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Prime Minister (1)

Please see Alan Walters's note at flag A.

Content to leave this to the Economic Secretary?

Or shall I enquire what justification will be offered for the apparently arbitrarily chosen £50m contribution to charity, and to whatever payments are to be made to existing depositors?

MCS 11/2

Have we consulted the A-G. I'm not sure we have the right to take £50 million in this way.

Treasury Chambers, Parliament Street, SWIP 3AG

M C Scholar Esq
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LONDON
SW1

9 February 1983

Dear Michael,

FUTURE OF THE TRUSTEE SAVINGS BANK GROUP

Over the last year or so the Economic Secretary has been discussing with the Trustee Savings Banks Central Board proposals for the transfer of the Trustee Savings Banks to the private sector. The Chairman of the Central Board, Sir John Read, has now asked the Economic Secretary formally to accept the Board's proposals as they have emerged from the process of discussion within the Trustee Savings Banks themselves and between the Central Board and the Treasury and the Bank of England.

The restructuring process will require major legislation, for which it is hoped to obtain time in the next session. Legislation to bring the TSBs within the Banking Act 1979 is in any case required by the end of 1985 in order to meet Community requirements.

At present there are 16 Trustee Savings Banks, which own collectively a number of specialised operations such as the United Dominions Trust Finance House, and the credit card company Trustcard. The TSBs are mutual organisations, controlled by self-perpetuating boards of trustees. The Page Committee's Report, published in 1973, recommended that the TSBs should move out of their traditional rôle as a form of national savings into fully-fledged banks, and legislation in 1976 and 1978 set the basis for this move.

The Central Board now propose that further legislation should transfer the assets and business of the existing TSBs to four new banking companies, to be set up under the Companies Act 1981. These banks will operate in England and Wales, Scotland, Northern Ireland and the Channel Islands respectively. It is expected that the banks in England and Wales and in Scotland will satisfy the Bank of England's requirements for recognised status under the Banking Act 1979. The Northern Ireland operation will probably be authorised in the first instance as a licensed deposit taker under the Banking Act, and for technical reasons will therefore rate for the time being as a subsidiary of the England and Wales bank. The Channel Islands bank will of course be subject to Channel Islands supervision. In the Isle of Man, the three branches of the existing TSB North West will continue to belong to the mainland bank.

A new holding company, TSB Group plc, will own the banking companies and the specialised operations now owned by the 16 present banks. It is intended to offer shares in TSB Group plc to the public, with priority to existing depositors and TSB employees. There will be special arrangements in the Channel Islands to take account of local interests and traditions: 49% of the shares in the Channel Islands TSB will be sold to local residents, and 51% will be held by TSB Group plc. The proceeds of the sale of TSB Group plc shares will be used to strengthen the Group's capital base and to compensate existing TSB depositors for the loss of any right to what is rather imprecisely defined as "produce" in the 19th century legislation which established the TSBs.

There is no satisfactory definition of "produce", but it is perhaps best described as the accumulation of earnings beyond interest paid out to depositors. As the TSB Group is to continue, there is no question of selling off its assets and distributing the proceeds among depositors. Nevertheless, Treasury Ministers feel that it is onlyright to recognise the removal of the right to "produce" in a mutually-owned institution at the moment when the TSBs are restructured as Companies Acts companies, and it is proposed to make payments to existing holders of interest bearing accounts, to be financed out of the share issue. I should emphasise that this information is commercially sensitive. To take account of the TSB's traditional role and the way in which reserves have been built up through the contributions of generations of savers, it is proposed to set up TSB charitable foundations which the TSB proposes to endow with a shareholding worth around £50 million. These charitable foundations will carry out general charitable works in each of the TSB's regions.

The Economic Secretary believes that these arrangements will give the TSB a new lease of life as a commercial bank and will provide satisfactorily for ownership and control, both of which are inadequate under present arrangements. The TSBs should be able to offer increased competition to the existing clearing banks. However, the conversion of the TSBs into a Companies Act body could provide an unprecedented opportunity for predators to attempt to acquire a going retail banking concern, before it has altogether found its feet as a fully-fledged clearing bank.

The TSB Central Board are emphatic that a takeover of the TSBs in such circumstances could not be allowed and would be inconsistent with the policy of setting the TSBs up as a "third force" in banking. On the other hand, complete and permanent immunity from takeover would give unacceptable shelter from market forces.

After some hard talking, it is now proposed that for the first five years after the share issue a provision in TSB Group plc's Memorandum of Association should limit shareholdings to a maximum of 5%. Thereafter the Articles of Association (which can be changed by a 75% majority of Shareholders voting) will limit maximum shareholdings to 15%. These safeguards do not go quite as far as the Central Board would like, but the Economic Secretary is satisfied that they represent a reasonable compromise between the need to make the TSBs subject to market disciplines and the need to prevent a premature takeover before the new business has had a chance to find its feet.

Up to now there has been little indication that these proposals will be politically sensitive. However, the Page Committee did recommend that the TSBs should continue to be a mutual organisation. In this respect the proposals differ from Page, as Treasury Ministers do not believe that a mutual organisation would be sufficiently subject to market disciplines, nor that ownership and control would be sufficiently clear; and it would not have access to market captial. Although the Labour Party has not up to now registered any dissent with these proposals, whose outline was announced by the TSBs in August last year, it is always possible that some opposition will emerge as the terms of the proposals sink in and legislation is put forward. Articles in the Guardian on 7 and 9 February may stimulate more interest.

The Economic Secretary is anxious to let Sir John Read have a reply before the next TSB Central Board meeting on 17 February, so perhaps I could assume there is no objection to these proposals unless I hear otherwise by 15 February.

Yours sincerely,

Chris Harrison

C D HARRISON