
Secretary of State for Trade and Industry

13 February 1987

Ian Stewart Esq MP
Economic Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG



Dear Ian,

Thank you for your letter of 11 February, and for copying to me your letter to Malcolm Rifkind.

I appreciate that a firm statement on the outcome of the current review of mergers is going to be necessary to reassure Members on both sides that our policy takes full account of public interest. I am however concerned about the implications of taking blocking powers just in relation to banks - the insurance companies have also lobbied for additional powers to be taken against foreign take-overs and the provisions in other legislation for which I am responsible, covering manufacturing industry and financial services, are likely to be drawn into the debate. I believe it is essential that we should discuss these matters before you table any amendments. I recognise that you will not want to leave this until the last minute. In any event, I am sure that my Department can help yours to ensure that Press comment on the issues is properly informed well in advance of Thursday's Report Stage.

I am copying this letter to recipients of yours.

Yours, Paul

PAUL CHANNON

JG6ABL

999-1

EXTRACT OF A LETTER TO THE ECONOMIC SECRETARY, FEBRUARY 1987

I have to say that my preferred course would be to head off back bench pressure with a firm statement that the question of foreign take-overs is being addressed in our review of competition and mergers policy and that for the present our policy in applying the Fair Trading Act powers takes full account of the public interest. The statement could go on to say that there is no reason whatever to think that the review will result in any weakening of the broad public interest criterion in the Fair Trading Act. However, if you judge that you cannot hold the line with that, then I would reluctantly go along with your proposed amendment. Because of my concerns and responsibilities I would want to be consulted about the terms in which it is presented both to Parliament and the Press and I would want your assurance that you would not concede more ground on this matter.

I am sending copies of this letter to the Prime Minister, Geoffrey Howe, Nigel Lawson, Malcolm Rifkind and the Governor of the Bank of England.

PAUL CHANNON

JG1AQT

999.49

LORDS COMMITTEE 23/3/87

[LORD WILLIAMS OF ELVEL.]

the banks and the banking system. I am sure the noble Lord has made that request in good faith, and I am sure that his right honourable friend will take all his remarks in the spirit in which they are meant. But we are dealing with legislation at the moment in the Committee. We shall be looking for rather stronger assurances on Report that not only has the message been passed along to his right honourable friend but that his right honourable friend has taken the message on board. We shall be looking for something a little more positive than the noble Lord has been able to give us today.

Lord Young of Graffham: One thing I can assure the Committee is that the Secretary of State for Trade and Industry will take these points on board. I cannot say what the outcome of the review will be, but I can say that the position of the banks and the banking system as a whole will be taken into account during the course of the current review of these matters.

Lord Elton: That seems both as general as one feared and as narrow as one could hope. We must preserve ourselves in hope until the Report stage. I am most grateful to my noble friend for the care with which he has dealt with our approaches. I hope that it will be even more evident in the correspondence which follows, and I beg leave to withdraw the amendment.

Amendment, by leave, withdrawn.

[*Amendment No. 51A had been withdrawn from the Marshalled List.*]

Clause 23 agreed to.

Clause 24 agreed to.

Lord Elton moved Amendment No. 52:

After Clause 24, insert the following new clause:

("*Restriction of significant shareholders.*

.—(1) The Bank may, unless it is satisfied that a person who is a significant shareholder in relation to an authorised institution within the meaning of section 37 below is a fit and proper person to exercise the rights of such a shareholder in relation to the institution, serve a notice of restriction on the person directing that, unless and until the notice is withdrawn, no voting rights shall be exercisable in respect of any specified shares to which this section applies, and a copy of any such notice of restriction shall be served by the Bank on the institution to whose shares the direction relates.

(2) A notice of restriction under this section:—

(*a*) shall, subject to subsection (4) below, specify the reasons for which the Bank is not satisfied that the person to which it relates is a fit and proper person to exercise the rights referred to in subsection (1) above; and

(*b*) shall give particulars of the right to make representations conferred by subsection (3) below.

(3) A person served with a notice of restriction under this section may make written representations to the Bank, and where such representations are made, the Bank shall take them into account in deciding whether to withdraw such notice.

(4) Paragraph (*a*) of subsection (2) above shall not require the Bank to specify any reason which would, in its opinion, involve the disclosure of confidential information the disclosure of which would be prejudicial to a third party.

(5) This section applies:—

(*a*) to all shares in the authorised institution in relation to which the person served with a notice of restriction under this section is a significant shareholder; and

(*b*) to all the shares of any other institution of which the authorised institution is a subsidiary

being in either case shares which are held by the person in question or any associate of his in excess of those which entitle him either alone or with any associate of his to exercise or control the exercise of 5 per cent. of the voting power at any general meeting of the institution concerned.").

The noble Lord said: This amendment proposes a new clause directed against acquisitions of significant shareholdings, where such acquisitions may be thought to be undesirable. A significant shareholder, I remind the Committee, is defined in Clause 37 as one who has acquired at least 5 per cent. but less than 15 per cent. of the voting powers, which is to say the shares, in the authorised institution in question. I can best explain my concern in this matter if I first remind the Committee of how the Government propose to deal with acquisitions of shareholdings in the next size upwards in the scale, that is to say those of controller shareholders. They are defined in Clause 103(3)(*c*) as those possessed of at least 15 per cent. of the voting power at general meetings.

The Government have made it clear, in the course of many debates both here and in another place, that they are fully aware of the importance of controller shareholders. The expression of this concern is to be found in Clauses 21 to 26. In these clauses we find that no person who wants to become a controller shareholder may do so until he has told the Bank of England that that is his intention. Unless the Bank then gives him a green light he is thereafter forbidden to acquire the necessary shares for a further three months. This is in order to give the Bank time to find out all about him and to make up its mind as to whether or not he is in fact a suitable person to be a controller shareholder. If he does not give his notice or if he does not wait out the full three months, then, by virtue of Clause 25(1) and (4), he may be subjected to a fine on summary conviction. If however he waits long enough for the Bank to make its inquiries and then has the temerity, if the result is not a green light but notice, or even a preliminary notice, of intention to serve a notice of objection, to acquire a controller shareholding, he does not merely get a fine on summary conviction, but is liable upon conviction on indictment not only to a very much bigger fine—the maximum in fact permitted by statute—but also to be sent to prison for two years. Those members of the Committee who take the *Observer* will know what awaits him there!

This response to transgression goes far beyond mere finger-wagging. It is a real and painful punishment that can only be justified by the need to protect authorised institutions in this field from a very real threat. The Government therefore accept the reality of the threat. What again is the threat to an authorised institution? It is the threat of an undesirable person getting hold of 15 per cent. of the shares. The justification for equipping the Bank of England, and in some instances the Treasury to intervene in such cases, backed by powers of criminal prosecution and the threat of imprisonment, is the accepted fact that a self-seeking holder of such a proportion of shares could use it to manipulate the market in those shares to his own advantage. That would be destabilising to the institution in question and that in turn would be bad for the whole banking sector.

When the Bill was introduced into another place, I understand that those provisions I have recited were

[LORD YOUNG OF GRAFFHAM.]

a case directly relevant to our debate and sets an important precedent. The proposed acquisition was found to be against the public interest. An important part of this conclusion was—I quote from the conclusions of the commission's 1982 report—that,

"transfer of ultimate control of a significant part of the clearing bank system outside the United Kingdom would have the adverse effect of opening up possibilities of divergence of interest which would not otherwise arise".

It seems clear that the matters about which concern has been expressed can be and have been, taken into account under the existing procedures. It is in the nature of these matters that the Government must avoid any commitments that a particular hypothetical case or class of cases will, or will not, be referred, or what the outcome should be. Nevertheless, my honourable friend the Economic Secretary to the Treasury has already said in another place—and I agree with him—that it is difficult to imagine that any foreign bid for a major British bank would not raise issues of public interest at least as great as those in the case to which I have already referred. These public interest factors have been taken into account in the past and I would hope, and certainly expect, that they will be taken into account in the future.

This, then, is the situation under the present legislation. I hope that what I have said has given assurances to noble Lords. Your Lordships will, however, be aware that the Government are currently undertaking a thorough review of the existing procedures covering both policy under the existing law and the statutory provisions themselves. I can therefore appreciate the concern that has been expressed, both in another place, during the course of our earlier debates and today about the continuation of the public interest criteria. It was, however, for this very reason that my honourable friend the Economic Secretary put on the record in another place an assurance on behalf of my right honourable friend the Secretary of State for Trade and Industry that there is no reason why the review will result in any weakening of the broad public interest criterion contained in the existing legislation.

I hope that this assurance also gives comfort to the noble Viscount, Lord Chandos, and to other noble Lords who have expressed concern on this point. My noble friend Lord Boardman drew attention to the statement made by my right honourable friend Norman Tebbit in 1984 when he was Secretary of State for Trade and Industry. He said that the policy

"has been and will continue to be to make references primarily on competition grounds". [*Official Report*, Commons, 5/7/84; col. 213.]

That of course, is the situation today subject to the conclusions of the current review. I think that it is entirely to be expected that questions of competition will be the dominant reason for referrals rather than the wider public interest issues which we have been discussing. But the policy statement of 1984 does not in any way rule out references on general grounds of public interest including the fact that the proposed acquisition is by an overseas company. This is a matter that has been made clear on a number of subsequent occasions.

Perhaps I may refer to a speech last November by my honourable friend Michael Howard who said:

"But Norman Tebbit never said that references would be made only on competition grounds and there have been a small number of exceptional cases in which mergers have been referred because they were thought to raise other public interest issues".

There have been a number of other cases subsequent to the 1984 statement where references have been made on grounds other than competition or where competition was only one of several factors. Such grounds included the special nature of a particular industry. While I cannot say that the acquisition of a British bank would automatically be referred, there is no doubt that both the statutory framework and the current policy towards references allow full scope for referral and consideration of proposed acquisitions of general public interest grounds. As my honourable friend Ian Stewart has already said, it is almost impossible to conceive that an overseas bid for a United Kingdom clearing bank would not be referred.

I hope that this restores confidence in the Government's position, and I refer here in particular to the noble Lord, Lord Thomson of Monifieth, who has written to me on the matter. I have also, as I undertook to do in our earlier debate, drawn the debate of your Lordships to the attention of my right honourable friend who has the prime responsibility for this review. I know that he will also take into account the various points that have been made today.

Finally the matter of reciprocity was raised: the statutory provisions, including those in the Bill, designed to encourage the opening up of overseas financial markets to British firms. This is an additional factor. The Monopolies and Mergers Commission procedures do not deal explicitly with reciprocity. The provisions of the Financial Services Act expanded by the provisions of this Bill provide the necessary reserve powers.

On the question of takeovers, the Bill provides a power for the Government to object to any proposed acquisition of control where the result of the acquisition proceedings would be controlled by an institution whose country of origin did not meet this test. This is an additional important safeguard. But I am aware that my noble friend Lord Elton asked whether the provisions in Section 183 of the Financial Services Act are sufficiently clear in allowing action to be taken against overseas banks if the reciprocity in one of the other financial fields is there.

The intention is that the power should be usable in this way. Whether the drafting is adequately clear is very much a matter of detailed legal interpretation. Nevertheless it is an important issue and Clause 23 works by reference to the section of the Financial Services Act to which my noble friend referred. I shall therefore ensure that the matter is thoroughly looked into and if necessary we can return to this matter at Third Reading.

My noble friend Lord Campbell of Alloway asked whether the Government more than the MMC should have the actual decision. Indeed this is not a point—as I think I have already said—that relates only to banks. One could argue the same for any sector where there might be a special interest on the part of the Government or in any other way. The noble Lord, Lord Grimond, I believe found this a very attractive

COMMONS REPORT

[Mr. Ian Stewart]

frustrated. The answer is, yes. If he were a wide boy, on a grand scale, he would never pass the fit and proper test. Only narrow boys would be able to pass the fit and proper test. Even if they appear to be narrow boys at the time they acquire their 15 per cent. but subsequently are shown to be wide boys, under the new provisions that I am introducing they would be subject to the blocking provisions. On all those counts, my hon. Friend can be satisfied that his concern will be met.

During the last hour or two the House has been considerably occupied with the question of reciprocity. I agree with the sentiments of a number of my hon. Friends that the reputation and success of the London financial markets have been based on open trading and that we do not want to introduce protectionist sentiments into our legislation, if they are unnecessary.

In a brief but, I thought, telling intervention my hon. Friend the Member for Harwich (Sir J. Ridsdale) said that he felt that in the case of Japan there is insufficient reciprocity and that it is very difficult for British or other foreign companies to gain adequate access to Japanese markets. Should the reciprocity provisions of the Bill or of the Financial Services Act 1986 be called into play if there were an approach by a Japanese company, it would be very difficult for me to disagree with his analysis. I shall resist the temptation to make a world tour and say, country by country, where I think that such problems might arise, but there has been anxiety about Japan and the point is very well taken.

The fundamental point about reciprocity that I should like to emphasise is that the provisions of the Financial Services Act and of this Bill are designed to open up markets overseas, not to put up the shutters around London. It is not only in the circumstances where a United Kingdom bank could not buy a Japanese bank that the provisions might be triggered; it is a much more general question of access to the provision of financial services. That applies to banking, insurance, investment and other matters. If hon. Members study the way in which new clause 2 is phrased they will see that it states:

"overseas countries which do not afford reciprocal facilities for financial business".

Therefore, we have gone far beyond the question of takeovers.

I felt it necessary to strengthen or rather, adapt the reciprocity provisions contained in the Financial Services Act 1986 because, whereas the threat of withdrawal of authorisation may be an appropriate sanction in the case of an investment or insurance business, in the case of banks that rely on taking deposits in the market from day to day, the withdrawal of authorisation may cause great difficulties for depositors. Therefore, the threat of that withdrawal of authorisation would not be a credible deterrent.

The reciprocity powers, should they ever be put into practice, must be workable. I hope that they will not be brought into play. I hope that other countries, encouraged by our example, will open up their markets to our banks and other foreign banks and financial companies. Other countries may discover, in the same way as we have discovered, that that action will create a thriving market, which is of great advantage, as indeed it has been for the City of London.

I do not believe that others should be entitled to become predators of our banking system and at the same time fail to offer us equivalent access to their markets. That is the essence of the case on reciprocity.

Amendment No. 13, moved by the hon. Member for Thurrock (Dr. McDonald) raised an important question about national interest. The Bill does not contain general powers to object to bank shareholdings on the grounds of national interest. That matter is the responsibility of the Monopolies and Mergers Commission. The Government's policy in applying the powers contained in the Fair Trading Act 1973 take full account of the public interest. Any projected foreign takeover of a British bank will continue to be subject to that policy.

I was asked what would happen as a result of the review of the Monopolies and Mergers Commission, carried out in the "General Review of Competition Policy", which is being conducted by the Department of Trade and Industry. I expressed the Committee's concern to my right hon. Friend the Secretary of State and he has confirmed that there is no reason why that review will result in any weakening of the broad public interest criterion contained in the Fair Trading Act.

I believe that we have an effective system contained in the Monopolies and Mergers Commission and that that system is the best way to deal with the question of public interest or national interest in the case of banks or any other sector. One of my hon. Friends said that if banking is a crucial sector—as Opposition Members and others have said—by definition, if an approach was made to one of our major banks, it would be referred to the Monopolies and Mergers Commission. I believe that it is inevitable that, if an approach was made to one of the high street banks, it would be referred to the Commission. I have no doubt that similar factors would be adduced in such a review as in the case of the Royal Bank of Scotland.

I believe that the anxieties that have been expressed on that score are not well-founded. Therefore, I hope that the House will accept the Government new clauses and the related amendments, but will object to amendment No. 13.

Question put and agreed to.

Clause read a Second time, and added to the Bill.

New clause 3

OBJECTION TO EXISTING SHAREHOLDER CONTROLLER

'(1) Where it appears to the Bank that a person who is a shareholder controller of any description of an authorised institution incorporated in the United Kingdom is not or is no longer a fit and proper person to be such a controller of the institution it may serve him with a written notice of objection to his being such a controller of the institution.

(2) Before serving a notice of objection under this section the Bank shall serve the person concerned with a preliminary written notice stating that the Bank is considering the service on that person of a notice of objection; and that notice shall—

(a) subject to subsection (5) below, specify the reasons for which it appears to the Bank that the person in question is not or is no longer a fit and proper person as mentioned in subsection (1); and

(b) give particulars of the rights conferred by subsection (3) below.

(3) A person served with a notice under subsection (2) above may, within the period of one month beginning with the day on which the notice is served, make written representations to the Bank; and where such representations are made the Bank shall take them into account in deciding whether to serve a notice of objection.

(4) A notice of objection under this section shall—

PS/Chancellor of the Exchequer

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215)
GTN 215) 4417
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From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

CH/EXCHEQUER
REC. 24 FEB 1987
ACTION X MRS LOMAX 24/2
COPIES TO SIR P. MIDDLETON
MR CASSELL

Michael Howard QC MP

CONFIDENTIAL

The Rt Hon Douglas Hurd MP
Secretary of State for
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

23 February 1987

Dear Douglas

GUINNESS INVESTIGATION

I am writing to express my concern about the front page story in the Guardian of Friday 13 February headed "Guinness inquiry snubs police aid". As you know, I am handling these matters in view of Paul Channon's family connection. The story (copy attached) alleged that the DPP had decided to keep the police out of the investigation, and that this decision had taken the heat out of the investigation and undermined the Government's claim that it intended to clean up the City. The allegations are, of course, untrue. They were denied by the DPP's office, and that denial seems to have killed the story as far as the press is concerned, but our political opponents are still seeking to score points on the basis of it. There is also continuing speculation about whether and when the police will be brought in.

My concern is that you should be aware that internal evidence suggests the story came from the police. There were somewhat similar stories about two weeks ago just after the decision was taken by the DPP's office, having consulted my officials, not to call in the police immediately as a police investigation at this stage might hamper the inspectors' enquiries and so make it more difficult to get at the facts. We took those stories up with the Fraud Squad at the time. It is extremely regrettable that there should nevertheless still be stories in the press, apparently coming from the police.

PM1AMV

I am sure you will agree that this kind of story is not only damaging to the Government's reputation but can also cause trouble between the various parties which need to work closely together to achieve our objectives of finding out the facts and prosecuting any offenders as soon as possible. All those involved must trust each other and be able to rely on the complete discretion of the others. This is particularly important in view of the much closer laison we are trying to establish in this case. We are determined not to let these stories stand in the way of establishing good working relationships but the stories must stop.

The question of when to bring in the police is a very sensitive one. We want to get ahead as quickly as possible but too early police involvement could make it more difficult for the inspectors - who have stronger powers than the police - to get at the facts. I understand also that the DPP is concerned that there might be problems about admissibility of evidence if the police were involved at a time when the inspectors are still interviewing the witnesses.

These are not matters which should be aired in public. It is essential that none of us comment publicly on how the investigation is being run or what stage has been reached, unless it is agreed by all concerned that a statement is desirable. We will certainly observe this rule and I should be grateful if assurances could be sought from the police that they will also do so.

I am copying this letter to the Chancellor of the Exchequer and the Solicitor General.

Yours ever

Michael

MICHAEL HOWARD

PM1AMV

999-80

Today

A sense of belonging—and betrayal

Page 21

Hippies hit the wholefood jackpot

Page 20

Guinea pigs under the gamma rays

Page 12

Tomorrow

Harold Macmillan was always a hard act to follow. David McKie reports from Oxford on the would-be chancellors waiting in the wings

News in brief

Job hope dashed

A RISE in the unemployment figures of 68,069 to 3,297,236 dashed government hopes of a steady reversal. Back page.

Mozambique plea

OXFAM and Save the Children launched a £4½ million appeal for starving Mozambique, where South African rebels have caused havoc. Page 9.

Borehole waste

A SYSTEM of disposing of nuclear waste in deep boreholes — claimed to be cheap and safe — was unveiled in London. Page 4.

Giscard non

MR VALERY Giscard d'Estaing, the former French president, made a surprisingly early announcement not to stand again in next year's

Fraud Squad angry as DPP refuses help for DTI inspectors

Guinness inquiry snubs police aid

By Paul Brown

The Director of Public Prosecutions has decided to exclude the police from investigations into the Guinness affair or other recent City scandals after extensive discussions with the Attorney-General and the Department of Trade and Industry.

Only inspectors appointed by the DTI will collect evidence in these affairs. Lawyers for the DPP, Sir Thomas Hetherington are considering prosecutions under the Theft Act for fraud, conspiracy or conspiracy to defraud, solely on the basis of the DTI inspectors' evidence, but without police involvement.

The snub has angered the Metropolitan and City police fraud squad which has been pressing to become involved in the investigations.

Some recent newspaper reports, which claimed that key police officers had cleared their desks ready to be called in by the DPP, are believed to have emanated from police sources. It is thought that the DTI was against involving the police.

The DPP's office said it could not comment "on conversations between the DTI, the DPP and the Attorney-General's office," or at what level it had been decided to exclude the police. A spokesman said the decision was not final, and the police could still be called in. In addition, keeping the police out did not preclude criminal proceedings under the Companies Act.

City analysts believe that the decision has taken the heat out of the investigation, and undermines the Government's claim that it intends to clean up the City.

The ponderous system of DTI inquiries begins with an announcement by a minister and the appointment of two inspectors. One is usually a senior lawyer, in most cases a QC, and the second is an accountant.

Under the Companies Act, inspectors investigating Guinness have the power to look at documents and make extensive inquiries before completing a factual report.

According to some City observers, the fact that different groups of inspectors are conducting individual investigations into separate aspects of the affair, rather than working as a team, is a handicap.

It means that common threads between the cases will be lost. The DTI cannot point to a successful prosecution resulting from this form of Companies Act investigation.

The inspectors report direct to the Trade and Industry Minister, as Mr Channon excluded himself from the affair because of his family connection with Guinness; Mr Michael Howard, Minister for Corporate and Consumer Affairs announced the Guinness investigation in the Commons.

The minister referred the matter to the DPP, who in turn consulted the Attorney-General, Sir Michael Havers, on whether the police should be called in. Close consultations between the two departments are known to have taken place but at what level is not disclosed.

As the Home Secretary, Mr Douglas Hurd, said in the Zircon affair, the Attorney-General makes these decisions as a law officer independent of political consideration or advice.

Even so the decision not to call in the police marks a new phase in the City scandals which began in November with a flurry of announcements by ministers.

Mr Geoffrey Collier, the former joint securities chief at Morgan Grenfell, was subsequently charged with three offences of insider dealing with a total alleged gain of £15,000. No other action on insider dealing ensued. Then during the Guinness inquiry, a number of resignations were forced in the company and among its advisers.

These were apparently triggered by the intervention of the Governor of the Bank of England, Mr Robin Leigh Pemberton, who in turn had been leant on by the Chancellor, Mr Nigel Lawson. Mrs Thatcher was reported to be impatient for action to show that the City was being cleaned up by the Government.

Moscow

Martin Walker

Mr Gorbachev's long campaign to improve the Soviet Union's international image suffered a serious reverse yesterday when a peaceful human rights demonstration in Moscow was brutally broken up.

Seven Soviet Jewish protesters were arrested, one of them a woman who was dragged through the slush of the Arbat pedestrian precinct before being bundled into a courtyard and taken away by uniformed police.

I was caught in a melee after an organised charge by plain-clothes men, kicked in the ankles, and punched several times in the kidneys before being pushed aside.

Aids campaign fails to convince

GUARDIAN MARPLAN POLL

By Andrew Veitch, Medical Correspondent

THE Government's £20 million Aids campaign is in danger of flopping, according to Guardian Marplan poll today.

More than 80 per cent of adults think the publicity will do little or nothing to limit the spread of the disease.

Nearly half say the leaflet delivered to households is not explicit enough in its description of Aids and how the virus can be caught.

Have you received the leaflet yet?
Yes
No
Don't know

The results may be less depressing than they seem for the Social Services Secretary, Mr Norman Fowler. Last year he rejected his advisers' demands for explicit descriptions of risky sex practices, and safer sex, for fear of provoking a Conservative backlash.

The Marplan results suggest that so far he is on safe ground: only 1 per cent of Conservative voters think the leaflet is too explicit compared to 5 per cent of Labour voters. However, 41 per cent of Conservative voters think it is not explicit enough, and 40 per cent of Labour voters.

Mr Fowler still has £1

PS/The Rt Hon Nigel Lawson MP

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From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

Michael Howard QC MP

CH/EXCHEQUE
REC. 24 MAR 1987
ACTION Mr Lomax
COPIES TO Sir P Middleton
Mr Cassell

Pups please
pup

The Rt Hon Douglas Hurd MP
Secretary of State
Home Office
50 Queen Anne's Gate
LONDON
SW1A 9AT

19th March 1987

Dear Douglas

Thank you for your letter of 4 March about press comment on the possible involvement of the police in the investigation into the Guinness affair.

I am grateful to you for arranging for our concerns to be taken up with the police. We are all anxious to ensure a close working relationship between the various parties involved in a major investigation. We are in close touch with the office of the Director of Public Prosecutions and have spoken to the Commanders of the Fraud branches of the police about the various press comments. It was only when further comments nevertheless appeared in the press that we thought it necessary to seek your assistance to ensure that our joint objective of securing successful prosecutions in this case was not undermined by press comment.

The question of briefing the Metropolitan Fraud Squad about their probable future involvement in the Guinness case is not of course a matter for me but my officials have been talking to the DPP's staff about what briefing should be provided. It is however important that, whilst we have made clear that the police will be brought in when appropriate, our precise intentions should not become public knowledge in advance.

Thank you again for your help.

Yours ever
Michael

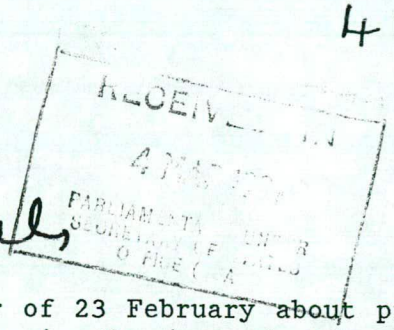
MICHAEL HOWARD

LT2AJY

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SWIH 9AT

4 March 1987



Dear Michael,

Thank you for your letter of 23 February about press comment on the possible involvement of the police in the investigations into the Guinness affair.

I am sorry you should feel that the police might have been involved in stimulating the newspaper stories in The Guardian. Although I have no operational control over the police, my Department has made immediate enquiries of them at working level. I understand they take the view that the press story is mischievous speculation which they too regard as unhelpful, and are not aware of any grounds for believing it might have originated with them. The press have made enquiries of the fraud squad about their possible role in the Guinness investigation but I am told that, in responding, the police confined themselves to explaining their normal role. I cannot be certain what may have been said by some police officer to some journalist, but The Guardian is not the most likely recipient of police confidences.

In addition I thought it worth having the point raised personally with the Commissioner and the Commissioner-designate, Mr Imbert. I hope that once the Serious Fraud Office is set up to supervise major investigations there will be an even closer relationship between your Department, the Serious Fraud Squad and London police investigating fraud. In the meantime it might be helpful if your officials raised any specific problems they might have with the Director of Public Prosecutions and the Commander of the Metropolitan and City Police Company Fraud Branch to see if they can be satisfactorily resolved.

Even though your Department and the Director do not see a need for police involvement in the Guinness case at this stage, I am glad to hear that you and the Director are considering briefing for the Metropolitan Police Fraud Squad whose officers would be involved if the police were to be called in later.

I am copying this letter to the Chancellor of the Exchequer and the Solicitor General.

Yours,

Douglas.

Mrs Brown
FOR ADVICE AND DRAFT REPLY IF APPROPRIATE
PLEASE BY:
11/3

Copies to:
PS/SOS
Mr Caines
Mr Rickford
Mr Woolman
Mr Hulton
Mr A Clark

Michael Howard, Esq., QC., MP.

197/031

CONFIDENTIAL AND PERSONAL

From: N MONCK
Date: 20 March 1987

CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Mrs Lomax

CITY MATTERS

I attach a paper of 20 February on this subject by George Guise of the Policy Unit at No. 10. This is the paper the Prime Minister mentioned - the paragraph on pension funds on page 13 - during the briefing for the last NEDC meeting. I found it a good read, but the main reason for showing you it is simply that the Prime Minister has read it through and may still have it in her mind.

2. The recommendations are on the last page. On 1, my brief for the mergers meeting next Tuesday will include a piece on the separate Takeover Panel Review on which the DTI are in the lead.

3. Recommendation 2 is in effect present practice. Recommendation 3 will be looked at in Part 2 of the Mergers Review. So will recommendation 4 (I sent you a note about it on 19 February).

4. Recommendation 5 must be right: the Bank and the DTI have produced papers on it. Mr Wilson is considering whether there is any shortcut which would avoid years of waiting for a new Accounting Standard.

5. George Guise gave me his paper on the understanding that it would not be shown to anyone except you, Sir P Middleton and Mrs Lomax.

A good page.

N MONCK

I have made a note of myself.

22/200

PRIME MINISTER 20 February 1987

CITY MATTERS

The City is turning into a big issue with no easy solutions. The purpose of this note is to give you the background and my analysis of the forces which are at work. It is therefore longer than usual and examines some matters in considerable detail. It reaches certain conclusions and recommendations and these should be taken as possible steps forward rather than hard answers.

The three key issues upon which Government needs to take a view are insider trading, stock market manipulation and merger policy. Relevant papers are DTI letter to Mr Norgrove dated 10 February, letter from the Chancellor to Paul Channon dated 23 January, replies from DTI and Bank of England dated 27 January, and a recent Bank letter dated 17 February.

RECENT BACKGROUND

None of these issues are new. The British have traditionally relied extensively on takeovers to restructure industry because shareholders often relegate the fate of their business to management boards. Without significant external involvement at board level by banks and institutional investors, as in America, Europe and Japan, British management tends to sit in isolation. What should therefore be the sanction of last resort, the takeover bid, is frequently the first formal notice to directors that they have been found wanting. It is therefore unsurprising that such bids are unwelcome and that, in Britain, the hostile bid is so common.

It is the recent scale of takeover activity and abuses which have focussed so much political attention. In 1986, £13.2bn was spent on acquisitions and mergers compared with £7.1bn

in 1985 and £1.1bn in 1981. Increasing internationalisation of the Stock Market has condensed the City into large financial conglomerates, many with foreign links, with share dealing, investment management and corporate finance combined.

Greater firepower is therefore concentrated within single institutions which actively promote takeovers and some are even paid in the form of 'success' fees. This combination has led to greater scope for insider trading - the use of confidential information to achieve share dealing profits - and the opportunity to manipulate share prices so that during a takeover bid the offeror company has its share price artificially boosted.

INSIDER TRADING AND MARKET MANIPULATION

Although these are related, both in effects and intent, they are different. Insider trading can occur whenever a company seeks to acquire another because the share price of the former generally falls while the latter rises. The reason is simple. In order to entice offeree shareholders the offeror will offer a premium, either in cash or in its own shares, thereby transferring immediate capital value from its own shareholders to the target company's. It does this because it believes its management capable of generating better overall profits for all shareholders after it owns the new business. Because this is a hypothesis, yet to be demonstrated in future declared earnings, the normal immediate market reaction is to shift both share prices in the same direction as the transfer of capital value: the offeror falls and the offeree rises. While the takeover bid is being put together a great number of people are aware that this is going to happen and the field is rife for dishonest profiteering. The number of suspicious price movements ahead of bids is quite alarming and, in the Appendix, I show a sample of what happened in the case of 15

instances during 1986. These fifteen companies share prices all rose by more than 20%, and in one case by 58%, during the month before the bid. In a sample of 78 takeovers during the first half of last year, the average price increase during the month before the bid was 11.3%. Over the previous three months the increase was 25%.

Whereas both insider trading and price manipulation are morally repugnant, the former is externally less damaging than the latter. The trading mentality, whether it is for fruit and vegetables at Covent Garden, or sophisticated financial instruments in New York, instinctively buys something in the morning if it knows that it is going to be more expensive in the afternoon. How this knowledge was acquired is rarely subject to scrupulous self examination. The trading instinct is not to play honourably but to win!

It has been said that insider trading is a victimless crime. That is not quite true because the immediate victims are the institutions who were not fast enough to act before the price rise. No amount of regulation would ever eliminate insider trading and self-regulation would scarcely dent it. It is therefore appropriate that insider trading is outlawed by the Companies Act and a regime of rigorous investigation and harsh penalties will limit it. Nevertheless, in terms of its market effect, all insider trading does is to cause a price adjustment to occur earlier than it would otherwise have done and unjustly to benefit small groups. It does not distort long term market structure.

Market price manipulation is quite different and, in the case of Guinness may have actually led to the Distillers Company going to the 'wrong' acquiror. When a company makes a takeover its share price generally falls, particularly if the currency offered is its own shares. In order to counteract this it has been traditional city practice for takeover companies like Hanson and BTR to try to convince

financial institutions to buy their shares during and immediately after the announcement of a bid. The argument is that holding their shares will ultimately advantage the institution because it will receive enhanced profits and stock market value.

These institutional groups are known as 'fan clubs' and in themselves are neither illegal nor immoral. However, they may distort the short term market. The protagonists argue that they stabilise the immediate share price to the benefit of all, without any long term artificiality. The next step, and I would argue the first stage of corruption, is when the fan club is not merely exhorted to buy the offeror's shares because of their long term value, but actually induced to do so by some financial consideration. This may be in the form of promises to put business into the institution at some later date and, in extreme cases, sufficient business to compensate for any financial loss through holding the shares.

In the case of Guinness, it would appear that its own funds were actually made available via Morgan Grenfell in order to match the investment in Guinness made by Ansbacher. A sum of money (£7.6m) equal to the value of the acquired shares was loaned interest-free to Ansbacher on some vague basis which is now the subject of intense scrutiny. Ansbacher claim that the money was actually given to them in order to buy Guinness shares. This is illegal in the UK where a company may not, except under special and previously announced circumstances, purchase its own shares.

It is therefore probable that the relative level of the Guinness share price, the Distillers share price and the Guinness rival bidder, Argyle, were not where a free market would have put them when Distillers shareholders accepted the Guinness offer. A major realignment of the drink industry, with the passing of assets from one management to another, may therefore have taken place in response to a

phoney market.

Legislation versus self-regulation

Regulation of the City is both legally based via the Companies Act and the Financial Services Act and voluntarily based via the Securities Investment Board (SIB) and the Takeover Panel. The SIB and its self-regulatory organisations (SROs) have only just been established and are responsible under statute to the Department of Trade and Industry. The Takeover Panel is responsible only to the Stock Exchange and carries the duty to spot the kind of abuse which happened with Guinness.

The Chancellor's letter argues that there is now an overwhelming case for statutory backing for the Takeover Panel. By contrast, both Messrs Channon and Leigh-Pemberton effectively ask that the Panel be given a second chance to improve its effectiveness. Leigh-Pemberton makes two positive suggestions: that adherence to the Panel code be required by the Financial Services Act, and that the outlawing of share price manipulation be enacted earlier than planned.

There are some good arguments in favour of self-regulation. First, market professionals working for the regulatory body are better able to keep pace with the rapid evolution of financial practice than outside Civil Servants. This could be overcome by seconding market professionals to regulatory bodies, although the pay would need to be high, much higher than regulatory bodies normally pay and far higher than Civil Servants' pay. Another reason advanced for self-regulation is that the law is clumsy and proof is difficult in highly complex financial matters. Only five prosecutions have been obtained in the five years that insider trading has been a criminal offence. In contrast, the Takeover Panel can make its judgements on the balance of probability. These judgements are normally accepted

voluntarily if the companies wish to retain their good name on the Stock Exchange. An effective Takeover Panel might therefore be more efficient than a body of takeover law.

However, the Takeover Panel is under increasing criticism both for ineffectiveness and inconsistency. It has an executive staff of only 15 advising 14 full members, all from city stables. Its Chairman is a banker, Sir Jaspar Hollom, who speaks with lofty disdain, of the Companies Act provisions because they are part of the legal machinery and are policed by the DTI and the Fraud Squad. He proudly distances the Panel, and its City code, from 'mere' legal requirements. His argument is essentially that the Panel is like the Committee of a gentlemen's club and has all the insight and authority needed to kick out the renegades.

With increasing reward and opportunity for corruption in the grasp of more individuals, this is a dangerously outmoded attitude. It would be marvellous if takeover behaviour could reliably be left to a caucus of honourable gentlemen whose financial circumstances leave them immune to temptation or greed. The world has evolved otherwise. The Panel has already lost much respect. One of its decisions has recently been overturned by the court of appeal and there is a danger that increasing resort to the courts will make the Panel become a legal entity by default.

Far better to recognise that the formal presence of the law belongs at the heart of city activity, and therefore to plan for it along the lines of the American Securities Exchange Commission (SEC). A simple but strict set of takeover rules, backed by law, would prevent many forms of price manipulation and, therefore, increase the efficiency of economic allocation whilst reducing fraud. The shape of such an enforcement agency, and its executive staffing, should be examined by the DTI, Treasury and the City in

harness. The model of the SEC would not be a bad starting point.

Disclosure Requirements

It is sometimes argued that tighter disclosure rules would curtail many of the abuses. The present rules require the purchaser of 5% or more of a company to disclose the fact directly to the Company Secretary and to the Stock Exchange. This is a legal requirement enforced by the Companies' Act. The Panel has recently proposed that a 1% holding should be disclosed under its own rules. Such disclosure requirements, if obeyed, would give a company early warning of the presence of a potential predator seeking to build up a position in its shares.

A difficulty arises when the acquisition is made by a nominee company, particularly one which is foreign based, if the purchaser does not wish his true identity revealed. The company itself has to spot the build up of such a nominee shareholding and then take its own steps to seek disclosure of the underlying buyer's identity. If the latter wishes to frustrate this intent there are many devices for doing so. A foreign nominee may refuse to respond to requests for the owner's true identity. The company can appeal to the Stock Exchange or the DTI to launch an investigation into its shares and to seek the forced revelation of the true buyer. Procedure is lengthy and cumbersome and frequently not enforceable because the overseas practice may not force such reciprocal disclosure requirements. This is particularly so in the case of Switzerland, where such secrecy is a holy cow.

As a last resort, a company can put to its shareholders the proposition that refusal to disclose identity may, at the Board's discretion, result in forfeiture of voting rights for such suspect shareholdings, or even the termination of

dividend rights until the disclosure is made. In the American system this kind of enforcement and requirement to register is policed by the SEC who have powers to take immediate action if disclosure has not been made. The system does not therefore rely upon the company itself discovering lack of compliance and then persuading regulatory bodies to act.

MERGER POLICY

The OFT and the MMC under the general directive of the 1984 Tebbit guidelines have concentrated on competition as the fundamental measure of public interest when assessing takeover or merger proposals. Under such policy the Secretary of State was quite right not to intervene on the BTR bid for Pilkington. Only three MMC references have been made on grounds other than competition since 1984 when the key issue was the danger of very high gearing after acquisition. The Liesner Review of law and policy on mergers is soon to report that existing arrangements generally work well and that fundamental change should be avoided in this administration. The second part of the Liesner Review due later this year, will assess arguments for extending the public interest criteria to, for example, short termism, so called junk bond financing, and foreign takeovers.

It is undisputed that a severe limitation in competition, while possibly being in the interests of the shareholders of both an offeror and an offeree can act against the national interest. Provided that competition is properly defined, having regard for low entry barriers in many industries and import accessibility, this view should be accepted.

More controversial is the question of how a takeover is financed and whether takeover activity will lead to short-termism. The two schools are quite polarised. One

argues that just as a Government cannot expect to run without an Opposition trying to convince electors that they can do better, neither should a business management team. The positive benefits of maintaining the threat of takeover will either wake up management as it did for Plessey or remove it as Hanson did for Imperial.

The opposing school argue that some companies are able to grow into vast high multiple conglomerates based on a reputation for financial window dressing and asset stripping. When the growth falters and the reputation is lost, these vast stock market concentrations will disintegrate. If such companies are highly geared by large borrowings, the result could be major bankruptcies, crisis in the secondary banking sector and damaging effects on the pound - all very much against the public interest which is the fundamental reference criterion of both the OFT and the MMC.

Short termism is addressed in the DTI letter of 10 February. This concludes, inter alia, that there is no general shortage of external finance for industry and that evidence for short-termism, such as cutbacks on R&D expenditure, training and investment, is inconclusive. It does, however, recognise that many industrial managers believe such pressures exist and act accordingly. The Bank of England's response of 17 February also raises the effects which accounting treatment has in fuelling the takeover cycle referred to above. Merger accounting is referred to later in this note.

THE SOURCES OF TAKEOVER PRESSURE

a. The Corporate Raider

In recent years, first in New York but now also in London, a further factor has emerged. This is the competitive

pressure for merchant banks and brokers to earn substantial fees by promoting hostile acquisitions. In New York the trend dates from a decade ago when fixed commissions on the Stock Exchange ended and caused a massive concentration of market share into the hands of a relatively small numbers of players. These firms were for the first time in cut-throat competition for survival and yet had substantial capital resources available. This produced two phenomena:

1. First, the investment banker who proposed to his client the acquisition of another company also offered to fund the purchase with repayment to come from a break-up sale, ie relatively risk free borrowing by the client.

2. There also resulted a change in the arbitrage market from dealing in announced acquisitions to dealing in rumoured acquisition targets. This caused the building of substantial stakes in target companies followed by forcing the pace of the anticipated acquisition. These blocks would be offered to putative bidders, thus assuring them of control and a speedy transaction.

The two trends together have accounted for the phenomenon of the corporate raider in the United States. Sometimes such raiders are professionals like Pickens, Goldsmith or Icahn. Substantial capital has also been made available to small companies with an aggressive reputation who have taken on targets many times their size offering cash rather than shares. In such cases it is frequently essential to break up the company immediately after acquisition as the only possible way to repay the enormous debt, which is really bridging finance. The reward for the bidder has been either the net difference between break-up value and the cost of borrowing or, alternatively, the retention of a small nugget

of asset value which fitted with the bidder's own corporate plans.

Such raids are not always against the public interest. Indeed, they are sometimes valuable in dislodging a sleepy management which has drifted into a holding company role adding little value to shareholders' investment over the years.

b. Credit Availability

Throughout history, dangerous phenomena in capital markets have often been caused by excessive credit availability. The recent surge in the number of leveraged bids have in part resulted from this and London will not yet have seen the full effects. Although the recent disgraces will probably stem merger activity over the next year, the underlying forces are still there, the availability of easy credit and particularly the 'junk bond'.

A junk bond is a financial instrument which has no inherent value unless the takeover, for which it is issued, is successful. It then carries an interest coupon far higher than normal market rates. This may force the issuing company to plunder its newly acquired target for cash in order to service the junk bond. The enforced pursuit of such short term gain may, in turn, force the break-up of the target regardless of the greater long term value of keeping it together.

Even though junk bond financing was not involved, it was unfocussed fears of this kind that were behind much of the recent concern over BTR and Pilkington. However, once it became clear that the level of gearing was such that BTR management could subsequently rely upon its own judgement as to whether Pilkington should be dismembered, or managed for cash rather than investing in research and development, the issue became one of which management would achieve the better long term results. There was clearly no question of

BTR being forced to dismember Pilkington regardless of what it subsequently found inside the company and judged worthy of preservation. The protagonists for more Government intervention on the basis of how an acquisition is financed frequently do not focus on the crucial difference between forced dismemberment immediately after acquisition and the case where the new management has sufficiently financial flexibility to consider the best long term deployment of the newly acquired assets.

c. The Position of the Banks

The peddlers of junk bonds in the United States, of whom Drexel Burnham Lambert is by far the most successful, have provided an answer to the bankers' problem left by the debt crisis in Latin America and troubled domestic business like real estate, energy, and agriculture. In a world where good borrowers are scarce a splendid way for banks to make money out of big companies is to let a predator loose on them. One set of banks benefits by financing and taking fees on the speculative bid whilst another set benefits by financing the victim company's purchase of its own shares (legal in the USA). Banks also generate fee income by urging more traditional companies to launch takeovers before becoming victims themselves - an invitation to pay protection money to the banks.

d. Merger Accounting

One little understood aspect of takeovers is that present audit practice often permits claimed returns to be unreal. Acquisition and merger accounting leaves great scope for subjectivity in the valuation of the acquired assets. Heavy writing down of plant and inventory by the successful predator helps boost subsequent earnings by reducing depreciation charges. The merger will therefore appear to have been successful even though underlying profitability

may not have been enhanced. The bigger the mess the acquired company is in, the bigger the apparent 'profit' on the acquisition, because troubled companies frequently sell at big discounts to underlying book asset values. The Bank letter of 17 February is very positive on the need for clearer statements of post merger profits.

e. Pension Funds

Predators sometimes reduce the cost of their acquisitions by raiding the pension funds of the acquired companies. This is possible because large lay-offs in manufacturing, particularly in Britain and the United States, together with declining rates of inflation and a booming stock market, have reduced pension fund liability whilst boosting the value of pension fund assets. Sacked workers may therefore unwittingly finance the takeover that put them out of business!

THE USA AND UK COMPARED

In the United States the political tide is beginning to turn against a complete free-for-all takeover market. Re-regulation is now firmly on the congressional agenda after successive revelations about corporate raids and insider dealing. I believe that what we have recently seen in London will be dwarfed by what has already begun in New York, with senior executives being led out of their institutions in handcuffs!

I have painted this picture of what might happen in the UK in some detail because the world has changed considerably since the Tebbit guidelines of 1984. There is growing pressure from many sources to find ways of curbing takeover activity based upon highly geared and potentially unstable financing arrangements. Indeed, to ignore financing considerations may be contrary to the ambitions of a

Government seeking a free and stable stock market.

CONCLUSIONS AND RECOMMENDATIONS

The financial reorganisation of the City has led to more scope for both insider trading and market manipulation. The latter is far more dangerous than the former but both need to be checked by legislation. Hostile takeover bids are increasing and pressure is building for stricter controls. Accounting standards permit artificial profit statements after a bid which in turn demonstrate apparent success.

I recommend that:

1. A body of law should be set up to police the Stock Exchange, takeover activity and disclosure requirements, along the lines of the American SEC. The DTI, the Treasury and the Bank should be asked to define the shape of such a body.

2. The OFT and the MMC should consider unstable financing arrangements as well as competition when examining a bid.

3. Ultimately the OFT and the MMC could be merged into a statutory body analogous to the American Federal Trade Commission (FTC).

4. Management accountability to shareholders should be enhanced both in annual report information, such as declaring R&D expenditure, and stronger powers for shareholders to block the management of their companies from launching takeover bids.

5. Merger accounting should be tightened so that success may be identified in the years after the event, rather than false 'profits'.

GEORGE GUISE

APPENDIX

HOW THE SHARE PRICES MOVED IN 1986

Bid Target	Bid Price	Price 1 day before	Price 1 Month before	% increase over 1 month
Pegler-Hattersley	669	472	388	+22%
Pritchard Services	129	85	66	+29%
Davenports Brewery	472	405	318	+27%
Samuel Properties	271	222	185	+20%
MCD Group	206	173	120	+44%
UKO International	253	135	97	+39%
Brickhouse Dudley	137	112	91	+23%
Hoggett Bowers (USM)	127	93	77	+21%
Bush Radio (USM)	145	145	92	+58%
Wadkin	237	140	112	+25%
Coin Industries	120	95	70	+36%
WW Group	354	255	198	+25%
Spencer Clark Metal Industries	140	79	63	+25%
David Dixon Group	334	325	248	+31%
Rowland Gaunt (USM)	140	77	53	+45%

Source: Acquisitions Monthly Database.

CONFIDENTIAL

We cleared Lawson rather ~ X; ~

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER
REC. 25 MAR 1987
ACTION Mr Monck
COPIES TO CST FST EST MST Sir P Middleton Mr Byatt Mr P Gray Mr Burgner Mrs Lomax Mr Scholar Mr Mountfield Mr Gilhooly Mr Moran Mr Tyrie Mr Cropper Mr Ross Goobey

24 March 1987

NOTE OF MEETING 24/3

MERGERS POLICY

The Prime Minister this morning held a meeting to discuss your Secretary of State's minute of 19 March, to which was attached a report by the Liesner Committee which has been reviewing Mergers Policy. There were present your Secretary of State, the Lord President, the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chancellor of the Duchy of Lancaster, the Chief Whip, Sir Robert Armstrong and Mr George Guise, No 10 Policy Unit.

Your Secretary of State explained that the review was being carried out in two stages. During the first stage, the Committee had considered changes which might be made without amending the relevant legislation. Within this constraint, the main area open to change was policy on whether particular bids should be referred to the Monopolies and Mergers Commission. The present practice was to refer bids primarily on grounds of competition. This remained probably the right basis for deciding referrals, and if this view was accepted, it would be best to make no announcement.

The Chancellor of the Exchequer agreed that it would probably be wrong to make any announcement at this stage. Whilst the CBI, for example, could agree that changes were needed, they could not say what changes they wished to see. The Chancellor further agreed that the present rules were basically satisfactory. However, some reinterpretation was now warranted. The scale of potential international competition and new entrants had reduced the risk that UK-based companies could exercise undue monopoly power. It should therefore be possible to adopt a more relaxed stance on possible threats to competition. On other matters, it would be helpful for Departments to agree with the Bank of England guidelines, which might be taken into account by the Monopolies and Mergers Commission in assessing highly-leveraged bids. There was a case for giving greater weight to reciprocity in assessing foreign bids. Other areas worth further consideration included the way in which referral of one bid where two parties were interested could lead to unfairness, and the bias which the present system tended to give in favour of bids by conglomerates. There was a need for a stronger and more effective Chairman of the MMC to replace Sir Godfray Le Quesne.

CONFIDENTIAL

Other points made in the discussion included the following.

i) Whilst there were strong arguments against making an announcement before the Election, it would be difficult for the Government not to give an indication of the direction of its policy on monopolies and mergers in the Manifesto or during the Election campaign. There was also a risk that at any stage a controversial takeover bid might be mounted, and it would look incompetent for the Government simply to say that the review was continuing.

ii) Mergers accounting was often unsatisfactory, leaving scope for overstatement of the gains arising from a change of ownership.

iii) Concern remained about the scope for predator companies to take assets from pension funds. (This point is recorded separately in greater detail in a letter from me to Geoffrey Podger, DHSS.)

iv) There was a case for requiring shareholders of a company wishing to mount a takeover to be consulted in the same way as the shareholders of a company being taken over were consulted. This would, however, create major difficulties where one potential bidder was foreign and another UK-based.

v) Whilst MMC investigations tended to be delayed by obstructionism by one of the parties, it ought still to be possible to speed up the process.

vi) The American practice of allowing takeovers to go ahead but with the threat of compulsory divestment later was a practice worth further consideration.

vii) The proposal to put the burden of proof on a company wishing to acquire another had nothing to commend it.

Summing up, the Prime Minister said that no immediate announcement should be made. However, the Government would be vulnerable to accusations of incompetence if it allowed the review to become too protracted. The work should now proceed with all speed, to be completed in time for a paper to be brought to the same group before the end of the Parliament. This should cover, among other things, accounting for mergers, highly-leveraged buy-outs (on the basis of guidelines to be discussed by Departments with the Bank of England) and possible changes to the institutional structure for dealing with monopolies and mergers.

I am copying this letter to the Private Secretaries to the Lord President, the Chancellor of the Exchequer, the Secretary of State for the Environment, the Chancellor of the Duchy of Lancaster, the Chief Whip and to Sir Robert Armstrong.

D R NORGROVE

Paul Steeples, Esq.
Department of Trade and Industry

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

5 May 1987

Dear Paul,

MERGERS POLICY

The Prime Minister this morning held a further meeting to discuss mergers policy, on the basis of your Secretary of State's minute of 29 April. There were present your Secretary of State, the Lord President, the Chancellor of the Duchy of Lancaster, the Secretary of State for the Environment, the Chief Secretary, the Chief Whip, Sir Robert Armstrong, Mr. Hans Liesner (Department of Trade and Industry) and Mr. George Guise (No.10 Policy Unit). The Chancellor of the Exchequer was present for part of the meeting.

NOTE OF MEETING 5/5

Your Secretary of State noted that at the Prime Minister's previous meeting (24 March) it had been agreed that the basis of policy should be to refer mergers primarily on competition grounds. Work had continued on the review and on particular points raised at that meeting. There was a need to try to speed up investigations. One possibility would be to amalgamate the mergers work of the Office of Fair Trading and the Monopolies and Mergers Commission. An announcement could either say simply that the Government intended to try to speed up the process of investigation or the possibility of an amalgamation could be mentioned. On accountancy rules, discussions with the professional bodies were in progress. The key requirement would be adequate disclosure. On highly leveraged bids, to issue general guidelines would set a challenge to advisers to avoid their provisions. It would not be appropriate to refer solely on grounds of high leverage.

In discussion the following points were made.

(i) Amalgamation of the mergers work of the OFT and MMC would create a single very powerful body. It might be possible to achieve some of the benefits of amalgamation by creating closer links between the two organisations (for example files could be transferred to avoid duplication of work when a recommendation to refer was accepted). It might also help now to replace the present Chairman of the MMC. It was noted that the effective operation of the present system depended heavily on the good sense of the Director-General of Fair Trading.

(ii) Markedly quicker investigation of mergers and takeovers would tend to weaken the ability of a company to defend itself: the defending company could at present adopt delaying tactics and in the meantime improve its performance. This was not however an argument which should persuade the Government against seeking to speed up the process of investigation and decision.

(iii) Discussions with professional accountancy bodies were likely to be protracted. It would be preferable to seek to persuade the Stock Exchange to make adequate disclosure a requirement.

(iv) In any announcement it would be better to say that the Secretary of State would not "normally" regard high leverage on its own as a ground for reference.

Concluding the meeting, the Prime Minister said that any announcement should make it clear that the Government would aim to speed up the process of investigation and decision, whether by amalgamation of the OFT and MMC or by other means. It was essential for a full disclosure of results to be made which would allow those interested to work out how successfully a merged or an acquired company had performed thereafter. This should be pursued with the Stock Exchange in the first place. Officials should consider further the question of the definition of the public interest, though this need not be mentioned in any announcement. It would be preferable for an announcement to be made in a speech rather than in a written answer. A decision on the timing of an announcement could be taken in due course.

I am copying this letter to Mike Eland (Lord President's Office), Tony Kuczys (H.M. Treasury), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Robin Young (Department of the Environment), Jill Rutter (Chief Secretary's Office), Murdo Maclean (Chief Whip's Office) and Trevor Woolley (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Paul Steeples, Esq.,
Department of Trade and Industry.

1316/51

FROM: MRS R LOMAX
DATE: 6 May 1987

CHANCELLOR

cc: PS/Economic Secretary
Sir P Middleton
Mr Monck
Mr Gray
Mr Ilett
Mr Cropper
Mr Ross Goobey

Thanks. I agree No need to write.

TAKEOVER PANEL REVIEW

The draft written answer on the Takeover Panel Review attached to Mr Channon's minute to the Prime Minister (below) takes account of our comments on earlier drafts (as recorded in Tony Kuczys's letter (below) to Paul Steeples of 5 May). The minute itself records your request for DTI, Treasury and Bank to undertake confidential work on a possible statutory system in case circumstances arise to make this necessary. Mr Channon's lack of enthusiasm for this task is evident, but he is prepared to go along with it, albeit to no precise timetable, provided it does not take precedence over implementing the present proposals, and on the understanding that it would remain confidential.

2. This is satisfactory. There is no need for you to write - unless, in the light of yesterday's meeting at No 10, you think it would be prudent to underline the importance you attach to undertaking the contingency work on a statutory system. We will provide a draft letter, if you think this is necessary.

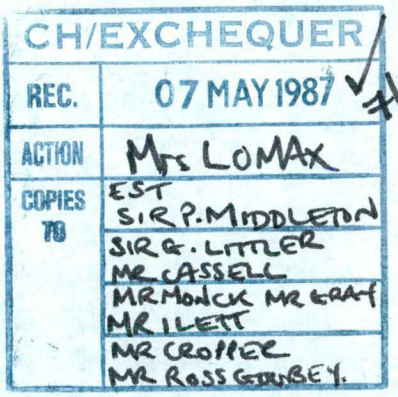
RL

RACHEL LOMAX

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA



From the Private Secretary

7 May 1987

Dear Paul,

TAKE-OVER PANEL REVIEW

The Prime Minister has seen your Secretary of State's minute of 6 May about the results of the review of the Take-over Panel. She is content with the proposed statement, subject to the views of colleagues, and believes that it should be published next week.

The Prime Minister would wish to see in draft the proposed consultative document about changes to the law proposed by the review group.

The Prime Minister understands the reasons which have led the Chancellor to propose that confidential work should continue on developing a possible statutory system for the Take-over Panel. However she accepts the force of the arguments put by your Secretary of State against a statutory system and she shares his view that if the confidential work became known it would cast doubt on the Government's confidence in its preferred solution and could undermine the authority of the Take-over Panel. The Prime Minister accordingly sees no need at present for continuing contingency work. The immediate task is to push on with the measures proposed by the review.

I am copying this letter to Mike Eland (Lord President's Office), Alex Allan (HM Treasury), Steven Wood (Lord Privy Seal's Office), Murdo Maclean (Chief Whip's Office), Rhodri Walters (Office of the Captain of the Gentlemen at Arms), John Footman (Bank of England) and to Trevor Woolley (Cabinet Office).

Yours,

David

(DAVID NORGROVE)

Paul Steeples, Esq.,
Department of Trade and Industry.

CONFIDENTIAL

C

EST WISHES TO RAISE TAKEOVER PANEL AT PRAYERS TOMORROW

TL
18/6

Ch

Papers with you — spare copies attached.

(EST has reservations about putting the Panel on a statutory basis)

1318/6

FROM: MRS R LOMAX
DATE: 17 JUNE 1987

PRINCIPAL PRIVATE SECRETARY

cc PS/Economic Secretary
Mr Monck
Mr P Gray
Mr Ilett

TAKE-OVER PANEL REVIEW

David Norgrove's minute of 7 May records the Prime Minister's view that there is no need at present for contingency work on a possible statutory system for the Take-over Panel. Mr Kuczys' minute of 11 May noted the Chancellor's comment that this should be re-opened vigorously immediately after the General Election.

If the Chancellor is still of the same view, he might want to discuss the matter informally with Lord Young before going back to the Prime Minister. DTI officials are adamantly opposed to doing this work, for a number of reasons: but Lord Young himself may be more open-minded.

RACHEL LOMAX

Ch
Did you raise this with Lord Young? Do you want to find another opportunity?
17/6

4142/021 NH

CONFIDENTIAL

FROM: M NEILSON
DATE: 25 June 1987

1. MRS LOMAX
2. CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Mr Monck
Mr Cassell
Mr P Gray
Mr Ilett

You ought to be aware of the draft EC directive on takeovers, but I'm sceptical of its value as an excuse for contingency planning. (Headlers & Jay DTI are resisting it anyway, too) KE. 25/6.

TAKEOVER PANEL REVIEW

You asked for a draft letter to send to Lord Young, not copied to colleagues, on the need to do contingency work on the statutory option for the Takeover Panel. I attach a draft.

2. The draft will be familiar, save for the reference to the draft EC takeover directive. This proposal has surfaced within the last month, and to comply with it in its current form would probably require the UK to set up a statutory takeover body. DTI are hoping to persuade member states that the directive should take the form of guidelines on the conduct of takeovers, rather than prescribing a particular institutional set up. Though the draft directive is clearly at a very early stage, and its implications are very unclear, it does help to deal with the main objection to contingency planning - that if this was leaked it would undermine the credibility of the panel. With the existence of the draft directive, the line could be sustained that the contingency work that is going on is in case EC developments should require a statutory system, rather than stemming from lack of confidence in the existing arrangements.

Pretty thin!

M NEILSON

124/24

4142/020 NH

CONFIDENTIAL

A type for this sig

DRAFT LETTER FOR CHANCELLOR TO SEND TO:

Right Hon Lord Young
Secretary of State for Trade and Industry

TAKEOVER PANEL

We have already had a brief word about the takeover panel. As you will know I have for some time thought that we should be doing contingency work within Government on what a statutory regime for takeovers would look like. There is always a risk that a sudden crisis, caused, for example, by successful legal challenge to the Panel's authority, (or some scandal which the Panel had been unable to prevent,) could put us in a position where we urgently needed to set up a statutory framework. It is clear from the review commissioned by your predecessor that this would be a very complex task; to start from scratch in a crisis situation would be a recipe for error and delay, creating dangerous uncertainty in the market.

The Prime Minister was against starting contingency work before the election, on the grounds that if there were a leak, this would undermine the credibility of the Panel, and of the new arrangements resulting from the review itself. I believe that, with the election behind us, the balance of the argument has now changed. I judge that the impact of a leak would be much less damaging than that of a regulatory crisis for which the Government was unprepared. There is also a new factor to weigh in this argument; the European Commission has published a draft takeover directive which, if implemented, would have a serious impact on how takeovers are regulated in the UK. Some form of statutory backing might be necessary. If it became publicly known that

contingency planning was going on, the work could be described as contingency planning for the possible imposition of EC wide rules. This would reduce the likelihood that such a leak would undermine the panel's authority.

Perhaps, when you have considered this further, we could have another word.

Can I suggest that you have another look at the arguments for doing some preparatory contingency work?

N LAWSON

Draft
Ch as
agreed
by Rachel &
me.

Ch

It was left that you
wd try & speak again
to Ld Young, to get him
to ask for contingency
work to be set in hand.

You will see Ld Y at
NEDC on Wednesday,
and Cabinet on Thursday.
However, Rachel has now
come round to the idea
of your sending a minute
instead — see below.

(If you take on Rachel's
amendments, the ref. to an
EC directive comes out

PTO

altogether, so no need to take on the EST's re-draft.

Letter (as amended by Rachel) to issue?

29/6

3755/060

CONFIDENTIAL

FROM: P D P BARNES
DATE: 29 June 1987

PS/CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr Cassell
Mrs Lomax
Mr Gray
Mr Ilett
Mr Neilson

TAKEOVER PANEL REVIEW

The Economic Secretary has seen Mr Neilson's submission to the Chancellor of 25 June, and the draft letter to Lord Young attached to that submission.

2. The Economic Secretary thinks that to present the EC directives argument as an excuse on which we can fall back undermines its force. He thinks it would be better to say:-

"Because the EC has now published a draft directive on takeovers it is in any case necessary to begin preparatory work on how this could affect the UK - not least so that we can influence future decisions on this draft. This will involve examining statutory options which might become obligatory. In this context a putative leak about any such contingency work would not seem to undermine the authority of the present panel."

Right. But Rachel wd omit the reference altogether (see below) AWK

P D P BARNES
Private Secretary

CONFIDENTIAL

RT4.67

CONFIDENTIAL

cc PS/EST
Sir P Middleton
Mr Monck
Mr Cassell
Mr P Gray
Mr Ilett
Mrs Lomax
Mr Neilson

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

30 June 1987

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

TAKEOVER PANEL

We have already had a brief word about the takeover panel. As you know I have for some time thought that we should be doing contingency work within Government on what a statutory regime for takeovers would look like. There is always a risk that a sudden crisis, caused, for example, by successful legal challenge to the Panel's authority, or some scandal which the Panel had been unable to prevent, could put us in a position where we urgently needed to set up a statutory framework. It is clear from the review commissioned by your predecessor that this would be a very complex task; to start from scratch in a crisis situation would be a recipe for error and delay, creating dangerous uncertainty in the market.

The Prime Minister was against starting contingency work before the election, on the grounds that a leak would undermine the credibility of the Panel, and the new arrangements resulting from the review itself. I believe that, with the election behind us, the balance of the argument has now changed: the impact of a leak would be much less damaging than a regulatory crisis for which the Government was unprepared.

Can I suggest that you take another look at the arguments for doing some contingency work?

NIGEL LAWSON

16/2 **CONFIDENTIAL UNDER SECTION 19 OF THE BANKING ACT 1979 until announced**

FROM: D R H BOARD
DATE: 6 July 1987

(personal) PPS Mr Culpin

MRS LOMAX

c c Miss Noble o/r
Mr D Jones

MIDLAND

I attach a draft, slimmed down "line to take" and background which - subject to finalisation tomorrow morning - will need to go to No 10 (copies to Scottish Office, NIO and DTI Private Offices), to our Press Office and (I suggest) to the FCO's Australian desk.

2. As of now, the Bank tell me that the various press releases will include:-

- emphasis by Midland on the positive opportunities for Clydesdale and Northern. By comparison, if they had stuck with Midland, the two subsidiaries (despite being excellent in every way, etc, etc) would have had to face closer integration with Midland's operations, cutting out of duplicated functions, and so on. For its part Midland would have had to sink time and money into integration;

- positive statements by Clydesdale's and Northern's chairmen;

- a short statement by NAB saying that the purchase had been agreed subject to approval by all the regulatory authorities (Australia, UK and Eire).

3. The Bank are currently planning to say simply that they have been consulted by the parties and that they have no objection of principle.

4. The Bank (David Carse) also tell me that NAB are now primarily concerned that the result of any MMC reference will not be known before the legal completion date (expected to be end-October).

Douglas Board

D R H BOARD

PS The Bank should fax copies of the final statements to the press by the parties to the Chancellor's office as soon as available – probably first thing in the morning. Mr Allan might like to check with the Governor's office then.

MIDLAND BANK ANNOUNCEMENT, TUESDAY 7 JULY 1987

LINE TO TAKE

Midland Bank has announced today steps which the board judge will put Midland in a sounder position, and will be good for its subsidiaries Clydesdale Bank and Northern Bank. It has been welcomed as good news by the chairmen of Clydesdale and Northern. The future for those two banks would otherwise have involved a greater degree of integration into Midland's operations. Midland's announcement is of course also related to the wave of change which we have been seeing in banks internationally, in the face of international debt problems. I welcome the general fact that the banking system is addressing those problems; the specific steps which Midland have announced are very much matters of their own commercial judgement.

DEFENSIVE

Monopolies and Mergers inquiry on national interest grounds?

That is a matter for my RHF the Secretary of State for Trade and Industry to consider.

[**IF PRESSED** on Banking Bill commitment to make a public interest reference to MMC in case of major clearing banks:] I shall not anticipate my RHF the Secretary of State for Trade and Industry. He is well aware of the general position on references to the Monopolies and Merger Commission in the case of takeovers of our major high street banks, as he himself explained it very clearly during the debates in another place on the Banking Bill.

Use of Financial Services Act reciprocity powers against Australia?

The Government has made clear that the reciprocity provisions in the Financial Services Act are designed to help us open up markets overseas, not to close down markets here. That is our general objective. In relation to any particular case, the Government has to weigh up what is in the national interest in that particular case.

Tax treatment of international debt provisions?

The general rules set out by the Inland Revenue in 1983 still apply. Tax relief is available for specific provisions where they represent a genuine loss, in terms of recoverability of the loan. [The hon Member knows perfectly well that the tax affairs of companies, as of individuals, are kept strictly confidential.]

BACKGROUND NOTE

Midland Bank announced this morning (7 July) major action to strengthen its capital position and to bring its provisions against problem country debt into line with recent market expectations. Major banks have been making substantially higher provisions against the non-payment of sovereign debt since Citicorp announced 25% provisions in May. In the UK, National Westminster announced 30% provisions in June. The Bank of England has made no secret of its desire to see higher UK bank provisions and the Chancellor has welcomed these developments. Other UK clearers are still considering their own position. Midland's announcement comprises:-

- [£700m] rights issue;

- [£920m] provisions against international debt, bringing these to around [27%];

- [£370m] from ~~the~~ sale of its wholly owned subsidiaries Clydesdale Bank and Northern Bank, and an Eire subsidiary, to a leading Australian bank - National Australia Bank.

MMC SCRUTINY OF FOREIGN ACQUISITION OF UK BANKS

2. Fully debated during proceedings on recent Banking Act. The Government's position was that reference to the MMC provided the appropriate means for consideration of public interest aspects of foreign acquisitions of UK banks; as well as competition policy and regional aspects.

3. Government not committed to refer <u>all</u> such cases, but there has been a precedent - 1982 Royal Bank of Scotland (RBS) case, where MMC found against acquisition by Hong Kong and Shanghai Banking Corporation. Individual cases to be judged on their merits, but presumption in favour of reference for a "high street" clearing bank such as Clydesdale (especially given regional implications). In the RBS case, the MMC specifically addressed Scottish interests, and Scottish banks generally will be anxious that references continue to be possible on Scottish as well as UK public interest grounds.

RECIPROCITY

4. The Financial Services Act reciprocity powers are in force. They allow the Secretary of State or the Treasury to refuse, remove or restrict authorisation to carry on banking, investment or insurance business in the UK if the institution is 'connected' with a country which does not allow UK firms to carry on any such business on terms as favourable as those available in the UK. The Secretary of State or the Treasury must also consider it to be in the national interest that such action be taken, and must consult affected parties. There is some prima facie evidence - e.g. the Foreign Takeovers Act 1975 - that Australia does not offer the UK reciprocal access to its financial markets.

5. The Financial Services Act does not provide powers to block acquisitions. In the Clydesdale case, they would operate after the acquisition, when Clydesdale would have become "connected" with an overseas institution. The sanctions would be removal or restriction of Clydesdale's authorisation. (The threat to do so might also be used beforehand.)

6. The new Banking Act reciprocity powers are not yet in force. During the final Commons stage of the Bill the then Economic Secretary announced the Government's intention to bring the bulk of the Act's provisions (including the reciprocity powers) into force on 1 October 1987. This is still the intention.

7. The Banking Act powers are explicitly aimed at preventing acquisitions of control before they take place. All proposed acquisitions of 15 per cent or more of UK banks will be required to be notified to the Bank in advance. The reciprocity provision empowers the Treasury to direct the Bank to serve a notice of objection in respect of a proposed foreign acquisition if the result of the acquisition proceeding would be to make the institution subject to the FS Act reciprocity powers (referred to above).

TIONAL AUSTRALIA BANK (NAB)

NAB is the product of the merger of 2 of Australia's oldest banking organisations. It is the largest Australian commercial bank in terms of assets. It has offices in the US, Europe, SE Asia and Tokyo.

2. Profit was stagnant in the last year (at A$300m, or £140m at the current exchange rate); NAB attributed this to difficult economic conditions in Australia. Total assets increased by 20% to A$42bn (£19bn).

CLYDESDALE BANK PLC

3. Clydesdale Bank is a recognised bank which is part of the clearing system. Although it is a wholly owned subsidiary of Midland, it is member in its own right of the BACS and CHAPS (electronic) clearing systems, and of the London town clearing, as well as of the separate Scottish cheque clearing.

4. It has about 350 branches and 6,600 staff. Its advances to customers (£1.8bn) represent about 12% of the market covered by the 4 leading Scottish banks (Bank of Scotland, Royal Bank of Scotland, TSB Scotland and Clydesdale). However the Bank and Royal Bank of Scotland have significant non-Scottish business, which is reflected in the ranking of the 4 banks by total assets:

Royal Bank of Scotland	£15bn
Bank of Scotland	£ 8bn
Clydesdale	£ 2.8bn
TSB Scotland	£ 1.8bn

5. Clydesdale has been cutting back on branches and staff. Its profit in 1986 (£17m after tax) was fractionally lower than in the previous year. The annual report commented that profit was satisfactory "during a time of continuing economic difficulty in Scotland". Sterling advances had increased by over 10%. But the report identified as particular problems the bank's cost base and substantial charges for bad debts, the latter partly blamed on difficult times in the Scottish oil servicing and supply industries, construction and agriculture.

6. As a result of the Bank Notes (Scotland) Act 1845, Scottish banks which then issued their own bank notes were permitted to continue to do so. (It differed from the English legislation which deprived banks of this privilege when they amalgamated.) Clydesdale, the Bank of Scotland and the Royal Bank of Scotland are the only banks which issue Scottish banknotes. Clydesdale notes account for about 25% of the Scottish issue. Scottish banknotes are not legal tender and, since the issuing banks have to back virtually all their notes with holdings of Bank of England notes, they do not profit by printing money.

NORTHERN BANK LIMITED

7. Northern Bank Ltd is a wholly owned subsidiary of Midland, incorporated in Northern Ireland. It is the largest bank in Northern Ireland. In the business sector it provides over 50% of clearing bank lending in the Province.

8. The bank has 2,200 staff. Total assets in 1986 were £1.4bn and profits after tax rose to £11.4m (from £9.3m). Like Clydesdale, Northern Bank's report emphasises the need to reduce its cost base, and the effect of difficult regional economic conditions.

RESTRICTED

FROM: A C S ALLAN
DATE: 7 July 1987

MRS LOMAX

cc Mr Culpin
Miss Noble
Mr Board
Mr D Jones

MIDLAND

The Chancellor has seen Mr Board's note to you of 6 July with the draft line to take. He feels that the first two sentences of the defensive line on reciprocity powers should be deleted (they say that the powers are designed to help us open up markets overseas, not to close down markets here). He feels this is not a good point, since it suggests we might say "we will block NAB and all other Australian takeovers until you open your markets to UK biders".

2. On the DTI line to take in Timothy Walker's letter to me of 6 July, the Chancellor felt that it was extremely unhelpful for it to refer explicitly to the fact that "our policy is to make references primarily on competition grounds". I have remonstrated with DTI's Private Office on this, but to no avail.

ACSA

A C S ALLAN

1318/67

FROM: D R H BOARD
DATE: 7 JULY 1987

1. MRS LOMAX
2. PPS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
PS/Sir P Middleton
Sir G Littler
Mr Cassell
Mr H Evans
Mr Culpin
Miss Noble o/r
Mr Neilson
Mr D Jones
Parliamentary Clerk
Ms Wheldon - T Sol

MIDLAND

I attach draft briefing on Midland's announcement this morning. If the Chancellor is content with it, you may wish to send it to No 10 (for Prime Minister's questions today), and to the Scottish Office, NIO and DTI Private offices. The suggested line on a possible MMC reference is formally neutral, and therefore consistent with DTI's position; however it does not pretend to be ignorant of what was said on the Banking Bill.

Douglas Board

D R H BOARD

(press comments below in separate minute)

13/016 NH

MIDLAND BANK ANNOUNCEMENT, TUESDAY 7 JULY 1987

LINE TO TAKE

~~Midland's announcement is related to the wave of change which we have been seeing in banks internationally, in the face of international debt problems.~~ I welcome the ~~general fact that~~ the way the banking system is addressing ~~those~~ the problems of international debt; the specific steps which Midland have announced are very much matters of their own commercial judgement.

it demonstrates the success of the debt strategy in providing time for banks to strengthen their balance sheets.

The ~~Midland's proposal~~ Midland Bank's proposal is a matter for them; but in general I welcome the fact that the banking system is now realistically addressing the problems caused by the international debt situation: this demonstrates the success of the debt strategy over the past five years in providing time for banks to strengthen their balance sheets and make adequate provision for bad or doubtful debts.

DEFENSIVE

Bad news for Scotland and Northern Ireland?

Midland Bank's board judge that the steps which they have announced today will put Midland in a sounder position, and will be good for its subsidiaries Clydesdale Bank and Northern Bank. It has been welcomed as exciting news by the chairmen of Clydesdale and Northern. The future for those two banks would otherwise have involved a greater degree of integration into Midland's operations.

Monopolies and Mergers inquiry on national interest grounds?

That is a matter for my RHF the Secretary of State for Trade and Industry to consider.

[**IF PRESSED** on Banking Bill "commitment" to make a public interest reference to MMC in case of major clearing banks:] I shall not anticipate my RHF the Secretary of State for Trade and Industry. He is well aware of the general position on references to the Monopolies and Merger Commission in the case of takeovers of our major high street banks, as he himself explained it very clearly during the debates in another place on the Banking Bill.

Use of Financial Services Act reciprocity powers against Australia?

In relation to whether the reciprocity powers are applicable in any particular case, the Government has to weigh up the facts and what is in the national interest in that particular case.

Tax treatment of international debt provisions?

The general rules set out by the Inland Revenue in 1983 still apply. Tax relief is available for specific provisions where they represent a genuine loss, in terms of recoverability of the loan. The hon Member knows perfectly well that the tax affairs of companies, as of individuals, are kept strictly confidential.

002/013 NH

BACKGROUND NOTE

Midland Bank announced this morning (7 July) major action to strengthen its capital position and to bring its provisions against problem country debt into line with recent market expectations. Major banks have been making substantially higher provisions against the non-payment of sovereign debt since Citicorp announced 25% provisions in May. In the UK, National Westminster announced 30% provisions in June. The Bank of England has made no secret of its desire to see higher UK bank provisions and the Chancellor has welcomed these developments. Other UK clearers are still considering their own position. Midland's announcement comprises:-

- £700m rights issue;

- £916m additional provisions against international debt, bringing these to around 27%;

- the sale of its wholly owned subsidiaries Clydesdale Bank and Northern Bank, and an Eire subsidiary, to a leading Australian bank - National Australia Bank - for a premium of £70m on top of net worth.

MMC SCRUTINY OF FOREIGN ACQUISITION OF UK BANKS

2. Fully debated during proceedings on recent Banking Act. The Government's position was that reference to the MMC provided the appropriate means for consideration of public interest aspects of foreign acquisitions of UK banks; as well as competition policy and regional aspects.

3. Government not committed to refer all such cases, but there has been a precedent - 1982 Royal Bank of Scotland (RBS) case, where MMC found against acquisition by Hong Kong and Shanghai Banking Corporation. Individual cases to be judged on their merits, but presumption in favour of reference for a "high street" clearing bank such as Clydesdale (especially given regional implications). In the RBS case, the MMC specifically addressed Scottish interests, and Scottish banks generally will be anxious that references continue to be possible on Scottish as well as UK public interest grounds.

RECIPROCITY

4. The Financial Services Act reciprocity powers are in force. They allow the Secretary of State or the Treasury to refuse, remove or restrict authorisation to carry on banking, investment or insurance business in the UK if the institution is 'connected' with a country which does not allow UK firms to carry on any such business on terms as favourable as those available in the UK. The Secretary of State or the Treasury must also consider it to be in the national interest that such action be taken, and must consult affected parties. There is some prima facie evidence - e.g. the Foreign Takeovers Act 1975 - that Australia does not offer the UK reciprocal access to its financial markets.

5. The Financial Services Act does not provide powers to block acquisitions. In the Clydesdale case, they would operate after the acquisition, when Clydesdale would have become "connected" with an overseas institution. The sanctions would be removal or restriction of Clydesdale's authorisation. (The threat to do so might also be used beforehand.)

6. The new Banking Act reciprocity powers are not yet in force. During the final Commons stage of the Bill the then Economic Secretary announced the Government's intention to bring the bulk of the Act's provisions (including the reciprocity powers) into force on 1 October 1987. This is still the intention.

7. The Banking Act powers are explicitly aimed at preventing acquisitions of control before they take place. All proposed acquisitions of 15 per cent or more of UK banks will be required to be notified to the Bank in advance. The reciprocity provision empowers the Treasury to direct the Bank to serve a notice of objection in respect of a proposed foreign acquisition if the result of the acquisition proceeding would be to make the institution subject to the FS Act reciprocity powers (referred to above).

NATIONAL AUSTRALIA BANK (NAB)

NAB is the product of the merger of 2 of Australia's oldest banking organisations. It is the largest Australian commercial bank in terms of assets. It has offices in the US, Europe, SE Asia and Tokyo.

2. Profit after tax was stagnant in the last year (at A$300m, or £140m at the current exchange rate); NAB attributed this to difficult economic conditions in Australia. Total assets increased by 20% to A$42bn (£19bn).

CLYDESDALE BANK PLC

3. Clydesdale Bank is a recognised bank which is part of the clearing system. Although it is a wholly owned subsidiary of Midland, it is member in its own right of the BACS and CHAPS (electronic) clearing systems, and of the London town clearing, as well as of the separate Scottish cheque clearing.

4. It has about 350 branches and 6,600 staff. Its advances to customers (£1.8bn) represent about 12% of the market covered by the 4 leading Scottish banks (Bank of Scotland, Royal Bank of Scotland, TSB Scotland and Clydesdale). However the Bank and Royal Bank of Scotland have significant non-Scottish business, which is reflected in the ranking of the 4 banks by total assets:

Royal Bank of Scotland	£15bn
Bank of Scotland	£ 8bn
Clydesdale	£ 2.8bn
TSB Scotland	£ 1.8bn

5. Clydesdale has been cutting back on branches and staff. Its profit in 1986 (£17m after tax) was fractionally lower than in the previous year. The annual report commented that profit was satisfactory "during a time of continuing economic difficulty in Scotland". Sterling advances had increased by over 10%. But the report identified as particular problems the bank's cost base and substantial charges for bad debts, the latter partly blamed on difficult times in the Scottish oil servicing and supply industries, construction and agriculture.

6. As a result of the Bank Notes (Scotland) Act 1845, Scottish banks which then issued their own bank notes were permitted to continue to do so. (It differed from the English legislation which deprived banks of this privilege when they amalgamated.) Clydesdale, the Bank of Scotland and the Royal Bank of Scotland are the only banks which issue Scottish banknotes. Clydesdale notes account for about 25% of the Scottish issue. Scottish banknotes are not legal tender and, since the issuing banks have to back virtually all their notes with holdings of Bank of England notes, they do not profit by printing money.

NORTHERN BANK LIMITED

7. Northern Bank Ltd is a wholly owned subsidiary of Midland, incorporated in Northern Ireland. It is the largest bank in Northern Ireland. In the business sector it provides over 50% of clearing bank lending in the Province.

8. The bank has 2,200 staff. Total assets in 1986 were £1.4bn and profits after tax rose to £11.4m (from £9.3m). Like Clydesdale, Northern Bank's report emphasises the need to reduce its cost base, and the effect of difficult regional economic conditions.

PUP

MIDLAND BANK ANNOUNCEMENT, TUESDAY 7 JULY 1987

LINE TO TAKE

The Midland Bank's proposal is a matter for them; but in general I welcome the fact that the banking system is now realistically addressing the problems caused by the international debt situation: this demonstrates the success of the debt strategy over the past five years in providing time for banks to strengthen their balance sheets and make adequate provision for bad or doubtful debts.

National Australia Bank

Media Release

National Australia
Bank Limited

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500 Bourke Street
Melbourne Victoria Australia
Telephone (03) 605 3857

GPS
DGPS
MW Gulp
MW George
W Lochie
MW Cooke
MW Quinn
MW Barnes

FOR IMMEDIATE RELEASE

7/7/87

NATIONAL AUSTRALIA BANK TO ACQUIRE CLYDESDALE BANK, NORTHERN BANK AND NORTHERN BANK (IRELAND) FROM MIDLAND BANK
RIGHTS ISSUE BY NATIONAL AUSTRALIA BANK TO RAISE A$432M (£193M)

Sir Rupert Clarke, Chairman of the Board of National Australia Bank Limited ("National Australia Bank") announces on behalf of the Board that National Australia Bank has today entered into an agreement to acquire the whole of the issued share capital of Clydesdale Bank PLC ("Clydesdale"), Northern Bank Limited ("Northern") and Northern Bank (Ireland) Limited ("Northern Bank (Ireland)") from Midland Bank plc ("Midland"). The consideration for the acquisition will be the sum of the combined net tangible assets of the three banks determined as at 30th June, 1987, plus £70m (A$157m). Completion of the acquisition is expected to take place by the end of October 1987. The consideration will be financed in part through a 1 for 5 rights issue announced today by National Australia Bank to raise A$432m (£193m).

Sir Rupert Clarke said:

> "For a long time National Australia Bank has identified the UK and Western Europe as a key area for further substantial expansion. The economies of the UK and Western Europe are at the moment enjoying a period of high prosperity and we believe that National Australia Bank will be considerably strengthened by these acquisitions.
>
> Clydesdale, Northern and Northern Bank (Ireland) are prestigious institutions and enjoy excellent reputations in their home territories. It is our intention to maintain each of the banks' head offices in their present locations. We believe that with our financial strengths, management skills and deep understanding of branch banking, we will be able to develop these operations to the benefit of National Australia Bank, the three banks, and their customers and staff in Scotland, England, Northern Ireland and the Republic of Ireland.
>
> Our Managing Director, Mr.N.R. Clark, and I have met the Chairmen and the Chief Executives of the three banks and I am delighted to say that they have unanimously welcomed us. This is of the greatest importance to us as we will obviously be relying on the widely recognised capabilities of the banks' local management. We look forward to the opportunity of visiting Glasgow, Belfast and Dublin over the next 24 hours to meet with more of the senior executives of the banks and to visiting over the coming months as many as possible of their principal branches. We are delighted to be associated with the banks, their customers and employees."

For further information contact
Corporate and Public Relations
at the above address.

Information on National Australia Bank

National Australia Bank is one of the three largest private sector banks in Australia, with total assets of over A$42bn (£19bn) and shareholders' funds of some A$2.2bn (£1bn) at 30th September, 1986. National Australia Bank's shares are listed in Australia, London, Tokyo and New Zealand. National Australia Bank has a current market capitalisation (including convertibles) of A$2.6bn (£1.2bn).

In the year ended 30th September, 1986, National Australia Bank achieved profit before taxation of some A$500m (£223m) and post-tax profit of A$304m (£136m). In the six months ended 31st March, 1987, National Australia Bank's pre-tax profit was A$282m (£126m), and post-tax profit was A$156m (£70m).

National Australia Bank is a major international bank providing a comprehensive range of financial products and services to individuals, corporations and governments within Australia, the Western Pacific region and around the world. It operates a nationwide branch banking system in Australia offering a wide range of banking and financial services to its customers. The National Australia Bank Group also provides life insurance, stockbroking, investment banking, fund management, leasing and travel services. National Australia Bank has over 1450 outlets within Australia, together with subsidiaries, branches and representative offices in Asia, the USA, Western Europe, New Zealand, Papua New Guinea and London. National Australia Bank employs some 23,000 people throughout the world.

Information on Clydesdale Bank

Clydesdale is a major Scottish bank which traces its origins back to the early nineteenth century. It is one of the three major banks operating in Scotland and at 31st December, 1986 had shareholders' funds of some £177m (A$396m) with total assets of some £2.8bn (A$6.3bn). In the year to 31st December, 1986, Clydesdale achieved profit before taxation of £28m (A$63m). Clydesdale's principal activities are the provision of a full range of banking facilities through some 350 branches, the bulk of which are spread throughout Scotland. Clydesdale also has branches in North West England and in London. Clydesdale's head office is in Glasgow, Scotland. In addition, Clydesdale offers investment management, executor and trustee services, insurance broking, computer leasing and Stock Exchange services. Clydesdale is well known as one of the three mainland UK banks which issues its own bank notes.

Clydesdale has a first class reputation for efficient provision of sophisticated personal and financial services, with particular emphasis on the development and use of electronic technology, particularly cash dispensers and point of sale funds transfer (EFTPoS).

Commenting on the acquisition, Sir Eric Yarrow, Chairman of Clydesdale, said:

> "My colleagues and I are delighted that the new owner of Clydesdale is to be National Australia Bank. We have a considerable regard for the quality, size and prestige of National Australia Bank and I believe that the acquisition will be to the long-term benefit of both parties. Clydesdale and National Australia Bank can look

forward to a most exciting future which I believe will offer excellent opportunities for Clydesdale to develop further in the UK."

Information on Northern Bank

Northern is a major bank operating within Northern Ireland, providing a full range of banking, financial and related services. In the year to 31st December, 1986, Northern achieved profits before banking levy and taxation of over £19m (A$43m) and at that date had total assets of £1.4bn (A$3.1bn) with shareholders' funds of £101m (A$226m). Northern's head office is in Belfast and it has some 110 branches throughout Ulster. In 1986 Northern provided over 50 per cent. of clearing bank lending in the business sector in Northern Ireland and it occupies an important position as one of the leading banks and as an issuer of bank notes in the province.

Commenting on the acquisition, Sir Desmond Lorimer, Chairman of Northern, said:

"I believe the opportunities presented by our new association with National Australia Bank will be of enormous benefit to Northern, its employees and, most importantly, its customers. We offer Midland our best wishes for the future and we look forward to taking full advantage of the new opportunities presented to us by National Australia Bank's acquisition. I am confident that under National Australia Bank's ownership Northern will have new and very exciting prospects."

Information on Northern Bank (Ireland)

Northern Bank (Ireland) was established on 1st July, 1986 as a separate limited company principally comprising the branch banks in the Republic of Ireland previously owned by Northern, together with a merchant bank, Northern Bank Finance Corporation, and the asset finance activities previously owned by Forward Trust Group (Ireland) Limited. At 31st December, 1986, it had net assets of I£41m (A$83m) with total assets of I£484m (A$986m).

Northern Bank (Ireland)'s head office is in Dublin and it operates a retail banking network comprising some 50 branches within the Republic of Ireland, concentrated mainly in the key population centres, together with corporate banking and asset finance business.

Commenting on the acquisition, Mr. C. H. Murray, Chairman of Northern Bank (Ireland), said:

"We are delighted with the proposed acquisition of Northern Bank (Ireland) by National Australia Bank. We believe that the opportunities provided through the association with a major Australian bank of the quality and standing of National Australia Bank will be substantial. We look forward to working closely with National Australia Bank to develop the range of services we offer, and to many years of happy collaboration."

Details of the sale and purchase arrangements

The acquisition of the three banks is conditional, inter alia, upon the agreement of all regulatory authorities, including the Bank of England, the Central Bank of Ireland and the Reserve Bank of Australia. Midland has given National Australia Bank warranties regarding the accounts of Clydesdale, Northern and Northern Bank (Ireland) and certain other matters.

The price for the three banks will be determined on the basis of the banks' combined net tangible assets (which at 31st December, 1986 amounted to £316m (A$707m)) following preparation of completion accounts to 30th June, 1987, on bases agreed between the two parties, plus £70m (A$157m). The acquisitions are expected to be completed by the end of October 1987.

Lazard Brothers & Co., Limited advised National Australia Bank throughout the negotiations.

Rights issue

The Board of National Australia Bank today announces a rights issue of approximately 108 million ordinary shares to stockholders on the basis of one new stock unit at A$4.00 (179p) per unit for each five stock units and partly paid shares held as at 19th August, 1987. Convertible noteholders will also participate on the same basis as though each convertible noteholder's entitlement had been converted to stock units as at 19th August, 1987. Fractions will be disregarded. Books will close for determination of entitlements on 19th August, 1987. The new stock units will be issued at a premium over par value of A$3.00 (134p), making a total payment of A$4.00 (179p) per share payable by 21st September, 1987.

As National Australia Bank is unable to comply with the provisions of securities law requirements in the United States of America, this offer cannot be made to stockholders with registered addresses in the United States of America or holders of American Depositary Receipts.

The new shares to be issued will rank pari passu in all respects with existing ordinary stock units save that they will not be entitled to receive any dividends in respect of the year ending 30th September, 1987.

The issue has been underwritten by J.B. Were & Son.

The proceeds of the issue, amounting to approximately A$432m (£193m), will assist National Australia Bank's acquisition of Clydesdale, Northern and Northern Bank (Ireland) announced today.

END

7th July, 1987

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Midland Bank Group News Release

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GPS
DGPS
Mr Gulpin
Mr George
Mr Loehnis
Mr Cooke
Mr Quinn
Mr Bamas

Tuesday, July 7 1987

MIDLAND TO INCREASE PROVISIONS, SELL CLYDESDALE BANK, NORTHERN BANK AND NORTHERN BANK (IRELAND) TO NATIONAL AUSTRALIA BANK, AND RAISE £700 MILLION BY RIGHTS ISSUE

In a series of measures designed to strengthen its capital position, and provide the foundation for future profitable growth, Midland is to:

- Increase to £1,187 million its total provisions for bad and doubtful debts on loans of £4,328 million (as at end of March 1987) to borrowers in 30 countries identified as having potential payments difficulties. This will result in a gross extraordinary charge of £916 million (£653 million after anticipated tax relief).

- Sell its wholly-owned subsidiaries Clydesdale Bank, Northern Bank and Northern Bank (Ireland) to National Australia Bank for a cash consideration based on the net assets of the companies plus a premium of £70 million.

- Raise approximately £700 million from its shareholders by way of a 1 for 1, non-underwritten, rights issue at 300p per share.

The net effect of these transactions (based on adjustment of capital ratios at December 31 1986) is to increase the ratio of equity to assets from 4.0 per cent to 4.7 per cent.

more...

Registered in England (No. 14259)
Registered Office Poultry London EC2P 2BX

Commenting on these measures, Sir Kit McMahon, chairman and group chief executive, said:

"We have for some time seen the need to strengthen the group in a number of ways - in its business focus, its organisation, its capital structure and its financial position. Today we have made three important moves towards our overall objective - by creating additional provisions on our LDC advances, by selling three of our subsidiaries and by raising £700 million from our shareholders.

"On the terms negotiated with National Australia Bank, the sale of Clydesdale Bank, Northern Bank and Northern Bank (Ireland) will improve the capital position of the group by reducing its total assets; by generating a surplus over existing book values; and by relieving us from the considerable capital expenditure - as well as the considerable management time - that would have been required to integrate the banks fully within the Midland group. On this third point, I believe that the management and staff of the three subsidiaries will find that they have a wider role to play within the strategy of National Australia Bank than in regional subsidiaries of a London clearing bank group.

"The proposed rights issue, together with the proceeds of these disposals, will enable us to maintain and develop selectively our major lines of business both at home and abroad. Our strategic aim, however, is to focus our capital and human resources as precisely as we can on those businesses which provide us with the greatest prospect of high and sustainable returns on equity. In furtherance of this aim we shall not be inhibited from either developing, or withdrawing from, particular businesses where it becomes clear that we have a comparative advantage or disadvantage, as the case may be.

more....

"Our chief priority, however, remains unchanged. It is to capitalise on our fundamental strengths as a leading provider of banking and related financial services to the personal and corporate sectors of the domestic economy; the development of our investment and global banking businesses will be largely directed to that end. We believe that by developing new and more sharply focused ways of devising, delivering and selling products to our domestic markets, we can both safeguard our earnings base and create the best basis for sustainable earnings growth in future, at home and abroad."

The Midland board expects to declare a first interim dividend for 1987 on the existing share capital at the same rate as for 1986. It also expects that, in the absence of unforeseen circumstances, the second interim dividend payment will maintain the rate of return on shareholders' investments after taking into account the effect of the rights issue.

During the first six months of 1987 Midland's UK banking sector has shown a strong advance over the comparable period in 1986. Performance within the investment and global banking sectors has been less even. Corporate finance, foreign exchange dealing and gilt-edged operations have been very satisfactory but, on the adverse side, exchange rate movements have depressed the sterling value of foreign currency profits, while the group's UK equity and US government securities operations, both acquired during the course of last year, have experienced difficulties. In addition, interest on medium term loans to Brazil will not be taken into profit as long as the payments remain subject to a moratorium.

Later this month Midland will despatch to shareholders a circular setting out details of these transactions and convening an extraordinary general meeting to approve the required increase in share capital, together with the results for the first six months of 1987.

- END -

Issued by: Alan Macdonald
Tel: 01-260 8195 (direct)
Tel: 01-260 8000, ext. 38195

Note to editors: Supplementary information about the provisions, disposals and rights issue is set out in an attachment to this press release.

Midland Bank Group News Release

SUPPLEMENTARY INFORMATION

1. The Provisions

a) The provisions have been calculated by reference to the economic circumstances relevant to each of the individual countries concerned. Virtually all such provisions are now specific.

b) Outstandings included in the amount of £4,328 million at the end of March 1987 were:

Brazil	£1,139 million
Mexico	£1,052 million
Argentina	£ 651 million
Rest of Latin America	£ 886 million
Rest of World	£ 600 million

c) The basis on which tax relief will be available on the additional provisions has still to be agreed with the Inland Revenue. Certain assumptions have been made which are subject to adjustment as the tax position is clarified.

d) After making these additional provisions the total specific and general provisions of the Midland Bank Group represents 5.8 per cent of total lending.

2. The Sales

a) The agreement for the sale of Clydesdale Bank, Northern Bank and Northern Bank (Ireland) is conditional upon receipt of the approvals and consents of the relevant regulatory authorities and governmental agencies. Subject to those conditions being satisfied the sale is expected to be completed by the end of October 1987.

b) The determination of the final consideration will take into account certain adjustments to the audited net assets of the companies at June 30 1987.

more...

c) At December 31 1986 the net assets of the three subsidiaries amounted to £317 million. Their aggregate profits for the year to December 31 1986 were £47 million before tax and £29 million after tax.

3. Rights Issue

a) The rights offer will require the issue of approximately 233 million shares at 300p per share.

b) The issue is conditional upon shareholders approving the necessary increase in authorised share capital and The Stock Exchange granting permission for the new shares to be admitted to the Official List.

c) Based on a closing share price on July 6 1987 of 647p and a theoretical ex rights price of 473.5p, maintenance of the rate of the 1986 second interim dividend of 15.5p per share would involve a second interim dividend payment for 1987 of 11.4p per share.

4. Overall effect

The contributions of each of these transactions to the net improvement in the group's equity to assets ratio are:

	%
Effect of provisions	(1.1)
Effect of disposals	0.5
Effect of rights issue	1.3

A, B, Doug Board MG. chancellor 1242.

NATIONAL AUSTRALIA SETS ISSUE TO BUY U.K. BANKS NRAV

MELBOURNE, JULY 7 - <NATIONAL AUSTRALIA BANK LTD> SAID IT WILL MAKE A ONE-FOR-FIVE RIGHTS ISSUE AT 4.00 DLRS A SHARE TO RAISE 432 MLN DLRS FOR THE ACQUISITION OF THREE BRITISH BANKS FROM MIDLAND BANK PLC <MDBL.L>.

07-JLY-0750 MON839 MONK

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CONTINUED ON - NRAW

MON-AAAA/DEAL-AAQA 0808

NATIONAL AUSTRALIA SETS =2 MELBOURNE NRAW

THE THREE BRITISH BANKS ARE <CLYDESDALE BANK PLC>, <NORTHERN BANK LTD> AND <NORTHERN BANK (IRELAND) LTD>, NATIONAL AUSTRALIA SAID IN A STATEMENT.

CONSIDERATION WILL BE 70 MLN STG PLUS THE SUM OF THE COMBINED NET TANGIBLE ASSETS OF THE THREE BANKS AS AT JUNE 30, IT SAID.

THESE ASSETS AMOUNTED TO 316 MLN STG AS AT DECEMBER 31, 1986, AND THE JUNE 30 LEVEL WILL BE DETERMINED AFTER THE PREPARATION OF ACCOUNTS ON BASES AGREED BETWEEN THE PARTIES, THE BANK SAID.

07-JLY-0750 MON840 MONK

CONTINUED FROM - NRAV

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CONTINUED ON - NRAX

MON-AAAA/DEAL-AAQA 0808

NATIONAL AUSTRALIA SETS =3 MELBOURNE NRAX

COMPLETION OF THE ACQUISITIONS IS EXPECTED TO TAKE PLACE BY THE END OF OCTOBER, SUBJECT TO THE APPROVAL OF THE BANK OF ENGLAND, THE CENTRAL BANK OF IRELAND, THE RESERVE BANK OF AUSTRALIA AND OTHER REGULATORY AUTHORITIES, THE NATIONAL AUSTRALIA SAID.

CHAIRMAN SIR RUPERT CLARKE SAID THE BANK HAD LONG IDENTIFIED BRITAIN AND WESTERN EUROPE AS A KEY AREA FOR FURTHER SUBSTANTIAL EXPANSION AND IT BELIEVED IT WOULD BE SUBSTANTIALLY STRENGTHENED BY THE ACQUISITIONS.

HE SAID THE THREE BANKS ARE PRESTIGIOUS INSTITUTIONS AND ENJOY EXCELLENT REPUTATIONS IN THEIR HOME TERRITORIES.

07-JLY-0753 MON845 MONK

CONTINUED FROM - NRAW

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CONTINUED ON - NRAY

MON-AAAA/DEAL-AAQA 0808

NATIONAL AUSTRALIA SETS =4 MELBOURNE NRAY

CLARKE SAID THE NATIONAL AUSTRALIA INTENDED TO MAINTAIN EACH BANK'S HEAD OFFICE IN ITS PRESENT LOCATION.

GLASGOW-BASED CLYDESDALE IS ONE OF THE THREE MAJOR BANKS OPERATING IN SCOTLAND WHILE THE BELFAST-BASED NORTHERN BANK OPERATES IN NORTHERN IRELAND AND NORTHERN BANK (IRELAND) IN THE IRISH REPUBLIC WITH ITS HEADQUARTERS IN DUBLIN, THE BANK SAID.

NATIONAL AUSTRALIA IS THE SECOND OF THE THREE MAJOR LISTED TRADING BANKS TO HAVE ACQUIRED A BRITISH BANK IN RECENT YEARS. AUSTRALIA AND NEW ZEALAND BANKING GROUP LTD (ANZA.S) ACQUIRED THE (GRINDLAYS HOLDINGS PLC) GROUP IN 1984.

07-JLY-0801 MON860 MONK

CONTINUED FROM - NRAX CONTINUED ON - NRAZ

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MON-AAAA/DEAL-AAQA 0808

NATIONAL AUSTRALIA SETS =5 MELBOURNE NRAZ

THE NATIONAL AUSTRALIA SAID THE RIGHTS ISSUE, INVOLVING ABOUT 108 MLN SHARES UNDERWRITTEN BY STOCKBROKER (J.B. WERE AND SON), WOULD BE MADE TO SHAREHOLDERS REGISTERED AUGUST 19.

THE 4.00 DLR ISSUE PRICE IS WELL BELOW TODAY'S MARKET CLOSE OF 5.06 DLRS.

THE NEW SHARES WILL RANK PARI PASSU WITH EXISTING UNITS EXCEPT THEY WILL NOT RANK FOR DIVIDENDS DECLARED FOR THE BANK'S CURRENT FINANCIAL YEAR ENDING SEPTEMBER 30.

THE BANK SAID IT EXPECTED TO MAINTAIN DIVIDENDS ON THE ENLARGED CAPITAL, AFTER ALLOWING FOR THE EFFECTS OF THE RECENT ONE-FOR-FIVE BONUS ISSUE.

07-JLY-0810 MON868 MONK

CONTINUED FROM - NRAY REUTER

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MON-AAAA/DEAL-AAQA 0808

MIDLAND SHARE PRICE 12AM +18 @ 665.

Chancellor 12/2
A, B, Doug Board
MG.
pup

MIDLAND BANK RAISES DEBT PROVISIONS, SETS ISSUE NRAK

LONDON, JULY 7 - MIDLAND BANK PLC <MDBL.L> SAID IT PLANNED A RIGHTS ISSUE TO RAISE AROUND 700 MLN STG. IT ALSO PLANS TO RAISE PROVISIONS ON BAD AND DOUBTFUL DEBTS IN 30 COUNTRIES TO 1.19 BILLION STG.

MIDLAND ANNOUNCED IT IS SELLING ITS CLYDESDALE BANK LTD, NORTHERN BANK LTD AND NORTHERN BANK (IRELAND) LTD UNITS TO NATIONAL AUSTRALIA BANK LTD <NABA.S> FOR NET ASSETS PLUS A CASH PREMIUMN OF 70 MLN STG.

THE INCREASED PROVISION WILL RESULT IN A GROSS EXTRAORDINARY CHARGE OF 916 MLN STG, REDUCED TO 653 MLN AFTER ANTICIPATED TAX RELIEF.

07-JLY-0730 MON809 MONK

CONTINUED ON - NRAL

P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =2 LONDON NRAL

THE RIGHTS ISSUE WILL BE ON A ONE-FOR-ONE BASIS AT 300P A SHARE. IT WILL NOT BE UNDERWRITTEN.

A SPOKESMAN SAID NET ASSETS OF THE UNITS BEING SOLD AMOUNTED TO SOME 317 MLN STG, FOR A TOTAL CASH SALE PRICE OF 387 MLN.

MIDLAND SHARES FIRMED SHARPLY ON THE ANNOUNCEMENT TO A HIGH OF 674P FROM 647P AT LAST NIGHT'S CLOSE BEFORE EASING BACK TO 653P AT 0730 GMT.

DEALERS SAID THE MARKET WAS REACTING POSITIVELY TO MIDLAND'S MOVE TO TACKLE THE DEBT PROBLEM AND NOTED THAT A SIMILARLY LARGE INCREASE IN PROVISIONS LAST MONTH BY NATIONAL WESTMINSTER BANK PLC <NWBL.L> WAS ALSO VIEWED FAVOURABLY.

07-JLY-0735 MON822 MONK

CONTINUED FROM - NRAK

CONTINUED ON - NRAM

P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =3 LONDON NRAM

THREE WEEKS AGO NATWEST SAID IT WOULD INCREASE GROUP PROVISIONS FOR SOVEREIGN DEBT BY SOME 466 MLN STG WHEN ITS FIRST-HALF RESULTS ARE PUBLISHED THIS MONTH, RAISING TOTAL PROVISIONS TO 2.8 BILLION STG.

MIDLAND'S MOVE MAKES IT THE SECOND U.K. MAJOR BANK TO FOLLOW THE LEAD SET BY CITICORP (CCI), WHICH ADDED THREE BILLION DLRS TO PROVISIONS IN MAY.

MIDLAND CHAIRMAN SIR KIT MCMAHON SAID THE MOVES WERE IN RESPONSE TO A LONG-SEEN NEED TO STRENGTHEN THE GROUP IN A NUMBER OF WAYS.

07-JLY-0756 MON850 MONK
CONTINUED FROM - NRAL CONTINUED ON - NRAN
P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =4 LONDON NRAN

THE SALE OF THE SUBSIDIARIES WILL IMPROVE THE CAPITAL POSITION, MIDLAND SAID. IT WOULD ALSO GENERATE A SURPLUS OVER BOOK VALUE AND RELIEVE THE GROUP OF CAPITAL EXPENDITURE NEEDED TO INTEGRATE THE UNITS FULLY.

THE RIGHTS ISSUE AND PROCEEDS OF THE SALES WOULD ENABLE THE GROUP TO MAINTAIN AND DEVELOP MAJOR LINES OF BUSINESS.

"IN FURTHERANCE OF THIS AIM WE SHALL NOT BE INHIBITED FROM EITHER DEVELOPING, OR WITHDRAWING FROM, PARTICULAR BUSINESSES WHERE IT BECOMES CLEAR THAT WE HAVE A COMPARATIVE ADVANTAGE OR DISADVANTAGE," MCMAHON SAID.

07-JLY-0808 MON866 MONK
CONTINUED FROM - NRAM MORE
P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =5 LONDON NRBQ

A MIDLAND BANK SPOKESMAN SAID THE MOVE RAISED PROVISIONS BY THE AMOUNT OF THE GROSS EXTRAORDINARY CHARGE.

TOTAL SOVEREIGN DEBT OUTSTANDING AT THE END OF MARCH WAS 4.3 BILLION STG, CONSISTING OF 1.14 BILLION TO BRAZIL, 1.05 BILLION TO MEXICO, 651 MLN TO ARGENTINA, 886 MLN TO THE REST OF SOUTH AMERICA AND 600 MLN TO THE REST OF THE WORLD.

AFTER MAKING THE PROVISIONS, THE TOTAL SPECIFIC AND GENERAL PROVISIONS OF THE GROUP WILL REPRESENT 5.8 PCT OF TOTAL LENDING.

MIDLAND SAID IT EXPECTED THE FIRST INTERIM DIVIDEND OF 1987 TO MATCH THAT OF LAST YEAR, WITH THE SECOND PAYMENT ALSO MAINTAINING THE RATE OF RETURN ON SHAREHOLDERS' INVESTMENT.

07-JLY-0814 MON877 MONL

CONTINUED FROM - NRAN MORE

P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =6 LONDON NRBR

BASED ON A THEORETICAL EX-RIGHTS PRICE OF 473.5P A SHARE, MAINTAINING THE RATE OF THE 1986 15.5P SECOND INTERIM DIVIDEND WOULD REQUIRE AN EQUIVALENT 1987 PAYMENT OF 11.4P A SHARE.

IN A SEPARATE STATEMENT, NATIONAL AUSTRALIA BANK SAID IT EXPECTED THE ACQUISITION OF THE MIDLAND UNITS WOULD BE COMPLETED BY THE END OF OCTOBER.

ANALYSTS NOTED THAT THE DISPOSAL OF CLYDESDALE AND NORTHERN WAS THE SECOND MAJOR DISPOSAL BY MIDLAND IN RECENT YEARS. IN FEBRUARY, 1986 IT SOLD ITS U.S. CROCKER NATIONAL CORP UNIT TO WELLS FARGO AND CO <WFC.N> FOR 1.08 BILLION DLRS.

07-JLY-0828 MON895 MONL

CONTINUED FROM - NRBQ MORE

P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =7 LONDON NRBS

ANALYSTS GENERALLY WELCOMED THE MOVE, NOTING THAT MIDLAND HAD LONG BEEN REGARDED AS THE MOST VULNERABLE OF THE U.K. BANKS TO OVERSEAS DEBT.

THE ACTION IT HAD TAKEN "BROUGHT A NEW AIR OF REALISM" TO ITS OPERATIONS, COMMENTED MARTIN GREEN OF BROKERS SMITH NEWCOURT.

"MIDLAND IS GETTING ITS HOUSE IN ORDER" ADDED JOHN TYCE OF ALEXANDERS LAING AND CRUICKSHANK. THE RIGHTS AND PROVISIONS WERE LARGELY IN LINE WITH MARKET EXPECTATIONS, WITH THE DISPOSALS MAKING UP THE DIFFERENCE BETWEEN THE TWO.

07-JLY-0836 MON907 MONL
CONTINUED FROM - NRBR MORE
P

MON-AAAA/DEAL-AAQA 0808

MIDLAND BANK =8 LONDON NRBT

ANALYSTS NOTED THERE HAD BEEN MARKET SUGGESTIONS MIDLAND MIGHT HAVE SOLD OFF ITS THOMAS COOK TRAVEL AGENCY BUSINESS INSTEAD.

EQUALLY, THERE WAS SPECULATION IT MIGHT NOT MATCH THE MASSIVE ONE-OFF INCREASE SET BY NATWEST, PREFERRING INSTEAD TO RAISE PROVISIONS MORE GRADUALLY OVER A LONGER PERIOD.

RECENT SPECULATION HAS SUGGESTED OTHER U.K. BANKS MAY ALSO MAKE INCREASED PROVISIONS, ALTHOUGH LLOYDS HAS SAID IT HAS NO PLANS TO COMMENT ON ITS POSITION BEFORE ITS HALF-YEAR STATEMENT ON JULY 24.

07-JLY-0839 MON910 MONL
CONTINUED FROM - NRBS REUTER
P

MON-AAAA/DEAL-AAQA 0808

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215
SWITCHBOARD 01-215 7877

5422

Secretary of State for Trade and Industry

13 July 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Ch

I am afraid Lord Young has been got at by his new Dept. DWK

CH/EXCHEQUER

REC.	15 JUL 1987
ACTION	Mrs Lomax
COPIES TO	Sir P Middleton, Sir G Littler, Mr Caseley, Mr Monck, Mr Gray, Mr Nelson, Mr Tiltt, Mr Cropper

Dear Nigel,

TAKE-OVER PANEL

Thank you for your letter of 30 June about undertaking contingency work within Government on what a statutory regime for take-overs would look like.

I understand why you propose that such work should be undertaken. I am not, however, convinced that the arguments in favour of it are sufficiently strong to outweigh the potential disadvantages. As you are aware, my Department has during the work on the Financial Services Bill and on the take-over review given preliminary thought to the possibility of a statutory system. This work has shown that it would be difficult to design such a system that would produce sufficient advantages to off-set the loss of the benefits of the current arrangements. I also doubt if we could sensibly take any contingency planning very far at this stage. I would be reluctant to decide on the proper place in the regulatory system for statutory regulation of take-overs until the new regime under the Financial Services Act has had the opportunity to settle into place. Furthermore, before we were able to tailor a system to deal with a crisis it would be necessary to know the nature of the weaknesses that caused it. The necessary confidential nature of any work would also not allow us to carry out the consultation among companies, practitioners, investors and other regulators which would be vital before we could legislate. I do not think,

JF5CAC

therefore, that the advantage in terms of being able to legislate quickly would be as great as you suggest.

Moreover, I doubt whether the work is necessary. The sanctions and improved monitoring and investigative capabilities that will be available to the Panel should be able to prevent most offences and to deal effectively with any offenders when they are identified. Even if the handling of a future cause were thought to be unsatisfactory I would want to look closely at the situation before deciding whether legislation was the answer. Nor is it clear that a legal challenge could undermine the Panel's authority to such an extent that an alternative form of regulation was necessary. At most, such a challenge might result in a greater number of the Panel's rulings being subject to decisions of the courts. While this would be unfortunate, it is not something that we would wish to attempt to remedy by legislation.

I do not think that the balance of the argument has changed significantly since the election. The force of the arguments against a statutory system which were recognised by the Prime Minister remains. Even with the election behind us a leak would still have a damaging effect on the Panel's credibility and on that of the review's measures, the most important of which have yet to be implemented. The contingency work might precipitate the crisis that you are concerned about.

I believe that we must have confidence in the Panel's ability to regulate the market with the help of the review's measures. The important task now is to get all those measures implemented as soon as possible. However I recognize the importance you attach to this and suggest we review the need for work on a statutory system in the late Spring of next year when the new regulatory system is in place.

Yours,

LORD YOUNG OF GRAFFHAM

JF5CAC

1318/6

pup-

Ch
X seems quite forceful, but need a relaxed timetable is a bit uncomfortable.
AA

FROM: MRS R LOMAX
DATE: 13 JULY 1987

PPS

cc PS/EST
Sir P Middleton
Mr Cassell o/r
Mr Monck
Mr Culpin
Miss Noble o/r
Mr Board
Mr D Jones

MIDLAND: OFT AND MMC

We now have a clearer idea of the likely timetable.

2. I understand from the OFT that Lord Young has asked Sir Gordon Borrie to tender his advice on the Clydesdale case after the House goes into recess: the OFT are aiming to produce their report around the second week in August. We have been asked for our views by 22 July (which we will, of course, clear with Ministers and the Bank). No doubt a similar request will be addressed to the Bank. The OFT are however allowing the normal 21 days from the date of announcement for representations from other interested parties (which brings us to 29 July).

3. If there is an MMC reference, it might take 3 or 4 months to complete, on normal form. So a reference would mean delaying the sale, which is otherwise planned for completion in October.

4. I think it is probably right to stick to the normal timetable, even though that rules out any statement before the House rises. If there is no reference, there will have to be a statement, to explain Lord Young's own position, given his Banking Bill assurances, and to protect those assurances for the future. But there is no mileage in rushing things: indeed it is in just this situation that it will be most important to have allowed adequate time for representations from interested parties, proper consideration by the Director General and so on. (If there is a reference, of course, there is nothing to explain).

[redacted]. The middle of August is not the ideal time for making statements: but Lord Young can always repeat the substance when the House reassembles in the autumn.

RL.

RACHEL LOMAX

MR 2/36

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 14 July 1987

MR MONCK

cc: PS/CST
PS/EST
Sir P Middleton
Mr Cassell
Mr Burgner
Mrs Lomax
Mr P Gray
Mr Ilett
Mr Cropper

AWK TO MONCK 14/7

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

The Chancellor has seen the Secretary of State for Trade and Industry's memorandum E(A)(87)28 of 13 July, and the draft statement Lord Young proposes to make. He has commented that the accounting treatment of mergers is certainly a weak link at present.

A W KUCZYS

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

RIFKIND TO ED YOUNG 17/7

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1 Victoria Street
LONDON
SW1H OET

17 July 1987

Dear David,

REVIEW OF MERGERS AND RESTRICTIVE TRADE PRACTICES POLICY

I have read with interest your Memorandum (E(A)(87)28) about the Review of Mergers Policy which we are to discuss at E(A) on 21 July. I am afraid I do not share your view that an early announcement of the interim results of the Review is desirable.

As you will be well aware, recent mergers and takeover bids affecting Scotland have led to a considerable amount of public discussion and disquiet, concerning the regional dimension of mergers, the alleged "short-termism" to which they give rise, and the continued appropriateness of our present reference policy. Contrary to what you say, the decision against reference of the BTR/Pilkington case has not closed the debate which, in Scotland, continues at a high level.

For these reasons I consider it more important than ever that the Review should include an opportunity for a Ministerial discussion of these points, and that the issues concerned should be fully considered by our officials. I had understood that such discussions and consideration were what Paul Channon had in mind when he wrote to me on 12 June 1986.

I hope that postponement of an announcement until after the recess will not be too troublesome.

I have copied this letter to members of E(A) and to Sir Robert Armstrong.

Yours ever,

MALCOLM RIFKIND

CH/EXCHEQUER
REC. 20 JUL 1987
ACTION Mr Burgner
COPIES TO CST FST PMC EST Sir P Middleton Mr Monck Mr Byatt Mr Mountfield Mrs Lomax Mr Scholar Mr Malcolm Mr Tyrie Mr Cropper

HMP19620

1528/003

CONFIDENTIAL

FROM: N J ILETT
DATE: 21 July 1987

CHANCELLOR

Ch/ Reply to issue? AJK 21/7

cc: Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Monck
Mrs Lomax
Mr Scholar
Mr Gray
Mr Neilson
Mr Cropper

OK.

TAKEOVER PANEL

Lord Young's letter of 13 July sets out in some detail why he does not wish to undertake contingency work within Government on a statutory regime for the Panel.

2. Lord Young brings out the usual arguments:

(a) "Preliminary work" by DTI officials suggests it would be very difficult to get the statutory approach right;

(b) We need some experience of the operation of the Financial Services Act regime;

(c) One cannot plan how to resolve a crisis without knowing what the crisis is;

(d) If the existence of the contingency planning were leaked the present Panel's authority would be undermined;

(e) Anyway the new arrangements for strengthening the panel will work.

3. But Lord Young offers to review the need for work on a statutory system late next Spring when the new regulatory system is in place.

4. You could challenge Lord Young's arguments on a number of

points - for example, officials have yet collectively to consider (i) whether the architecture of a statutory system could be devised so as to achieve the right balance between strength and flexibility and (ii) whether the flexibility in the present system is actually worth what it is claimed to be worth. And the points about the risk of a leak are greatly overstated, particularly now that we have a draft EC directive on takeovers.

5. That said, I doubt there is much point in continuing the correspondence with Lord Young, given the Prime Minister's views as expressed before the election. So I attach a draft reply which hopes that Lord Young's judgement is indeed correct, notes your continued concern, and takes him up on his offer to review the need for contingency planning on a statutory regime in the Spring 1988. (The letter refers to the Spring rather the actual implementation of the Financial Services Act in case implementation is further delayed.)

M.

N J ILETT

CONFIDENTIAL

DRAFT LETTER TO:

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

TAKEOVER PANEL

Thank you for your letter of 13 July.

Obviously, I share your hope that the Takeover Panel will now be able adequately to regulate the market with the help of the measures which the review identified.

But I remain concerned that we are less well prepared than we ought to be to move fast if the present position becomes untenable or if (perhaps as a result of judicial review) the balance of advantage shifts decisively towards a statutory system. So I welcome your suggestion that we should review the need for work on a statutory system next Spring.

NIGEL LAWSON

4010/001

6/30

Tony

FROM: R MOLAN
DATE: 21 July 1987

cc Mrs Lomax
PS/Chancellor

MR MONCK

cc Mr Burgner
Mr Gray

22/7

MERGER REFERENCES

You asked whether the statement by Mr Clarke at 'X' on the attached Hansard extract is in fact true. DTI officials say that it is.

2. Without the benefit of DTI's advice, my interpretation of the Fair Trading Act had led me to believe that the Secretary of State could act without the DGFT's advice, though I did speculate whether a decision taken in this manner would be open to judicial review on the grounds that there was an expectation that his advice would be taken into account. The Act talks on one hand about the DGFT's duty to keep himself informed of mergers and to advise the Secretary of State on the case for a reference and on the other about the Secretary of State's discretion whether or not to refer. But it says nothing about this discretion being dependent on the DGFT's advice being taken into account. However, DTI's lawyers take the view that it is implicit in the Act that the Secretary of State is obliged to consider his advice before he takes his decision although he is not obliged to follow it.

R MOLAN

British Airways/British Caledonian (Merger)

3.31 pm

Mr. Tony Blair (Sedgefield) *(by private notice)* asked the Chancellor of the Duchy of Lancaster what advice he has received from the Director General of Fair Trading regarding a reference to the Monopolies and Mergers Commission of the proposed merger of British Airways and British Caledonian Airways.

The Chancellor of the Duchy of Lancaster and Minister of Trade and Industry (Mr. Kenneth Clarke): None, Sir. The offer was announced only this morning. The Director General of Fair Trading will advise my right hon. and noble Friend the Secretary of State on the question of a reference to the Monopolies and Mergers Commission as soon as reasonably practicable.

Mr. Blair: Will the right hon. and learned Gentleman confirm that the proposed merger unquestionably satisfies the criteria for investigation by the commission and that he can impose the time limit that he wants? Is he aware that the first the unions knew of this merger was hearing about it on their car radios this morning on their way to a meeting called late last night? What guarantees will he give on job losses in this industry and the other industries that depend upon it?

Most important of all, what has happened to the Government's policy of efficiency through competition? Is it not right that, in 1984, the Civil Aviation Authority specifically called for a multi-airline industry and warned that

"otherwise this country might willy nilly find itself with one privately owned but less than efficient monolith at the end of the day"?

Is he also aware that, in their response to that, the Government specifically agreed with the CAA and said that there must be a multi-airline industry? Is he further aware that, as late as April this year, the Secretary of State for Transport said that the Government were committed "to a sound and competitive multi-airline industry"?

Is it not a conspicuous irony that after years of public ownership, when merger was resisted and competition promoted, privatisation should within months lead to merger embraced and competition stifled? What will be the protection for consumers in this private monopoly? Is it not the case that, as with British Telecom, faced with a choice between private profit and the public's rights as consumers, the Government choose private profit every time?

Mr. Clarke: None of that follows from the present position or from my answer to the hon. Gentleman's question. The legal position is that the Director General of Fair Trading has a duty to advise my right hon. and noble Friend the Secretary of State whether this matter should be referred to the Monopolies and Mergers Commission. That is the strict position and we must wait for that advice. It would be improper for me at this stage, before we have that advice, to give my opinion as to whether it satisfies the criteria for a reference. We must wait and see.

I am sure that the unions, in common with the rest of the public, heard about this proposed offer this morning. The correct steps for the trade unions or anyone else interested is to make representations to the director general as quickly as possible, who will, as quickly as possible, give his reaction to them. He will then give his opinion and advice to my right hon. and noble Friend the Secretary of State for Trade and Industry. Something to which the director general will obviously address himself is the effect of this proposed merger upon the competitive position in the airline industry. That is one of the matters upon which we now await his opinion. As the law provides, we must wait for that opinion.

I believe that the hon. Member is getting very hot under the collar and jumping the gun. We will have the advice of the director general as soon as he can reasonably provide it. Then my right hon. and noble Friend will decide whether to refer this offer to the Monopolies and Mergers Commission.

Mr. Nicholas Soames (Crawley): Will my right hon. and learned Friend take it from me that I believe that a decision to refer this offer would be a mistake and against the interests of British aviation? However, will he assure me that, whatever decisions are taken, they are taken speedily so that the many thousands of my constituents who work not only for British Caledonian but for British Airways may take advantage of the splendid opportunity that this merger represents?

Mr. Clarke: No decisions will be taken by the Government until we have the advice of the Director General of Fair Trading. My hon. Friend's submission is the type of submission that should now be made to the director general so that he can give his advice to the Secretary of State as quickly as possible and as quickly as practicable in this rather complex case.

Mr. David Steel (Tweeddale, Ettrick and Lauderdale): How on earth can the Minister square what he has said with the 1984 Government White Paper? The hon. Member for Sedgefield (Mr. Blair) quoted part of that White Paper, but the full quotation reads that the Government's objective was

"to encourage a sound and competitive multi-airline industry with a variety of airlines of different characteristics"

Surely the proposed merger is inconsistent with that statement. Indeed, that statement was repeated in the prospectus for the British Airways privatisation.

Mr. Clarke: It was a sound policy in 1984 and it may be that—*[Interruption.]*—and it may be a sound policy now. The fact is that an offer has been made by British Airways upon which we have taken no decisions and have given no reaction. It is being assumed that a decision has been taken about whether or not to refer this merger. That is not so. That decision cannot be taken by the Secretary of State until he has the advice of the Director General of Fair Trading. Therefore, all that is happening is that hon. Members are beginning to ask hypothetical questions about events which may or may not arise when my right hon. and noble Friend is in a position to make a decision.

Mr. Michael Grylls (Surrey, North-West): If the Government have to consider this case later on, will my right hon. and learned Friend bear in mind that British Airways is not all that large in international terms? It has to compete with sizeable airlines overseas, many of which are much bigger than British Airways. Although we want to see as much competition as possible in Britain, probably on the domestic routes, an airline must be large to compete

overs[illegible] Perhaps British Caledonian is not big enough to compe[illegible]on the international routes and that may be a very good reason for allowing this merger to go ahead. Presumably those factors will be taken into account.

Mr. Clarke: My hon. Friend's arguments are extremely relevant. It is obvious that there will be a variety of opinions and submissions on this matter. Those opinions and submissions are best made, at this stage, to the Director General of Fair Trading. He will give his advice upon a bid by one private company to suggest a merger with another private company. My right hon. Friend the Secretary of State will take his decision about whether to refer this proposed merger to the Monopolies and Mergers Commission when he has had a chance to reflect upon the advice of the director general, who will listen to all the competing arguments. That is the only stage we have reached to date.

Mr. Doug Hoyle (Warrington, North): Does the Minister agree that the chaotic and anarchic situation in the industry is entirely due to the Government and the United States Government pressing for deregulation? That has led to the formation of mega airlines in the United States, six of which are bigger than British Airways. Does the Minister also agree that it is very bad industrial relations practice to announce this proposal on the same day that the unions got to know about it at 9.30 am? Surely the Minister cannot dodge his responsibilities by trying to skirt around that. Does the Minister also agree that, whatever happens, if the merger is referred, an early decision should be made because many jobs in the industry are at stake?

Mr. Clarke: It sounds as though the director general will hear some conflicting opinions from Opposition as well as Conservative Members. The hon. Member for Sedgefield (Mr. Blair) sounded fairly passionate on the subject of competition. It is my opinion that deregulation and increased competition on the transatlantic routes in particular have been of great benefit to the industry, especially its passengers. This exchange is already revealing that this is a complex issue which ought to be dealt with, as it has to be dealt with by law, by the proper process of waiting for the advice of the Director General of Fair Trading. I suggest that hon. Members make their representations to the director general, stop getting so excited on the first day we have heard that the bid has been made and wait in due course for a considered decision by my right hon. and noble Friend the Secretary of State when he has the director general's advice on the public interest involved in this matter.

Mr. Anthony Steen (South Hams): Can my right hon. and learned Friend say whether the Government were also caught by surprise this morning or whether discussions were going on behind the scenes? Will he say one other thing to the director general when the time comes? Will he say that, If this merger goes ahead, some 90 per cent. of all airline licences will be in the hands of one company, that it will have further licences which belong to airlines in which it has an interest and that, therefore, the death knell will soon be heard for the future of independent airlines?

Mr. Clarke: We have known within the Government about the possibility of this bid for about a week, but obviously we could not reveal that fact until the merger was announced at 8 o'clock this morning. That has enabled all these representations, including my hon. Friend's, to be made to the director general. He will weigh up all the competing considerations which have already been tumbling out within a few hours of the news going public. It will take perhaps a few weeks before he comes back with his advice to my right hon. and noble Friend the Secretary of State.

Mr. Alex Salmond (Banff and Buchan): I am interested in the right hon. and learned Gentleman's concept of the Government having no policy. Can he tell us exactly when the Government started to have no policy on competition in the airline industry and, when they last had a policy, what it was?

Mr. Clarke: I said nothing of the kind — [HON. MEMBERS: "Answer."] If I got up at the Dispatch Box and began, on the Government's behalf, to give instructions to the director general about what his opinion should be on this bid which he is now considering, the whole House would rightly be outraged. It is now the statutory duty of the director general to consider this bid. My right hon. and noble Friend the Secretary of State has no power to decide whether to refer this matter to the Monopolies and Mergers Commission until he has the director general's opinion. Certain sections of the House have reacted to what has been said in this moring's newspapers or on the radio and are already sounding off about a complex takeover bid which we have to consider in the correct way, which is the way laid down by statute. It would be improper for me to anticipate what my right hon. and noble Friend's decision might be.

Mr. John Wilkinson (Ruislip Northwood): Does my right hon. and learned Friend agree that this worrying episode makes it absolutely clear that there is a need for harmonised company law within Europe and deregulation in air transport to allow the emergence of transnational airlines? As that is not the case, will my right hon. and learned Friend make it clear that a policy will be instituted which will permit genuine competition, at least on the domestic side, or the scheduled domestic carriers will soon be gobbled up?

Mr. Clarke: My hon. Friend raises interesting points about transport and airline policy on which I am tempted to comment, but I suggest that he take the first suitable opportunity to raise them in the House with my right hon. Friend the Secretary of State for Transport who takes a proper interest in this matter and, I think, shares many of my hon. Friend's views.

1319/20

CONFIDENTIAL

We need a discussion; but I think the paper could go leaving further points if any to be made at a meeting

FROM: MRS R LOMAX
DATE: 21 JULY 1987

1. SIR PETER MIDDLETON

Copy attached for:

Economic Secretary

2. CHANCELLOR

cc Sir G Littler
Mr Cassell
Mr Monck
Mr Board
Mr D Jones
Mr Molan
Miss Wheldon - T Sol

C/ Content for RL to send attached paper to OFT asap - with a discussion later as PEM suggests?

CR 21/7

LOMAX → CH 21 JULY

MIDLAND - CLYDESDALE AND MMC

The OFT have asked for our views on the proposed acquisition of Clydesdale by the National Australia Bank. A similar request has gone to the Bank. The deadline for responses is Wednesday 22 July, though that could probably slip by a couple of days.

2. There is no question of anything we might produce at this stage being published: it would simply help to shape the DGFT's report to the Secretary of State. We should also have an opportunity to comment orally on the DGFT's report, if the OFT follow normal practice and convene a meeting of officials from the main interested Departments, probably in a couple of weeks time. In addition the Bank will be writing with their views, focusing on the commercial and prudential aspects of the acquisition. (I attach a preliminary draft of their contribution).

3. We are under no obligation to supply written views, if we choose not to. We do not seem to have done so in the Royal Bank/Hong Kong Shanghai Bank case (and we certainly provided no substantive evidence for the MMC, contenting ourselves, as we usually do, with recording general agreement with the Bank).

4. There are, however, two issues on which the OFT have particularly asked for comments, which fall more naturally to the Treasury than the Bank. The first is the background to various Ministerial remarks about national interest powers during the passage of the Banking Bill: and the second is the question of reciprocity.

There are always a number of considerations to be taken into account in any takeover, and the reciprocity dimension is one of them. But it is not always the decisive one.

5. We therefore tried our hand at drafting a paper to see what it looked like. The exercise was instructive. There is a fair amount of uncontentious background material on both the public interest and reciprocity issues, which we think is worth drawing the OFT's attention, though they could probably assemble most of it themselves without much difficulty. This is set out in the attached paper.

6. But there are two tricky questions. The first is what to conclude about whether public interest considerations justify a reference in this case. The second is how much to volunteer about the case for exercising our reciprocity powers.

Public Interest: Line to Take

7. On the substance of the first issue, we think that the balance of argument is probably against an MMC reference, providing this can be justified without undermining the assurances given in the House by Lord Young and the previous Economic Secretary. There has been remarkably little public fuss - either because NAB are foreign or because Clydesdale are Scottish (indeed the Scots seem positively to prefer the NAB to Midland). The significance of Clydesdale's status as a clearer has scarcely been noted, and there has been very little comment about the lack of Australian reciprocity. From a prudential stand point, there is much in this acquisition for both Clydesdale and Midland. And while it is by no means inevitable that an MMC reference would scupper the deal, as the NAB have allegedly told the Bank, that must be a risk.

8. On the other hand, Lord Young is on record as saying that "it is almost impossible to conceive that an overseas bid for a UK clearing bank would not be referred". This is difficult to get round: looking at the general sense of his remarks, however, it might be possible to justify not referring the bid on the following lines:-

> "Together Clydesdale and Northern account for only 2% of UK private sector sterling deposits, and only 1½% of private

sector sterling deposits, and only 1½% of private sector sterling borrowing (compared with a 5% share of retail banking in the 1981 Royal Bank of Scotland case). Neither - unlike Royal Bank of Scotland - has a nationwide UK retail network. And, as subsidiaries of Midland, neither has a fully independent role - again, in contrast to RBS. Of course, it is possible to envisage a situation where foreign ownership of UK banks was at such a high level that almost any foreign acquisition would raise questions about the integrity of the domestic banking system. But we are not in that position.

As the Bank has pointed out, the acquisition may have some wider benefits. It could enhance the independent identities of these two banks, with potentially beneficial effects on competition in Scotland and Northern Ireland, and possibly the UK market as a whole. It is also of some relevance that the proposal has been welcomed by the senior managements of Clydesdale and Northern, and has not, in general, aroused the sort of public anxieties voiced during the passage of the Banking Act.

Taken separately, none of these factors is decisive: but taken together, they suggest that the acquisition of either or both institutions would not, at this time, constitute such a threat to the public interest that the general presumption in favour of a reference should apply".

9. We could include some paragraphs on these lines in the paper to the OFT. But it may be better to make the points orally to the OFT when they hold their interdepartmental official meeting. We are fairly sure that DTI officials will be arguing strongly against a reference: and we think it likely that Scottish Office will do the same. The Bank are on the same side for prudential and commercial reasons. Against this background, there is no compelling reason for the Treasury to go on the record against a reference. And, other things being equal, we would prefer not to get into the business of giving the OFT written verdicts unless there is a good reason to do so.

Reciprocity

10. We also need to consider how much to say to the OFT about reciprocity. Strictly speaking, this acquisition raises no new issues. The Banking Act powers are not yet in force, and the option of restricting or revoking the authorisation of an Australian owned financial institution under the Financial Services Act existed before NAB thought of Clydesdale. In practice, however, a highly publicised takeover by the national of a country which itself imposes statutory controls on foreign takeovers is bound to raise the question afresh. What is chiefly remarkable about the present case is the lack of public comment on this issue.

11. Even so, there is no need for us to say anything to the OFT about reciprocity. The Fair Trading Act is freestanding, and the OFT's advice to the Secretary of State is not in any way conditional on what we do under the Financial Services Act. There is also some risk that if we do comment in this case, the OFT will expect us to do so in future, as a matter of course. We would therefore prefer not to commit ourselves on paper: however, we could take the following line if pressed: "on the information now available to us, we do not believe that it would be appropriate to exercise our reciprocity powers in this case". (These words are carefully chosen to avoid the suggestion that there is no reciprocity case to be made against Australia).

12. Thinking about the NAB/Clydesdale case has made us aware of two issues on which we need to do further work:-

(i) we need to discuss with DTI how we should approach the reciprocity issues raised by individual cases, and, in particular, how we should field public queries about the possible exercise of our powers. Ministers have stressed that these are reserve powers, intended to improve the UK's access to foreign markets, not to inhibit foreign access to UK financial markets. It is clearly not appropriate to apply a reciprocity test to every foreign player in the UK, or even to

Not very helpful for use in takeover cases.

every new foreign entrant to our markets. Equally, it is not sensible, even if it were politically realistic, to behave as if the powers do not exist. We need to consider with DTI how to strike the right balance;

(ii) improving access to Australian markets: recent Antipodean interest in our financial institutions naturally raises questions about whether we are doing enough to improve our access to Australian markets. The NAB acquisition provides an opportunity for us to put pressure on the Australian authorities. More generally, we and the Bank might consider whether there is a case for a more systematic attack on other financial markets. We already have a carefully thought out strategy towards the Japanese: arguably, we should take a similar line towards the Australians, the Swiss, and the Canadians.

Next Steps

14. Subject to your comments, we would like to send the attached paper to the OFT as soon as possible. It does not commit us to any particular line either on the case for a reference, or on the exercise of our reciprocity powers under the Financial Services Act. But can, if we choose, offer oral comment on both these issues over the next few weeks: a suggested line to take is set out in paragraph 8 above. You may want to discuss.

RL.

RACHEL LOMAX

CONFIDENTIAL

COMMERCIAL-IN-CONFIDENCE

PROPOSED ACQUISITION OF CLYDESDALE BANK AND NORTHERN BANK BY NATIONAL AUSTRALIA BANK

NOTE BY HM TREASURY

This note has been prepared in response to a request from the Office of Fair Trading for a summary of the Treasury's views on the proposed acquisition of Clydesdale Bank plc and Northern Bank plc, by National Australia Bank (NAB), from Midland Bank plc.

2. A separate paper has been prepared by the Bank of England which deals with the background to the acquisition, the objectives of Midland and NAB in reaching agreement, and considers the prudential and (banking) supervisory issues, including the application of the Banking Act 1979. The Treasury agrees with the Bank's treatment of those issues and this paper therefore concentrates on the wider 'public interest' questions raised by the case. Particular attention is paid to issues raised in the debates which occurred during proceedings on the recent Banking Bill. (Now the Banking Act 1987, due to come into force on 1 October 1987).

3. The background to the debates referred to above was the inclusion in the Banking Bill of new statutory powers to regulate the acquisition of controlling shareholdings in UK banks (strictly, in UK institutions authorised under the Act). These provisions will require any person who intends to acquire such a controlling shareholding to give advance notice of the fact to the Bank of England, which is then empowered to object to the acquisition on grounds specified in the legislation. In the Bill as originally drafted, the grounds for objection were restricted solely to prudential matters concerning, for example, the 'fitness and properness' of the would-be controller and the interests of depositors with the 'target' institution.

4. It became clear, however, during the course of debates that there was a considerable body of opinion, on both sides in Parliament and also among the banks themselves, in favour of a more widely-based

power to enable the authorities to object to the acquisition of control of a UK bank on 'national interest' grounds. The concern was primarily with the potential for large holdings in major UK banks to be acquired by overseas institutions, where it was argued that foreign control of such banks could operate contrary to the national interest, given the importance of their role in the financial and economic life of the country. Amendments to the Bill were tabled, with a degree of cross party support, to provide such a broad national interest power. (These amendments were subsequently defeated or withdrawn).

5. In responding to these arguments, the Government took the view that it would be unnecessary and undesirable for such powers to be included in the Bill because existing procedures under the Fair Trading Act already provided for the consideration of public interest questions raised by acquisitions and that these procedures applied to banks as they did to firms in other sectors. The Government did not accept that a case had been made for special treatment for banks.

6. The subsequent debates inevitably focussed not only on the scope of the Fair Trading Act, but also on the Government's policy in applying the legislation. In this context, it was argued by the proponents of wider powers that there were firm policy restrictions on the range of cases that would be referred for investigation by the MMC; that the policy concentrated on competition issues; and therefore that an investigation could not be expected where the issues concerned the more general public interest.

7. The Government's policy ~~of making~~ on references ~~primarily but not exclusively on competition grounds~~ was made clear during the course of the Banking Bill debates, and an assurance given that there was no reason why the current review of policy would "result in any weakening of the broad public interest criterion" contained in the Act.

8. Remaining concerns therefore centred on the kind of bank acquisitions that could in practice be expected to be referred on public interest grounds. The case of the Hong Kong and Shanghai

Banking Corporation's bid for Royal Bank of Scotland was discussed as a precedent, in particular the basis of the Commission's conclusion that the proposed merger could be expected to operate against the public interest inter alia because of "...transfer of ultimate control of a significant part of the clearing bank system outside the United Kingdom..." (MMC Report Cmnd 8872, paragraph 12.39 see Annex A).

9. The Treasury's view, reflected in Ministerial statements made at the time, (see Annex B) is that questions of the general public interest would arise from proposed foreign control of one of the major high street banks. It does not follow that the Treasury considers that any such acquisition would necessarily be contrary to the public interest. Individual cases would be viewed as such and in the context in which they arose. But where the largest institutions are concerned it is inevitable that questions of public interest - and a degree of public concern - will arise, and therefore that there is a presumption in favour of investigation in such cases.

10. These questions of public interest are not unfamiliar and were considered in the HKSB/Royal Bank case. They concern the banking sector's strategic importance for the UK economy, its central role in the system of money transmission, and as the provider of the bulk of credit required in other sectors. In the UK, a large proportion of this activity is concentrated in a very few major institutions.

11. Legitimate concerns could therefore arise if one or more of those institutions were to become owned or controlled from overseas. However, it does not follow from this, as mentioned above, that acquisition of any retail banking institution by overseas interests, at a particular time, will give rise to such concerns; or that there could not be countervailing factors in favour of such an acquisition. During proceedings in the House of Lords, Lord Young of Graffham said "It is in the nature of these matters that the Government must avoid any commitments that a particular hypothetical case or class of cases will, or will not, be referred, or what the outcome should be". Hansard 6 April 1987, Annex B .

Reciprocity

12. In addition to the discussion of broad national or public interest issues, proceedings on the Banking Bill also gave rise to a discussion of the principle of 'reciprocity' and its application to overseas control of UK banks. The Financial Services Act 1986 contains powers which allow the Secretary of State or the Treasury to refuse, remove or restrict authorisation to carry on investment, insurance or banking business in the UK if the institution is 'connected' with a country which does not allow UK firms to carry on any such business on terms as favourable as those available in the UK. The Secretary of State or the Treasury must also consider it to be in the national interest that such action be taken.

13. During the course of the Bill, the Government accepted that there was a case for extending these powers to apply specifically to the acquisition of controlling shareholdings in UK banks. The Banking Act 1987 therefore will empower the Treasury to direct the Bank of England to issue a notice of objection to a proposed acquisition of control if the result of the acquisition proceeding would be to make the institution subject to the Financial Services Act powers referred to above.

14. It has been stated on a number of occasions that the reciprocity provisions (in both Acts) are considered by the Government to be reserve powers, the purpose of which is to encourage the opening-up of overseas financial markets and not to provide a barrier to market entry in the UK. (Annex C).

15. Like the protection of depositors, the reciprocity aspect of the public interest is therefore governed by specific statutory provisions. The Treasury do not believe that reciprocity considerations should be a primary consideration in determining the exercise of powers under the Fair Trading Act.

HM TREASURY

JULY 1987

Reference ANNEX A.

MMC: RBS/HKS REPORT.

Conclusions

12.38. In respect of the proposed merger between Royal Bank Group and Standard Chartered, we find (in paragraphs 12.15 to 12.19) that its effects on career prospects, initiative and business enterprise in Scotland would be damaging to the public interest of the United Kingdom as a whole. These adverse effects outweigh any benefits that we can foresee. We therefore find that the proposed merger may be expected to operate against the public interest.

12.39. In respect of the proposed merger between Royal Bank Group and HSBC, we find not only the adverse effects on Scotland mentioned in paragraph 12.38, but also that transfer of ultimate control of a significant part of the clearing bank system outside the United Kingdom would have the adverse effect of opening up possibilities of divergence of interest which would not otherwise arise (see paragraphs 12.26 to 12.29). We conclude that, taken together, these effects adverse to the public interest outweigh any benefits that can be foreseen. We therefore find that this proposed merger also may be expected to operate against the public interest.

attached II

12.40. We wish to make it clear that it is not our intention to imply that leading Scottish financial institutions in general, or clearing banks in particular, should in no circumstances be taken over by companies based outside Scotland. If we had thought that Royal Bank Group needed better management or additional capital which could be obtained only by a merger, or that it had poor long-term prospects as an independent concern, we might well have been persuaded that in the circumstances of the case a merger would not be expected to operate against the public interest.

12.26. This general line of argument seems to us at least to raise a presumption that the transfer overseas of control over a significant part of the United Kingdom clearing bank system would have undesirable consequences. The detriment to the public interest, according to this line of argument, is not the chance, which may be remote and will surely be unquantifiable, that a specific conflict of interest of this kind envisaged above may arise from the transfer of control. The argument is that the transfer of control overseas, as a specific consequence of an acquisition, is itself detrimental to the public interest because it avoidably opens up, in an industry central to the economy, possibilities which are not merely fanciful of divergence of interest which would not otherwise arise. The presumption is in principle rebuttable and particular cases must be judged on their merits. For example, a United Kingdom bank might be so clearly in need of fresh blood and impetus that a bid from outside would on balance be preferable to the *status quo*. In the present case it might be argued that the Royal Bank Group's share of United Kingdom clearing banking should be treated as *de minimis* or that an acquisition by HSBC should not be regarded as involving a transfer of control overseas.

12.27. We wish to emphasise that the proposition under discussion here is in no sense hostile to the competition provided by overseas banks in this country. As was shown in Chapter 3, the number of overseas banks directly represented in London has grown over the last decade to about 350 and many have developed substantial business, particularly in wholesale and investment banking. It is undeniable that the United Kingdom authorities have operated a conspicuously liberal regime in relation to this influx and that the competition so provided has been beneficial. Nor is it to be inferred that all aspects of retail banking and money transmission should, according to the argument under discussion, be insulated from overseas influences. It is necessary to look at the merits of particular cases and put them in the context of the structure of banking in the country concerned.

12.28. As will be seen from paragraph 12.40 below, we do not believe in this case that the presumption against transferring control overseas can be rebutted by any overriding need to bring fresh blood and stimulus to Royal Bank Group. In paragraphs 12.31 to 12.36 below we deal with the question whether there are benefits from either merger to set against any adverse effects. We do not think that the 5 per cent of retail banking controlled by Royal Bank Group can be regarded as *de minimis*, particularly in view of RBS's large share of the market in Scotland. We have also considered whether an acquisition by HSBC of Royal Bank Group should be seen as an exception to the general argument that transfer of control to an overseas bank might give rise over a period to possible divergences of interest. Certainly there is no question of our regarding HSBC as a 'foreign' bank; but that does not in itself avoid the presumption set out in paragraph 12.26. In the case of Hong Kong there is the further consideration that the United Kingdom Crown remains the sovereign power and it may be contended that because of this no conflicts of interest of the kind envisaged in the argument can arise. We think it is well understood, however, that the Government there must have primary regard to the welfare of its population and the interests of its territory, and it therefore seems to us right in common parlance to regard control of Royal Bank Group by HSBC as involving a transfer of control overseas.

12.29. The fact that HSBC proceeded with its bid, notwithstanding the Bank's clear indication that the bid would be unwelcome, may be seen as an example of the kind of divergence of interest that might arise and as an indication that HSBC, if in control of a United Kingdom clearing bank, would not always be prepared to accept the Bank's customary authority in United Kingdom banking matters. A consequence of HSBC's proceeding further with its bid is that the Bank's authority in this area would be seen by others to be weakened.

ANNEX B
15.1.87

MR. IAN STEWART

BANKING BILL: COMMONS - STANDING - COMMITTEE (FIFTH SITTING)

COLS: 147, 148, 1518 152.

(1) The review centres on the provisions of the Fair Trading Act 1973 and the Government's policy on how they should be applied. The proposed takeover of a major British bank would almost certainly qualify for reference by the Secretary of State to the Monopolies Commission. It is almost inconceivable that the proposed takeover of one of the high street banks would not trigger such a reference. In practice, that is bound to be the case.

The present statutory obligation of the commission is to consider whether the proposed merger qualifying for investigation under those terms may be expected to operate against the public interest. Clearly the public interest includes both the domestic and the international public interest. The national interest, as well as other domestic questions, must be considered. The commission is bound to take into account all matters appearing to be relevant.

In the case of the Royal Bank of Scotland, it is true that one of the grounds used by the commission, and contained in the report of the Committee of London and Scottish Bankers was that

"the takeover would have damaging effects on career prospects, initiatives and business enterprise in Scotland."

I must say to my hon. Friend the Member for Stafford that factors other than career prospects are involved, even in the quotation from this document. However, that is far from being the end of the story and it gives a wrong impression of what the commission decided. The commission's report said that it took account not only of the adverse effects on Scotland but of the transfer of ultimate control of a significant part of the clearing system outside the United Kingdom which would have the adverse effect of opening up policies of divergence of interest which would not otherwise arise. That, of course, is a divergence of national interest.

(2) **Mr. Stewart:** I am not resting everything on future provisions which are not yet formulated. If I were doing so, it would not be a convincing argument and I should not be putting it forward with such confidence.

I am arguing that the existing system has already, in the one case where the issue was considered, come to the conclusion which my hon. Friend would want it to come to. Under the terms on which the commission and the Government operate on major proposed mergers, there is no likelihood of an attempted foreign takeover of one of our major banks without such an attempt being examined by the commission. Equally, it is unlikely that the commission would not take into account the same national interest powers as have been discussed.

MR DAN STEWART

THURSDAY 19.2.87

COMMONS REPORT STAGE
OF THE BANKING BILL

VOL 110
No 56
COL 1108

I was asked what would happen as a result of the review of the Monopolies and Mergers Commission, carried out in the "General Review of Competition Policy", which is being conducted by the Department of Trade and Industry. I expressed the Committee's concern to my right hon. Friend the Secretary of State and he has confirmed that there is no reason why that review will result in any weakening of the broad public interest criterion contained in the Fair Trading Act.

I believe that we have an effective system contained in the Monopolies and Mergers Commission and that that system is the best way to deal with the question of public interest or national interest in the case of banks or any other sector. One of my hon. Friends said that if banking is a crucial sector—as Opposition Members and others have said—by definition, if an approach was made to one of our major banks, it would be referred to the Monopolies and Mergers Commission. I believe that it is inevitable that, if an approach was made to one of the high street banks, it would be referred to the Commission. I have no doubt that similar factors would be adduced in such a review as in the case of the Royal Bank of Scotland.

MONDAY
23.3.87

LORD YOUNG OF GRAFFHAM

LORDS -

BANKING BILL - COMMITTEE (SECOND DAY)

VOL : 486 COLS : 26-27.

NO : 60

To continue, the legislation charges the commission to consider whether any proposed takeover would be likely to operate against the public interest. The Government have powers to deal with that matter. There has been a relevant banking case—that of the proposed acquisition of the Royal Bank of Scotland by the Hong Kong and Shanghai Banking Corporation. In this case it was found that the acquisition would be likely to be against the public interest. Concern has been expressed today about acquisition of our major clearing banks; yet it is surely difficult to conceive of such a case which would not raise issues of public interest at least equivalent to those on which the Royal Bank of Scotland case was decided. My honourable friend the Economic Secretary to the Treasury has already stated in another place that the public interest criterion will remain a part of these procedures.

MONDAY
6.4.87.

LORD YOUNG OF GRAFFHAM.
LORDS -
BANKING BILL - REPORT

VOL: 486 COL: 818
NO: 68

It seems clear that the matters about which concern has been expressed can be and have been, taken into account under the existing procedures. It is in the nature of these matters that the Government must avoid any commitments that a particular hypothetical case or class of cases will, or will not, be referred, or what the outcome should be. Nevertheless, my honourable friend the Economic Secretary to the Treasury has already said in another place—and I agree with him—that it is difficult to imagine that any foreign bid for a major British bank would not raise issues of public interest at least as great as those in the case to which I have already referred. These public interest factors have been taken into account in the past and I would hope, and certainly expect, that they will be taken into account in the future.

Perhaps I may refer to a speech last November by my honourable friend Michael Howard who said:

"But Norman Tebbit never said that references would be made only on competition grounds and there have been a small number of exceptional cases in which mergers have been referred because they were thought to raise other public interest issues".

There have been a number of other cases subsequent to the 1984 statement where references have been made on grounds other than competition or where competition was only one of several factors. Such grounds included the special nature of a particular industry. While I cannot say that the acquisition of a British bank would automatically be referred, there is no doubt that both the statutory framework and the current policy towards references allow full scope for referral and consideration of proposed acquisitions of general public interest grounds. As my honourable friend Ian Stewart has already said, it is almost impossible to conceive that an overseas bid for a United Kingdom clearing bank would not be referred.

ANNEX C

MR HOWARD 25/3/86

FINANCIAL SERVICES BILL
STANDING COMMITTE E
COLS: 918,920.

In a sense, the clause is a reserve power; we hope that by using it effectively in negotiations we shall never need to operate it, but if we fail in those negotiations and it becomes clear that we are not being given fair access to the markets of any other country and that other countries are taking advantage of access to our markets but are denying access unfairly to our businesses, we shall not hesitate to use it.

Mr. Howard: May I respond first to the last question asked by my hon. Friend the Member for Bournemouth, West (Mr. Butterfill)? The powers under the clause will be discretionary and will enable all the matters to which he referred to be taken into account. He is right to say that they should be used only as a last resort, and after careful consideration. Thereafter, one should not hesitate. There is nothing between my hon. Friend and myself there.

THURSDAY
19. 2. 87.

MR. IAN STEWART.

BANKING BILL - REPORT STAGE IN THE COMMONS

VOL 110: COLS: 1107- 1108
NO 56.

The fundamental point about reciprocity that I should like to emphasise is that the provisions of the Financial Services Act and of this Bill are designed to open up markets overseas, not to put up the shutters around London. It is not only in the circumstances where a United Kingdom bank could not buy a Japanese bank that the provisions might be triggered; it is a much more general question of access to the provision of financial services. That applies to banking, insurance, investment and other matters. If hon. Members study the way in which new clause 2 is phrased they will see that it states:

"overseas countries which do not afford reciprocal facilities for financial business".

Therefore, we have gone far beyond the question of takeovers.

I felt it necessary to strengthen or rather, adapt the reciprocity provisions contained in the Financial Services Act 1986 because, whereas the threat of withdrawal of authorisation may be an appropriate sanction in the case of an investment or insurance business, in the case of banks that rely on taking deposits in the market from day to day, the withdrawal of authorisation may cause great difficulties for depositors. Therefore, the threat of that withdrawal of authorisation would not be a credible deterrent.

The reciprocity powers, should they ever be put into practice, must be workable. I hope that they will not be brought into play. I hope that other countries, encouraged by our example, will open up their markets to our banks and other foreign banks and financial companies. Other countries may discover, in the same way as we have discovered, that that action will create a thriving market, which is of great advantage, as indeed it has been for the City of London.

MONDA,
23.3.8,

LORD YOUNG OF GRAFFHAM

LORDS -

BANKING BILL - COMMITTEE (SECOND DAY)

VOL : 486 COLS : 26-27.

NO : 60

/ The purpose of reciprocity provisions in both the Financial Services Act and this Bill are importantly aimed at opening up the markets of others and not at closing our own. It is very much to be hoped therefore that these powers will never be used, but they are there if they are needed. It has been suggested, not only in this Chamber but in the course of debates in another place, that there is insufficient reciprocity in the case of Japan. My honourable friend the Economic Secretary said in another place that he would find it difficult to disagree with that analysis, as would I. I shall look closely with interest at the consortium in Japan, in which Cable and Wireless are at the moment playing a part, to see exactly how well they define reciprocity. That is a point which I have no doubt we shall look at with care and attention in the future. /

MONDAY
27/4/87

LORD BEAVERBROOK
LORDS —
BANKING BILL - THIRD READING.

VOL: 486 Col: 1244
No: 72

As the Government have made clear on a number of occasions, both here and in another place, the purpose of the reciprocity provisions in the Financial Services Act and in this Bill is not to erect barriers to trade or to close down or clear the City of overseas institutions. The purpose is not to put a fence around British financial markets. The purpose of the provisions is to encourage other countries to adopt a more open approach to their own markets—the sort of open approach for which London is rightly renowned. I am sure that my noble friend supports that objective.

The United Kingdom has benefited greatly from that open approach which has helped to contribute to London's eminent position among world financial centres. Your Lordships need have no fears that the Government are unaware of that. However, it has been accepted by your Lordships and in another place that the Government should have available reserve powers aimed at encouraging others to open their own markets on a reciprocal basis. It is not acceptable to the Government that other countries should have the advantage of open access here but not offer reciprocal opportunities to British firms. The Government hope that it will not prove necessary to use these powers.

As your Lordships know, the Government are pursuing the question of access to other markets on a number of fronts. I have nothing further to add on that at this stage, but we will continue to pursue our case vigorously. We are fully aware of the sensitivity of this issue and any action will be taken only after the fullest possible consideration.

THURSDAY
7.5.87.

MR IAN STEWART

COMMONS –

BANKING BILL: LORDS AMENDMENTS CONSIDERED.

VOL: 115
NO: 103

COL: 884

As I have said during earlier stages in our consideration of the Bill, we hope that we shall not have to implement these provisions. Our purpose is to open up foreign financial markets rather than to close the City, or British financial markets, to foreign institutions. It is clearly right that the relevant provisions in our legislation by way of reserve powers should be effective if ever they have to be used. Although the new clause is designed for the avoidance of doubt, it adds strength to our commitment and will make it clear to all outside that we want to have provisions of this sort and that we want them to be right, so that if they have to be used they will be effective in practice.

0520h

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17 July 1987

270 5653 —
830 2007.

DRAFT

D J Saunders Esq
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Dear Mr Saunders

This letter sets out the Bank of England's views on the proposed sale by Midland Bank of Clydesdale Bank and Northern Bank to National Australia Bank.

The Bank has had the opportunity to discuss with each of the two principals their motives and objectives in the transaction.

From Midland Bank's point of view, the sale of the banks* is designed, along with a rights issue of £700 mn, to strengthen its capital position following substantially increased provisioning against problem country debt. Apart from improving the bank's capital ratios, the sale will also save Midland the future costs, in terms of both capital expenditure and management effort, of integrating the banks' systems, controls and organisational structure etc into the Midland group as a whole.

In the case of National Australia Bank (NAB), the acquisition of the banks is seen as a means of diversifying out of what is an increasingly competitive domestic market into retail banking in the UK. (NAB's Australian operations are largely retail.) Our understanding is that NAB plans to retain the separate identities of the banks under the umbrella of a holding company to be

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* Northern Bank (Ireland) is also being sold. This bank is based in the Irish Republic and thus does not fall within the direct supervisory responsibility of the Bank of England.

incorporated in the UK. This is designed to provide a mechanism whereby NAB can exercise overall policy control and direction of the banks (which we believe to be important for supervisory purposes) without impeding day to day operations. Each of the banks' head offices will be maintained in their present locations. The prospect of being able to retain distinct national identities (which were tending to be subsumed within the Midland Group) has meant that the prospective change of ownership has been welcomed by the Boards and managements of the banks.

NAB's plans for the banks, in general terms, are to develop their existing profit potential in their own markets and, in the longer term, to use them as the basis for possible expansion into the rest of the UK and into Europe. NAB has emphasised to the Bank that it has a long-term commitment to the UK market and that it is prepared to devote substantial capital, personnel and other resources to make a success of an investment which will be significant in NAB group terms: the assets of the banks being acquired will account for **% of the total assets of the enlaraged NAB group.

The Bank has considered formally the prudential implications of the change of ownership of Clydesdale Bank and Northern Bank (and their subsidiaries) against the criteria set out in the Banking Act 1979. It has also considered the impact on Midland Bank itself and on National Australia Bank which is recognised under the Banking Act by virtue of its existing branch presence in London. The conclusion reached was that the Bank has no objection in principle to the sale. This view was passed to National Australia Bank prior to the announcement of the sale.

The Bank has also satisfied itself that effective supervisory arrangements for the supervision of Clydesdale Bank and Northern Bank and for the enlarged NAB group as a whole will exist following the sale.

I understand that your Office would also welcome the Bank's views on the competition aspects of the sale and on any wider public interest questions which might arise. Although the Bank does not regard itself as an expert on the technical aspects of the

competition criteria, it is difficult to see that the proposed sale is anti-competitive. As noted above, Clydesdale Bank and Northern Bank will continue to operate as separate entities in their respective markets. To the extent that NAB is successful in its intention of developing the operations of the banks in their own regions, this could result in an improvement in competition and in the provision of banking services to personal and commercial customers in Scotland and Northern Ireland. Competition in the UK market as a whole would also be increased if the banks are able to expand into England and Wales. (Clydesdale presently has a small number of branches in North West England and in London.) Correspondingly, Midland will also be freed by the sale to expand into Scotland and Northern Ireland if it wishes to do so, which would be a further factor tending to increase competition in those regions. If this scenario proves correct, the overall strength and diversity of the UK banking industry would be enhanced.

As already noted, NAB also has a presence in the UK through its London branch. Our understanding is that this will be kept separate from the banks being acquired, with which in any case it has little overlap given its largely wholesale operations.

In view of Clydesdale Bank and Northern Bank's largely domestic orientation, it is difficult to see that the sale will have any significant effect one way or the other on the capacity of the UK banking system as a whole to compete in international financial markets. However, there could be some positive impact in the longer-term if the two banks, under NAB, were eventually able to expand their operations into Europe.

The Bank has also considered whether the transfer of ownership of part of the UK clearing system to NAB has adverse implications for monetary control. The same issue was, of course, raised in 1981 by the proposed merger of Hong Kong and Shanghai Banking Corporation with Royal Bank of Scotland, but we believe that it does not apply with the same force in this particular case. While the banks concerned are important in their own regional markets (Northern Bank particularly so), they account for a relatively small part of the UK retail banking market as a whole

(together about 2% of the UK private sector's sterling deposits and about 1 1/2% of its sterling borrowings) and of the overall UK clearing system. Moreover, the general banking and financial environment has changed since 1981. As a specific example, the clearing system has been restructured since the Child Report in December 1984 and has been opened up to any bank (whether or not foreign-owned) or building society which meets explicit and objective criteria for entry.

The Bank has concluded therefore that it would not wish to object to the proposed sale on UK monetary policy grounds or on the grounds of any threat to the money transmission system. It should be emphasised, however, that each such case needs to be judged on its particular merits, and that circumstances might be envisaged where the foreign acquisition of a major UK bank would give rise to concerns about the public interest which would outweigh any potential benefits from a change of ownership.

Conclusions

The Bank's views can be summarised as follows:

(i) there appears to be a strategic rationale for the sale on both sides: Midland's financial health would be improved and it would be more able to devote time and resources to its core banking business; NAB would have the opportunity to expand abroad in retail banking which is its particular area of expertise;

(ii) the banks being acquired have welcomed the change of ownership as offering the chance of retention of national identity. If NAB's plans are successful, the banks should have the opportunity to develop both within their own regional areas and, in the longer term, outside these;

(iii) this could help foster increased competition, improve the range of banking services available to customers and enhance the overall strength and diversity of the UK banking industry;

(iv) the Bank has no objections in principle to the proposed sale on prudential grounds and is satisfied that effective supervisory arrangements will be maintained after the sale;

(v) in this particular case, the Bank has no objections on UK monetary policy grounds, nor does it believe that there is a threat to the UK payments mechanism.

[In the light of the above points, the Bank does not believe that there is a case for the proposed sale to be referred to the Monopolies and Mergers Commission on either competition or public interest grounds.]

Yours sincerely