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10 DOWNING STREET

From the Private Secretary

10 December 1985

BANKING SUPERVISION WHITE PAPER

The Prime Minister is content with the Chancellor's foreword to the Banking Supervision White Paper, which you sent me with your letter of 9 December.

I am sending a copy of this letter to John Mogg (Department of Trade and Industry) and to John Bartlett (Bank of England).

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

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9 December 1985

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Jean David,

BANKING SUPERVISION WHITE PAPER: CHANCELLOR'S FOREWORD

... I attach a draft of the Chancellor's foreword to the Banking Supervision White Paper, which, as the Prime Minister knows, we are hoping to publish on 17 December. The printing deadlines are now extremely tight, and to be sure of publishing on time, we need comments by tomorrow morning at the latest.

I am copying this to John Mogg (DTI) and John Bartlett (Bank of England).

Yours ever

Rachel

RACHEL LOMAX
Principal Private Secretary

Prime Minister

A couple of very tiny

suggestions in para 8.

Content?

JDS

9/12

*(This is the Chancellor's
own drafting.)*

CHANCELLOR'S FOREWORD TO BANKING SUPERVISION WHITE PAPER

An effective system of banking supervision is as important as the banking system itself. For without it there will not be the confidence on which sound banking depends - from the confidence of the individual depositor that his money is safe to confidence in Britain as one of the foremost financial centres in the world.

2. The circumstances of the collapse of Johnson Matthey Bankers and its rescue by the Bank of England in October 1984 thus raised issues going far wider than the affairs of JMB itself. Accordingly, in December 1984 I set up a Committee under the Chairmanship of the Governor of the Bank of England to look into our system of banking supervision and make recommendations.

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3. The Leigh-Pemberton Committee's Report, published in June 1985, made it clear that while the JMB debate represented a wholly atypical lapse in a system of supervision that has had a good record over the years, and which compares well with the experience of financial centres overseas, there nevertheless remained serious weaknesses both in the implementation of banking supervision in the UK and in its statutory framework, the Banking Act of 1979. The rapidly-developing nature of banks and the banking system makes it all the more important to address these weaknesses speedily and effectively, without at the same time hobbling British banks with excessive regulation.

4. I therefore announced on 20 June 1985 that a White Paper would be published later in the year, with a view to bringing forward new banking legislation as soon as practicable. In the six months which have followed, the Bank of England has held discussions with the banking industry and other interested parties on the basis of consultative papers. The Government have carefully considered both the Leigh-Pemberton Committee's recommendations and the outcome of consultations. This White Paper now sets out the Government's proposals for both legislative and non-legislative changes.

5. The latter are every bit as important as the former, for at the heart of effective supervision lies the organisation, ability and motivation of the supervisors. Substantial improvements have already been made by the Governor of the Bank of England and more are envisaged. A new Board of Banking Supervision will cement these changes into place. Under the proposals set out in this White Paper, the supervisors will become increasingly professional in their approach, forcefully directed from the top.

6. But at the same time the Bank of England, which the Government believe should continue to be the supervisory authority for British banks, cannot do its job without an adequate statutory framework. The Government has accordingly decided to strengthen this in a number of important ways, which are summarised in Chapter 1 of this White Paper and thereafter discussed at length. They cover in particular the provision of information, the role of bank auditors, and the problem of large ^{expenses.} expenses.

7. I am conscious, however, that banking supervision can no longer be considered in isolation. As the Leigh-Pemberton Committee pointed out, the growth of financial conglomerates poses particular problems for regulators. The Government are urgently considering these problems in the context of their interlocking legislative proposals for banking supervision, building societies and financial services. It is essential that, taken together, the new arrangements provide effective supervision, capable of dealing with the whole of the rapidly changing financial services sector.

8. Finally, there remains the ever-present problem of financial fraud. The Government is determined to do all in its power to eradicate ^{fraud} [this cancer], and has already taken action to that end. But the most important ^{deterrent} obstacle to serious financial fraud is effective supervision. The banking supervisors require that banks are managed by fit and proper persons, and that they conduct their business prudently. The proposals in the White Paper strengthen the supervisors' powers to achieve this, and thus greatly reduce the scope for banks to be managed incompetently or dishonestly - and there is always a risk that the one will lead to the other. They will ensure that better internal controls further reduce

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overblown

opportunities for fraud. The proposed dialogue between supervisors and auditors will provide an additional important defence. London's pre-eminence as a world banking centre is based on freedom and probity. We are determined to preserve both.

9. Together with the measures contained in this session's new legislation on building societies and financial services, I believe the proposals in this White Paper will provide a sound basis for the supervision of rapidly developing financial markets. It is of the first importance that they should succeed.

