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25. 6.82

MR GEORGE
THE GOVERNORS - Advance copies

Copies to Mr Loehnis
Mr Walker
Mr Fforde
Mr Coleby
Mr Dawkins
Mr Sangster
Mr M J Balfour
Mr Holland
Mr Hill
Mr Hayward
Lord Cromwell

NOTICE ON CAPITAL MARKET ISSUES

1 I attach a draft of a guidance notice we would like to issue to the capital market, if possible next week.

2 The main purpose of the notice is to clarify a number of points about corporate deep-discounted and indexed stocks following the announcement in the Chancellor's statement to-day that companies are free to make such issues. On past experience we can expect to get a considerable number of detailed questions from the market about these stocks and it is helpful in responding to have in place an informal notice setting out the basic framework. We issued a similar notice, which was well received in the market, in November 1980 covering the re-opening of the London market to foreign borrowers after the ending of exchange control (copy attached).

3 The notice covers five main questions, the background to which is as follows.

(i) Queuing arrangements

4 The Chancellor's statement announced that companies are now free to issue deep-discounted (and were already free to issue indexed) stocks, subject to the normal arrangements for obtaining timing consent from us. Paragraph 3 of the notice sets out the procedure for obtaining timing consent. It confirms that we will bring these issues into the new issues queue just like any other issue; this should be entirely non-controversial.

(ii) <u>Deep-discounted and indexed issues by foreign companies</u>

5 The Chancellor's statement that companies are free to issue deep-discounted and indexed stocks applies to issues both by UK and by foreign companies. We are concerned, however, that, at any rate initially, the main response could come from foreign companies, and particularly from US ones. US companies have resorted heavily to deep-discount dollar issues in the euro-bond market in recent months and we are told that a large number of them would be interested in making similar issues in sterling. This possibility is the more plausible when one recognises that US companies have the advantage over British companies that, under their home US tax rules, they can obtain tax relief for the uplift on deep-discounted issues on an "accruals" basis, year by year over the life of the stock, whereas British companies can only obtain tax relief in one lump in the year in which the uplift is paid out, i.e. on redemption.

6 It would plainly be acutely embarrassing for Ministers if an announcement which is intended to assist UK companies merely resulted in an avalanche of foreign issues. The Treasury have therefore agreed that we should ration issues by foreign companies through our operation of the queue. This is covered in paragraph 4 of the notice. Exactly what constitutes a foreign company is inevitably a matter of judgment, on which we shall exercise our discretion in the light of the volume of applications to make issues of this type. The notice gives us cover to do so.

(iii) <u>Deep-discounted and indexed issues by non-corporate borrowers</u>

7 The green light in the Chancellor's statement is explicitly limited to issues by <u>companies</u>. We shall be asked if companies can be stretched to include bodies (such as the French state agencies) which are state-owned, but purportedly operate on a commercial basis. We have agreed with the Treasury that we should make it clear that this is not the intention, since the purpose of the exercise is to facilitate stock issues by <u>private</u> sector companies. For this reason <u>UK</u> public sector bodies (e.g. local authorities) will not be allowed to make such issues; and it follows that issues of this type by <u>foreign</u> public sector bodies should be similarly excluded. There is thus no question of any discrimination against foreign issues on this score. Paragraph 5 of the notice covers this point.

(iv) <u>Conventional issues by foreign borrowers (bulldogs)</u>

8 Quite independently of the Chancellor's statement, we have began to be concerned at the prospect of a considerable quickening in the flow of foreign borrowers - virtually all of them sovereign names - wanting to bring bulldog issues. Discussions in the Bank have highlighted the twin dangers this could carry, for the exchange rate and for the prospects of a return to the market by domestic UK companies. We therefore wrote to HMT earlier this month to ask them to seek agreement from Ministers that, if quickening demand from foreign borrowers should emerge, we would limit the foreign offtake from the market to a maximum of £100 mn a month and, if necessary, would indicate to the market that we were rationing bulldog issues (though without quantifying the limit). We would explain this to the market <u>not</u> by any alarmist reference to concern at the impact on the exchange rate, but by reference to the perfectly natural wish to leave space in the queue for issues by domestic UK companies.

9 We still await an answer from the Treasury on this question: it will be discussed at a meeting on Monday. In the hope that we can win agreement, paragraph 5 (last sentence) of the notice covers the point in a low-key fashion, by confirming that the market remains open for conventional (i.e., full-coupon, non-indexed) bulldog issues, but with the proviso that we will have regard to "the need to avoid congestion in the market and to leave capacity for issues by UK companies". This inevitably embodies an element of discrimination against foreign borrowers. We do not think that, in this mild form, it creates any problems in relation to EC (or OECD) obligations, but we are checking on the point.

(v) <u>Queuing sterling euro-bonds</u>

10 We also want to take the opportunity of this notice, again quite independently of the Chancellor's statement, to bring sterling euro-bonds into our queuing arrangements. We reserved the right to do this in our earlier notice if we felt that such issues were beginning to have any important impact on the domestic market, i.e. by being sold to domestic investors rather than abroad.

11 We have had indications from the market in recent weeks that this point is now approaching. A number of short-dated bulldogs have carried bearer options and been sold as much abroad, through euro-bond-style selling groups, as in the domestic market; and we are told that the most recent sterling euro-bond issues earlier this month attracted significant domestic investment interest. The result is that the two instruments are now effectively the same and it therefore makes little sense to queue one but not the other if they differ in name but not in substance.

12 This point is covered in paragraph 6 of the notice. Before proceeding with this step, however, we will want to take a more considered view from the market as to whether the process of integration between the domestic and euro-sterling markets is as advanced as we believe. I have arranged to discuss this question on Monday with a group from the Accepting Houses arranged by the AHC: paragraph 6 is therefore subject to revision in the light of the outcome of that meeting. We have not yet put the point to the Treasury, but we have obtained confirmation from the Treasury Solicitor that our powers under COBO do extend to sterling euro-bonds.

13 The notice also covers one other minor point, for the record - the decision by the Stock Exchange (at our suggestion) already promulgated last year to raise the upper limit on placings in the gilt-edged market from £7 mn to £12 mn.

25 June 1982

Ian Plenderleith (4491)
Gilt-Edged Division HO-P

RE-DRAFT (25. 6.82) /Date/

CAPITAL MARKET ISSUES IN THE UNITED KINGDOM

1 This notice supplements that issued by the Bank of England on 10 November 1980 and provides further guidance on the arrangements which the Bank wishes to see observed for new issues in the UK capital market.

Deep-discounted and indexed stocks

2 The Chancellor of the Exchequer announced on 25 June that, subject to the normal arrangements for obtaining timing consent from the Bank of England, companies are now free to issue deep-discounted (including zero coupon) stocks in sterling. They have for some time been free to issue indexed stocks in sterling. At the same time the Inland Revenue issued a statement clarifying the tax position of such stocks. The purpose of these announcements is to facilitate stock issues by companies, as an alternative source of finance to bank borrowing.

3 The procedure for obtaining timing consent from the Bank of England, which is required under the Control of Borrowing Order 1958 (as subsequently amended), is set out in the Bank's notice of 10 November 1980 (paragraphs 5 and 6). Deep-discounted and indexed issues will be brought into the new issues queue which the Bank operates through the Government Broker. Requests for timing consent should in the first instance be directed to the Government Broker at Mullens & Co; and issues for which timing consent is granted will be assigned a date in the queue, which may not be altered without re-application for timing consent.

4 Subject to this requirement, deep-discounted and indexed issues may be made both by UK and by foreign companies. However, in administering the queue the Bank will have regard to the tax advantages that some foreign companies may enjoy over UK companies in relation to issues of this type by virtue of differences between UK and foreign regulations governing the tax treatment of such issues. The Bank will accordingly limit the size and frequency of such issues by foreign companies to the extent necessary to avoid congestion in the market and to leave capacity for issues by UK companies.

5 Since the intention of the Chancellor's announcement is to facilitate stock issues by companies, approval from H M Treasury will not for the time being be forthcoming for deep-discounted or indexed issues by local authorities. For the same reason, consent will not at present be given for such issues by other sovereign, parastatal or public sector borrowers. Consent for such borrowers to make conventional stock issues on a full-coupon, non-indexed basis will continue to be given in accordance with the Bank's notice of 10 November 1980, having regard to the need to avoid congestion in the market and to leave capacity for issues by UK companies.

Sterling euro-bonds

6 In the Bank's notice of 10 November 1980, it was stated that the Bank did not at that stage consider it necessary to operate a queue for issues of sterling euro-bonds, since such issues appeared at that stage to have only a limited impact on the domestic market. It was indicated, however, that the Bank might wish to bring sterling euro-bonds within the queuing arrangements if they came to have an important impact on the domestic market.

7 Over the past two years the domestic sterling capital market and the sterling euro-bond market have tended to become more closely integrated; and there have been signs more recently that issues of sterling euro-bonds can attract significant domestic investment interest. The Bank considers that, in order to promote the development of the sterling capital market on an efficient and orderly basis, it would now be appropriate to bring issues of sterling euro-bonds within the new issues queue. Accordingly all such issues will henceforth be subject to the queuing arrangements summarised in paragraph 3 above.

Access to the Gilt-Edged Market

8 The Bank's notice of 10 November 1980 recorded that it was a requirement for the admission of securities to the gilt-edged market that they should on issue be offered in their entirety for public subscription, unless the issue was £7 million or less in amount. The opportunity is taken in this notice to confirm that in June 1981, as was communicated to the market at the time, The Stock Exchange, with the agreement of the Bank, increased the limit of £7 million to £12 million.

9 In all other respects the Bank's notice of 10 November 1980 remains in effect. The Bank's Gilt-Edged Division stands ready to respond to questions on this and the earlier notice and to give guidance on other matters which may arise in relation to capital issues in the UK.

Bank of England

/Date/

CAPITAL MARKET ISSUES IN THE UK

1 This notice provides guidance on the arrangements which the Bank of England wish to see observed for new issues in the UK capital market.

2 The ending of exchange control re-opened the sterling capital market to issues by foreign entities and promises to bring a significant expansion in international operations in the UK capital market. The Bank of England will be concerned to promote the development of the market on an efficient and orderly basis.

3 To this end, the Bank do not wish capital issues in sterling, including in principle those carrying a sterling option, to be made in markets outside the UK and will for this purpose, where necessary, seek the co-operation of overseas authorities. Foreign entities are, however, following the ending of exchange control, free to make issues in the UK capital market - both of debt and of equity - on the same basis as domestic entities. Moreover, both domestic and foreign borrowers are free to issue sterling euro-bonds (including floating-rate notes) without restriction on the use of the funds; and there is no restriction on the purchase of such securities by UK residents.

4 In order to promote the development of the UK capital market, the Bank consider that it may be helpful to give guidance from time to time on the arrangements which they wish to see observed in relation to new issues in the UK, including issues of sterling euro-bonds. Three aspects are covered in this notice.

TIMING CONSENT

5 New issues in sterling for amounts of £3 million or above are subject to timing consent by the Bank of England, under the Control of Borrowing Order 1958 (as subsequently amended). Foreign entities wishing to make such issues are thus, like domestic entities, required to seek the consent of the Bank of England in advance to the timing of the proposed issue. Requests for timing consent should in the first instance be directed to the Government Broker at Mullens & Co.

6 For new issues in sterling other than issues of sterling euro-bonds, the Bank operate, through the Government Broker, a new issues queue. Issues for which timing consent is granted will be assigned a date in the queue, which may not be altered without re-application for timing consent. In administering the queue the Bank have regard to the capacity of the market and to the need to maintain orderly arrangements for new issues.

7 The Bank do not at present consider it necessary to operate a queue for issues of sterling euro-bonds, nor for non-sterling issues in the UK market, since such issues appear at this stage to have only a limited impact on the domestic market. The Bank wish however to be in a position to monitor such issues and therefore ask that, in addition to the requirement for timing consent in paragraph 5 above to which sterling issues are subject, notification should be given as early as possible in advance to the Bank's Gilt-Edged Division of any proposed sterling euro-bond or foreign currency issues in the UK market, including those carrying a sterling option or a conversion option into sterling securities. In the case of issues in sterling,

where it appears that there may be a clash of dates between similar issues the Bank will seek to arrange discussions between the issuing houses to explore the possibilities for avoiding unnecessary disturbance to the market; but in general final decisions will be left to the respective houses. If such issues should come to have an important impact on the domestic market, the Bank may at that stage wish to bring them within the queuing arrangements set out in paragraph 6 above.

LEADERSHIP

8 In order that the impact of new issues on the sterling capital market may be adequately monitored, the Bank wish to see all capital issues in sterling, including those carrying a sterling option, led by a UK-based institution with the capacity in the UK to act as an issuing house. Foreign-owned institutions with such a capacity will be eligible to lead sterling issues if in the Bank's view there are reciprocal opportunities in their domestic capital markets for equivalent UK-owned institutions; but the Bank will for the present expect such issues to be co-led by a UK-owned institution with the capacity in the UK to act as an issuing house. In each case, the Bank will look to the UK-owned co-lead manager to ensure that the arrangements in paragraphs 5-7 above are observed. Foreign-owned institutions which do not meet the reciprocity requirement will be eligible to participate in a co-management position, but not as a leader or co-leader.

ACCESS TO THE GILT-EDGED MARKET

9 The gilt-edged market comprises those securities which are traded on the scales of minimum commissions set out in Appendix 39, Section A, to the Rules and Regulations of The Stock Exchange. The securities which currently trade in this sector are, in broad terms, British Government and Government-guaranteed securities, UK corporation and county stocks and bonds, the securities of certain UK public boards, securities issued by the IBRD and the IADB, Commonwealth Government and provincial securities, Commonwealth corporation stocks and certain Irish securities.

10 The Stock Exchange, with the agreement of the Bank, are prepared henceforth to consider extending admission to the gilt-edged market additionally to future issues of sterling stocks and bonds made in their own name by other overseas central governments and by other international institutions with which the UK is associated. Application for an issue to be admitted to the gilt-edged market should be made in advance to the Quotations Department of The Stock Exchange. It will continue to be a requirement of such admission that the securities should on issue be offered in their entirety for public subscription, unless the issue is £7 million or less in amount. In addition to the requirements for timing consent in paragraphs 5-7 above, the Bank will also wish to be notified in advance of the terms of any issue to be made in the gilt-edged market.

11 The Bank's Gilt-Edged Division stands ready to respond to questions on this notice and to give guidance on other matters which may arise in relation to capital issues in the UK.

Bank of England
10 November 1980