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Treasury Chambers, Parliament Street, SW1P 3AG
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24 February 1986

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON SW1

NBPR.

Dear Paul

REGULATION OF THE WHOLESALE MONEY, FOREIGN EXCHANGE AND BULLION MARKETS

The Governor has expressed to me his concern about important gaps in the proposed regulatory framework which the financial services, banking and building societies legislation will form. In a nutshell, he is concerned that the Bank's present non-statutory surveillance of the wholesale money, foreign exchange and bullion markets could well prove an insufficient backing for the Bank's authority in the future, when the bulk of the financial services industry will be statutorily regulated. I have to say that, having looked into this, I agree with the Governor, and believe we should provide statutory backing for the Bank's role in these markets.

At present, the Bank of England oversee the wholesale foreign exchange and currency deposit markets through the British Bankers Association (BBA) and the Foreign Exchange and Currency Deposit Brokers Association (FECDBA), and have a non-statutory system of "recognition" in these markets, and a Code of Conduct. The bullion market is subject to less formal supervision and there is no written Code. The Bank's regulation of the sterling money markets is also less formal, and is exercised through a joint standing committee of principals and brokers in the sterling deposit market, with an appropriate Code of Conduct for all participants.

The Bank's specific proposals are as follows:-

(a) Wholesale foreign exchange and bullion markets
The Bank seeks statutory powers

(i) To enable them to deem banks and licensed deposit-takers (a distinction to be abolished in the new banking legislation), also to be authorised to conduct a business in the wholesale foreign exchange and/or bullion markets;

(ii) To authorise directly brokers and other non-bank principals conducting a business in the foreign exchange/bullion markets;

(iii) To issue conduct of business rules to govern transactions in these markets.

(b) The Bank regard the following as those instruments dealings in which constitute the wholesale money market:-

- Certificates of deposit up to 5 years original maturity (traded in London)

- Other sterling or foreign currency debt liabilities of UK recognised banks, LDTs and building societies of up to five years original maturity (as defined in Section 18 of Schedule 1 of the Financial Services Bill);

- Treasury Bills; local authority bills; local authority bonds of up to one year; commercial paper of up to one year; short-term (up to one year) corporate bonds; sterling deposits and commercial bills (notwithstanding their exclusion from the scope of the Financial Services Bill). Equivalent non-sterling instruments would also be covered.

One route our officials have explored at an earlier stage is the exclusion of some or all of these instruments from the definition of invetment in the Financial Services Bill. The Bank does not now propose exclusion, but suggests as a preferable route that it should be given powers:-

(a) To deem banks and licensed deposit-takers, authorised as deposit-takers under the Banking Act, to be similarly authorised to participate in the money markets.

(b) To authorise directly brokers participating in the money markets.

(c) To issue conduct of business rules for banks and brokers.

In the case of the money markets, however, the Bank do not wish to authorise other non-bank or non-broker participants. Under the Bank's scheme, the SIB or the relevant SRO would authorise participants who were neither banks nor brokers, and would issue identical rules of conduct to those issued by the Bank.

I am not wedded to the detail of the Bank's scheme, which clearly needs to be thought through further. In particular, there is an awkwardness about divided responsibility for authorisation in the money market, and it may be that the price of giving statutory backing to the Bank's traditional authority is a responsibility for authorising all those conducting a business in that market.

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The position of the wholesale money markets under the Financial Services Bill has been under discussion between our officials for some months. I entirely accept that it is unfortunate that the Bank have brought this new proposal to our attention at such a late stage, when the Financial Services Bill is already in Committee. But these provisions do fit logically into the conceptual framework of the Financial Services Bill. On the model of the reciprocity provisions, already included in the Bill, I might be given parallel powers to yours to designate an agency - the Bank of England - in respect of the foreign exchange, bullion and money markets. The Bank would then have similar powers to the SIB in relation to those markets which it supervised, and those provisions of the Financial Services Bill which were appropriate would apply to institutions operating in those markets.

I hope that our officials can discuss this soon, and report to us urgently.

I am copying this letter to the Prime Minister, the Lord Privy Seal, the Chief Whip and Governor of the Bank of England.

Yours
Nigel

NIGEL LAWSON