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**STRUCTURE OF BANKING SUPERVISION**

I attach a further note by officials explaining in more detail the proposal for a Banking Commission outlined in paragraph 56 of the main paper for the Prime Minister's meeting on Banking Supervision on Monday.

I am copying to John Bartlett (Bank of England).

*Yours ever  
Rachel.*

RACHEL LOMAX



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STRUCTURE OF BANKING SUPERVISION

Note by the Treasury

This note supplements the paper attached to the Chancellor's minute to the Prime Minister of 15 October. It sets out in more detail a possible model for a separate Board which would be charged with statutory responsibility for banking supervision. For convenience we have so far called this a "Banking Commission".

Background

2. Our objective is to improve the structure of supervision, while leaving responsibility for banking supervision with the Governor and day to day operation of supervision as at present with the staff of the Bank of England's banking supervision division.

3. The aims are:-

(a) to provide a clearer distinction between banking supervision and the other responsibilities and functions of the Governor and Bank, making any conflicts between them more explicit;

(b) to redress the balance of power between the supervisors and the rest of the Bank, enhancing the role of supervision and giving the supervisors a more independent role; and

(c) to make this clear in public.



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It is recognised that the Court of the Bank of England is not, with its present membership, well suited to the task of overseeing banking supervision. The logic of the arguments would point to establishing a new and completely separate organisation for supervision. The present proposal is designed to achieve the advantages while avoiding administrative upheaval, new bureaucracy and any risk of undermining the authority of the Governor.

### Responsibilities and Powers

4. The new Banking Bill would confer on the Board the responsibilities for protection of depositors, and authorisation and supervision of banks, currently given to the Bank of England under the 1979 Banking Act. If desired, it should be possible to establish a "shadow" Board in advance of the legislation.

5. The structure could open the way in time to bring the responsibilities for supervision of building societies and banks under one body.

6. The Board's powers would be those proposed for the banking supervisors in the main Treasury paper. It would, however, need a further power to permit mutual exchanges of supervisory information with the Bank of England as well as with other supervisors.

### Division of responsibility between the Board and Bank of England

7. The Board would be responsible only for banking supervision. The Court would retain all of its other responsibilities, including its responsibility for decisions in potential rescue cases.

8. The Governor at present has two distinct roles. This structure would distinguish them further: as Governor of the Bank and as Chairman of the Board responsible for banking supervision. Where conflicts emerged - for example with monetary policy or policy on international debt - the Board would give



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a clear expression of the supervisors' point of view. In some cases the Governor himself might be able to resolve such conflicts. In other cases it is right that they should be discussed more widely within Government.

Composition

9. The Governor would be ex-officio Chairman of a Board of, say, six or at most eight. The Deputy Governor and the Bank of England Director responsible for banking supervision would also be members. There would be broad balance between in house "Bank" members, and outsiders. The outsiders should not be "representative" of particular interest groups, but people with experience of banking business, former bankers and accountants.

10. We suggest that appointment should be by the Chancellor with the agreement of the Governor.

11. There is a need to maintain continuity, and demonstrable freedom from political interference. Terms of office might be of five years, with the first appointments staggered to avoid a complete change of personnel after the first five years. It should be difficult to dismiss members. This might perhaps be achieved by making dismissal possible only by the Chancellor with the agreement of the Governor, on demonstrable grounds that the member concerned is no longer "fit and proper".

Accountability

12. At present, the Bank of England is required, under the Banking Act 1979, to report annually to the Chancellor on its actions under the Act. The new Board would report directly and annually to Parliament. The Chancellor would continue to answer Parliamentary questions on the general policy of banking supervision, but would not be answerable to Parliament on the handling of individual cases.



Finance and Accounts

13. The statutorily distinct Board would produce separate accounts. As with the proposed Financial Services and Building Societies legislation, supervision would be self-financing, and paid for by the supervised institutions. The cost could either be met by fees or, as at present, from the profit the Bank of England makes from holding compulsory interest-free deposits from the major banks.

Relationship with responsibilities of the Court

14. The Governor and Bank already carry out functions that are not the responsibility of the Court. The Bank provides services to the Treasury on the note issue, gilt edged operations, and the operation of the foreign exchange reserves. The relationship with the new Board would be somewhat similar. In particular:-

(a) If we had a system of fees paid to the Board, the Bank could charge the Board for the services of the Supervision Department in the same way as the Treasury is now charged for services provided to it.

(b) Staffing of the Supervision Division would primarily be a matter for the Bank (and ultimately the Court), taking into account the views of members of the Board. The Supervision Division would be mainly staffed by career Bank of England staff who would continue to have wide career opportunities in the Bank. But it would also be important to provide for a proportion of inward secondees.

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