

PO-CH/NL/0711 PART A

2/2

25 JAN 1989

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AQ

FINANCIAL SECRETARY	
REC.	25 JAN 1989
ACTION	Mr S. Judge
COPIES TO	PPS CST
	Sir P. Middleton
	Mr Anson, Mr Monck,
	Mr Odling-Smee, Mr Bent,

Department of
Trade and Industry

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London SW1H 0ET

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Our ref
Your ref
Date 25 January 1989

Mr Tyrie, Mr Call, Ms Wheldon (T. Sol).

Norman

Ch/ Mr Newton correctly judges that the BSC decision was made not on prudential grounds but in the light of Treasury guidance on building societies. @15

GIROBANK

As you may be aware, one of the parties showing interest in purchasing Girobank from the Post Office is the Alliance and Leicester Building Society. They have, I understand, indicated that they are interested only in a 100% acquisition, including Girobank's corporate business and have sought the Building Societies Commission's reactions to this proposition.

It seems that the Commission's reaction to Alliance and Leicester's proposals is much influenced by the fact that the question of the extent to which it would be right to enable building societies to participate in corporate sector business was considered early last year and that the Treasury then took the view that it would be inconsistent with the nature and purpose of building societies to enable them to undertake significant corporate sector business. I understand that the view has been taken within the Commission that there are no grounds for seeking a re-examination of such a recent policy decision.



the department for Enterprise

I fully appreciate that the prudential regulation of building societies is the responsibility of the Commission and it would not be right to interfere with their decisions in this regard. But I am also conscious that a combination of Girobank with its large number of customers and network of 22,000 Post Office counters and a large building society may offer to both parties imaginative opportunities to develop joint business: I would be sorry to compromise these opportunities by requiring Girobank to sell off its established and profitable corporate business.

We are also committed to the policy of returning public sector undertakings to the private sector and we announced last June that Girobank would be sold. Alliance and Leicester is one of very few organisations which are at present indicating serious interest in purchasing Girobank. If they are prevented from pursuing that interest this is likely to have a significant effect on the Post Office's ability to attract a buyer willing to offer an acceptable price for Girobank. There seem to me to be sufficient grounds for reconsidering where the balance now lies between potentially conflicting objectives. This is of course a matter on which it is primarily for Treasury Ministers to take a view. However, it may be that in the light of new factors there is a case for signalling to the Building Societies Commission a relaxation of the present policy, which could open the way to the purchase of Girobank by a building society. I am sure that none of us would want to see such a case go by default.

TONY NEWTON

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE

FROM: G F DICKSON

DATE: 9 FEBRUARY 1989

1. MR ODLING-SMEE
2. ECONOMIC SECRETARY

cc
 PS/Chancellor
 PS/Financial Secretary
 Sir P Middleton
 Mr Anson
 Mr Scholar
 Mr Monck
 Mr D J L Moore
 Mr Pirie
 Mr Bent
 Mr Judge
 Mr Kröll
 Mr Tyrie
 Mr Call

Mr Bridgeman - BSC
 Mr Mathews - BSC
 Ms Wheldon - TSol

GIROBANK: ALLIANCE AND LEICESTER BUILDING SOCIETY

At your meeting with Mr Bridgeman on Tuesday, it appeared that a feasible solution could be found to the A&L's request to buy Girobank.

2. The necessary legislative steps would be:

- (i) ease restrictions on money transmission services to all societies. They would be given the power to provide overdraft facilities linked to money transmission to corporate customers. This would require an affirmative Order under section 19 of the Building Societies Act;
- (ii) designate Girobank, by name, to allow the purchasing society to invest in a deposit taking subsidiary. This would require a negative Order;
- (iii) allow societies to arrange lending and leasing to companies and manage the loans off balance sheet. This could either be accomplished by the designation of individual companies or by removing

restrictions in Schedule 8 to the Act (by a negative Order). The latter option was preferred because it would grant the power to all societies.

3. The above changes would allow the society to purchase Girobank and to run the money transmission service with more flexibility than it would be allowed at present. Girobank (as a subsidiary of the society) could continue to administer the corporate lending, provided it removed the existing loans from its balance sheet. It would also be able to arrange new loans for companies, but not to make them on its own balance sheet. We need to explore, with BSC officials, how quickly these changes can be made.

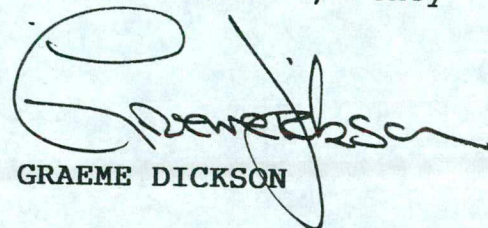
4. Although the A&L can eventually be told that they may proceed on this basis to bid for Girobank, there are still a number of hurdles;

- (i) they would need to ensure that the corporate lending and leasing can be removed from Girobank's balance sheet and that they are content with this solution;
- (ii) the BSC will need to be satisfied on the prudential aspects of a bid;
- (iii) the Bank will also need to be satisfied, as the supervisors of Girobank.

Recommendation

5. We recommend that work begin on the legislative changes, that the Post Office's advisers should be asked to analyse Girobank's assets for the BSC and that the BSC should begin discussions with the A&L on this basis. By the time a meeting is arranged with the A&L, the BSC hope to have confirmed that the legislative changes are possible - their lawyers have given the work highest priority. Therefore, at the same time we recommend that consultation should begin with the Building Societies Association on the details of the Orders. This would make it clear to all societies, very soon, that they may bid for Girobank.

6. You may now wish to reply to Mr Durward's letter of 25 January and to Mr Newton's letter to the Financial Secretary of 25 January (perhaps your Private Secretary would clear this with the Financial Secretary's office). Draft replies are attached; they have been agreed with PE.



GRAEME DICKSON

DRAFT LETTER FROM THE ECONOMIC SECRETARY TO

Mr S Durward
Alliance and Leicester Building Societies
49 Park Lane
London W1Y 4EQ

Thank you for your letter of 25 January concerning the sale of Girobank.

2. Your approach is indeed both legitimate and welcome, but, as you are aware, it poses some problems in terms of building societies' powers. However, the Building Societies Commission is prepared to examine a number of options which would allow a building society to bid for Girobank. You might like to take up their invitation to discuss possibilities with them.

3. I regret that I cannot give the definitive answer you requested. The final decision on whether a society may proceed on any new venture of this scale rests with the Building Societies Commission. It will need to be assured of the prudential aspects of a bid. The Bank of England will also have to be satisfied about the proposed arrangements because of its responsibility for supervising Girobank.

4. I hope that you will take up the opportunity to resume discussions with the Building Societies Commission and that a mutually acceptable solution can be found.

PETER LILLEY

DRAFT LETTER FROM ECONOMIC SECRETARY TO MR NEWTON

GIROBANK

Thank you for your letter of 25 January to Norman Lamont. With his agreement I am replying, as the difficulties relate primarily to the regulation of building societies.

2. I have now discussed this with Michael Bridgeman, Chairman of the Building Societies Commission. We have identified two main problem areas.

Overdrafts connected with Corporate money transmission

3. Building Societies are allowed to provide corporate money transmission services at the moment. Their clients may overdraw their accounts on a temporary basis, but only if such overdrafts are accidental and occasional. They are not allowed to arrange overdraft facilities, for use as necessary. Such restrictions would make it difficult for Girobank's corporate customers to use its money transmission services.

4. We are therefore considering a general extension to societies' powers to permit them to allow overdraft facilities for corporate customers, but only in respect of their money transmission activities.

Loans and leasing finance to incorporated business, and loans to individuals in excess of £10,000

5. At present, societies are not allowed to make such loans and I would not wish to make a general extension of their powers to cover this sort of activity.

6. I have also considered with Michael Bridgeman whether it would be possible for the Alliance & Leicester to buy all of Girobank, on the condition that it undertook to dispose of such loans, if it had not converted to a plc within two years. However, I feel that it would not be appropriate to anticipate a decision of the members in favour of conversion in this way: and if the A & L did not go ahead with conversion, this could place the Commission in the invidious position of forcing the A & L to sell off their corporate loan book at a loss.

7. However, I think that it would be possible for Girobank to continue to manage and service these loans, on an agency basis, provided that they did not feature on Girobank's balance sheet. It would require a minor extension to societies' powers by means of a negative Order. (This would be similar to the personal lending schemes some societies operate, at present, as agents). Such a change would allow a building society to acquire Girobank provided that it proves possible for Girobank to remove commercial loans and leasing arrangements from its balance sheet.

The way forward

8. I hope you agree that these two proposals represent a feasible way forward. So far as we are concerned, the BSC lawyers will need to do some work on the legal angles; the Commission will consult the industry (through the Building Societies Association) on the draft Orders; and I would then have to take one affirmative order through the House (the other two will be negative). This will all clearly take some time: but I hope we will be able to let the A&L and the BSA know of the full proposals in a week or so.

9. I have sent the enclosed letter to Mr Durward at the A&L. In the meantime we can take things forward between the A&L and the Post Office. So far as the Post Office and Schrodgers are concerned, I suggest that you ask them to do the following:

a. prepare, in conjunction with Girobank, information on their assets, analysing them into fixed assets, personal loans and overdrafts under £10,000, personal loans and overdrafts in excess of £10,000, mortgage loans, overdraft facilities to companies, other loans to companies, and leased assets on their balance sheet. Their off-balance sheet items should also be listed, identifying those for which the Bank require capital backing and those which are only noted in the accounts;

b. consider themselves (ie without consulting possible buyers) how the Post Office might dispose of the "problem loans" to be covered by the agency agreement described above (including securitisation options). It might even be best for the Post Office to keep these assets on its balance sheet, with a view to sale at a later date (ideally to the A&L if and when it converts to a plc);

c. consider themselves whether the proposed extension of powers is likely to rekindle interest from other societies. Schroders should however not discuss this possibility with other societies until they have been formally told by the BSC.

10. I should stress the importance of ensuring that Schroders do not mention the possible extension of powers to the A&L, or any other party, until the A&L have themselves been informed by the BSC. (By the time the A&L have contacted the BSC, I hope that the BSC will be in a position to let the industry as a whole know of the changes.) Once the A&L do know about the proposed extensions to building society powers, Schroders will clearly need to start work with them on the agency agreement and the splitting of the loan book, in order that they can fix their bid price.

9. I realise that Schroders will have a difficult task in keeping the A&L's interest alive, especially given that they are reported to want to take a final decision on whether to proceed (and on their offer price) early in March.

PETER LILLEY

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cc PS/chx PS/FST
PS/SR P MIDDLETON
MR ANSON MR OUNY-SNEE
MR SCHOLAR MR MONCK
MR DILLMOORE MR FICKE
MR BENT MR JUOGE
MR DICKSON MR KROLL
MR TURIE MR CARR
MR BRIDGEMAN
MR MATTHEWS
10 February 1989
MS WHELDON TSOZ.

Treasury Chambers, Parliament Street. SW1P 3AG

Prof
✓

Mr Newton
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1

Dear Tony

GIROBANK

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C O N F I D E N T I A L
C O M M E R C I A L I N C O N F I D E N C E

Loans and leasing finance to incorporated business, and loans to individuals in excess of £10,000

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The way forward

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COMMERCIAL IN CONFIDENCE

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I realise that Schroders will have a difficult task in keeping the A&L's interest alive, especially given that they are reported to want to take a final decision on whether to proceed (and on their offer price) early in March.

Yours ever
Peter

PETER LILLEY

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COMMERCIAL IN CONFIDENCE



Treasury Chambers, Parliament Street, SW1P 3AG

Mr S Durward
Alliance and Leicester Building Societies
49 Park Lane
LONDON
W1Y 4EQ

(0 February 1989

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I hope that you will take up the opportunity to resume discussions with the Building Societies Commission and that a mutually acceptable solution can be found.

Yours sincerely
Peter Lilley

PETER LILLEY



FROM: J M G TAYLOR
DATE: 10 FEBRUARY 1989

pmg

PS/ECONOMIC SECRETARY

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Odling-Smee
Mr Scholar
Mr Monck
Mr D J L Moore
Mr Pirie
Mr Bent
Mr Judge
Mr Dickson
Mr Kroll
Mr Tyrie
Mr Call

*[I have taken some
pts. off this string -
they will need to be
reassociated later]*

Mr Bridgeman - BSC
Mr Mathews - BSC
Ms Wheldon - TSol

GIROBANK: ALLIANCE AND LEICESTER BUILDING SOCIETY

The Chancellor has seen Mr Dickson's note of 9 February.

2. He has commented that this is welcome. We will clearly need to give all major building societies an opportunity to bid, before there is any question of closing with Alliance and Leicester.

JMG

J M G TAYLOR

**C O N F I D E N T I A L
C O M M E R C I A L I N C O N F I D E N C E**



pmf

**FROM: S M A JAMES
DATE: 14 February 1989**

PS/FINANCIAL SECRETARY

**cc: PS/Chancellor
PS/Sir P Middleton
Mr Anson
Mr Odling-Smee
Mr Scholar
Mr Monck
Mr D J L Moore
Mr Odling-Smee
Mr Pirie
Mr Bent
Mr Dickson
Mr Kroll

Mr Bridgeman - BSC

Ms Wheldon - Tsy Sol**

GIROBANK : ALLIANCE AND LEICESTER BUILDING SOCIETY

Brian Williamson, whom I understand the Financial Secretary knows, had a word with the Economic Secretary about Girobank.

2. Mr Williamson has some connection with the Irish Bank/Bank of Ireland? who are interested in buying Girobank. He wanted advice on whom they should appoint as merchant bankers. The Economic Secretary suggested Mr Williamson might contact the Financial Secretary about this.

SMA

**S M A JAMES
Private Secretary**

GIROBANK

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE

FROM: S P JUDGE
DATE: 15 FEBRUARY 1989

1. MR MOORE *SW 15/2*
2. FINANCIAL SECRETARY

cc: PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Monck
Mr Moore
Mr Odling-Smee
Mr Bent
Mr Pirie
Mr Dickson
Mr Kroll
Mr Portes
Mr Call
Mr Tyrie

GIROBANK: PRIVATISATION

This submission brings you up to date on the prospects for the sale of Girobank.

2. You already know about the position with the Alliance & Leicester (Mr Dickson's recent submissions to the Economic Secretary). The Economic Secretary expects to announce the changes to general building society powers on Friday, via an arranged PQ. The Building Societies' Commission will write to the major societies next week, pointing out that the changes would, if implemented, affect the ability of societies to tender for Girobank. (Probably only the top six would be big enough to buy Girobank.)

3. The Co-op Bank continue to show interest (as reported in my submission of 8 December).

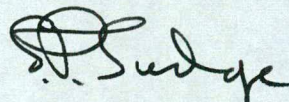
4. Schroders advised us yesterday of interest from two further institutions. Singer and Friedlander have entered an indicative bid of around £120 million. S & F are a small merchant bank, with pre-tax profits of about £13 million in 1987. Previously owned by Britannia Arrow Holdings, S & F are now independent. In the field of international finance they were one of the first banks to become principal players in the secondary market for LCD debt. Growth of profits in banking and investment management has been achieved by concentrating on "niche" business.

5. Finally, the Bank of Ireland are also showing interest, although they are apparently still searching for a merchant bank.

6. Schrodgers discussed these four potential purchasers with the Bank of England yesterday. The Bank have undertaken to form preliminary views on the three banks by the end of this month, but to leave the A & L to the BSC at this stage. Singer and Friedlander originally asked for exclusive negotiating rights for a period of four weeks, but have settled for an undertaking from the Post Office that they will not sign a contract with anyone else before 10 March. Given the further work that has to be done by all four potential purchasers (and the two regulators) this should not constrain the Post Office's freedom of manoeuvre. All four parties hope to decide whether to make serious bids at Board meetings between 3 and 14 March.

7. Assuming that this process produces an acceptable short list, Ministers will then have to decide whether to wait for further bids from other major building societies (Mr Taylor's minute of 10 February to the Economic Secretary's office).

8. So much for the good news. The bad news is that the DTI Select Committee are taking evidence on Girobank on 1 March. This is despite strong representations from Mr Newton's office to the Committee Clerk that this timing would be most unhelpful. We understand that Mr Newton has not spoken himself to the Chairman, Mr Warren: DTI doubt that this would achieve anything. Clearly this hearing will take place at a very sensitive time in the sale process. We will make sure that we see the briefing prepared for Mr Newton and, if possible, Sir Bryan Nicholson.



S P JUDGE

php

The BSC have made good progress, and it would be helpful

FROM: G F DICKSON
DATE: 15 February 1989

- 1. MR ODLING-SMEE to make the announcement
- 2. ECONOMIC SECRETARY

- cc PS/Chancellor
- PS/Financial Secretary
- Sir P Middleton
- Mr Anson
- Mr Scholar
- Mr Monck
- Mr D J L Moore
- Mr Pirie
- Mr Bent
- Mr Judge
- Mr Kröll
- Mr Dyer
- Mr Tyrie
- Mr Call

add PS/EST 15/2

Handwritten notes in a circle: "1. Mr. Odling-Smee" with arrows pointing to the list items.

*Content for this PR to be tabled this pm? (f.m.)
Assure me that it does not commit us in any way to the Minister (Leicester)
df 15/2*

- Mr Bridgeman - BSC
- Mr Mathews - BSC
- Miss Wheldon - T/Sol

GIROBANK: ALLIANCE AND LEICESTER BUILDING SOCIETY

The purpose of this note is to seek your agreement to the proposed announcement on the extension to building societies' powers and the guidance to be given to societies on purchasing Girobank.

2. The Building Societies Commission's lawyers are making good progress with the draft orders. They believe that an announcement could be made this Thursday (16th). (This submission assumes this will be possible; we will let you know when Mr Bridgeman has confirmed the timing.)

3. One of the orders requires affirmative resolution: you may, therefore, wish to announce the proposed change by means of a written PQ, before there is consultation with the building societies on it. A draft question and answer is attached at Annex A.

4. The answer explains that the changes are being made as a result of the "Schedule 8 Review" last summer; they are necessary to allow societies to make full use of the new powers. The BSC also hope to make an Order later this week to allow societies to purchase mortgages. You announced the intention last year when

the review was completed. Details of this Order have been included in the draft answer to give more weight to the announcement.

5. If you are content to make the announcement by means of a PQ, Mr Bridgeman will write to Mark Boleat at the Building Societies Association, giving details of the orders, after your answer has been given. The latest draft is attached at Annex B and the letter will be copied to all building societies' Chief Executives.

6. Early next week (or a few days after the PQ), Mr Bridgeman plans to write to the Chief Executives of the large societies informing them that the BSC's position on Girobank has developed since last summer. The latest draft letter is attached at annex C. The Alliance and Leicester will be invited to meet BSC officials after the letters have been posted. Mr Bridgeman wishes to inform all the relevant societies at the same time because it involves a change to legislation affecting all societies.

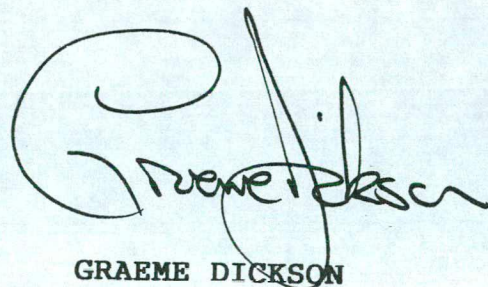
Conclusion

7. It would be useful to have your agreement on the following points:-

(i) Are you content to announce the changes by means of an arranged PQ?

(ii) If so, are you content with the broad outline of the attached draft?

(iii) Are you content with the arrangements for informing building societies?



GRAEME DICKSON

ARRANGED PQ FOR ANSWER BY ECONOMIC SECRETARY

Question

"To ask: MR CHANCELLOR OF THE EXCHEQUER
 whether he plans any further amendment to Schedule 8 to the
 Building Societies Act 1986; and will he make a statement."

Answer - "When the Order amending Schedule 8 was approved by the
 House last June [OR Vol 135 No. 172 col.1338] I did not
 expect that there would be any need to make major
 amendments to this legislation for some years. However,
 the attention of the Treasury and the Building Societies
 Commission has been drawn to the fact that the
 intentions of the orders are being frustrated in two
 respects. I have asked the Building Societies
 Commission to consult societies on draft orders to deal
 with them.

The first is that some societies have been frustrated in
 developing money transmission facilities by the fact
 that although they could offer such facilities to
 companies, they cannot offer them incidental overdraft
 facilities. The wording of the Order approved last June
 allows a society not to stop a cheque thereby causing an
 accidental overdraft; but does not allow it to grant
 occasional overdraft facilities. I intend to table a
 draft order for approval by each House, which would add
 a new type of Class 3 asset. It should enable societies
 to offer temporary and incidental overdraft facilities
 in order to secure money transmission business. But it
 would not allow continuing unsecured lending to a
 company in the form of an overdraft.

The second frustration is that a society can provide a wide range of financial services to companies, but they cannot grant them unsecured loans. This has prevented societies competing effectively with other institutions. I have therefore decided that although societies should continue to make unsecured loans only to individuals, they should be able to arrange unsecured loans and leases for companies as agents. I have asked the Building Societies Commission to consider making an order to amend Schedule 8 to the Act removing this restriction.

I also announced last June that the Building Societies Commission would consult societies and other interested bodies about making an order to permit societies to own or take an equity stake in companies involved in the acquisition of mortgages from other lenders. They have made this order today and it will be laid before the House [in the next few days/today].

I regard this package of measures as a ~~"tidying-up"~~ exercise to allow societies to make full use of the Schedule 8 powers. I hope that all of the orders can be made and, where necessary, approved within a short period. Many societies have their Annual General Meetings during March and April and they may wish to adopt the revised powers at this time."

WNI

Letter to
M Boleat Esq
Director General
Building Societies Association
2 Saville Row
LONDON
WLX 1AF

MONEY TRANSMISSION SERVICES

The attention of the Treasury and this Commission has been drawn to the fact that the intentions of the "Schedule 8 Review" orders made last summer are being frustrated in two respects. I am writing to consult the Building Societies Association on draft orders to deal with them.

2. The first is that some societies are being frustrated in developing their money transmission facilities by the fact that although they can offer such facilities to companies, they cannot offer the latter overdraft facilities. The existing wording permitting occasional overdrafts allows the society not to bounce a cheque causing an accidental overdraft, but does not extend to granting facilities. The Economic Secretary has now agreed in principle to table an order for approval by each House of Parliament, which would add a new class of class 3 asset - the balances outstanding on occasional or temporary overdrafts arising from overdraft facilities given incidental to a money transmission service to a body corporate. This should enable societies to give the types of facility necessary to secure money transmission business. But it would not allow continuing unsecured lending to a company in the form of an overdraft.
3. The Economic Secretary has informed Parliament of his intentions in a written answer to Mr [] MP given this afternoon.
4. The second frustration is that a society could deal with a request

for an unsecured loan from an existing customer which was from an individual, but over the £10,000 limit, by arranging the loan with, say, a finance house, but it could not deal in a similar way with a request for any size of unsecured loan from a company which was a money transmission customer. The Commission accordingly proposes to make an order removing the restriction to individuals on the powers to arrange unsecured loans and to arrange leases.

5. I attach drafts of the two orders, on which we would welcome the comments of societies, preferably through the Association.
6. The power in the [title] order will require adoption. (The other should not require amendment of a society's memorandum, since it merely involves the removal of a statutory restriction.) Some societies may wish to do this at their forthcoming AGM's. The simplest way to do this, before Parliament has passed the resolution approving the order, is for the notice to members of the special resolution to refer, for the definition of what the term in the amendment to the memorandum means, to the draft order, laid before the House. But this would require the draft order to have been laid, before the society circulated its notice to members.
7. If this is to be done, time is very short in relation to March and April AGM's. The sooner we have a response on the texts, the more of your member societies will be able to adopt it this year. Accordingly, could I leave it to you to organise a response on the drafts as quickly as possible, rather than my suggesting a date?

J M Bridgeman

Enclosures: Draft SI's (2).

Letter to
Chief Executives of the
[] largest societies

Girobank plc

I attach a copy of the letter which I have ~~today~~ sent to the Director General of the Building Societies Association, launching a consultation on two proposed extensions of the powers available to societies. Both relate to the development of money transmission services. Copies are being sent to societies generally under cover of a DCE letter.

2. These changes, if implemented will affect the ability of societies to tender for Girobank plc, compared with the position which the Commission set out in July last. The current position on this is accordingly set out in the enclosed new note for societies which may be interested in tendering for Girobank as an entity.
3. I should perhaps add that I am writing similarly to the Chief Executives of all societies with over £ billion commercial assets - those which might be able to acquire Girobank, transferring some business off balance sheet while remaining comfortably within the Class 3 limits on an aggregated basis. This letter implies no judgement by the Commission on either its relevance to your society in the light of your corporate plan, or the prudential issues which would arise.

J M Bridgeman

Enclosures: Guidance Note
Letter to BSA
Draft SI's (2)

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Peter Lilley Esq MP
Economic Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

ECONOMIC SECRETARY	
REC'D	28 FEB 1989
ACTION	FOR INFO
COPIES TO	PS/CHK, PS/CST
	PS/FST, PS/PMG
	Sir P Middleton
	Mr Scholar
	Mr Odhly-Smee

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

2

Mr D.J.L MOORE

Mr Piria

Mr Dickson

Mr Bridgeman

BSC

Direct line
Our ref
Your ref
Date

215 5147

27 February 1989

GIROBANK

Thank you for your letter of 10 February about the difficulties hindering the acquisition of Girobank by a building society.

I am grateful to you and to the Building Societies Commission for the effort you have put in to identifying appropriate solutions to the difficulties. The proposals you have put forward seem to me to offer a basis on which the acquisition of Girobank could prove attractive to a building society. We have passed on to the Post Office and Schrodgers the specific points for consideration that you mentioned and we await the outcome, which I hope will prove positive.

TONY NEWTON

FROM: G F DICKSON

DATE: 15 MARCH 1989

1. MR PIRIE *AP-15/3*
2. ECONOMIC SECRETARY *^* *✓*

cc Mr Odling-Smee
Mr Moore
Mr Bent
Parliamentary Clerk
Mr Judge
Mr Portes
Mr Johnson
Mr Mathews - BSC
Mr Perrett - BSC
Mrs Edwards - BSC

Mr Gregory - T. Sol

THE BUILDING SOCIETIES (MONEY TRANSMISSION SERVICES) ORDER 1989

Drafting of the Money Transmission Services Order has now been completed following a short round of consultation. It has been approved by the Building Societies Commission's Statutory Instruments Committee and the Commission will meet on Thursday 16 March to formally consider the order. A final draft is attached.

2. This order is required to be made by the Treasury and is subject to the affirmative resolution procedure. It is not planned to come into force until 1 July but (assuming the Commission approve it on Thursday) it would be useful to lay the draft order before the Easter recess so that societies can adopt the new power at their spring annual general meetings. The debates can be arranged for a convenient time during the coming months unless the Alliance and Leicester emerge as front runners for Girobank. In that case the Order may need to be made before their AGM at the end of April. The order is unlikely to be controversial (unless it is linked to the purchase of Girobank) so the Commons debate could be taken in Committee.

3. I should be grateful if you would indicate your approval that the draft order may be laid.

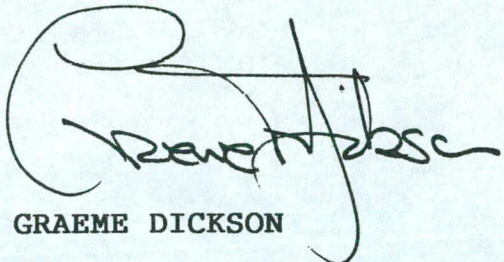
Details of Order

4. The purpose of the order is to allow societies to operate accounts on which bodies corporate can overdraw, temporarily or occasionally, in the course of receiving money transmission services. The power does not apply to individuals: they can already obtain overdrafts up to £10,000. It is also restricted to societies with commercial assets of at least £100 million.

5. The Order creates "money transmission service debts" as a new form of Class 3 asset. It also ensures that the debts owing to the society become aggregated towards the Class 3 asset limit (current 5 per cent.) Article 6 of the Order provides for the manner in which this new category of assets is to be aggregated with other class 3 assets. It is a great improvement, in terms of clarity, on the equivalent provision in the Limited Credit Facilities Order 1987, so the opportunity has been taken to amend the 1987 Order to bring it into line with this Order.

Additional Orders

6. When a draft of this order has been approved by Parliament, the BSC will make a negative order, coming into force on the same day, to amend Schedule 8 to the Act. The main effect will be to allow societies to arrange loans and leasing for companies. I shall show you the final draft nearer that time. If the Alliance and Leicester emerge as likely purchasers of Girobank, it will also be necessary to make a Designation Order (negative procedure). The Order if required would be laid immediately after the Easter Recess. There is a chance that it could be prayed against.



GRAEME DICKSON

Draft Order laid before Parliament under section 19(7) of the Building Societies Act 1986, for approval by a resolution of each House of Parliament.

[DRAFT] STATUTORY INSTRUMENTS

1989 No. ...

BUILDING SOCIETIES

The Building Societies (Money Transmission Services) Order 1989

Made - - - - - 1989

Coming into force 1st July 1989

The Treasury, in exercise of the powers conferred on them by section 19 of the Building Societies Act 1986(a), and of all other powers enabling them in that behalf, hereby makes the following Order, a draft of which has been laid before and approved by resolution of each House of Parliament:

Title and commencement

1. This Order may be cited as the Building Societies (Money Transmission Services) Order 1989 and shall come into force on 1st July 1989.

Interpretation

2. In this Order -

"the Act" means the Building Societies Act 1986;

"the 1987 Order" means the Building Societies (Limited Credit Facilities) Order 1987(b); and

(a) 1986 c.53.

(b) S.I. 1987/1975.

"society" means a building society.

Money transmission service debts and accounts

3.- (1) The forms of property which, by virtue of this Order, a society is to have power, subject to the provisions of this Order, to acquire, hold and dispose of as class 3 assets are money transmission service debts.

(2) For the purposes of this Order -

- (a) "money transmission service debt" means the sum in which a person is indebted to a society on a money transmission service account (whether that sum represents principal, interest or other sums payable on the money transmission service account and whether it is immediately payable or not),
- (b) "money transmission service account holder" means that person, and
- (c) "money transmission service account" means an account which is provided by a society to a person to facilitate the provision of money transmission services by the society to that person and on which that person may, temporarily or occasionally, in the course of and as an incident of receiving money transmission services from the society, become indebted to the society.

Societies to which power is available

4. The power conferred by this Order is not available to a society which does not for the time being have a qualifying asset holding, but the cessation of its availability does not require the disposal of any property.

Limit on power

5. A society may acquire, hold and dispose of a money transmission service debt only where it is owed by a person other than an individual.

Class 3 asset limits

6. The aggregate of money transmission service debts owing to a society shall count in accordance with section 20 (commercial asset structure requirements) of the Act towards the limits applicable to class 3 assets under that section, and in calculating that aggregate -

- (a) where the society has the power conferred by section 34(1) of and item 1 of Part I of Schedule 8 to the Act (power to provide banking services) and the power conferred by this Order, any current overdraft which could be permitted under either of those powers shall be treated as a money transmission service debt;
- (b) where a money transmission service account holder holds other accounts with the society, the value of any shares or deposits in those other accounts shall not be taken into account;
- (c) where the society has money transmission service accounts upon which there is no current indebtedness to the society, the balance of such accounts shall not be taken into account.

Amendment of the 1987 Order

7. For article 7 of the 1987 Order there shall be substituted the following article -

"Class 3 asset limits

7. The aggregate of facility debts owing to a society shall count in accordance with section 20 (commercial asset structure requirements) of the Act towards the limits applicable to class 3 assets under that section, and in calculating that aggregate -

- (a) where the society has the power conferred by section 16 of the Act and the power conferred by this Order, and the society has made arrangements which could be made under either of those powers, the society shall, in respect of each such arrangement, record the power under which it is to be treated as having been made;

- (b) where the society has the power conferred by section 34(1) of and item 1 of Part I of Schedule 8 to the Act (power to provide banking services) and the power conferred by this Order, any current overdraft which could be permitted under either of those powers shall be treated as a facility debt;
- (c) where a facility account holder holds other accounts with the society, the value of any shares or deposits in those other accounts shall not be taken into account; and
- (d) where the society has facility accounts in respect of which there are no current facility debts, the balance of such accounts shall not be taken into account."

..... 1989

.....

.....

Two of the Lords Commissioners
of Her Majesty's Treasury.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order empowers building societies with commercial assets of at least £100 million to operate accounts on which a person other than an individual can overdraw, temporarily or occasionally, in the course of receiving money transmission services. Any such indebtedness will count as a class 3 asset. Class 3 assets may not currently exceed more than 5 per cent of a society's total commercial assets.

The Order also amends article 7 of the Building Societies (Limited Credit Facilities) Order 1987 so that the aggregation of facility debts for the purposes of calculating the limits applicable to class 3 assets is made in the same manner as the aggregation of money transmission service debts under article 6 of this Order.

[BS(MTS)]

est.ld/james/17 Mar/Dickson

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

U
PPS in



FROM: S M A JAMES
DATE: 17 March 1989

MR DICKSON

cc: Mr Odling-Smee
Mr D J L Moore
Mr Bent
Mr Pirie
Mr Judge
Mr Portes
Mr Johnson

Mr Matthews - BSC
Mr Perrett - BSC
Mrs Edwards - BSC

Mr Gregory Tsy Sol

BUILDING SOCIETIES (MONEY TRANSMISSION SERVICES) ORDER 1989

The Economic Secretary was grateful for your minute of 15 March. He is content for the draft order to be laid. He notes that if the order is linked to the purchase of Girobank it will indeed become controversial.

S M A JAMES
PRIVATE SECRETARY

FROM: G F DICKSON

DATE: 20 MARCH 1989

1. MR PIRIE *AS 25/3*
 2. ECONOMIC SECRETARY

cc PS/Chancellor
 PS/Financial Secretary
 Mr Odling-Smee
 Mr Moore
 Mr Bent
 Parliamentary Clerk
 Mr Kroll

Mr Mathews - BSC

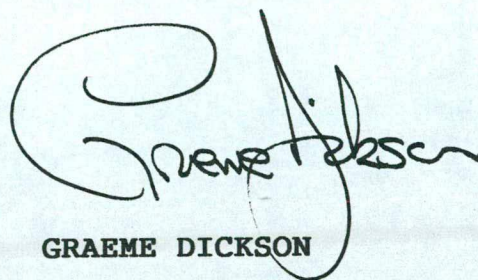
GIROBANK: MONEY TRANSMISSION ORDER

(behind; not copied to this office; I am assured this oversight will not recur)
 My minute of 14 March requested your approval to lay the draft Building Societies (Money Transmission Services) Order before the Easter recess. I noted that the debates on the order could be arranged for a convenient time unless the Alliance and Leicester emerged as front runners for Girobank.

2. The Independent on 16 March reported that the A&L would be putting a special resolution to its annual meeting on 25 April to enable the society to acquire Girobank. The BSC have confirmed that the society wish to adopt the power in the Money Transmission Services Order in addition to the general power to acquire Girobank. PE advise that the A&L should continue to be encouraged as serious candidates to purchase Girobank. The A&L plan to tell the Post Office on 3 April whether they plan to bid. However the Society (and possibly others) will wish to adopt the power whether or not they bid so it is worth making the order ~~sooner~~ rather than later.

3. I therefore recommend that the Commons debate on the order should, if possible, be held before 25 April. A draft letter is attached for your private secretary to send to the Chief Whip's Office requesting that they try to arrange time for a debate as soon as possible after the Easter recess. I also recommend that you ask for the order to be considered by Merits Committee. This order applies to all building societies and does not, in itself, give them the power to invest in Girobank. If it is, nevertheless linked to Girobank and becomes controversial, the order may have to be taken on the floor of the House.

4. I should be grateful if you would confirm that you are content with the arrangements.

A handwritten signature in black ink, appearing to read 'Graeme Dickson'. The signature is stylized with a large, looping initial 'G' and a vertical line extending upwards from the 'i'.

GRAEME DICKSON

DRAFT LETTER FROM PS/ECONOMIC SECRETARY TO:

PS/Government Chief Whip
12 Downing Street
London
SW1

THE BUILDING SOCIETIES (MONEY TRANSMISSION SERVICES) ORDER 1989

The Treasury intends to lay a draft of the above order before the Easter recess. The draft must be approved by both Houses and is planned to come into force on 1 July. However, a building society may anticipate the power on the date on which either House approves the draft.

2. The order grants a general power to all large societies which will facilitate the provision by societies of money transmission services to companies. However, it must also be adopted by the members of a society which wished to purchase Girobank. The Alliance and Leicester Building Society is considering seriously whether to make a firm proposal to purchase Girobank and Treasury and DTI Ministers wish to encourage their interest.

3. The Society intends to put a resolution to its members at its annual meeting on 25 April to allow the adoption of the money transmission power and the power to purchase Girobank. The resolution will only be valid if the Money Transmission Services Order has been approved by one House before 25 April. I should therefore be grateful if you would use your best endeavours to

arrange for the order to be debated in the Commons as soon as possible after the recess. The Economic Secretary would prefer to debate the order in Merits Committee, if that is possible in the time available.

I am copying this letter to Linda Joyce in the Chancellor of the Duchy of Lancaster's Office.

PRIVATE SECRETARY

PWP

dti

the department for Enterprise

ch/ A progress report on Girobank. As you will see from papers behind, the Money Transmission Order has now been laid and we are hoping to have it debated before the A+L's AGM on 25 April.

Eric Forth MP
Parliamentary Under Secretary of State for
Industry & Consumer Affairs

22 MAR 1989

CONFIDENTIAL

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON SW1P 3AG

FINANCIAL SECRETARY	
REC.	22 MAR 1989
ACTION	MR. R. M. BENT
COPIES TO	PPS, CST, EST Sir P. Middleton Mr. Anson, Mr. Schdax Mr. Monck, Mr. Moore

Direct line
Our ref
Your ref
Date

215 4301
D02ABZ

21 March 1989

Dear

Norman

Mr. S. Judge
Mr Odling - Smeeth
Mr. Krou
Mr. Tyrie
Mr. Call.

GIROBANK

Tony Newton wrote to you on 20 February about progress towards the sale of Girobank. He said then that the four potential purchasers were being steered towards submitting firm bids by 17 March. In Tony's absence I am writing to let you know the latest position.

Disappointingly, none of the four potential purchasers in the event submitted a bid. However, all of them did write setting out the position they had reached. The letters suggest that there are still significant difficulties to be resolved in all four cases but there are some positive aspects. The Alliance and Leicester, which is the most promising of the four, have indicated that they expect to be able to take a final decision and, if favourable, submit a bid by 3 April. The Co-operative Bank have also said that they remain keenly interested although they have not indicated when they expect to be in a position to take a final decision. The Bank of Ireland now seem a much more doubtful prospect. They have fundamental concerns about the future for Girobank, further assessment of which they estimate will take four to six weeks. It is far from certain that at the end of this

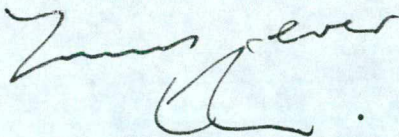
period they would submit a bid. Singer and Friedlander now appear a very unlikely purchaser. They have asked for a lengthy period of exclusive negotiating rights (ten weeks) during which they would want their accountants to undertake a detailed assessment of the business to form the basis for a decision whether to bid. As they now appear the least likely purchaser, there can be no question of the Post Office agreeing to this request and Singer and Friedlander are therefore fairly certain to withdraw.

The Post Office Board met today to discuss how to proceed and will meet again next week to review the issues as necessary. They propose to give priority to the Alliance and Leicester and the Co-operative Bank. This seems right to me. The Post Office should not risk losing the interest of either of these parties by delaying matters in the hope that others can be kept in play. I understand, however, that the Post Office now regard it as unlikely that, for example, arrangements for the future of Girobank's corporate business will be sufficiently far advanced for any bid submitted by the Alliance and Leicester in early April to provide a basis at that stage for selection of a preferred bidder. While neither I nor the Post Office consider it advisable to set a deadline of 3 April, or any other date, I shall look to the Post Office to try to ensure that both the Alliance and Leicester and the Co-operative Bank will be in a position to express a firm view towards the end of April. If the Bank of Ireland can be encouraged to do so as well then this would be helpful although it should clearly be a lower priority.

It is now clear that the Post Office will not have reached the stage of identifying a preferred bidder by the end of March. When he appeared before the Trade and Industry Select Committee on 1 March, Tony Newton said he understood the Post Office were hoping to achieve this. The absence of a preferred bidder by the end of this month may therefore give rise to some comment. Tony did, however, make clear that he had not set a firm timetable and we shall be able to refer to this should we need to comment.

Tony and I will continue to keep you and colleagues informed of developments.

I am copying this letter to the Prime Minister, John Moore, John Wakeham and Sir Robin Butler.



ERIC FORTH

est.ld/james/21 Mar/Dickson

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE



Handwritten initials: PWP

FROM: S M A JAMES
DATE: 21 March 1989

MR DICKSON

cc: PS/Chancellor
PS/Financial Secretary
Mr Odling-Smee
Mr D J L Moore
Mr Bent
Mr Pirie
Mr Kroll

Mr Mathews - BSC

GIROBANK : MONEY TRANSMISSION ORDER

The Economic Secretary was grateful for your minute of 20 March. He is content that we should press for a debate on the order, if ... possible, before 25 April. I attach a copy of the letter I have sent to the Whips' office today.

Handwritten signature: S M A James

S M A JAMES
PRIVATE SECRETARY

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE



Treasury Chambers, Parliament Street, SW1P 3AG

**M MacLean Esq
PS/Government Chief Whip
12 Downing Street
London
SW1**

22 March 1989

Dear Murdoch,

THE BUILDING SOCIETIES (MONEY TRANSMISSION SERVICES) ORDER 1989

The Treasury intends to lay a draft of the above order before the Easter recess. The draft must be approved by both Houses and is planned to come into force on 1 July. However, a building society wishes to incorporate the power into its memorandum of powers at its AGM on 25 April and can only do so if it has been approved by either House.

The order grants a general power to all large societies which will facilitate the provision by societies of money transmission services to companies. However, it must also be adopted by the members of a society which wished to purchase Girobank. The Alliance and Leicester Building Society is considering seriously whether to make a firm proposal to purchase Girobank and Treasury and DTI Ministers wish to encourage their interest.

The Society intends to put a resolution to its members at its annual meeting on 25 April to allow the adoption of the money transmission power and the power to purchase Girobank. The resolution will only be valid if the Money Transmission Services Order has been approved by one House before 25 April. I should therefore be grateful if you would use your best endeavours to arrange for the order to be debated in the Commons as soon as possible after the recess. The Economic Secretary would prefer to debate the order in Merits Committee, if that is possible in the time available.

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE

I am copying this letter to Linda Joyce in the Chancellor of the
Duchy of Lancaster's Office and to Rodri Walters.

*Yours
fneida*

S M A JAMES

PRIVATE SECRETARY

CONFIDENTIAL: COMMERCIAL IN CONFIDENCE

FROM: S P JUDGE (PE2)

DATE: 7 April 1989

x4931

FINANCIAL SECRETARY

cc PS/Chancellor ✓
 PS/Chief Secretary
 PS/Economic
 Secretary
 Sir P Middleton
 Mr Anson
 Mr Scholar
 Mr Monck
 Mr Moore
 Mr Odling-Smee o/r
 Mrs Lomax
 Mr Bent o/r
 Mr Pirie
 Ms Osmond
 Mr Dickson
 Mr Kroll
 Mr Call
 Mr Tyrie

mp
 ✓

GIROBANK PRIVATISATION

You might like to know that the **Alliance & Leicester** have now submitted a bid. Their offer price of £120m - subject to various significant caveats and conditions - is in the middle of the range mentioned in Tuesday's FT (attached).

2. The A&L have given the Post Office until Thursday, 13th April to grant them a three month period of exclusive negotiating rights.

3. The Post Office have been working on the legal, accounting and tax implications of transferring to the Post Office those assets which cannot be sold to a Building Society (namely corporate loans and leases, which amount to about £500m). GEP are considering the public expenditure implications of the cash injection to Giro's balance sheet that would be needed.

4. The A&L have not yet formally approached either the Bank or the BSC about this bid, although they recognise the need to do so urgently if they are given exclusive negotiating rights.

5. I attended a meeting this afternoon between DTI and Hambros (their Merchant Bank Advisers). It was agreed that the PO should be pressed to negotiate an extension of the A&L's deadline until

the end of April, if possible. Schrodgers expect bids from the Co-Op Bank and the Bank of Ireland by Friday 14th. (Singer and Friedlander, the fourth runner, have definitely withdrawn). Some time will be needed thereafter for the PO to assess (and negotiate on) the outline terms and conditions accompanying each offer, before choosing which party should be given exclusive negotiating rights; and for Ministers to consider the Board's recommendation. Not surprisingly, the advisers think that, once the PO grant exclusive negotiating rights to one bidder, the other two would show no further interest if those negotiations came to nothing.

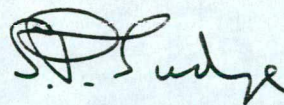
6. At a subsequent meeting (at which I was not present) the PO asked Schrodgers to negotiate an extension to the A&L's deadline to 20 April, to follow a Board meeting on 17 April. This timetable will obviously be very tight. We should know early next week if the A&L will agree to this. If they don't then the PO will have to consider their offer in ignorance of the other two.

Contingency Planning

7. The Post Office are still very confident that they will sell Girobank this year. But if they are unable to select a preferred bidder by the end of this month they are likely to argue that the privatisation should be called off for the foreseeable future. Phillip Sellers, Post Office Board Member for corporate finance and planning, has set up a small group to make plans for this contingency: the Treasury is represented on it. The PO will be investigating a range of options.

Conclusion

8. The sale process is hotting up. I will submit further advice next week: DTI Ministers are likely to write on the general issues connected with a sale to a Building Society.



S P JUDGE

1 Column

Alliance & Leicester to bid for Girobank

By Richard Waters

ALLIANCE & LEICESTER, the UK's fifth-largest building society, will become the first institution to make a formal bid for Girobank when it offers more than £100m early this week.

The move, approved at an Alliance board meeting on Friday, could mark the final chapter in the long process of privatising the Post Office's banking subsidiary.

At the end of last year, the sale appeared to be on the rocks when the Government was unable to find a suitable buyer. By February, however, it was announced that a shortlist of four potential buyers had been found. These were known to include Alliance & Leicester and Co-operative Bank.

Alliance & Leicester has not disclosed how much it will offer, but is understood to have set a figure below the £140m it was reported to have considered. Nevertheless, a sale at a figure approaching this would come as a relief to Schroders, the London merchant bank advising Girobank, as the price was understood last autumn to have fallen to nearer £100m.

There are still significant points of difference which will need to be hammered out if Alliance & Leicester is to buy the bank. It is understood to be unhappy, for instance, that Girobank has a five-year contract with the Post Office to use its counters, but only a one-year contract with the Department of Social Security for payments by Giro.

If the Government accepts the Alliance & Leicester offer, the society will then become the preferred bidder and will be given exclusive rights to negotiate over this and other conditions.

An Alliance & Leicester board member said yesterday that the society was wholly committed to maintaining the Girobank operations centre in Bootle, Merseyside. Unlike other societies, he said, Alliance & Leicester had no cheque processing operations of its own and so had little overlap with the bank's existing operations.

However, he declined to commit the society to retaining all of the Bootle staff. "We would have to run it as a business and do whatever we needed to do," he said.

The way for a building society takeover of Girobank was cleared earlier this year when the Government relaxed the Building Societies Act to allow societies to offer services to companies.

Alliance & Leicester said it would use its acquisition to build a chequebook operation. Building this from scratch would be expensive, as suggested by the recent experiences of other societies, it said.

FROM: S P JUDGE (PE2)

DATE: 7 April 1989

x4931

FINANCIAL SECRETARY

cc PS/Chancellor
 PS/Chief Secretary
 PS/Economic
 Secretary
 Sir P Middleton
 • Mr Anson
 • Mr Scholar
 • Mr Monck
 • Mr Moore
 • Mr Odling-Smee o/r
 • Mrs Lomax
 • Mr Bent o/r
 • Mr Pirie
 • Ms Osmond
 • Mr Dickson
 • Mr Kroll
 Mr Call
 • Mr Tyrie

GIROBANK PRIVATISATION

You might like to know that the Alliance & Leicester have now submitted a bid. Their offer price of £120m - subject to various significant caveats and conditions - is in the middle of the range mentioned in Tuesday's FT (attached).

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3. The Post Office have been working on the legal, accounting and tax implications of transferring to the Post Office those assets which cannot be sold to a Building Society (namely corporate loans and leases, which amount to about £500m). GEP are considering the public expenditure implications of the cash injection to Giro's balance sheet that would be needed.

4. The A&L have not yet formally approached either the Bank or the BSC about this bid, although they recognise the need to do so urgently if they are given exclusive negotiating rights.

5. I attended a meeting this afternoon between DTI and Hambros (their Merchant Bank Advisers). It was agreed that the PO should be pressed to negotiate an extension of the A&L's deadline until

the end of April, if possible. Schroders expect bids from the Co-Op Bank and the Bank of Ireland by Friday 14th. (Singer and Friedlander, the fourth runner, have definitely withdrawn). Some time will be needed thereafter for the PO to assess (and negotiate on) the outline terms and conditions accompanying each offer, before choosing which party should be given exclusive negotiating rights; and for Ministers to consider the Board's recommendation. Not surprisingly, the advisers think that, once the PO grant exclusive negotiating rights to one bidder, the other two would show no further interest if those negotiations came to nothing.

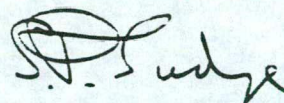
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Contingency Planning

7. The Post Office are still very confident that they will sell Girobank this year. But if they are unable to select a preferred bidder by the end of this month they are likely to argue that the privatisation should be called off for the foreseeable future. Phillip Sellers, Post Office Board Member for corporate finance and planning, has set up a small group to make plans for this contingency: the Treasury is represented on it. The PO will be investigating a range of options.

Conclusion

8. The sale process is hotting up. I will submit further advice next week: DTI Ministers are likely to write on the general issues connected with a sale to a Building Society.



S P JUDGE

Alliance & Leicester to bid for Girobank

By Richard Waters

ALLIANCE & LEICESTER, the UK's fifth-largest building society, will become the first institution to make a formal bid for Girobank when it offers more than £100m early this week.

The move, approved at an Alliance board meeting on Friday, could mark the final chapter in the long process of privatising the Post Office's banking subsidiary.

At the end of last year, the sale appeared to be on the rocks when the Government was unable to find a suitable buyer. By February, however, it was announced that a shortlist of four potential buyers had been found. These were known to include Alliance & Leicester and Co-operative Bank.

Alliance & Leicester has not disclosed how much it will offer, but is understood to have set a figure below the £140m it was reported to have considered. Nevertheless, a sale at a figure approaching this would come as a relief to Schroders, the London merchant bank advising Girobank, as the price was understood last autumn to have fallen to nearer £100m.

There are still significant points of difference which will need to be hammered out if Alliance & Leicester is to buy the bank. It is understood to be unhappy, for instance, that Girobank has a five-year contract with the Post Office to use its counters, but only a one-year contract with the Department of Social Security for payments by Giro.

If the Government accepts the Alliance & Leicester offer, the society will then become the preferred bidder and will be given exclusive rights to negotiate over this and other conditions.

An Alliance & Leicester board member said yesterday that the society was wholly committed to maintaining the Girobank operations centre in Bootle, Merseyside. Unlike other societies, he said, Alliance & Leicester had no cheque processing operations of its own and so had little overlap with the bank's existing operations.

However, he declined to commit the society to retaining all of the Bootle staff. "We would have to run it as a business and do whatever we needed to do," he said.

The way for a building society takeover of Girobank was cleared earlier this year when the Government relaxed the Building Societies Act to allow societies to offer services to companies.

Alliance & Leicester said it would use its acquisition to build a chequebook operation. Building this from scratch would be expensive, as suggested by the recent experiences of other societies, it said.

FROM: N MONCK
DATE: 10 April 1989
EXT: 4399

FINANCIAL SECRETARY

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Moore
Mr Odling-Smee o/r
Mrs Lomax
Mr Bent o/r
Mr Pirie
Mrs Burnhams
Mr Judge
Ms Osmond
Mr Dickson
Mr Kroll
Mr Call
Mr Tyrie

pmw

GIROBANK PRIVATISATION

Mr Judge's minute of 7 April reports that Alliance and Leicester are pressing for a three month period of "exclusive negotiating rights".

2. At the moment we seem to have three bidders of various degrees of seriousness. I don't see why the Post Office should weaken its own negotiating position by agreeing to exclusivity until the enquiries the bidders want to make have reached the point at which the answers to them will not affect the price, ie they are about genuine details. So long as the answers to the enquiries can affect the price offered, it must be in the Post Office's and hence the taxpayer's interest to keep as many bidders in play as possible. In the last resort there may be a risk of killing the bid by taking this line. But we certainly should not assume at this stage that a robust commercial reply to a request for exclusivity will produce such a reaction for real rather than as a negotiating ploy. (The current Shorts negotiation is relevant to this).

3. It would be helpful to know if you agree that exclusivity should be rejected, at least at this stage.

NM

N MONCK

13 APR 1989

the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line
Our ref
Your ref
Date

215 5147

13 April 1989

FINANCIAL SECRETARY	
REC.	13 APR 1989
ACTION	MR. R. M. BENT
COPIES TO	PPS, CST, EST
	Sir P. Middleton
	Mr. Anson, Mr. Monck
	Mr. Scholok, Mr. Moore

Jan Norman

Mr. Odling-Smee
Mrs. Lomax Mr. Pirie
Mr. S. P. Judge

GIROBANK: SALE TO A BUILDING SOCIETY

Eric Forth's letter of 21 March explained that no bids had at that stage been received for Girobank and that, of the four potential bidders, the Post Office were focussing attention on the Alliance and Leicester and Co-operative Bank, with less prospect of either the Bank of Ireland or Singer and Friedlander making a bid. The Alliance and Leicester have now submitted a bid and we expect the Co-op to do so shortly. The Bank of Ireland and Singer and Friedlander have decided not to bid. This letter sets out the details of the Alliance and Leicester bid and seeks agreement on how it should be handled by the Post Office.

The Alliance and Leicester bid is for £120 million (£81 million cash plus repayment of the £39 million subordinated loans). This is subject to a number of adjustments which at present seem likely to have a modest positive affect on the bid price but there would be a downward adjustment in the event of any rise in interest rates. It is also subject to a number of conditions and warranties which may significantly lower the eventual price. It is not possible at this stage to estimate what the bottom line could be, but my expectation is that it will be above the £90 million minimum price which my advisers, Hambros, regard as acceptable in present circumstances.

cc: Mr. Dickson
Mr. Kroll
Mr. Tyrrie Mr. Call
E

BRYABO



the department for Enterprise

The Alliance and Leicester originally set a deadline of 13 April for a decision on their bid, but have agreed to extend this to 20 April. The Post Office and its advisers expect that the Co-op Bank will submit a bid by 14 April. If this is achieved it will allow a brief opportunity to consider comparative bids; but we cannot rely on a Co-op bid meeting this timescale. A decision must be made on the Alliance and Leicester bid by Wednesday 19 April, before it lapses.

The Alliance bid is subject to the condition that there should be a three month period of exclusive negotiating rights and, even if this period can be negotiated down, the effect of this condition is that the choice at the end of it would be between a sale to them or no sale at all. There is every likelihood that a bid from the Co-op will contain a similar condition. Despite the evident risks, there seems to me to be little alternative but to indicate to the Post Office that in principle we would be prepared for them to enter in to a period of exclusivity with a preferred bidder. I shall of course try to give you and colleagues the opportunity to comment on any bid from the Co-op. For the present, however, I believe that while the Alliance bid is not ideal, it would be acceptable, depending of course on the terms of any Co-op bid, for them to become the preferred bidder. In any event I shall also need to be satisfied in relation to David Young's responsibilities under competition legislation.

There is a second issue in relation to the Alliance bid which needs to be resolved now. This concerns the handling of Girobank's leasing and corporate lending business, which a building society will not be able to undertake as principal even after the changes in building society regulations recently announced by Peter Lilley. This business needs to be sustained in order to safeguard the value to the purchaser of the corporate business it will acquire as principal. Peter Lilley set out in his letter of 10 February a possible solution and this has, as he predicted, proved to be the best course. The details are set out in the attached note. I believe these have already been discussed with your officials. I should welcome your endorsement that we should proceed in this way.

The sale process has now been underway for some 10 months. We have resurrected the process once, when it appeared to be failing. The Alliance and Leicester is one of only two organisations showing serious interest in acquiring Girobank at a reasonable price and the only one to have made a bid so far. We must take all the necessary steps now to keep alive the interest which exists. Even then, we cannot be sure that a sale will result. Unless we do secure a sale quickly from amongst the present potential purchasers, I consider that we shall have no option but to withdraw the bank from the market. This will

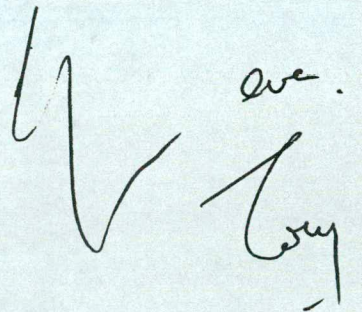
BRYABO

give rise to different, but nevertheless significant, difficulties. Your officials and mine are already discussing these with the Post Office, on a contingency basis. It seems clear, however, that additional investment to help regain lost market share and more flexible procedures for responding to Girobank proposals may well be required.

To summarise, I should be glad of your agreement to:

- (i) my confirming to the Post Office that we recognise the possible need for them to enter into an exclusive negotiation from next week;
- (ii) depending on further negotiations with the Alliance and Leicester and any bid from the Co-operative Bank, we should be prepared for them to recognise the Alliance as the preferred bidder; and
- (iii) if the Alliance becomes the preferred bidder, the leasing and corporate loans business should be handled as set out in the attached note.

I am copying this letter to the Prime Minister, John Wakeham, John Moore and Sir Robin Butler.

A handwritten signature in black ink, appearing to read 'Tony Newton', with a large 'W' or 'N' shape above it. The signature is written in a cursive style.

TONY NEWTON

GIROBANK'S LEASING AND CORPORATE LOAN BUSINESS

Peter Lilley's letter of 10 February set out the changes in building society regulations which it was proposed should be made to facilitate a sale of Girobank to a building society. Although the proposed changes will be very helpful in opening the way for a building society to acquire Girobank, a building society will be able to conduct leasing and corporate lending business only as agent and not on its own account. Peter Lilley's letter suggested that the Post Office and its advisers, Schroders, should be asked to consider what arrangements might be made for dealing with this part of Girobank's business. He suggested that the best solution might be for the Post Office to take this business onto its own books.

The Post Office has now completed its analysis of this business. This shows that transfer of this business onto the books of the Post Office is indeed likely to offer the best solution in terms of maximising the return. Indeed, there is little or no alternative if Girobank is to be sold to a building society. The Alliance and Leicester Building Society bid is conditional, amongst other things, on this business being preserved through retention by the Post Office of the assets relating to leasing and corporate lending.

Girobank's leasing subsidiaries, held by its subsidiary Giroleasing Holdings Limited, have outstanding leasing assets and forward funding commitments of about £350 million. A forced sale of these assets would be very unlikely to realise their full value. It would result in a loss to Girobank which would be reflected in the sale price. Their retention by the Post Office, on the other hand, would maximise both the proceeds of the sale of Girobank and the benefit from the leasing business.

In addition, Girobank has outstanding about £100 million of corporate leasing, made up of some 200 corporate overdrafts and 150 term loans. These could be transferred to the Post Office by means of a scheme under section 50 of the British Telecommunications Act 1981. Transfer to any third party would require consultation and negotiation with each individual borrower. This would be impracticable. In the eyes of the purchaser, loss of this business would damage the corporate business which Girobank will retain.

Sale to a building society in principle offers a good option for transferring Girobank to the private sector and this option is unlikely to be available unless the Post Office retains these assets. I believe that we should therefore be prepared to accept such a solution. There may be no other disposal option.

The ability to offer new corporate lending business (albeit as agent) will be important to maintaining and developing Girobank's corporate business. Other institutions may be interested in acting as principal in this new business. It may, however, be necessary to make some arrangement for the Post Office to assume some additional corporate lending business if it does not prove possible to make arrangements with a third party in time to avoid any break in availability. This would need to be subject to clear limits both on the extent of lending and the duration of the arrangement.

The effects on profits and losses of the transfer are not expected to be significant. Financing of the transfer does, however, raise significant issues. Ideally any transfer would include both assets and matching liabilities and the restructuring would have no EFL consequences. That is not possible in this case. The leasing advances and corporate lending are financed by personal and corporate deposits which are at the heart of Girobank's business and could not be transferred out. It will therefore be necessary for the Post Office to refinance the prohibited assets: the precise cash effect will depend on the business outstanding at completion, but is likely to be in the region of £450-£550 million. The transaction will not affect Girobank's EFL because of its special treatment as a bank. It will, however, have a direct effect on the Post

Office's EFL, adding £450-550 million this year. In future years the Post Office's EFL would of course benefit from the income from this business, which will largely wind down over the next three to five years.

Such a refinancing arrangement by the Post Office and the adverse EFL implications, as well as the temporary retention of part of Girobank's business in the public sector, may be expected to cause comment. Officials in DTI and Treasury will need to consider carefully how best to deal with this.

RP3ACX

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BF 24/4
[for progress report]

Ch/ To note especially the
PX implications of the
A+L bid. A pity that officials
didn't spot this earlier.

FROM: S P JUDGE (PE2)
EXT: 4931
DATE: 14 April 1989

- 1. MR MOORE
- 2. FINANCIAL SECRETARY

cc
Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Moore
Mr Odling-Smee o/r
Mrs Lomax
Mrs R J Butler
Mr Bent o/r
Mr Pirie
Mr MacAuslan
Mr M G Richardson
Mr Devereux
Miss Osmond
Mr Dickson
Mr Kroll o/r
Mr Portes
Mr Call
Mr Tyrie

015

A&L have bid £120 million and the Co-op £124 million, both with conditions which have to be probed further. Mr Newton wants reactions by Monday lunch-time on 2 main points on the A&L bid. The Chief Secretary will want to consider the public expenditure consequences explained in § to below: a net £300 m plus this year, unwinding in later years. We advise that this should be accepted if necessary, but that we should pursue other financing methods which would avoid the problem. If these worked the outcome this year would be minus £120 m on the PO's EFL.

You have agreed that the PO should be urged not to give exclusivity to either bidder before they are very much clearer on the price options.

SW 14/4

GIROBANK PRIVATISATION

Mr Newton's letter of 13 April: (behind)

- seeks your agreement to the Post Office's proposed handling of the bids from the Alliance & Leicester (which arrived last week) and the Co-op Bank (which arrived at 2.30 pm today);
- in particular, seeks your agreement to the Post Office (PO) granting exclusive negotiating rights to one of these bidders next week; and
- seeks your agreement to his proposals for handling the leasing and corporate loans business, if Giro is sold to the

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A&L. This would have significant public expenditure implications in 1989-90, which the Chief Secretary will wish to consider. The PO need to know if these implications now rule out a sale to a building society. In our view - after consulting GEP - they do not, and it may prove possible to sidestep them altogether.

2. This submission, which has been agreed with FIM and GEP, recommends that you write on the lines of the attached draft. This letter should issue early on Monday, if it is to affect the meeting of the Post Office Board that evening.

Alliance & Leicester bid

3. As Mr Newton says, the A&L bid is for £120m, subject to a number of adjustments and conditions, which the Post Office and Schroders are trying to whittle down. The more conditions that survive, the greater the risk of a bidder walking away later on, blaming the Government. We are concerned about the following, in particular:

- A&L propose that the PO should undertake to supply funds for new loans to corporate bodies that Girobank might generate (as the Post Office's agent) after privatisation. This could hit the 1989-90 EFL;
- they seek an undertaking that the PO would retain the "prohibited assets" that cannot be sold to them (ie corporate loans and leases), and give them an option to buy these assets if and when they convert to a plc (a la Abbey National). We do not agree that the PO should hang on to these assets against the possibility that A&L will become eligible to take them over;
- the A&L ask for an undertaking from the PO that it will not compete with Girobank in respect of the latter's services, for an agreed period.

an outrageous set of conditions

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4. Subject to satisfactory resolution of these points, and others, we would agree with Mr Newton's statement that "while the Alliance bid is not ideal, it would be acceptable". We understand that both he and the Board would prefer to sell to them rather than to the Co-op.

Co-op Bid

5. The Post office have just received a bid from the Co-op - for £124 million, again subject to various qualifications and conditions. We have not yet been able to assess this bid, but a sale to the Co-op would of course avoid the public expenditure problems described in paragraphs 8-15 below.

Exclusivity

6. Mr Newton's letter reports that the A&L have asked for a three month period of exclusive negotiating rights. Their offer initially expired yesterday, but they have been persuaded to extend it until 20 April. The advice from Hambros - DTI's advisers - is in line with Mr Monck's note of 10 April. There will come a time when the PO will wish to indicate a firm wish to sell to a specified bidder, at a specified price. This will then be followed by a period of negotiation (which we expect to last up to 3 months) over the details, legal agreements etc. The question is whether the PO will have a sufficiently clear understanding of the bid by next Thursday. We think that they may not have. If this is so, both bidders should be asked to revise their bids to take account of the seller's concerns, and exclusivity should not be granted until the position on the price, or the variables which might effect it, are as clear as possible. Clearly there is an element of brinkmanship here (and the last page of Mr Newton's letter previews the IFR bid he will make if the sale is called off), but if the bidders are serious they will expect this behaviour from the PO.

7. The draft letter makes points along these lines. It must be accepted that once such detailed "pre-exclusivity" negotiations are concluded, the PO will want to grant exclusivity very quickly. But we do not think the PO should move to exclusivity before Ministers have

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had an opportunity to consider the position again, although this may have to be done very quickly indeed. We discussed this line with you this afternoon, and you agreed with it.

Public Expenditure Implications of a A&L bid

8. The attachment to Mr Newton's sets out the rather complicated financing and public expenditure implications of a bid from a building society. Briefly, about £550 million of "prohibited assets" (loans and leases to corporate bodies) will have to be removed from Girobank's balance sheet.

9. The ideal option would be to sell these assets before privatisation to another financial institution. However, the logistics of reassigning the corporate loans would make this very difficult; and for the corporate leases a sale would crystallize a loss of £16 million, which reflects the divergence (at current interest rates) between the book and market values of their fixed interest leases.

10. The PO therefore propose to replace these assets with cash. This cash injection will score against the PO's external financing limit (EFL) and thus the 1989-90 public expenditure planning total. Conversely, as the loans and leases mature, the cash payments from the private sector to the Post Office will reduce net public expenditure.

11. The net effect in 1989-90 is difficult to predict. However we can be confident that it will be less than the full £550 million mentioned above:

i. the Post Office should be able to sell some of the "problem assets" during 1989-90 (and should be encouraged to do so);

ii. some of the leases and loans would anyway mature before the end of the financial year; and

iii. it may be possible to replace the assets on Giro's balance sheet with liquid assets other than cash, eg, a

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marketable loan from Giro to the Post Office. This would be the ideal solution because the EFL effect would be confined to the benefit from the sales proceeds - up to £120 million.

12. Taking into account the expected proceeds of £120 million, our best assessment for the impact on public expenditure is as follows:

Change in Post Office's EFL	£million
1989-90	+300
1990-91	-80
1991-92	-70
1992-93	-70
1993-94 and later years	<u>-200</u>
	<u>-120</u>

(Not surprisingly, the net effect over time, £-120m, is equal to the proceeds from the sale).

13. The Chief Secretary will wish to consider these figures - which are still somewhat uncertain. They represent our best estimate of the effects of a straight cash injection, with limited sales of leasing assets by the PO after privatisation.

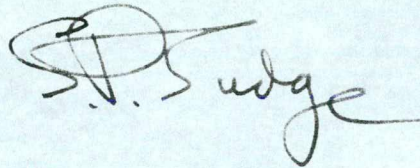
14. GEP point out that the prospect of annual EFL 'savings' of £50-100 million in 1990-91 and later years would help to mitigate some of the difficulties of the forthcoming Survey. On the other hand, an addition of £300 million (or so) in 1989-90 would be a potent threat to our ability to hold this year's planning total. GEP's first formal position report on 1989-90 will not appear until early next month. But the early indications are that the £3.5 billion Reserve will be overspent: more than £0.5 billion of Reserve claims have already been agreed and LG are forecasting overspending by local authorities of over £2.5 billion. Against this (albeit uncertain) background, an extra £300 million for Girobank would damage whatever chance remained of holding the 1989-90 planning total. On balance, GEP do not think that public expenditure considerations should rule out a sale to the A&L.

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15. PE would agree: although the affect on the PO's EFL will be presentationally awkward - and will no doubt necessitate messy footnotes in future PEWPs - we think this could be handled.

16. We will of course follow up, with FIM's help, the various options identified in paragraph 11 for mitigating the effects, and in particular 11 iii. This will take some time - iii. would involve Girobank and the A&L, and the Bank and Building Societies Commission (as their respective regulators).

A handwritten signature in cursive script, appearing to read "S. P. Judge". The signature is written in dark ink and is positioned in the center of the page.

S P JUDGE

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DRAFT LETTER TO MR NEWTON

GIROBANK: SALE TO A BUILDING SOCIETY

Thank you for your letter of 13 April.

2. Our officials have discussed further the likely public expenditure impact on the Post Office's EFL if Girobank is sold to the A&L. They now agree that the net impact is likely to be around +£300 million in 1989-90, with offsetting savings of £80 million or so in each of the following Survey years.

3. Although this effect in the current year would be presentationally unwelcome, John Major would be willing to accept it if necessary. It will however be important to do all we can to minimise the impact:

- the PO must be encouraged to sell as many of their leasing assets as possible during 1989-90 (subject of course to securing a good price). In particular they should sell their forward funding and commitment leasing arrangements;
- the PO should therefore not give an undertaking to hold on to the "prohibited assets", and to sell them back to the A&L if and when they convert to a plc;

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- we must closely restrict the amount of new corporate loans that the PO undertake to supply via Girobank after privatisation. And the PO must undertake to arrange for a third party to take over this new lending as soon as possible this year.

- I am not convinced that the PO will need to (or should) provide funds for new corporate leases generated by Giro;

- officials and advisers, together with the Bank and the BSC, should investigate the possibility of replacing Giro's "prohibited assets" with a liquid asset other than cash, so that the net EFL effect would be limited to the benefit from the sale proceeds. Treasury officials will take the initiative on this.

4. Turning to the exclusivity point, I gather that the PO have now received a bid from the Co-op bank, and that Schroders will be discussing both bidders' proposals with them next week. I accept that there will come a time when the PO will want to grant exclusive negotiating rights to one bidder, and move to detailed work on the legal agreements and so on. However I do feel that they should not advance to this position until they are clear on the relative merits of the two bids, and have refined the conditions attached to them as far as possible, in particular those which affect the price. This seems essential if they, and we, are to defend the price as the best available from the

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competing bids received. If this assessment cannot be completed by Thursday - the A&L's deadline - then it should be explained to both bidders that a few more days work is needed. I am not convinced that this approach would provoke either party to walk away, and I understand that it is in line with your advice from Hambros.

5. In the meantime, on the information that is available, I would agree with your assessment of the acceptability of the A&L's bid.

4. I am copying this letter to the Prime Minister, John Wakeham, John Moore, Nigel Lawson, John Major and Sir Robin Butler.

N L

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CONFIDENTIAL



FROM: P T WANLESS
DATE: 17 April 1989
Ext. 5086

PS/FINANCIAL SECRETARY

cc: Chancellor
Economic Secretary
Sir Peter Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Moore
Mr Odling-Smee
Mrs Lomax
Mrs R J Butler
Mr Bent
Mr Pirie
Mr MacAuslan
Mr M G Richardson
Mr S P Judge (PE2)
Mr Devereux
Miss Osmond
Mr Dickson
Mr Kroll
Mr Portes
Mr Call
Mr Tyrie

PWP
(or BF?)

GIROBANK PRIVATISATION

The Chief Secretary has considered Mr Judge's submission of 14 April.

2. He is content with the public expenditure consequences of around £300 million in 1989-90 with offsetting savings of £80 million or so in each of the following Survey years.

3. He is content for paragraph 3 of the letter to Mr Newton to be redrafted to read:

"This effect in the current year would clearly be unwelcome to John Major and he has therefore asked me to stress the importance of doing all we can to minimise the impact:...."

PW.

PETER WANLESS
Assistant Private Secretary



CC: CHANCELLOR,
 CHIEF SECRETARY,
 ECONOMIC SECRETARY,
 SIR P. MIDDLETON,
 MR ANSON, MR MONCK,
 MR SCHOLAR, MR MOORE,
 MR OOLING-SMEE,
 SWIP 3AG Mrs LOMAX,
 Mrs R.J. BUTLER, MR BENT,
 MR PIRIE, MR MACAUSLAN,
 MR M.G. RICHARDSON,
 Mrs S. JUOGE,
 17th April 1989
 MR DEVEREUX, MISS OSMOND,
 MR DICKSON, MR KROLL,
 MR PORTES, MR CALL,
 MR TYRIE.

Duncan
 Did these
 come in
 this morning?
 S

Treasury Chambers, Parliament Street,

The Rt Hon Tony Newton, OBE
 Chancellor of the Duchy of Lancaster
 1 Victoria Street
 London SW1H 0ET

yesterday — PWP
 Saw Jay

GIROBANK: SALE TO A BUILDING SOCIETY

Thank you for your letter of 13 April.

Our officials have discussed further the likely public expenditure impact on the Post Office's EFL if Girobank is sold to the A&L. They now agree that the net impact is likely to be around +£300 million in 1989-90, with offsetting savings of £80 million or so in each of the following Survey years.

This effect in the current year would clearly be unwelcome to John Major, and he has therefore asked me to stress the importance of doing all we can to minimise the impact:

- the PO must be encouraged to sell as many of their leasing assets as possible during 1989-90 (subject of course to securing a good price). In particular they should sell their forward funding and commitment leasing arrangements;
- the PO should therefore not give an undertaking to hold on to the "prohibited assets", and to sell them back to the A&L if and when they convert to a plc;
- we must closely restrict the amount of new corporate loans that the PO undertake to supply via Girobank after privatisation. And the PO must undertake to arrange for a third party to take over this new lending as soon as possible this year.
- I am not convinced that the PO will need to (or should) provide funds for new corporate leases generated by Giro;
- officials and advisers, together with the Bank and the BSC, should investigate the possibility of replacing Giro's "prohibited assets" with a liquid asset other

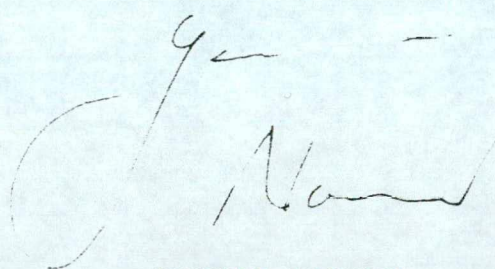
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than cash, so that the net EFL effect would be favourable rather than unfavourable and confined to the benefit from the sale proceeds. Treasury officials will take the initiative on this.

Turning to the exclusivity point, I gather that the PO have now received a bid from the Co-op bank, and that Schrodgers will be discussing both bidders' proposals with them next week. I accept that there will come a time when the PO will want to grant exclusive negotiating rights to one bidder, and more to detailed work on the legal agreements and so on. However I do feel that they should not advance to this position until they are clear on the relative merits of the two bids, and have refined the conditions attached to them as far as possible, in particular those which affect the price. This seems essential if they, and we, are to defend the price as the best available from the competing bids received. If this assessment cannot be completed by Thursday - the A&L's deadline - then it should be explained to both bidders that a few more days work is needed. I am not convinced that this approach would provoke either party to walk away, and I understand that it is in line with your advice from Hambros.

In the meantime, on the information that is available, I would agree with your assessment of the acceptability of the A&L's bid.

I am copying this letter to the Prime Minister, John Wakeham, John Moore, Nigel Lawson, John Major and Sir Robin Butler.

A handwritten signature in dark ink, appearing to read 'Norman Lamont', is written over a large, faint circular stamp or watermark.

NORMAN LAMONT

CONFIDENTIAL

CONFIDENTIAL

FROM: D J L MOORE (PE)
x 4440

DATE: 18 APRIL 1989

FINANCIAL SECRETARY

cc: Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Odling-Smee
Mrs Lomax
Mr Bent
Mr Pirie
Mr Judge
Mr Call
Mr Tyrie

DMJ
✓

GIROBANK PRIVATISATION

The Post Office Board wishes to announce this Thursday, concurrently with a Written Answer, that it has accepted a conditional offer from the Alliance and Leicester and has agreed to enter into a period of exclusive negotiations with them to bring the sale to a conclusion within the next few weeks.

2. Mr Newton at DTI will write - and probably speak - to you tonight seeking your agreement to this tomorrow morning. I recommend that you give it. As I explain below, A&L are offering a better price than the Co-op. The Post Office prefer them for operational and personnel reasons. An A&L bid is more complex because, as a building society, they cannot take on corporate leasing and lending activities. But that is not a sufficient reason to override the price advantage and the Post Office's commercial judgement.

Price

3. On Monday A&L increased their bid by £10 million to £130 million compared with the Co-op's £124 million. Both bids would be adjusted downwards in negotiation, notably to take account of differences between book and market values of

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securities and leases. The Post Office's present estimate is that the outcome could be a price of £110 million to the A&L against £96.5 million to the Co-op.

4. The arithmetic could be disturbed by changes during the offer period to interest rates, and an increase could substantially reduce or even eliminate the A&L's price advantage. But subject to that the Post Office would expect A&L to remain at least £6 million better than the Co-op and very probably more.

EFL effects

5. In your letter of 17 April to Mr Newton you made 5 points on the need to minimise the impact on the Post Office's EFL in the current year. All these points are acceptable to the Post Office. They already intended to negotiate with the A&L on the basis that, if it proves necessary for the Post Office to take on leasing and corporate lending business from Girobank, they will run that business down and take on no new business. If A&L were to become a plc in due course the Post Office would be ready in principle to transfer back at market value any leasing or corporate lending business which was left outstanding.

6. We are still considering within the Treasury whether there are ways of confining the EFL effects to the benefit from the sale proceeds. While I made clear that I did not know whether this would be practicable, the aim is very welcome to the Post Office and I was assured that they would do nothing to close off options for tackling this problem.

Exclusivity

7. The Post Office, DTI, Schrodgers and Hambros are all convinced that it is necessary to give A&L exclusivity for negotiations on Thursday or at the most just a few days later. I am now satisfied that we should go along with this. To do otherwise would be to run contrary to the commercial judgement of the Post Office who are the sellers; and to run a risk that A&L would pull out. The Post Office feel that it would not be administratively possible

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for Giro to negotiate concurrently on a mass of details, particularly the Post Office's counters contract, with 2 bidders. Nor do they think that without exclusivity the bidder would readily spend money and time on due diligence and other procedures.

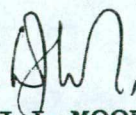
8. However, they accepted my point that it was always possible that something could go wrong in the negotiations with A&L. For example, they have to get clearance from the 2 regulators, the Bank and the Building Societies' Commission. If this, or indeed anything else, turned out to be a show stopper the Post Office would want to bring the Co-op back into play. Therefore it is essential to try to keep the Co-op warm over the next month or so. They agreed with this. Subject to Ministerial approval tomorrow morning, the Chairman of the Post Office will speak to the Co-op and explain that while their bid was in many respects attractive A&L had got the edge because of price.

Summary

9. To sum up, I recommend you to agree with Mr Newton that given the price offered and the Post Office's commercial and operational preference Ministers should approve acceptance of the A&L bid.

10. You could go on to say that you are pleased that the points in your letter of 17 April are accepted by the Post Office. You recognise the case for moving now to exclusivity but as much as possible should be done to keep the Co-op warm against the possibility that something might go wrong in the negotiating period.

11. Finally, can I stress that all the above, and in particular the possible outcome on price, is commercially sensitive.


D J L MOORE

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pmw



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the department for Enterprise

The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

Rt Hon Norman Lamont MP
Financial Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

FINANCIAL SECRETARY	
REC.	9 18 APR 1989
ACTION	MR MOORE
COMES TO	PS/CX, CST, EST, SIR P MIDDLETON, MR ANSON, MR MANCKS MR SCHOLAR, MR ODLING-SMEE, MRS LOMAX, MR BENT, MR PIRIE, MR JUDGE, MR CALL, MR TYRIE

Department of
Trade and Industry

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Our ref
Your ref
Date 18 April 1989

SALE OF GIROBANK

Thank you for your letter of 17 April.

The Post Office has now received bids for Girobank from the Co-operative Bank as well as the Alliance and Leicester Building Society. The Post Office Board has unanimously decided that the Alliance bid is better and that they should be given exclusive negotiating rights for three months.

I attach a paper evaluating the two bids which I believe your officials helped to prepare. I think the Board has made the right decision and that the price, although still conditional, is fully acceptable. The bid also measures up satisfactorily to our other criteria; and our officials have agreed that the points in your letter of 17 April can be properly met.

We are publicly committed to the sale of Girobank. I am satisfied that this is likely to be the last opportunity for some time to accomplish the sale at a satisfactory price.

The Alliance has made its bid conditional on being given exclusive negotiating rights by 20 April. There are still uncertainties about the bid and I propose to ask the Post Office

STYABB



the department for Enterprise

Chairman to attempt to retain the interest of the Co-op Bank. Once a preferred bidder has been identified, however, we could not expect to pursue that interest except at a much reduced price. On the other hand, there is a significant risk that the Alliance will withdraw if the Post Office does not meet its deadline and, even if we were successful in pressing them not to withdraw for a few days, there would still be insufficient time to resolve the remaining conditions, which depend upon intensive, exclusive negotiation. I hope therefore that you will agree to my telling the Chairman by midday on 19 April that we are content with the Board's decision. I have in mind announcing it on 20 April in an arranged PQ.

I am sending copies of this letter to the Prime Minister, John Wakeham and John Moore, and to Sir Robin Butler.

TONY NEWTON

STYABB

GIROBANK SALE

Issue

This paper evaluates the two bids for Girobank. Its conclusion is that the unanimous preference of the Post Office Board for the bid from the Alliance and Leicester Building Society is correct.

The Bids

2. Alliance and Leicester have offered £130m for the equity and loans compared with the Co-op's £124m. A comparison of the two bids is attached at Annex A. Both bids are subject to a number of adjustments and warranties. The likely effect of these on the price is set out at paragraph A of the Annex. After adjustment it appears that Alliance and Leicester's bid is likely to be worth £110m compared with the Co-op's £96.5m. The valuations of securities are, however, sensitive to interest rates changes and a 1% increase in interest rates would reduce substantially Alliance and Leicester's price advantage. However the Post Office and Schroders take the view that if both bids were to be negotiated that of Alliance and Leicester would keep a price advantage of at least £6m.

3. There is little to choose between the bids on other grounds. Both bids are conditional, raising many of the same issues, for example renegotiation of the Counters contract. Each raises one substantial uncertainty. In the case of Alliance and Leicester special arrangements must be made for the corporate lending and leasing business. These can be made on the lines indicated in the letter from the Financial Secretary of 17 April (see para 7 below). In the case of the Co-op the terms for obtaining finance from DG Bank have not yet been negotiated. CWS has offered to provide funds if negotiations with DG Bank fall through, but this could delay negotiations with the Post Office.

Grant of exclusive negotiating rights

4. There are clearly risks attached to selecting a single preferred bidder, in view of the remaining uncertainties. Failure to resolve any of the conditions attached to an offer would allow the purchaser to withdraw from a contract. However, the Post Office and its advisers judge that there is little further progress which can be made in the absence of an exclusive relationship. For example, issues such as the Counters contract depend on detailed negotiations to which there are commercial objections in the absence of the greater security that would come from exclusivity. Resources are also a substantial difficulty in pursuing two sets of detailed negotiations.

5. Our advisers agree that for practical and commercial reasons there must come a point at which a single preferred bidder must be identified and given exclusive negotiating rights. It is a matter of judgement when that stage in the negotiating process is reached. The views of the Post Office and its advisers who are responsible for that process and are in close touch with the parties must therefore be given considerable weight in reaching that judgement. Though it would not be impossible to put pressure on the Alliance and Leicester not to insist on their deadline of 20 April, DTI officials agree that the few days extension which might be secured would not materially affect the information available. A period of exclusivity is necessary to resolve the outstanding conditions and should now be granted.

Factors to be taken into account in evaluating bids

6. In announcing the sale of Girobank last June the then Chancellor of the Duchy set out a number of factors which the Post Office and Government had agreed should be taken into account in evaluating bids. These were:

- (i) price;
- (ii) acceptability to the Bank of England;
- (iii) increased competition and choice for consumers;
- (iv) the continuing importance of the relationship with Post Office Counters; and
- (v) arrangements for staff to share in the future success of the bank.

Judged against these criteria neither bid raises any significant question of suitability. The prices are above that which our advisers have indicated should be the minimum acceptable and seem likely to remain so. The Bank of England, although it cannot give a firm view until it has been able to evaluate prospective purchasers' detailed proposals for the bank, has indicated that it sees no objection in principle to either. Both the Alliance and Leicester and the Co-op could, with the acquisition of Girobank offer wider choice for consumers. The Alliance and Leicester in particular does not at present offer its own current account or credit card facilities. Both bidders, although looking for changes in the terms of the Counters contract, have indicated their wish to continue the relationship. Both plan to offer employees an opportunity to participate in the success of the business.

Public Expenditure Aspects of the Alliance and Leicester Bid

7. The Financial Secretary's letter of 17 April stressed the importance of doing everything possible to minimise the EFL impact of the transfer to the Post Office of the leasing and corporate lending business which is ultra vires for a building society. DTI and Treasury officials have discussed with the Post Office the points raised in that letter. The Post Office is well seized of the need to keep open the method of funding transfer of the ultra vires business to allow full exploration of the options for minimising the EFL impact. The Post Office confirmed that if it took over the leasing assets from Girobank it would be looking to sell them on as soon as it was commercially advantageous to do so. In responding to Alliance and Leicester, the Post Office would not therefore commit itself beyond offering first refusal to Alliance and Leicester. On the question of new leasing and corporate lending business, the Post Office has made clear to Alliance and Leicester - and will do so again in responding formally to its offer - that it does not envisage taking on any new business for the Society.

Timetable for Further Action

8. Every effort should be made to avoid the risk entailed in asking the Alliance and Leicester to defer their deadline, since no material benefit is likely to result from a few days extension.

9. A positive response by the Post Office to the Alliance and Leicester on 20 April depends on the Government confirming early on 19 April that it is content with the Board's recommendation, subject to the ultimate satisfaction of the Bank of England and the Building Societies Commission and of the Secretary of State in relation to competition legislation.

10. The Chancellor of the Duchy of Lancaster will make the first public disclosure by means of a written parliamentary answer at 3.30 pm on 20 April. The Post Office will confidentially concert with the Alliance and Leicester the terms of their own public announcement and the communication with Girobank staff and customers, which will take place on 20 April at the same time as the Parliamentary answer is made.

GIROBANK SALE - COMPARISON OF BIDS

A	<u>Price</u>	£m	£m
		Alliance & Leicester	Co-op
1.	Offer price - equity	91	85
	- loans	39	39
	total	<u>130</u>	<u>124</u>
2.	Price adjustments		
(i)	dividends paid by Girobank since 31.3.88	(2.1)	-
(ii)	warranty on value of net assets	?	?
(iii)	difference between book and market value of quoted securities	(2.5)	(2.5)
(iv)	difference between book and market value of unquoted securities	9.5	-
(v)	valuation of subordinated debt	0	-
(vi)	possible prepayment of Nippon loan	not expected to be material	-
(vii)	difference between book and market value of leasing book	(16)	(16)
(viii)	difference between book and market value of Bootle freehold	-	not expected to be material
(ix)	1988-89 pre-tax profits of not less than £18.7m	?	-
(x)	S 278 tax indemnity	(7.0)	(7.0)
(xi)	sale expenses	(2.0)	(2.0)
	Adjusted price	<u>109.9</u>	<u>96.5</u>

B Features of difficulty in Co op bid

	Alliance and Leicester	Co op bank
1. Source of funds	No apparent difficulty	Need to reach agreement with DG Bank but fallback of CWS. Could slow down negotiations.
2. Risk Asset Ratio	No condition	Want Bank of England to agree RAR in range 10-10.5%
3. Reduction in workforce	No figures but want to agree any extension of the present no-compulsory redundancy-scheme	Said to plan a reduction of 2,000 in the 6,000 workforce; interest in value of Bootle freehold suggests might consider closure. But expect after discussion with the unions to include Girobank staff in a no-compulsory-redundancy scheme

C Features of difficulty in A & L bid

1. Transfer of business	Transfer of leasing and corporate loans business which are ultra vires to a building society. Existing corporate loans business at least likely to need to be transferred to PO.	As a bank, Co op has powers to carry on this business
2. Profitability of Corporate loans business	Conditional on continued profitability of corporate money transmission business, particularly its vulnerability to loss of major customers; and warranty required on continuity of all major commercial customer contracts.	-
3. Counters contract	Wants abatement of charges in event of industrial action affecting delivery of mail by Royal Mail	-

D. Subjects on which both bids have similarly onerous requirements

	Alliance and Leicester	Co op bank
1. Girobank contracts with Counters DSS and PO	Appropriate amendment to benefit A & L, including C3 above	Review of elements of Counters contract and harmonisation (unspecified) between Counters and DSS contracts. Contracts not to be terminated for at least seven years
2. Notes Held to Order facilities	Satisfactory agreement required for Girobank to share in benefits	Fruitful negotiations on implementation, recognising that Co op already holds the status; would probably require fewer centres from Counters than A & L.
3. CALM	Satisfactory demonstration of CALM	Twelve weeks audit of CALM
4. Pension fund asset	Satisfactory arrangements of transfer	To be adequately funded on a basis agreed
5. Senior management	Managing Director Mr M Williamson to enter into a satisfactory service contract with Girobank	Assurances of likelihood of securing senior management continuity
6. MMC	Confirmation that DTI will not refer; cannot be given but no evident grounds for reference	Confirmation that DTI will not refer; more likely to affect competition
7. Competition from PO and Counters	Agreement required not to compete in respect of Girobank services for a period to be agreed; Post Office cannot fetter its statutory powers in this way but might give some comfort; terms need clearance with OFT	Undertaking required that PO will not compete with Girobank and Co op/ Girobank group for the provision of certain financial services; Post Office cannot fetter its statutory powers in this way but might give some comfort; terms would need clearance with OFT



CC: PPs, CST, EST
2 Sir. P. Middleton
MR. ANSON
MR. MONCK
MR. SCHULZ

Treasury Chambers, Parliament Street, SW1P 3AG

MR. ODLING - SNEE
MRS. HONIX
MR. BERT
20 April 1989
MR. PICKIE
MR. JUDGE
MR. TYRRE
MR. CULL

The Rt Hon Tony Newton, OBE, MP
Chancellor of the Duchy of Lancaster
1 Victoria Street
London SW1H 0ET

Dear Tony

ppp

SALE OF GIROBANK

Thank you for your letter of 18 April. As my office have already told yours, I am content with your proposals, and look forward to developments.

I am copying this letter to the Prime Minister, John Wakeham and John Moore, and to Sir Robin Butler.

NORMAN LAMONT

CONFIDENTIAL

FROM: D J L MOORE (PE)
X 4440

DATE: 20 APRIL 1989

FINANCIAL SECRETARY

cc: Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Odling-Smee
Mrs Lomax
Mr Bent
Mr Pirie
Mr Gieve
Mr Gunton
Mr Dickson
Mr Judge
Mr Call
Mr Tyrie

Handwritten notes:
PMP
P P P P

GIROBANK PRIVATISATION: ANNOUNCEMENTS

I attach the Written Answer which the Chancellor of the Duchy will give this afternoon and the Post Office's press announcement.

2. You will see that the WA refers to the need for the 2 regulators, the Bank and the Building Societies' Commission, to approve the deal. The wording has been cleared with them by FIM. Both have to be satisfied that the acquisition will be satisfactory from a prudential point of view and we cannot take a favourable verdict for granted. This is one of the reasons why I believe, and DTI agree, that if at all possible the Co-op should be kept interested.

3. You will see that the Post Office's press announcement refers to the price offered of £130 million. We considered whether this was wise since the negotiated price could well be less - perhaps down to around £110 million on the Post Office's provisional and commercially sensitive internal assessment. But the Post Office and both Schrodgers and Hambros thought it better on balance to give the gross figure. This is to prevent speculation that a poor price has been obtained and because the figure is likely to come

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out one way or another anyway, quite probably at the Alliance and Leicester AGM.

4. In their Q and A briefing DTI and the Post Office are taking the line that the number of bids received is commercially confidential, as of course are the names of those who bid apart from the A&L. This of course has not stopped accurate leaks.



D J L MOORE

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Version 20/4/89

**SALE OF GIROBANK - DRAFT WRITTEN ANSWER TO A PQ, FOR ANSWER
ON 20 APRIL**

To ask the Chancellor of the Duchy what further progress has been made in finding a suitable buyer for Girobank

After detailed discussion with a number of interested parties, the Post Office Board has decided to accept the conditional offer made by the Alliance and Leicester Building Society to purchase Girobank plc. I have endorsed this decision which I am satisfied takes full account of the factors for the sale set out by myself and my predecessor.

I understand that the Alliance and Leicester's conditional offer to the Post Office ^{is} to acquire the equity and subordinated debt of Girobank for £130 million subject to completion adjustments. The Post Office will now enter in to detailed negotiations with the Alliance and Leicester with a view to completion as soon as practicable within the coming weeks. My consent will be required before the final sale can take place. In addition, the requirements of the relevant competition legislation will need to be satisfied and the agreement of the Bank of England will be needed to the operation of the bank under a new owner. If the negotiations are successful the Alliance and Leicester will also need to satisfy the Building Societies Commission before the sale is completed.

Approved 1300.

[Signature]

(for Immediate release)

The Post Office

Sale of

Girobank plc

The Post Office announces that it has received a conditional offer from the Alliance & Leicester Building Society ("Alliance & Leicester") to acquire the equity and subordinated debt of Girobank plc ("Girobank") for £130 million (subject to various completion adjustments). The Board of the Post Office has accepted this offer and has agreed to enter into a period of exclusive negotiations with Alliance & Leicester with a view to finalising the sale as soon as practicable within the coming weeks. The sale cannot be completed until Alliance & Leicester is given the appropriate statutory powers, which is expected this summer.

It is not expected that any further announcements will be made until the sale has been completed.

20th April, 1989.

PRESS ENQUIRIES:

The Post Office

Alan Feinstein (Director, Public Relations)

Tel: 01-245 7923

Schroders

Gerry Gilmstone

Tel: 01-382 6089

Alliance & Leicester

Scott Durward (Chief General Manager)

Tel: 01-629 6661

J.P. Morgan

Terry Eccles

Tel: 01-600 2300

Carter Vainn Pollen

[Chris Mathews]

Tel: 01-823 3436

PPP (Alliance & Leicester Girobank string)

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The Rt. Hon. Tony Newton OBE, MP
Chancellor of the Duchy of Lancaster and
Minister of Trade and Industry

- 6 JUL 1989

Rt Hon John Major MP
Chief Secretary
HM Treasury
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Department of
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Our ref
Your ref
Date

215 5147

5 July 1989

FINANCIAL SECRETARY	
REC.	6 JUL 1989
ACTION	Mr Moore
COPIES TO	CMX CSTEST
	Sir P. Middleton,
	Mr Anson, Mr Monck,
	Mr Scholan,
	Mr Odling-Smee,
	Mrs Lomax, Mr Bent,

John John

cc: Mr Pirie,
Mr Judge,
Mr Tyrre.

GIROBANK SALE

The Post Office Board has recently considered proposals put forward by Girobank, with the endorsement of Alliance and Leicester, for arrangements to enable Girobank to continue to offer corporate lending facilities after sale to the Society. I am advised by the Post Office that rejection of this proposal could jeopardise the sale process and I am therefore writing to let you know where matters stand.

We had always recognised the complications inherent in the sale of Girobank to a building society given the restrictions on building societies powers to carry on corporate business. However, Peter Lilley in his letter of 10 February identified a way forward which would allow Girobank to continue to offer corporate lending facilities provided this was done on an agency basis with both the assets and the risks removed from Girobank's books. This was accepted by the Post Office as an appropriate and viable solution and apparently accepted by Alliance and Leicester in its offer for Girobank, which included as a condition that the Post Office should retain the ultra vires assets temporarily unless or until the Society made other

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arrangements for continuation of the business. After careful consideration of the competing bids from Alliance and Leicester and the Co-operative Bank, we agreed that, subject to the caveats set out in Norman Lamont's letter of 17 April, we could endorse the Post Office's acceptance of Alliance and Leicester's offer.

The proposal on which Sir Bryan has now sought my views seems to me to be very different in character from the basis on which we endorsed acceptance of Alliance and Leicester's offer. I understand that it stems from a recent reassessment by Girobank of the relationship between corporate lending and its main corporate deposit business. Contrary to its previous position, the bank now takes the view that customers are increasingly looking to a single bank to provide a full banking service and, with increasing competition from the High Street banks for corporate deposit business, the ability to offer in house corporate loan facilities is crucial to retaining the corporate deposit business on which Girobank's profitability depends. It has therefore proposed that the bank should retain the corporate lending book but that, with a view to meeting the Building Societies Commission's concerns, the risk should be removed by a Post Office guarantee and deposit with Girobank of an amount corresponding to the value of the amount drawn down under loans. Girobank proposes that this guarantee should be for £200 million, to cover present outstanding loans of approximately £150 million and allow reasonable scope for new lending. It is envisaged that the guarantee would be for three years or until the Alliance and Leicester converted to plc status.

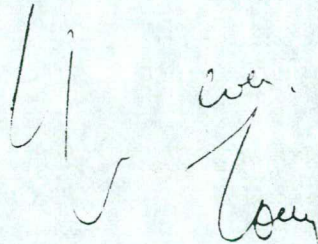
Quite apart from the regulatory issue of the ownership of such assets by a building society, the disadvantages associated with this proposal seem to me to be overwhelming. From the point of view of control of public expenditure, the Post Office would have little effective control over future lending policy and, with no exposure to risk, there would be limited incentive for Girobank to act prudently. Although the proposal is for the length of the guarantee to be limited, that would in practice be unenforceable if at the end of the three years Alliance and Leicester had not converted to a plc. There are also competition considerations: what would effectively be a Government guarantee for Girobank's corporate lending activities would be very likely to be seen by other banks as unfair competition.

Had the proposal been before us in this form at the time that we were considering the bids from Alliance and Leicester and the Co-op, Sir Bryan Nicholson accepts that it would have swung the balance in favour of the Co-op's offer. As you know, allegations have already been made in the House that the Co-op's rejected bid was better than that accepted from Alliance and Leicester. A guarantee on the lines proposed would make it very difficult to refute such allegations. Presentationally it would in any circumstances be difficult to justify such a substantial and open-ended guarantee to secure a sale for £130 million.

There is clearly a possibility that rejection of the proposal could cause Alliance and Leicester to withdraw but I believe this is one that we must accept. Should Alliance and Leicester withdraw there is still the possibility of going back to the Co-op which is understood to remain interested in buying Girobank. If the sale process collapsed completely, we would be in a difficult position but one which was defensible. However, it is far from clear to what extent the Society is committed to Girobank's guarantee proposal and in Sir Bryan's judgement Alliance and Leicester remains very keen to buy Girobank. There is no evidence that Alliance and Leicester has yet made serious efforts to find a third party for an agency arrangement: Hambros' advice is that although this will not be easy, there are a number of potential partners in the market. It therefore seems to me unlikely - and I believe Sir Bryan agrees - that Alliance and Leicester would withdraw without investigating fully alternative options.

I have therefore told Sir Bryan that I consider the guarantee proposal indefensible and can see no realistic chance of our endorsing it. I have said that the Post Office should tell Alliance and Leicester that this is the case and should strongly encourage them to look for a partner to provide lending facilities on the lines we had originally envisaged.

I am copying this letter to the Prime Minister, John Wakeham and Sir Robin Butler. If you or colleagues see any difficulty with the course I have indicated, I should be grateful to know by the end of the week.



TONY NEWTON

PWP

Ch/ This minute, which brings you up to date on A+L, is rather oddly set out. You may find it more comprehensible if first you read Mr Newton's letter, behind. It all looks a little touch & go still.

1. MR MOORE

2. FINANCIAL SECRETARY

FROM: S P JUDGE (PE2)

EXT: 4931

DATE: 10 July 1989

Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mrs Lomax
Mr Odling-Smee
Mr Moore
Mr Bent
Mr Pirie
Mr MacAuslan
Mr M G Richardson
Mr Gilhooly
(para 18)
Mr G Wilson
Mr Kroll
Mr Dickson
Ms Osmond
Mr Portes
Mrs Chaplin
Mr Tyrie
Mrs Gilmore - BSC
PS/IR (para 18)
Mr Nield - IR

DIS ✓
If the sale to A+L goes through it will be later than we had hoped - end October rather than July. And it could of course still fall through? A+L may have second thoughts as they find out more, and they have yet to clear the regulatory hurdles. We must hope that the Co-Op would be willing to emerge from the wings if necessary.

In the meantime the main questions discussed below are the timing of the BSC's Designation Order and the handling of Giro's corporate loans. JWN 10/7.

GIROBANK: SALE TO THE ALLIANCE AND LEICESTER BUILDING SOCIETY

Summary

Mr Newton's letter of 5 July:

- brings you up-to-date on progress since the A&L was granted exclusive negotiating rights at the end of April (following your letter of 20 April to him);

- recalls that the A&L cannot continue corporate leasing and lending. It was agreed in April that these assets should be sold off separately if possible, or transferred to the Post Office. It appears that it will be possible to sell the leases, but not the loans (mainly because of banking confidentiality legislation);

- considers what should be done with the corporate loans currently on Giro's balance sheet, given that they are more important to Giro's key corporate money transmission business than was originally thought;

- reports that he has told the PO that he is not attracted by Giro's suggestion (supported by the A&L) that the PO should give a three year cash-backed guarantee for £200m to Girobank, in case any of their corporate loans turn bad; and

- proposes that, for loans but not for leases, the PO revert to the original plan, as set out in your letter of 17 April. The PO retain the existing prohibited assets and Giro act as agents, both to them and to private sector third parties, in respect of post-privatisation corporate loans. The aim should be to unwind these arrangements as quickly as is sensible.

2. This submission has been agreed with GEP, FIM and (so far as it concerns them) the BSC. It recommends that, subject to the views of the Economic Secretary on the Building Society aspects, you support Mr Newton's line with the Post Office. The key questions to be considered are listed in paragraph 24. The public expenditure implications (paragraphs 20 and 21) are more favourable in 1989-90 than those which the Chief Secretary was willing to accept in April. A draft letter is attached at A: Mr Newton asks for an early reply. As he says, there is some risk that this approach could cause the deal to come unstuck - in which case the PO would try to resuscitate the earlier bid from the Co-op, who clearly would then be in a strong negotiating position. Mr Newton thinks it right to accept this risk: we agree.

3. On timing, we had hoped that the BSC would be able to table the necessary Designation Order this side of the recess. In his earlier letter of 19 June Mr Newton asked the Lord President to provide time for a debate on the Order before the recess, so that Parliament might have a chance to discuss the sale before it is completed (there is also a Trade and Industry Select Committee hearing on Girobank at the end of this month). The Lord President has agreed to this. However, the BSC do not now expect to be able to table the Order this month, because of the uncertainty over corporate loans: this will delay the sale timetable somewhat. The

Commission, collectively, presently take the view that it would not be in accord with their responsibilities to make an Order before the deal is finalised. The A&L are expected to take a final decision on their bid in September, and (subject to the Bank's regulatory approval and the Designation Order coming into effect) the sale is therefore likely to be completed around the end of October.

Background

4. A considerable amount of work has been done since April by the PO (advised by Schrodgers), the A&L and the Girobank Board.† This work is fairly accurately summarised in the Observer article attached at B. In particular:

- the PO have rebuffed most of the more outrageous warranties requested by the A&L;
- CALM - Giro's new and somewhat unproven computerised ledger system - has apparently performed to the A&L's satisfaction;
- detailed negotiations are continuing on the draft contract;
- the negotiations with the Counters business covering the remuneration for services they provide to Girobank have made reasonably good progress;

Saturday's papers also reported that Lord Young has decided not to refer the bid to the MMC.

5. The A&L Board are satisfied with the progress to date on these points. In addition, the BSC and the Bank have had some

† Led by Malcolm Williamson - who has been suspended from the PO Board to avoid any conflicts of interest, and has since indicated that he does not want to work for the A&L after the sale.

preliminary discussion with them. The Commission staff are appraising the business issues involved in the acquisition as the negotiations proceed. But the formal submission from the A&L, once the negotiations are completed, will need to be put before a full meeting of the Commission: this could take a few weeks. The Bank will also need to be content with the arrangements.

Designation Order

6. There is however still quite a lot of work still to do before the sale can be finalised. We believe that most of the technical issues have now been sufficiently sorted out to enable the BSC, with Treasury consent, to draft the Designation Order covering Girobank. This order will add "Girobank plc" to the list of bodies that a Society may invest in or support. It does not imply approval by the BSC of the actual bid.

7. The timing of this negative procedure Order is now proving rather tricky. There are three options:

a. to lay the Order this month, and to arrange a debate on it before the Recess. The BSC would continue their regulatory investigations over the summer and, if satisfactory, the sale could be completed soon after the A&L's September Board meeting;

b. to lay the Order in September, by which time the regulatory work should have been completed. The Order would not take effect until the end of October, to enable an early debate to take place once the House reassembles (currently expected for mid-October). The A&L would enter into a provisional contract in September, conditional on the Order coming into effect, with completion around the end of October;

c. to lay the order immediately the House reassembles, and for contracts to be exchanged and completed shortly thereafter.

8. The Post Office, A&L, DTI and PE Group would obviously prefer a., because it minimizes the delays. Parliament would have discussed the sale properly before it went ahead, and there would be no risk of delays once the A&L and PO were ready to exchange contracts in September. However the BSC do not believe that it will be possible to lay the Order this month, given that important points and contract terms are still unresolved. They do not want to lay an Order this month based on one set of assumptions only to find that a different Order is needed in September once the negotiations have been finalised.

9. PE accept this point, and have encouraged the A&L to clarify their intentions to the BSC as quickly as possible, in the hope that this will enable the Order to be laid and debated before the Recess. If this turns out not to be possible we are left with b. and c.. Both involve delay - especially c, which would seriously jeopardise the sale. We would recommend b. as the fallback: although Ministers could expect some criticism for allowing the Order to be laid in the Recess, Parliament would still debate it before it came into effect.

Prohibited Assets

10. As mentioned above, the BSC are not yet able to finalise the Order. The main outstanding issue relates to exactly what will be done with Giro's "prohibited" assets - corporate loans and leases. This note seeks Ministers' views on this important point.

11. So far as leases are concerned, we are now much more optimistic that Girobank will be able to sell the subsidiary that holds these assets (worth about £300m) at or around the time of the main sale. Most leases are one-off transactions, undertaken for tax purposes, are not part of a continuing banking relationship, and should therefore be easy to sell without damaging Giro's business. Fortunately, this transaction will not affect the PO's or Giro's EFL.

12. The real problem relates to the corporate loans, which are part of a normal banking relationship. After doing more work, Giro now think that some 60% of their core money transmission business is dependent on the availability of corporate loans. Money transmission services for businesses (eg supermarket chains) form a key part of Girobank's business, and account for more than 100% of its profits. It follows that the A&L are most concerned that its profitability should be maintained. They have been told that they cannot have a formal warranty to that effect, but if the arrangements for corporate loans are not satisfactory to them then they are likely to pull out or reduce their offer price.

13. So the key question is who should provide corporate lending after the sale. There are three options:

i. Girobank could after all be allowed to make such loans. But allowing all Societies and their subsidiaries to do this would fly in the face of the decisions Ministers took last year on Societies' powers. The Commission would not wish to extend the power to make corporate loans to only one society. But an extension to all societies would be contrary to the Economic Secretary's statements on corporate lending. The BSC advise that this would be a major step to take, and the prudential implications would need careful consideration;

ii. the Post Office could take over the existing loan book - some £150m or so, and reach an agency agreement with Giro, who would collect the interest etc (but not bear the risk). The PO would undertake for a limited time to provide a limited amount of new loans to existing customers. Giro would therefore have to find someone in the private sector for whom they could act as agent, who would refinance existing loans and finance the rest of the new loans. This is the option envisaged in April. Building Societies do now have powers to act as agents in this way, and this change was indeed made partly with Giro in mind; and

iii. a recent proposal by Giro, which Mr Newton has rejected, which is midway (in regulatory terms) between i.

and ii.. Giro would actually retain the existing loans, and make new ones (and hold them as assets on its balance sheet), but the PO would guarantee any bad debts up to, say, £200m. The PO would back this guarantee by depositing cash with Giro to match the amount of ultra vires loans they currently hold. It would lapse if and when the A&L converted to a plc.

The "guarantee" option

14. A traditional guarantee would normally only affect the PO's EFL if and when it was called. But the cash deposit variant described at iii. would score against the EFL as it was made in 1989-90, although this effect would be reversed if and when the A&L converted to a plc. But if the A&L decided not to convert, the worse case scenario would lead to additions to the PO's EFL in perpetuity as a result of the privatisation, as the PO guaranteed an ever-increasing loan portfolio! As Mr Newton says, a guarantee on these lines would be unattractive on competition grounds, and would be hard to defend publicly. Moreover, although the PO could assess the quality of the existing loans (and they are thought to be a good risk), it is very difficult to see how they could effectively assess new loans and it would be inappropriate for the PO to accept a risk on this basis. As Mr Newton says, Giro would only have a limited incentive to act prudently (although they would clearly wish to maintain their reputation as competent bankers).

15. From the financial viewpoint, PE are therefore dubious about option iii) - as are the PO Board and DTI. It does look like something of a try-on by the Giro management, who want their lives after the sale to be made easy. It would be inconsistent with the usual "clean break" policy underlying privatisation.

16. FIM and the BSC are also unhappy, from a regulatory viewpoint. They advise that:

- it would be technically possible to make an affirmative Order creating a new type of "Class 3" asset which a Society may hold, namely corporate loans backed by a

guarantee from a public corporation. However, class 3 assets are limited to 5% of a society's total commercial assets - 7½% from next January - and this may be a practical constraint. Loans guaranteed in this way might also require capital backing by Girobank;

- but, even if the Commission and the Bank agreed to this - which is not automatic - it would be at variance with the general policy on corporate loans (paragraph 13 i.), would discriminate in favour of the A&L, and would be a pretty obvious fiddle designed to get the Government out of a hole; and

- the PO would only want to give a guarantee for, say, three years - on the presumption that the A&L convert to a plc within that timescale. But this is an obvious regulatory trap: the BSC could find themselves being forced at that time to choose between insisting on a distress sale of the A&L's ultra vires assets - possibly at a loss - or allowing them to convert to a plc when they were not adequately prepared to do so, or allowing them to hold such loans unguaranteed, which Ministers might not be prepared to permit generally.

17. All in all, we advise that option iii. should not be considered further. Do you, and the Economic Secretary, agree?

The "third party" option

18. If so, then we think you will wish to support Mr Newton's line with the PO - ie they should tell the A&L that only option ii. is on offer and they should find a third party to provide new loans, for whom they would act as agent. Hambros - DTI's advisors - think that such a financial institution can be found: the State Bank of New South Wales is one possibility. (The PO are also trying to persuade Schrodgers - their advisors - to show some interest!) So far as the borrowers are concerned, this option could cause some difficulties with the tax treatment of their

interest payments: we are following this up with the Revenue†. The PO envisage taking over £150m of existing loans, and providing perhaps £20m of new finance to these existing customers over the next two years or so, where it was in the PO's commercial interest to do so (they will continue to have an interest in the scale of Girobank's corporate money transmission business, as Counters will still do much of the work). But the presumption would be that when short term facilities come up for renewal (and they account for most of Giro's existing corporate loans) Giro would look to the private sector third party to provide the finance.

19. Under this option, the PO and the A&L would reach an informal understanding that if the latter converted to a plc they would buy back all the loans remaining on the PO's balance sheet. A legally binding contract to this effect would be outside the A&L's powers, and would anyway probably require extra capital backing to satisfy the Bank of England. (It is of course of no interest to the PO whether the A&L reached a similar understanding with the third party).

20. The PO, Schrodgers and Hambros think that this scenario for the PO's likely future involvement in corporate lending is attainable and sensible, and that it will not unduly damage Giro's business prospects. We agree with this judgement, and do not think there is much scope for pushing the A&L (and Giro management) further. On this basis, the net effect on the PO's EFL and on public expenditure could be as follows - subject to the usual health warnings:

† Simply, borrowers are allowed to pay interest gross to banks, but have to pay it net of tax to non-banks.

	£million					
	1989-90	1990-91	1991-92	1992-93	Later ⁽⁺⁾	Total
Giro privatisation	-24	-58	-6	-6	-26	-120
Tariffs and other IFR issues*	+41	+100	-	-50	-	
TOTAL	+17	+42	-6	-56	-26	
Memo: corporate loans held by PO at end of period	96	38	32	26	-	

* Based on the 1p/1p tariff increase announced for this September, and plausible assumptions for the outcome of the forthcoming IFR.

+ These savings would be advanced if the A&L convert to a plc.

21. The 1989-90 total of +£17m is £117m more than was assumed in GEP's June position report - see Mr Richardson's note of 19 June, which reported that the Reserve was forecast to be underspent by only £200m. But the implications for 1989-90 compare quite well with the £+300, -80, -80, -80 million profile mentioned in my note of 14 April, and which the Chief Secretary said would be an acceptable consequence of selling Giro to the A&L. (Mr Wanless' note of 17 April to your Private Secretary). The improvement flows from the fact that the PO and their advisers are now much more optimistic that the leasing business can be sold off before the end of the financial year. GEP think that this revised profile is acceptable. Does the Chief Secretary agree?

22. In conclusion, we advise you to request the BSC to draft the designation order on this basis, for laying as soon as possible (see also paragraphs 7-9 above). Do you, and the Economic Secretary, agree? Further, although Mr Newton omitted to mention this in his letter to the Lord President, the Economic Secretary will wish to note that the debate on the Order - a Building Society matter - will be for Treasury rather than DTI Ministers.

Contingency Plans

23. If the A&L fail to find a suitable third party, then we expect them to pull out. Hambros have been keeping in direct

touch with the Co-op and report that they were sorry to lose the original competition. But if the PO go back to them at the end of the A&L's 3 month period of exclusivity we must expect a much lower offer. It may even turn out that the Co-op will not show sufficient interest, in which case we think Giro would have to be taken off the market for the foreseeable future. Ministers would then have to take some fairly tough decisions on its long-term future: should capital be invested to produce a more attractive and secure business, or should it be closed down as quickly as possible? (We would of course need to seek the Bank's advice at an early stage).

Conclusions and Questions

24. We would be grateful for Ministers' views on these points:

a. do you and Economic Secretary agree that the "guarantee" option should not be pursued (paragraphs 14-17), and that the PO should revert to the "third party" option (paragraphs 18-20)?

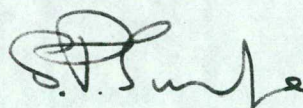
b. is the Economic Secretary content for the draft designation order to be finalised as quickly as possible on this basis? (paragraph 22)

c. and for it to be laid and debated as soon as possible? Ideally this will be before the recess, if the A&L are able to satisfy the BSC on the technical arrangements for dealing with corporate loans (see also paragraphs 6-9);

d. is the Economic Secretary content to take part in such a debate? (paragraph 22)

e. do you and the Chief Secretary agree that the PO should try to run down the corporate loans transferred to them as quickly as possible, but that they should be allowed to make a limited amount of new loans to existing customers (say, £20m in total over the next three years) if commercially justified on business grounds? (paragraph 18). Note that the public expenditure implications (paragraph 20) are more manageable than those which the Chief Secretary said in April would be acceptable.

25. If the answers to all these questions is "Yes", you may like to write on the lines of the attached draft (I have rounded the illustrative EFL effects in a favourable direction).



S P JUDGE

DRAFT LETTER TO MR NEWTON

Thank you for your letter of 5 July to John Major, which I have discussed with him and Peter Lilley.

I agree with you that Girobank's proposal for a guarantee should not be accepted. Quite apart from the fact that Building Societies may not make loans - whether guaranteed or not - to corporate bodies, the Post Office would be faced with a considerable risk over which it would have only limited control.

I therefore think it is right to tell the Post Office to revert to their original plan, namely:

- i. for them to take over the existing corporate loans;
- ii. to run them down as quickly as possible, while making a limited amount of new loans (say, a total of £20 million over the next few years) at full market rates, but only where the Post Office can justify this on business grounds; and
- iii. for Girobank to reach an agency agreement with one or more private sector third parties, to cover new loans post-privatisation and the refinancing of existing facilities as they come up for renewal.

Under such arrangements, the overall net impact on the Post Office's EFL of the privatisation might be about £-30 million in 1989-90 and £-60 million in 1990-91, with further reductions in

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later years (or when the A&L, if they convert to a plc, buy back the loans from the Post Office). John Major would be content with public expenditure effects of this order: he has of course written to you separately about the EFL implications of the PO's mainstream activities.

We must ensure the Post Office drive a hard bargain with the A&L. There is a chance that they might decide to pull out, but I agree with you that we should accept this risk. I also agree that if the A&L did pull out the Post Office should reopen discussions with the Co-op Bank, who would not have the same difficulties over corporate loans.

So far as the Girobank Designation Order is concerned, I understand that the position on corporate loans is not yet sufficiently clear to enable the Commission to table the Order later this month. I hope that the A&L and the Commission will be able to sort this issue out, but we have to accept that it may not be possible for the Order to be laid until after the A&L's Board meeting in September. The PO and A&L would then be able to enter a conditional contract, with completion occurring once the Order takes effect. This would be early in the spillover session, so as to allow time for a Parliamentary debate on the Order. I gather that John Wakeham has agreed to find time for a debate before the recess, if it proves possible to lay the Order this month: Peter Lilley would support such a move, and would expect to speak in the debate, as it will be primarily on a Building Society regulatory matter. I should also stress that if the BSC are able

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to lay the Order this month, this will be without prejudice to their decision on the regulatory issues.

I am copying this letter to the Prime Minister, John Wakeham and Sir Robin Butler.

NORMAN LAMONT

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Girobank's friendly Alliance



A testing timetable for Alliance's Durwood and Girobank's Williamson (left), Bridgeman (inset) could yet veto the deal.

ANOTHER building society may have been capturing most of the recent headlines, but rather less flamboyantly the £12 billion Alliance & Leicester has now been negotiating its £130 million conditional offer for Girobank for seven weeks.

This protracted horse trading was possibly inevitable. Both the society and the Government have much to play for.

A successful resolution of all difficulties will result in the birth of a unique building society and banking hybrid. But the emergence of an unjumperable hurdle, or a veto on the purchase by one of the regulatory authorities concerned (the Building Societies commissioner Michael Bridgeman could decline to sign the designation order) will mean a return to base for what is arguably the Government's most embarrassing privatisation venture.

Alliance & Leicester, led by chief general manager Scott Durward, was given an exclusive three-month negotiating period when it emerged as the preferred bidder for Girobank in April. The hope then was that the sale would be completed by the end of July. This is still the target but neither Alliance & Leicester nor Girobank disguise that there are still knotty problems to be untied.

'We are trying to stick to the timetable but it is a testing one,' says Malcolm Williamson, Girobank's managing director.

The marriage of Alliance & Leicester and Girobank would create a unique building society and banking hybrid, but negotiations still have a long way to go. JOANNA SLAUGHTER reports.

'We are keen to buy out on the right terms and with the right bits and pieces sorted out,' comments Peter White, Alliance & Leicester's deputy chief general manager. 'We are not going to buy just for the sake of buying.'

Three areas, in particular, are absorbing much investigative time. First, unsurprisingly, lawyers for both the building society and the post office wish to negotiate certain warranties. Second, Alliance & Leicester needs to review the enormously complex set of contracts which Girobank has negotiated with Post Office Counters, and with the DHSS, a key Girobank customer. As the society only has 400 branches these contracts, covering 20,000 post offices, are very important.

The third area of complexity concerns Girobank's £30 million corporate lending book. Initially it was assumed that Alliance & Leicester, as a building society, would not be able to take this over and that the business, together with Girobank's £300 million leasing operation, would have to be sold separately.

However, it now appears that some of the corporate lending could fall within the building society's permitted powers. The two sides are also investigating ways likely to be acceptable to the authorities whereby the residual lending could be retained.

Girobank will certainly be mightily relieved when its

future is decided. Its sale was announced a year ago and the Government hoped to find a purchaser by November. It was forced to extend the deadline, however, owing to a lack of suitable buyers.

The initial dearth of suitors for Girobank may have been somewhat disheartening for the bank's staff but Williamson declares that he was not too surprised. The criteria set prohibited any of the leading clearing banks from bidding. Prospective owners were thus confined to what might be called 'fringe' UK institutions and overseas banks. The latter, Williamson believes, did not really understand what Girobank was about.

'I would have welcomed an overseas bank,' he comments. 'It would have made good strategic sense.'

The absence of a queue of suitable buyers, when Girobank was put on the market, should not be read as an indication that the bank is held in low esteem. On the contrary, Girobank is undoubtedly something of an oddball among financial institutions and it bears only the most fleeting resemblance to a traditional bank. Nevertheless, it now offers its 2.5 million personal customers an increasingly comprehensive package of

banking and financial services.

Its lack of branches has made it the natural pioneer of telephone and direct-mail banking, while its 20,000 post office outlets are being used more efficiently as shop windows for Girobank products. 'We are trying to do things that are different, operating in a different way to the other clearing banks,' says Williamson. 'My argument is that all the cost trends and marketing methodology are pulling away from the branches.'

One area where telephone banking appears not to have worked is in the marketing of Girobank's mortgages where sales have been disappointing. 'Big household decisions are less easy to do that way than we thought at the outset,' concedes Williamson. 'Some face-to-face selling is needed.'

Girobank's profits appear to have reached a plateau but Williamson argues that the figures are misleadingly muted. Although operating profits since 1985 (when Williamson arrived from Barclays) have risen from £18.8 million to only £23.5 million, this modest increase conceals a big investment in infrastructure (the switch from ICL to IBM computers cost £25 million), the launch of many new products and the elimination of post office subsidies.

The main argument for Girobank's privatisation is that it will ease its capital constraints. Says Williamson: 'I always thought privatisation was not only desirable but necessary. I could see I was never going to get the degree of support I needed to fire on all cylinders.'

He also believes that the marriage with Alliance & Leicester will provide potential synergies. 'If we had been able to privatise through a flotation it would have been my game plan to acquire a building society,' he comments.

For Alliance & Leicester, the acquisition of Girobank will mean, among other things, the acquisition of a current account banking service without the heavy financial and administrative strains of setting one up (in the teeth of fierce competition) from a standing start.

Girobank also has a valuable Visa card operation, which the building society lacks. There is something like a 100,000 overlap between its customers and the Alliance & Leicester's 2.7 million investors and 450,000 borrowers.

'The trick is to be able to cross-sell to the Girobank's customers,' points out White.

One pertinent point is whether Alliance & Leicester can carry Girobank without raising capital by converting to a plc.

The society has made no secret of the fact that it expects to convert one day. Rumours are that it came close to beating Abbey National to the flotation post. It does not see the acquisition of Girobank as the trigger for conversion and — short term — the purchase will not mean that the society needs additional capital. It has raised £250 million of subordinated debt to pay for Girobank and to build up an estate agency chain.

'I think we will go plc when we find some strategic thing that we want to do but that we can't do now,' says White. 'There will be reasons for us to go at some stage.'

It must be a matter of some urgency to resolve the remaining problems, and to complete Girobank's sale. This could be pushed through by August, but if this proves impossible, the intervention of the parliamentary summer recess will presumably entail a postponement until the autumn.

Such a delay would do Girobank no favours. As Williamson puts it: 'Ever since the sale was announced we have been in a strategic

limbo. There are many things on hold and that is not good for a business in a fast-moving market-place.'

It is possible, although unlikely, that the Alliance & Leicester's bid could stumble at the last fence. Unresolved difficulties apart, the Building Societies Commission — or even the Bank of England, for that matter — could halt the purchase on prudential grounds. Should this happen, the sooner the Government puts up yet another 'for sale' notice, the better.

SUNDAY TIMES

Legal threat on water immunity

A2-3
by Greg Hadfield and Richard Palmer

THE government is facing a legal challenge to plans to give all 6,400 sewage works immunity from prosecution for river pollution for at least a year after water privatisation.

Friends of the Earth, the environment group, yesterday threatened to take the government to court after discovering that Nicholas Ridley, the environment secretary, is attempting to grant immunity until at least September 1990.

A government amendment to the Water Bill, to be debated in the Lords on Tuesday, would prevent samples collected by existing water authorities from being used as evidence of illegal discharges from any of the 6,400 sewage works in England and Wales.

The "amnesty" will apply for at least a year from the establishment this September of the National Rivers Authority watchdog body, and is

expected to replace alternative plans to relax discharge limits.

Nearly one in five sewage works regularly discharges illegal effluent and many would face regular prosecution if they were private companies. Ministers have already invited "problem" sewage works to seek a relaxation of restrictions. Since March, more than 1,000 applications have been submitted.

Andrew Lees, Friends of the Earth water campaigner, said yesterday: "Protecting the water industry from prosecution for criminal offences flies in the face of an even-handed approach to pollution control. The government has now moved the goalposts twice. This time, they are being removed entirely for a year."

However, the Department of Environment said the amendment was only a "technical" one. "It would be wrong in law for a utility company to be open to prosecution on the basis of samples taken by a water authority when it was under the old regime," it said.

SUNDAY TELEGRAPH

Water prosecution

THE European Commission is likely to prosecute Britain over its failure to deal with excess nitrate in water supplies, which could upset privatisation, says the Observer.