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~~EP F/3~~

FROM: R M PERFECT

DATE: JULY 1982

1. MR LAVELLE

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Burns
Sir K Couzens
Sir W Ryrie
Mr Littler
Mr Middleton
Mr Britton
Mr Lavelle
Mr Kemp
Mr Monck
Mr Moore
Mr Robson
Mr Sedgwick
Mr Turnbull
Mr Hall
Mr Peretz o/r
Mr Ridley

BULLDOG ISSUES

Mr Peretz'minute of 23 June reported that the Bank were seeking continued Ministerial backing for a limit on overseas sterling bond issues ("bulldog issues") ~~("bulldogs")~~. You agreed that there was no need to include a reference to such a limit in your monetary statement of 25 June. We have explored the matter further with the Bank who now wish to issue an informal guidance note. This minute seeks your approval.

Background

2. Borrowers wishing to issue sterling bonds need Treasury consent under the Control of Borrowing Order which the Bank administers on behalf of the Treasury. The Bank organise a three month long queue in order to avoid clashes of issues which might disturb the market.

3. At present the Bank operate an informal limit on bulldog issues of around £100 million a month. The purpose is to ensure that there will be space in the queue available at short notice for domestic UK corporate borrowers if they should wish to return to the capital market. The only domestic corporate candidates to do so have been Barclays Bank and Midland Bank, each of which have recently raised £100 million, but the Bank report that a number of industrial companies have expressed guarded interest. One of the points these companies stress is that, if they do decide to issue bonds they may wish to do so quickly, possibly to take advantage of the publication of results or other company news. This would not be possible if the three month queue were filled up with bulldog issues.

4. The Bank have been able to operate the limit on bulldogs in recent months without attracting great attention because foreign applications have not generally ~~exceed~~ exceeded the limit. Nonetheless the size of issues by New Zealand and Australia have been reduced and planned issues by the World Bank and some French state agencies have been held up. However now that the embargo on deep discounted bonds has been lifted the Bank expect greater overseas interest notably from US corporations which may be able to benefit from an asymmetry in the taxation of the interest on deep discounted bonds in the UK and the US. The interest earned by an investor on a deep discounted bond is not taxable in the UK until the bond is redeemed but a US corporation will be able to deduct the amortised interest from its US tax liability as it accrues. Inland Revenue are currently reviewing the UK company tax treatment. The end of the Falklands crisis and continued high dollar interest rates may also stimulate interest in bulldog issues.

5. The Bank are concerned that if the £100 million limit does now begin to bite there may be complaints from foreign borrowers whose issues are delayed despite obvious gaps in the queue. Sovereign borrowers who are ~~derived~~ deprived of access to the market can be expected to appeal to Ministers in private and in public. The Bank therefore wish to have Treasury approval to maintain the limit. If there are complaints they could reasonably be met by pointing to our desire to facilitate a return to the stock market by domestic companies.

6. We have considered whether it would be possible to imitate the German and Japanese arrangements whereby the market is encouraged to take a view as to the amount of foreign issues the market can absorb. (The idea would have been to distance the Government and underline the technical nature of the control) However there are many more ~~banks~~

banks in London capable of leading on a bond issue many of which principally represent foreign borrowers. The Bank therefore do not believe that it would be possible to limit foreign issues in this way.

## Draft Bank of England Notice

7. The Bank wish to issue a notice (draft attached at Annex 1) outlining the treatment of deep discounted and indexed stocks and reminding potential issuers of the procedures for seeking timing consent under the Control of Borrowing Order. The last such Notice was issued in November 1980 and no reference was made to any limit on bulldog issues since the exchange rate was then uncomfortably high. In the present Notice the Bank would like to make a low key reference to the possibility of a limit on bulldogs so that their written guidance is consistent with the answers they give to specific questions. Paragraphs 4 and 5 of the draft Notice have been drafted with this in mind.

8. Paragraph 4 of the draft Notice deals with deep discount and indexed issues and says that 'the Bank will regulate the size and frequency of such issues to avoid the risk of congestion in the market and to leave capacity for issues by UK companies'. The paragraph goes on to refer to the tax advantages that some foreign companies may enjoy. This wording is designed to indicate the way the Bank will operate the market but has been kept deliberately low key to avoid arousing misplaced fears of exchange controls and to minimise the chances of international complaints of discrimination against foreign companies.

9. Paragraph 5 of the draft Notice deals with sovereign and public sector borrowers and indicates that they will not be allowed to make deep discount or indexed issues but may continue to make conventional bulldog issues. The Bank would prefer to reiterate that consent will be given 'having regard to the need to avoid the risk of congestion in the market and to leave capacity for issues by UK companies'. HF and EF accept that the Bank do administer the queue in this way and are content for them to say so in response to questions but consider it unnecessary to reiterate the point in this Notice since the sentiment is already expressed in the previous paragraph. While the Bank would prefer to retain these words they would be content to delete them if you wished.

International obligations

10. The EC founding treaty and the OECD Code of liberalisation of capital movements encourage us to liberalize capital flows between countries. ~~But there is no doubt that we can administer a control of this sort without seeking derogations from these undertakings~~. As regards EC law, Treasury Solicitor advises (Annex 2) that it would be prudent to consult the Commission at some stage so that we can, if necessary, argue that Article 3 of the Capital Movements Directive applies ~~the control is an exchange restriction rather than~~ a ~~discriminatory domestic rule governing the market~~. Any consultation could be done through UKREP as a routine matter. The OECD capital movements code allows us to place a reservation if we wish to discriminate against foreign bond issues. However in order to keep the presentation low key we would propose initially to explain that the Bank's treatment was even handed once tax and other considerations were taken into account.

Euro sterling bonds

11. The Bank's draft notice (paras 6-7) brings sterling eurobonds within the normal requirment for timing consent. The Bank consider that the progressive blurring of the distinction between domestic and euro-bond issues makes this step appropriate. [The Bank may wish to make some revisions to this part of the Notice in the light of confidential discussions with the accepting houses and the Stock Exchange which are currently taking place].

Recommendations

12. It will of course be possible to review the size and need for any limit on bulldog ~~building~~ issues in future, taking into account any representations from domestic and foreign borrowers. However the Bank need to be able to explain their handling of the queue to the market.

13. The Chancellor is invited to agree that:

a. the Bank continue to administer a limit of roughly £100 million a month on bulldog issues;

b. that the policy be explained to the market in the terms of paragraph 4 of the Bank's notice;

c. that in view of the need to avoid emphasising any discrimination against foreign borrowers the phrase 'having regard to the need to avoid the ~~rsik~~ risk of congestion in the market and to leave capacity for issues by UK companies' be deleted from paragraph 5 of the draft Notice. This policy would still be adequately described in paragraph 4;

d. that consultations with EC and OECD be designed to minimise criticism and publicity;

e. that Euro sterling bonds be brought within the normal ~~quering~~ queuing arrangements.

R M PERFECT