

Prime Minister ^①

Content with Treasury proposals?

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MR TURNBULL

4 December 1984

TRUSTEE SAVINGS BANKS

Yes not

The Trustee Savings Banks are very odd organisations. Nobody owns them. They have a special relationship with the Government but are not part of the public sector and are not guaranteed by us. The Treasury's broad proposals - agreed by the Prime Minister in 1983 - for establishing them as public limited companies owned by private shareholders and freely competing as retail banks are entirely sensible.

Special Favours

Back in 1983 the Prime Minister was rightly worried about apparently arbitrary arrangements for distributing some of the funds which the TSBs would raise by their share issue. Depositors were to get a special bonus. The Treasury have now dropped this idea. £50 million was to be spent on endowing charitable foundations to reflect the TSBs' traditional roles as local self-help organisations. The Treasury still favour this but have conceded that it will be a decision for the new organisation to take after the shares have been sold so new shareholders will be able to object.

Timetable

The timetable is tight. The Bill and explanatory White Paper are to be published in about a fortnight. The aim is to

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get the Bill through Parliament in the Spring with a share issue to raise about £700 million in the Autumn. We will need to ensure the TSB flotation doesn't get in the way of any major privatisations.

Presentation

The Treasury don't want to present the TSB restructuring as privatisation because:

- we aren't the owners and hence aren't getting any of the receipts;
- they want an easy passage for the Bill through the House by presenting it as equivalent to a private Bill for rearranging the affairs of, say, a major bank;

At the same time they want to play up its significance in competition policy. The new TSBs with 3 million depositors and an extensive retail branch network will, when freed from Treasury regulation, be a lively competitive institution.

This approach is alright though I hope the Treasury won't be too high-minded about refusing to claim credit for it as a privatisation measure, especially after the event.

Predators

There are big aggressive financial institutions - such as

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Citibank - very keen to expand in the UK retail sector. They would swallow up the TSBs. It is proposed that the articles of association of the new companies will fix a maximum shareholding of 5% for the first five years, and thereafter, 15%. The idea is to protect the new bodies in the early years. The Treasury looked at the option of a golden share but rightly rejected it as no overriding strategic interest is involved. Anyway, we don't own them and they should be as free as any other private bank.

I personally wouldn't be surprised if the TSBs provide one of the major takeover battles of the late 1980s.

Recommendation

I recommend that the Prime Minister agrees with the Treasury's plans for publishing a Bill and White Paper.

David Willetts

DAVID WILLETTS

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PWE
SH2AAS
bcc: Mr Willett

10 DOWNING STREET

From the Private Secretary

6 December 1984

Trustee Savings Banks Bill:
White Paper

The Prime Minister has seen your letter to me of 30 November. She is content with the proposals in the White Paper and is content for it to be issued in the week after next.

I am copying this letter to David Morris (Lord Privy Seal's Office) and Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

David Peretz, Esq.,
H.M. Treasury

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BP with response

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Andrew Turnbull Esq
Private Secretary
10 Downing Street
SW1

30 November 1984

Dear Andrew

TRUSTEE SAVINGS BANKS BILL: WHITE PAPER

The TSB is now scheduled to reach L Committee on 12 December with Second Reading early in the New Year, as suggested by the Lord Privy Seal. The Bill is virtually complete; Counsel is consulting the Law Officers and the House authorities on a couple of points of law in order to ensure that the Bill is as sound as possible in the time available.

The Bill will cover only those parts of the TSB reorganisation which require legislative approval. The TSB Group will put other parts of the plan into effect on their own authority, though Treasury Ministers have examined and agreed to their proposals in some detail. These are essentially those set out in Christopher Harrison's letter to Michael Scholar of 9 February 1983, although the idea of paying a bonus to depositors has been dropped and shareholders in the new company will now be able to object to the endowment of TSB charitable foundations.

Treasury Ministers have it in mind to publish a short White Paper when the Bill is introduced. This will probably be on 17 or 18 December because of the Economic Secretary's Community commitments at the end of the previous week. In order to explain the reorganisation proposals, it is necessary to describe both the Bill itself and the TSBs' own input to the operation. The White Paper is therefore in two parts.

The first sets out the content of the Bill and explains the historical context in which the relationship between the TSBs and the Government evolved. It stresses the

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contribution that the reorganisation of the TSBs will make to the increase of competition in retail banking, picking up the reference in The Queen's Speech. The passage (Section 4) on the law relating to ownership has been cleared with the Law Officers.

The second part of the White Paper will reproduce a letter from the Chairman of the TSB Central Board to the Chancellor setting out those parts of the plans which fall principally to the TSBs themselves to carry out. This covers the commercial progress of the TSB Group, their plans for the future, the share issue and the protection against takeover through provisions in the new company's memorandum and articles of association.

The intention is that the Economic Secretary and Sir John Read should hold a joint press conference, probably on 17 or 18 December, to mark the introduction of the Bill and the publication of the White Paper.

It is difficult to judge the extent to which the Bill may be opposed in Parliament. It is unlikely to arouse the degree of hostility from the Opposition which a straightforward privatisation measure would face. Treasury Ministers intend to present the Bill as far as possible as a measure agreed between the Government and the TSBs, which only requires public legislation because of the special historic relationship. Parallels with privatisation may best be drawn after the passage of the Bill, though the Bill will be presented as helpful to the Government's competition policy.

There may however be some difficulty in persuading individual critics that TSB depositors have no claim to ownership of the banks, although the Law Officers have given unequivocal advice to that effect. Some critics may also argue that the TSBs should remain mutual organisations or that a special legal regime of some kind should continue to apply, for example in relation to staff rights or protection against takeover. Treasury Ministers will argue that in order to compete effectively the TSBs must be put on the same legislative footing under the Companies Acts and the Banking Act as the other major retail banks; and that the detailed proposals have been worked out by the TSBs themselves in consultation with the Treasury.

I attach a copy of the draft White Paper as it now stands. We may need to make further minor changes to reflect the final language and content of the Bill. We hope to get the White Paper to the printers by 6 December.

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I am sending copies of this letter to David Morris and Richard Hatfield.

*Yours ever
David*

D L C PERETZ

TRUSTEE SAVINGS BANKS WHITE PAPER

1. Introduction

1.1 The Government attaches great importance to the benefits which competition brings to the economy. Major changes in the financial sector are now in progress; it is vital that financial institutions should be capable of reacting to these changes and should take advantage of the new opportunities which are emerging.

1.2 With the agreement and support of the Trustee Savings Banks Central Board and of the trustees of the individual Trustee Savings Banks (TSBs), the Government is therefore glad to be able to put before Parliament a Bill which will enable the TSBs to complete their transition to fully-fledged private sector status, and to remove the long-standing special restrictions on the TSBs' freedom of action.

1.3 The Government is convinced that this Bill will benefit the TSBs, their customers, and their employees. The Government believes also that this Bill, together with the further proposals for the future of the TSBs set out in the annex to this White Paper, will be of wider benefit to the economy because it will increase choice and competition in the financial sector and in particular in retail banking.

1.4 The Bill will enable the TSBs and the other members of the TSB Group to implement their plans to reorganise into a Companies Act structure and to issue shares. It will make legislative provision where that is necessary for the reorganisation. There are, however, important aspects of the plans for the future of the TSB Group which do not require legislation. They are the

concern of the TSB Central Board and the individual TSBs rather than of the Government, but they form an essential part of the total proposals for the future of the TSBs. They do not make sense without the Bill any more than the Bill makes sense on its own.

1.5 The Bill therefore needs to be considered in the light of these other elements. In a letter to the Chancellor of the Exchequer, the Chairman of the TSB Central Board, Sir John Read, has set out the main points of the reorganisation which the TSBs are planning under their own powers but following detailed consultations with the Treasury. This letter is reproduced at Annex 1. As Sir John Read says, the Government is in general agreement with the TSBs' plans.

1.6 The Bill will also provide for the repeal of the existing legislation relating to TSBs. This follows from the decision to reorganise the Group into a corporate organisation under the Companies Acts and to bring the new banking companies under the Banking Act. So the Bill will bring to an end the special statutory relationship which the TSBs have had with the Government and with Parliament for nearly 170 years.

2. Background

2.1 The TSBs had their origins as saving institutions and are essentially privately run. Had the TSBs been conventional private sector banks, they would in the usual way have sought a private Bill to reorganise their operations. However, for historical and legal reasons the TSBs require the authority of a public Act of Parliament to change their basis of operation, even though much of what is in that Bill would otherwise be in a private Bill. To understand why this is so, it is necessary to look in a little detail at the history of the TSBs and their relationship with Government.

2.2 In many parts of the British Isles, particularly in Scotland and the North of England, the local TSB has been a feature of the community since the earlier part of the last century. As the economy developed to the point where wage-earners started to earn enough money to put aside savings, the leaders of local communities made it their business to set up savings banks to encourage thrift and self-help. These institutions were run as an act of public service by trustees who had some experience in financial matters, often local businessmen, landowners, or clergymen.

2.3 From 1817 (in England and Wales) and 1835 (in Scotland) Parliament established a statutory framework for the savings banks, covering among other things the duties of the trustees and the rights of depositors. The statutory framework was modified from time to time by a succession of Trustee Savings Banks Acts. In order to safeguard depositors, trustees were required to invest depositors' funds with the Government or in Government securities or later with local authorities. Indeed, for much of their history, TSBs functioned essentially as an arm of national savings.

2.4 From the earliest TSB Act, TSBs were subjected to the strict supervision of Government agencies, and this is still the case today. The Treasury supervises many aspects of the TSBs' business, in particular their overall lending limits.

2.5 By 1860 there were over 600 TSBs. From that time the number of separate TSBs fell, as banks amalgamated, to 100 just before the Second World War and to 20 at the time of the TSB Act 1976. But deposits grew steadily, and doubled during the Second World War. After 1945 there was some increase in the level of cooperation between the banks. This was stepped up in the late 1960s when shared computer and clearing facilities were introduced. The TSB Act 1976 placed inter-TSB cooperation on a more

formal statutory basis in particular with the creation of the Trustee Savings Banks Central Board.

2.6 By the 1960s, it was becoming obvious that TSBs needed to adapt to the changing environment. Traditional TSB depositors now required more sophisticated financial services than the TSBs were able to provide. Although limited additional services were now offered, in particular a cheque account service introduced in 1965, these were not sufficient to retain depositors. The result was that TSBs lost custom to other financial institutions; and although deposits continued to grow, the TSBs' share of the total deposit market declined.

2.7 In June 1971 the then Government invited a Committee chaired by Sir Harry Page to consider the future role and development of National Savings and of the TSBs. At that time, there were over 73 trustee savings banks which offered a basic savings facility to their depositors which had scarcely changed in its essentials for 150 years. In 1973 the Page Committee recommended radical changes to the status, operations and services of the TSBs, in particular, the development of the TSBs' banking services to compete effectively with the major private sector clearing banks.

2.8 As a first step, it was necessary for Parliament to authorise the TSBs to provide additional services; and (as explained at 2.5 above) to revise the statutory framework so as to enable the TSBs to build up the degree of coordination and central operations necessary in order to fulfil their potential. The Trustee Savings Banks Acts 1976 and 1978 provided these powers. In 1981 Parliament consolidated the two 1970s Acts with earlier TSB legislation, and the framework for the present Trustee Savings Bank movement is therefore set out in the Trustee Savings Banks Act 1981.

2.9 Recent years have brought many changes for the TSBs as the process of evolution initiated by the Page Report and the 1976 Act gathered pace. By the end of 1983, amalgamations had reduced the number of TSBs to four, covering England and Wales, Scotland, Northern Ireland and the Channel Islands respectively. Over the same period, cooperation between TSBs was greatly increased, and the TSB movement as a whole, now known as the TSB Group, built up a wide range of financial services. These changes are set out in the following paragraphs and were described in the TSB Group's Report for 1983.

3. The recent expansion of TSB activities

3.1 The new freedoms granted by the 1976 and 1978 Acts enabled the TSBs to develop rapidly the range of services they could offer to their customers. This development of the business has prepared the ground for the final stages of the TSBs' reorganisation.

3.2 On the liabilities side, whereas three-quarters of a million people had held cheque accounts with TSBs in 1975, by the end of 1983 the figure had reached 3½ million. In 1975 the TSB Group joined the central clearing system through their central banking company, Central Trustee Savings Bank Limited. The TSBs have participated fully in the development of electronic banking and clearing systems.

3.3 On the assets side, the TSBs started in 1977 to make personal loans to their customers. In 1979, they introduced a mortgage service and started commercial lending. The TSB Group has established or acquired a number of specialist companies which are owned jointly by the four TSBs and the TSB Central Board through a holding company, Trustee Savings Banks (Holdings)

Limited. These deal with instalment credit, credit cards, life and general insurance, unit trusts and money market operations. The TSB Group as a whole is therefore now a substantial financial organisation.

4. Ownership

4.1 Paragraphs 2.3 to 2.9 above outlined the circumstances in which the TSBs evolved and their special relationship with the Government over the years. Because of these special circumstances, ownership of the TSBs has never been established. The TSB Acts are silent on this basic question.

4.2 In spite of the fact that the TSBs used to function as an arm of national savings, the TSBs do not belong to the Government. Nor do they belong to the trustees, to their employees or to their depositors. Depositors with TSBs are not comparable with shareholders in building societies. Nor are they in a position similar to holders of equity in companies. The making of a deposit with a TSB and the earning of interest on that deposit does not carry with it the implication of a share in the ownership or a claim to the reserves of the bank.

4.3 The Government thinks it essential for the further development of the TSBs that ownership should be clearly established for the future. After careful consideration and discussion with the TSB Central Board, the Government has decided that this should be achieved through the offer for sale of shares in a public limited company. The TSBs would thereby achieve proper accountability to shareholders and the new Group would obtain access to further capital as necessary to meet the future needs of the organisation.

5. The restructuring operation

5.1 The TSB Central Board announced the main points of the reorganisation plan in August 1982.

5.2 The main effect of the Bill will, as stated above, be to put the reorganisation plan into effect by restructuring the TSBs under a top holding company - TSB Group plc - in such a way as to establish them on the same legal basis as the other major UK banks. The new TSBs will be limited companies under the Companies Acts. They will seek authorisation from the Bank of England under the Banking Act 1979 (except in the Channel Islands and Isle of Man where they will seek local authorisation). As already mentioned the present system for the authorisation and supervision of the TSBs by the Treasury and other Government Departments will come to an end.

5.3 In technical legal terms, the Bill itself will not actually change the status of the existing TSBs, but will vest all their assets, liabilities and obligations in the "new" TSB banking companies. Thereafter the old TSBs will cease to exist. Similarly the parts of the TSB Group at present controlled in the manner described at paragraph 3.3 will be transferred to the ownership of TSB Group plc.

5.4 The difference between the old and the new structures can be seen from the following tables.

5.5 The new TSB banking companies and the specialist companies which the TSB Group at present owns will all be subsidiaries of the new holding company, TSB Group plc. Once the Bill is enacted, the Treasury will decide when to activate the vesting mechanism, in consultation with the TSB Central Board. Following vesting, shares in TSB Group plc will be offered for sale. This will be the responsibility of TSB Group plc as the successor to the TSB Central Board. As the TSB Central Board have already announced, TSB customers and staff will have priority in subscribing for shares. The proceeds of the issue will go to strengthen the TSB Group's capital resources and so to serve as the basis for future expansion.

6. Taxation

6.1 As evolution of the TSBs towards a Companies Act structure has progressed, the tax regime which applies to them has had to be adapted to the changing circumstances. From a taxation point of view, the first stages of transition were marked by provisions in the Finance Act 1980. These included a switch from taxation of the TSBs as investment companies to taxation as trading concerns. Further changes introduced this year brought the TSBs within provisions of the Taxes Act 1970 relating to groups of companies and consortia for corporation and capital gains tax purposes.

6.2 The reorganisation of the TSBs and the other members of the TSB Group in the final stage of transition to a Companies Act structure again has tax consequences. In the absence of provision to the contrary, these would be of an adverse nature because of the unique status of the present TSBs and the framework of the Group. The Bill therefore contains provisions to put the tax position of the TSBs with regard to the reorganisation on a broadly similar basis to what it would have been if had been carried out within a group of limited companies.

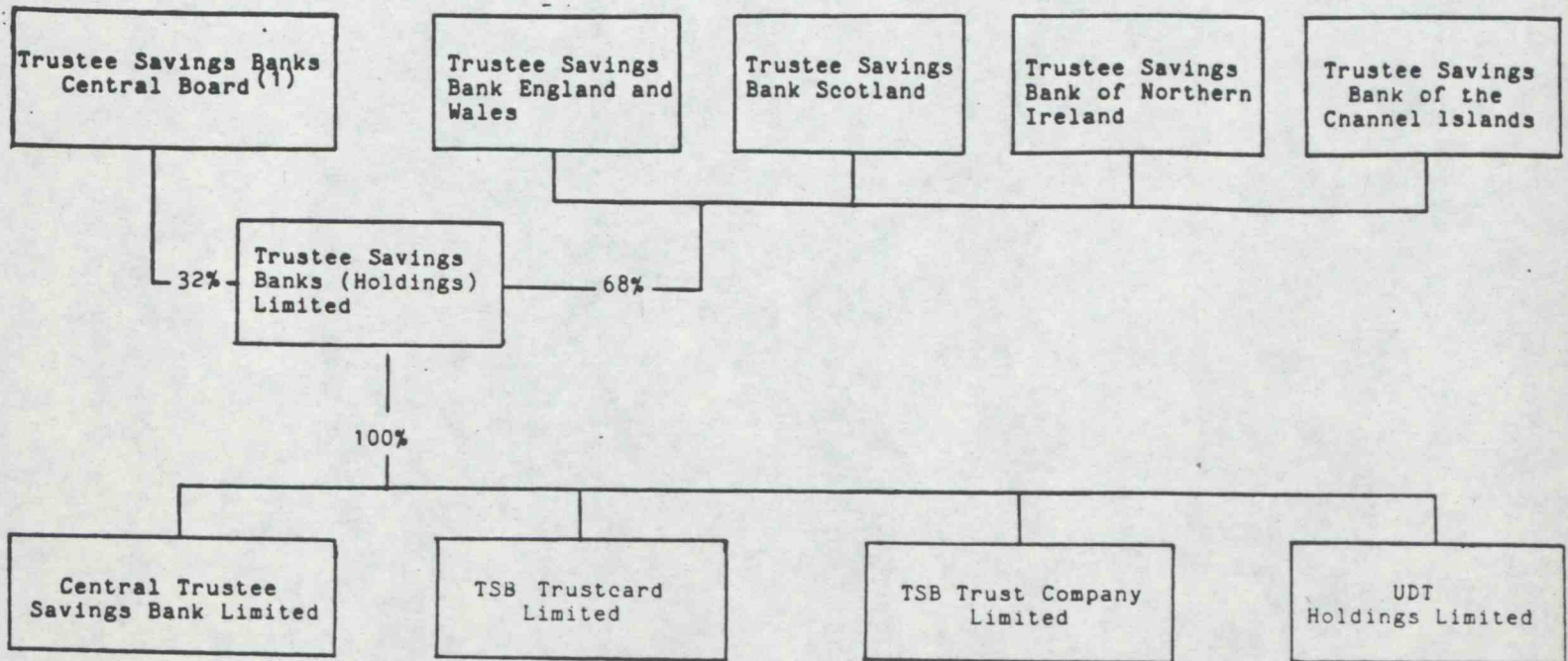
7. Channel Islands and the Isle of Man

7.1 The present TSBs operate as retail banks throughout the United Kingdom, the Channel Islands and the Isle of Man (in the latter case, through branches of TSB England and Wales). As with earlier TSB legislation, the respective Island authorities have agreed that the TSB Bill should - exceptionally - have direct effect in the Channel Islands and the Isle of Man, because it is clearly right that the reorganisation should take place on the same legal basis and at the same time in the different jurisdictions. Sir John Read's letter explains certain special arrangements which will apply to the new Channel Islands banking company.

Table Present TSB structure

Trustee Savings Banks Central Board and the four Trustee Savings Banks governed by the Trustee Savings Banks Act 1981.

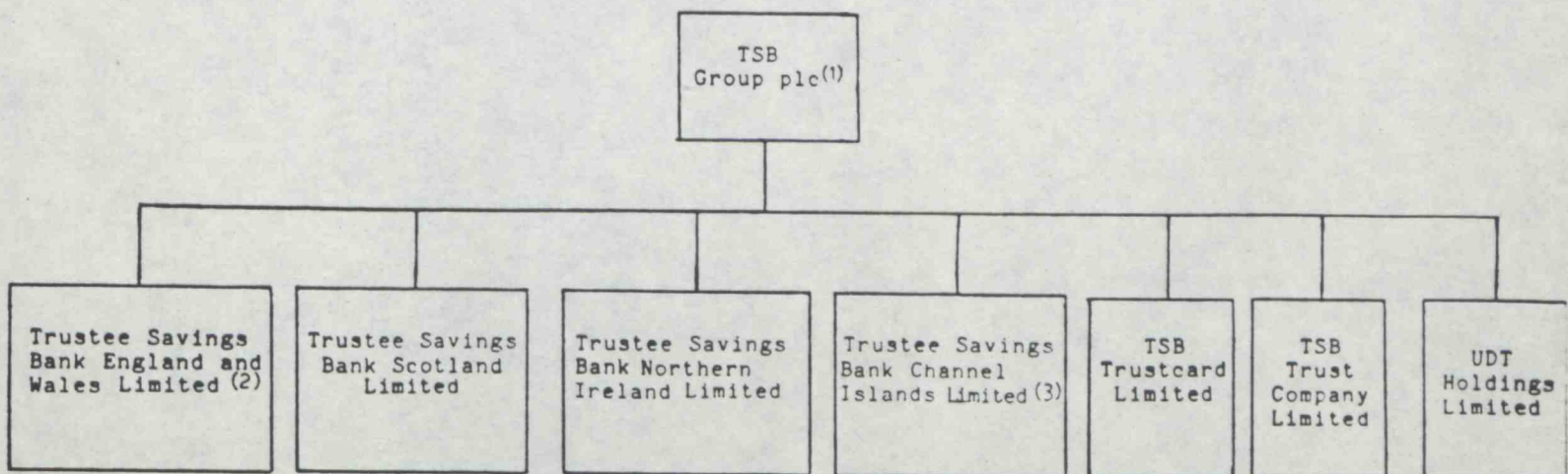
Limited companies governed by the Companies Acts.



(1) Includes a representative from each Trustee Savings Bank

Table 2 Proposed TSB structure

All limited companies governed by the Companies Acts.



(1) To be owned by shareholders following flotation

(2) To incorporate the operations of Trustee Savings Bank England and Wales and Central Trustee Savings Bank Limited

(3) 49% to be owned locally in the Channel Islands; other subsidiaries to be wholly owned by TSB Group plc.

DRAFT

29 November 1984

LETTER FROM: SIR JOHN READ

TO: CHANCELLOR

As you are about to introduce the TSB Bill into Parliament, it seems an appropriate moment for me, on behalf of the Trustee Savings Banks Central Board and the individual Trustee Savings Banks, to write to you for two purposes: first, to reiterate our warm support for the Bill, and second, to place on record the steps ^{we} have taken or are taking to further our reorganisation, although not requiring the specific authority of the Bill. These steps, taken together with the Bill, reflect the plans which we have developed over the past few years in close consultation with the Treasury.

The TSB Bill

2. I confirm that you have the full support of the TSB Group in promoting this Bill. In August 1982, after lengthy and very careful consideration of the options, both by the Treasury and within the TSB Group, I announced that the TSB Group wished to reorganise into a Companies Act structure and to acquire additional capital and a wide pattern of ownership by issuing shares to the public. As the main purpose of the Bill is to permit the TSBs to take these steps, we naturally welcome it.

3. It is right that the new TSBs should be subject in all respects to the same system of supervision as the other major retail banks, so it is appropriate that the Bill should abolish the present framework for the authorisation and supervision of TSBs. It follows that the Bank of England should supervise the new UK TSB banking companies under the Banking Act 1979.

Recent changes within the TSB Group

4. The reorganisation of the TSB Group will be the last stage in the major process of evolution which has marked the last decade. The very substantial changes which have taken place within the TSB movement over that time have laid the foundations for the reorganisation. A process of amalgamations has reduced the number of TSBs to the present four and has greatly improved their overall effectiveness and capacity to compete in the market place. With the agreement of the Treasury, where that is required under the present TSB legislation, the TSBs have greatly widened the services they offer to their customers, in particular in developing personal lending, including mortgages, and commercial lending.

5. At the same time, the Group as a whole has built up the specialist activities of the subsidiaries it holds through TSB Holdings; instalment credit (United Dominions Trust Ltd), credit cards (our Visa payments and credit card is ^{operated} by TSB Trustcard Ltd), life and general insurance

and unit trusts (TSB Trust Company Ltd), and corporate finance and money market operations (Central Trustee Savings Bank Ltd). Our Group holds more than £8 billion in deposits; has 6 million customers with 13 million accounts; runs operations in all areas of personal financial services; and has reserves exceeding £600 million. Further details are available in the TSB Group's Report for the year ended 20 November 1983. The TSB Group today is radically different from the TSB movement of ten years ago and has shown that it is fully capable of competing with other financial institutions in a fast-changing environment.

Elements of the proposals which are not in the Bill

6. While the Bill is needed to enable the last stages of our plans to be put into effect there are, as I have already suggested, other major elements which do not need specific legislative authority. For this reason, the Bill cannot be seen in isolation from these other parts of the proposals, so it is appropriate to record how we intend to proceed on the key points which are not contained in the Bill. I understand that the Government is in general agreement with these proposals.

Share issue

7. First and foremost, we intend to maintain our traditions as a personal bank, proud of our achievements in the communities which we were established to serve. It is

for this reason that, as I announced in August 1982, we plan to bring about the issue of shares to the public in a manner which will achieve wide ownership of the new TSB Group among our customers and staff.

8. As the Bill does not provide for the share issue as such the new TSB Group will deal with this under its own powers like any other public company. As with all share issues, there will be many points which can only be settled near the time of flotation and in the light of market conditions. Equally, the timing of the share issue cannot yet be determined, though we would wish to proceed as soon as reasonably practicable once the legislation has come into effect. We are firmly set on the principle of wide ownership of our shares, with priority for our customers and staff.

9. As TSB staff are required to have TSB accounts as part of their terms of service, they will be able to subscribe for shares on the same basis as ~~other~~ customers. In addition, we propose to reserve a small part of the share issue with priority to staff, so that even if there is more demand from customers for shares than can be satisfied, no member of staff who wishes to buy shares will be excluded.

Boards

10. The initial Board of TSB Group plc will consist of the outgoing members of the TSB Central Board, together

with other directors appointed for their professional and specialist contributions. The shareholders will then have the responsibility of electing the directors at the Group's Annual General Meetings. The individual banks and other companies in the Group will have their own Boards, appointed by the main Board of TSB Group plc and will include regional bank representatives, executive directors, and independent directors as at present.

11. In addition, we intend to maintain the tradition of local involvement inherited from our predecessors by keeping regional boards which were set up in 1983 to take the place of the boards of trustees of the former TSBs which merged into the present TSBs at that time. This will help to ensure a continuing close relationship between the TSB Group and local communities.

Protection against takeover

12. We have taken the view that it would not be right, given the history and traditions of the TSBs, for the TSB Group to be unduly exposed to the risk of takeover, especially in the early years following reorganisation. The draft memorandum ~~and articles~~ of association of TSB Group plc therefore contains ^aprovisions that in the first five years following the issue no one shareholder may own more than 5 per cent of its ordinary shares. The draft articles of association of the company provide that after this five year period has elapsed, no one shareholder may

own more than 15 per cent of these shares. This arrangement will give the new Group a very fair degree of protection against takeover, particularly in the first five years.

Implications for TSB customers, staff and others

13. The major implication for TSB customers is that they will be given priority along with staff in subscribing for shares in the TSB Group. That apart, the proposals for reorganisation should not affect the TSBs' customers or the other institutions with which the TSBs do business in any way. We intend for continuity purposes to retain "Trustee Savings Bank" in the full legal title of the new banking subsidiaries, although the marketing emphasis throughout the Group will be based on "TSB". For TSB staff the direct impact is likely to be minimal compared with the effect of the changes of the past decade and all rights of staff and pensioners will be preserved^d.

TSB charitable foundations

14. I also announced in August 1982 that once the reorganisation operation was under way the TSB Group intended to proceed with the endowment of certain regional charitable foundations. These ~~would~~^{will} continue the TSBs' traditional role in contributing to the life of the community by assisting local needs of many different kinds. We envisage that these foundations will be funded through covenants. They will also hold special shares in TSB Group plc which

will entitle the foundations to vote only on matters directly concerned with their interests. We intend that, after the reorganisation, our new holding company, TSB Group plc, will proceed to endow the foundations under its own powers.

Channel Islands

15. Finally, a word on the Channel Islands TSB. Given that the TSB's many customers resident in the Channel Islands are governed by local taxation laws, clearly an investment in a local company will be more attractive to them than in a UK registered company. Accordingly we intend that 49% of the shares in the future TSB Channel Islands company should be offered locally; the remaining 51% will be held by TSB Group plc. Some directors of TSB Channel Islands Ltd will be appointed by the local shareholders.

16. In conclusion, this letter sets out the plans which we have agreed with you for completing the transition of the TSB Group to private sector status and we look forward to proceeding with our proposed share issue as soon as reasonably practicable following the passing of the necessary legislation.



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