

SUBJECT
MASTER

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10 DOWNING STREET

6 June 1986

From the Private Secretary

Dear Mike,

BIG BANG

The Prime Minister yesterday held a meeting to discuss the Big Bang on the basis of the note attached to your letter to me of 7 May and a note attached to John Footman's letter of 28 May. Present were your Secretary of State, the Chancellor of the Exchequer, the Governor of the Bank of England, Sir Peter Middleton, Mr. David Walker, Mr. John Caines and Professor Brian Griffiths.

The Chancellor of the Exchequer, opening the discussion, agreed with the Prime Minister that the Big Bang posed risks. Some things were bound to go wrong. But the changes were inevitable if the City was to maintain its competitiveness. The risks would not arise in relation to the City's ability to finance Government or industry; indeed, the greater depth of the markets and the stronger competitive pressures should help. Nor should the small investor be priced out of the market. Personal equity plans would help small investors and the clearers were now competing strenuously to win business from them. There would, however, be strong pressures on British-owned businesses from American and Japanese competition. There was a risk that people would move into less well regulated areas and particular risks would arise during the period between the Big Bang and the time when the arrangements under the Financial Services Bill would come fully into effect in 1987. The supervisors would need to employ good people and to exercise great vigilance.

In discussion the following main points were made:-

- (i) middle-sized British firms would probably be most at risk from increased competition. The Australians had sought to protect their domestic firms against overseas competition by imposing an additional capital requirement on foreign businesses. This was not, however, an acceptable

option in London. The authorities might need to use moral suasion during the period of adjustment and there was a clear need to put more pressure on the Japanese to ensure reciprocity. The increasingly global nature of the securities markets offered new opportunities to British firms even though their dominance of the domestic market was likely to be eroded;

- (ii) the opportunities for fraud were a particular concern. The temptation to fraud, or to unethical behaviour, would be increased by the competitive pressures. It was encouraging that some institutions had begun to appoint "compliance directors";
- (iii) the increasing scale of risks carried off balance sheet by financial institutions was a concern which the Bank was seeking to meet by requiring capital to be allocated against those risks. The American and Japanese regulatory authorities were likely to follow suit;
- (iv) the more closely banks were regulated the more business would move into the capital markets. This placed an increasing weight on international co-operation amongst supervisors and regulators;
- (v) the SIB had not at present managed to attract top quality staff;
- (vi) it would be important to take every opportunity to point to the benefits to the wider economy of the changes in the City. There was a risk that people would only look at the high salaries and the deal-making;
- (vii) it was a matter for concern that the Roskill recommendation for dispensing with juries in complicated fraud cases seemed likely now to be rejected;
- (viii) the Neale Report on Lloyds was not now likely to be ready until September. It was possible that there would be recommendations requiring legislation;
- (ix) as had happened with Lloyds, there was a risk that problems would come to public notice after passage of the Financial Services Bill, discrediting it, even though the problems themselves had their origins before the new system had been put in place.

The Department of Trade and Industry, with the Bank of England, would need to be vigilant to close any gaps in the regulatory framework and to keep it up to date as the financial markets changed.

BF
The Prime Minister would be grateful for a further report on the state of preparations for the Big Bang to be circulated around the middle of September.

I am copying this letter to Rachel Lomax (H.M. Treasury) and John Footman (Bank of England).

Jws,

David

DAVID NORRGROVE

Mike Gilbertson, Esq.,
Department of Trade and Industry.