

# **Bank of England**

## **Statements of Principles**

**Banking Act 1987**

**The Banking Coordination (Second  
Council Directive) Regulations 1992**



*May 1993*

# Banking Act 1987: Statements of principles

## Banking Act 1987

## The Banking Coordination (Second Council Directive) Regulations 1992

### 1 Introduction

1.1. This statement applies generally to all institutions authorised by the Bank under the Banking Act 1987 ('the Act').<sup>(1)</sup> In a number of different provisions of the Act apply which are not credit institutions as defined in the law of the UK (see specific references in section 16 of the Act) which requires the Bank to publish a statement of principles in accordance with which it proposes to act—

(a) in interpreting the criteria in Schedule 3 to this Act and the revocation specified in section 11 of the Act;

(b) in exercising its power to restrict an authorisation.

1.2. These principles are, however, subject to the Bank's decision on which institution to revoke or restrict an authorisation. The Bank's interpretation of the Schedule 3 criteria and the section 11 grounds for revocation are set out in the statement of principles underlying the exercise of its powers to grant, revoke or restrict authorisations. The Bank's interpretation of the minimum standards and considerations which it has regard to exercising its powers to revoke or restrict an authorisation. The Bank's interpretation of the section 11 grounds for revocation are set out in the statement of principles underlying the exercise of its powers to grant, revoke or restrict authorisations. The Bank's interpretation of the minimum standards and considerations which it has regard to exercising its powers to revoke or restrict an authorisation. The Bank's interpretation of the section 11 grounds for revocation are set out in the statement of principles underlying the exercise of its powers to grant, revoke or restrict authorisations.

(1) As amended by the Banking Coordination (Second Council Directive) Regulations 1992. The Bank's interpretation of a restriction on the listed activities of a UK subsidiary is set out in the statement of principles underlying the exercise of its powers to grant, revoke or restrict an authorisation.

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# Banking Act 1987: Section 16

## 1 Introduction

1.1 This statement applies generally to all institutions authorised by the Bank under the Banking Act 1987 ('the Act').<sup>(1)</sup> In a number of instances however different provisions of the Act apply to institutions which are not credit institutions incorporated under the law of the UK (see specific references). The statement is made pursuant to section 16 of the Banking Act which requires the Bank to publish a statement of the principles in accordance with which it is acting or proposing to act—

- (a) in interpreting the criteria specified in Schedule 3 to this Act and the grounds for revocation specified in section 11 . . . ; and
- (b) in exercising its power to grant, revoke or restrict an authorisation.'

1.2 These principles are, however, not only relevant to the Bank's decisions on whether to authorise an institution or revoke or restrict an authorisation. The Bank's interpretation of the Schedule 3 criteria and of the section 11 grounds for revocation, together with the principles underlying the exercise of its powers to grant, revoke or restrict authorisation, encapsulate the main standards and considerations to which the Bank has regard in conducting its supervision of all authorised institutions. The functions of banking supervision therefore include monitoring the compliance of authorised institutions with these standards and identifying any threats to the interests of depositors and potential depositors. If there are concerns, the Bank will consider what action should be taken to ensure compliance with these standards and to

protect depositors and potential depositors. Where appropriate it will seek remedial action by persuasion and encouragement. However, if its legal powers are exercisable and the Bank judges that it is necessary to exercise them in order to ensure compliance with the standards or to protect the interests of depositors and potential depositors it will move to revoke or restrict authorisation.

1.3 The Act requires institutions and their officers and controllers to meet high standards in terms of their conduct. The maintenance of those standards benefits not only depositors and potential depositors but also the interests of the institution's other customers. Nevertheless the Bank's powers under the Act focus primarily on the interests of depositors.

1.4 The statement includes references to various papers published by the Bank which set out its detailed approach to a number of matters relevant to the principles, and the principles should be interpreted accordingly. Copies are available from the Banking Supervision Division, Bank of England, Threadneedle Street, London EC2R 8AH (telephone number 071-601 5082).<sup>(2)</sup>

1.5 Part 2 of the statement considers the interpretation of each of the minimum authorisation criteria in Schedule 3. Part 3 considers some issues which relate only to authorised institutions which are discount houses. Part 4 sets out the considerations relevant to the Bank's exercise of its discretion to grant authorisation. It includes some paragraphs on the authorisation of overseas institutions. Part 5 considers

(1) As amended by The Banking Coordination (Second Council Directive) Regulations 1992.

(2) The Bank's policy notices are intended to inform authorised institutions of the approach it generally adopts in relation to particular supervisory issues. The Bank's application of a particular policy in an individual case will, however, need to take into account all the facts of the particular situation and should therefore be interpreted accordingly.

the interpretation of the various grounds for revocation in section 11 of the Act. Part 6 sets out the principles underlying the exercise of the Bank's discretion to revoke or restrict an authorisation.

## 2 Schedule 3: minimum criteria for authorisation

2.1 Before an institution may be granted authorisation the Bank has to be satisfied that all the criteria in Schedule 3 to the Act are fulfilled with respect to it. This part of the statement sets out the Bank's interpretation of these criteria. It considers first the prudent conduct criterion in paragraph 4 of the Schedule as this sets the standards of most obvious relevance to the interests of depositors, actual and potential, and to assessing whether an institution's directors, controllers and managers are fit and proper persons to hold their positions. It then considers the other criteria in Schedule 3, concluding with the fit and proper person criterion.

2.2 Where the applicant institution is a foreign bank whose principal place of business is outside the UK, in assessing whether or not certain of the criteria are met by the institution the Bank has in certain circumstances a discretion to rely on assurances from the supervisor of the institution in that place that the supervisor is satisfied with respect to the prudential management and overall financial soundness of the institution (see Part 4 below).

### Schedule 3, paragraph 4: requirement for a bank to conduct its business in a prudent manner

#### General

2.3 Paragraph 4(1) of the Schedule requires an institution to conduct its business in a prudent manner.

2.4 Sub-paragraphs (2)-(8) specify various detailed requirements, each of which must be fulfilled before an

institution may be regarded as conducting its business in a prudent manner in terms of paragraph 4(1). But, as sub-paragraph (9) makes clear, this list of detailed requirements is not exhaustive. There are other considerations relevant to whether the business is being conducted prudently. These considerations, which are sometimes summarised under the heading of the 'general prudent conduct' requirement, are described in more detail below (paragraph 2.31).

### Schedule 3, paragraph 4(2) and 4(3): requirement for a bank to have adequate capital.

2.5 The Bank's general approach to the assessment of capital adequacy is set out in the following papers<sup>(1)</sup>—

Title	Date of issue
Implementation in the United Kingdom of the directive on the own funds of credit institutions <sup>(2)</sup> (BSD/1990/2)	December 1990
Implementation in the United Kingdom of the solvency ratio directive <sup>(3)</sup> (BSD/1990/3)	December 1990

These papers were amended by the following:

Implementation in the United Kingdom of the directive on the own funds of credit institutions (BSD/1992/1)	January 1992
Verifications of interim profits in the context of the Own Funds Directive (BSD/1992/5)	August 1992
Amendment to the Bank's notice Implementation in the United Kingdom of the solvency ratio directive	November 1992

The adoption of the method of assessing capital adequacy set out in these papers implements the two EC banking directives which provide agreed minimum standards for the capital adequacy of banks throughout the EC and mirror the Basle Accord, *International Convergence of Capital Measurement and Capital Standards* agreed in 1988 by member countries of the Basle Committee on Banking Supervision<sup>(4)</sup> including the UK. The Bank applies this method to assess the capital adequacy of all banks incorporated in the UK.

(1) This approach does not however extend to the discount houses, which are authorised under the Banking Act and are supervised not by the Bank's Banking Supervision Division but its Wholesale Markets Supervision Division (see Part 3 below).

(2) 89/647/EEC.

(3) 89/299/EEC.

(4) Members of the G10 and Luxembourg.

2.6 A number of other papers are also relevant to this subject—

Title	Date of issue
Foreign currency exposure	April 1981
Foreign currency options	April 1984
Note issuance facilities/revolving underwriting facilities (BSD/1985/2)	April 1985
Large exposures in relation to mergers and acquisitions (BSD/1986/1)	February 1986
Subordinated loan capital (BSD/1986/2)	March 1986
Large exposures (BSD/1987/1) <sup>(1)</sup>	September 1987
Large underwriting exposures (BSD/1987/1.1)	February 1988
Loan transfers and securitisation (BSD/1989/1) <sup>(2)</sup>	February 1989
Implementation in the United Kingdom of the Directive on the Consolidated Supervision of Credit Institutions (BSD/1993/1)	February 1993
Country debt provisioning matrix	February 1993

2.7 Capital is defined for the purposes of paragraph 4(2) as own funds<sup>(3)</sup> (as laid down in the Own Funds Directive) and consists of Tier 1 and Tier 2 items. These are defined in the Bank's notice *Implementation in the United Kingdom of the directive on own funds of credit institutions*, as are the limits on how much certain items of Tier 2 capital may contribute to the total of own funds for supervisory purposes. Certain asset items, such as goodwill, are deducted in calculating own funds.

2.8 In order for capital to be sufficient for the purposes of the sub-paragraph it must be of an amount which is commensurate with the nature and scale of the institution's operations; and of an amount and nature sufficient to safeguard the interests of its depositors and potential depositors, having regard to the factors mentioned in paragraph 4(3) and to any other factors which appear to the Bank to be relevant. Paragraph 4(3)(a) refers to the nature and scale of the institution's operations; and paragraph 4(3)(b) to the risks inherent in those operations and in the operations of any other undertaking<sup>(4)</sup> in the same group in so far as they are capable of affecting the institution.

2.9 In addition, in the case of UK incorporated credit institutions, in order for capital to be sufficient for the purposes of paragraph 4(3A), the institution must maintain own funds which amount to not less than ECU 5mn (or an amount of equal value denominated wholly or partly in another unit of account). However, such institutions which were authorised under the Act immediately before the commencement of the regulations implementing the Second Council Directive are required to maintain own funds of an amount not less than ECU 5mn or the highest level the institution attained at any time after 22 December 1989 (whichever is the lower).<sup>(5)</sup>

2.10 A key purpose of capital is to provide a stable resource to absorb any losses incurred by an institution, and thus protect the interests of its depositors and potential depositors. Capital must therefore have two main qualities to achieve this purpose fully—a capacity to absorb losses and permanence. All types of capital recognised by the Bank in Tier 1 have these characteristics. Tier 1 capital will not be of an appropriate nature if there are concerns that it may be paid away to the detriment of depositors' interests. Thus, for example, the Bank will only permit distributable reserves to be included in the capital base if the likelihood of such reserves being paid away is remote.

2.11 The Bank recognises that some other types of capital also provide protection to depositors on an on-going basis. In particular, certain other types of capital, while not meeting the two criteria of ability to absorb losses while allowing an institution to continue to trade and permanence, can provide protection to depositors. Some subordinated term debt is therefore eligible to be included in own funds subject to the conditions and limits set out in the paper *Implementation in the United Kingdom of the directive on the own funds of credit institutions* (as amended). It is an essential feature of such capital that it must be fully subordinated to the interests of depositors to give

(1) As amended by two subsequent notices, BSD/1990/1 and BSD/1992/2.

(2) As amended by a subsequent notice, BSD/1992/3.

(3) This definition applies in respect of UK incorporated credit institutions only. In respect of other institutions the requirement is expressed in terms of net assets—that is, in relation to a body corporate, paid-up capital and reserves—together with other financial resources available to the institution of such nature and amount as are considered appropriate by the Bank. Such 'other financial resources' are in practice constituted by subordinated loan stock issued by the institutions subject to the conditions set out in the Bank's notice, BSD/1986/2.

(4) 'Body corporate' in the case of an institution which is not a UK incorporated credit institution.

(5) Where there has been a change in the parent controller of the institution after 1 January 1993 the requirement is generally ECU 5mn.

them a measure of protection against loss in a liquidation.

2.12 The Bank would not expect any element of capital regarded as permanent to be repaid except as part of a capital reconstruction it had approved. The Bank would normally only give its consent to the early repayment of capital where it was being replaced by capital of higher quality (for example, replacing term subordinated debt with perpetual debt or equity) or where the institution's need for capital was reduced for the foreseeable future.

2.13 Central to the Bank's approach to the assessment of capital adequacy is the framework of measurement set out in the paper *Implementation in the United Kingdom of the solvency ratio directive* (as amended). The measurement framework focuses primarily on the credit risk to which a bank is subject, ie the risk of counterparty default whether arising from on-balance-sheet or off-balance-sheet business. The Solvency Ratio Directive imposes a minimum standard for risk asset ratios for bank groups of 8%. (Similarly the Basle Accord established a minimum standard for the capital ratio of internationally active banks of 8%.) Although the Solvency Ratio Directive generally applies only on a consolidated basis, the Bank continues to require all UK incorporated banks to maintain a minimum risk asset ratio on a solo basis as well.

2.14 However there are other factors which are not directly addressed within this framework which the Bank takes into account in the assessment of the capital adequacy of an authorised institution. This is achieved in part by requiring institutions to hold capital against certain additional items not specified in the Solvency Ratio Directive; and in part by varying the minimum risk asset ratio applied (known as the 'trigger' ratio). The Bank sets trigger ratios for individual banks according to an overall assessment of the risks that they face and the quality of their risk management. A bank is required to meet its trigger ratio at all times. In order to lessen the risk that the trigger ratio might be breached, the Bank generally expects each institution

to conduct its business so as to maintain a higher ratio (the 'target' ratio).

2.15 Part of the risk assessment for capital adequacy assessment purposes is an analysis of the quality of the loan book, for example of its concentration with regard to particular economic sectors or counterparties or geographical concentration. In order to enable the Bank to monitor concentrated positions vis-à-vis individual counterparties or groups of connected counterparties there are special reporting requirements for large exposures.<sup>(1)</sup> But other risks too are taken into account in this assessment. These include, for example, the market risks which a bank faces, in particular foreign exchange and interest rate risk, and how those risks are managed. The operational risks to which an institution is exposed, that is risks arising from negligence or incompetence in the management of either the institution's own assets and exposures or those of third parties, are covered. Risks arising from holding companies, subsidiaries, associates and other connected companies which might expose an institution to direct financial costs or general loss of confidence by association (contagion risk) are also taken into account.

2.16 The judgment formed about the risks and the institution's ability to manage those risks is largely qualitative, based on the Bank's contact with management and information provided as part of the regular returns or on an ad hoc basis. Factors taken into account by the Bank in assessing an institution's risk management capabilities include the expertise, experience and track record of its management, its internal control systems and accounting systems.

2.17 The magnitude of foreign exchange position risk is assessed quantitatively on the basis of a formal measurement system set out in *Foreign currency exposure* (April 1981) and *Foreign currency options* (April 1984).

2.18 In the case of UK incorporated banks, risk analysis is undertaken both on a consolidated basis, in order to capture exposures arising in subsidiaries and other connected companies, as well as in the authorised

(1) From 1 January 1994 this area will also be covered by the EC directive on the monitoring and control of large exposures of credit institutions.

institution, and on an unconsolidated basis, in order to assess whether there is an appropriate distribution of capital within a group. The second EC Directive on the supervision of credit institutions on a consolidated basis was implemented in 1993 by the Bank's notice *Implementation in the United Kingdom of the Directive on the Consolidated Supervision of Credit Institutions* (BSD/1993/1). This requires that consolidated supervision covers capital adequacy and large exposures, and extends to banks' parents and the financial subsidiaries of parents where the majority of the group's activities are financial in nature. For the purposes of the consolidated supervision of capital adequacy, the assets of financial companies in the group are risk weighted and added to the total of risk weighted assets, while their capital liabilities may be included in own funds, provided they meet the conditions set out in the Bank's relevant notices. (Group companies which are principally exposed to market risk are subject to a slightly different treatment, which is described in the Bank's Notice BSD/1993/1.) For the purpose of large exposures monitoring, the exposures incurred by the group companies are aggregated with those of the authorised institution and measured against group capital.

2.19 Consolidated returns covering capital adequacy and large exposures form only one source of information for the Bank's consolidated supervision, which aims to form a qualitative judgment of the strength of the overall group to which a bank belongs in order to evaluate the potential impact of the other group companies on the bank. Thus, for example, where a banking group fails to meet the trigger risk asset ratio set for it, the Bank would consider that this posed a threat to the bank so requiring it to consider whether to take action in respect of the institution.

**Schedule 3, paragraphs 4(4) and 4(5): requirement for a bank to have adequate liquidity<sup>(1)</sup>**

2.20 An institution's ability to meet its obligations when they fall due depends upon a number of factors. In normal circumstances it depends, in particular, on the institution's ability to renew or replace its deposits and other funding, the extent to which the profile of

future cash flows from maturing assets matches that of its maturing liabilities, and the amount of high quality liquid assets which it has readily available. Many of the factors relating to the assessment of capital adequacy are also relevant to judging the adequacy of liquidity, notably the quality of management of the institution, its internal control systems, the nature of its activities and its position in the market. Each institution is assessed in the light of its own particular circumstances, including any potential liquidity problems which could arise in group or other connected companies or other developments in or affecting those companies which could have implications for the liquidity of the institution.

2.21 Each institution is expected to formulate a statement of its liquidity management policy, taking into account the factors described above. It must identify any particular strengths and weaknesses and analyse its capacity to survive a crisis. This policy is the basis for discussions with the Bank, with the objective of agreeing minimum standards for that institution's liquidity. As part of its liquidity monitoring framework established with each institution, the institution will normally be required to comply with guidelines on the liquidity mismatches it may run in the sight-to-eight-day and sight-to-one-month bands of a maturity 'ladder' comparing its assets to liabilities and other commitments. This may be supplemented where appropriate by a requirement to hold a certain quantity of highly liquid assets.

2.22 The Bank's approach is described in greater detail in its paper *Measurement of Liquidity*, issued in July 1982.

**Schedule 3, paragraph 4(6): requirement for a bank to have adequate provisions**

2.23 This mirrors the Companies Act 1985 (as amended) requirement that provision should be made for depreciation or diminution in the value of an institution's assets, for liabilities which will or are expected to fall to be discharged and for any losses

(1) See footnote (1) on page 4.

which it will or expects to incur. Thus provisions need to be made for, inter alia, bad and doubtful debts, expected losses on contingent liabilities (for example, connected with guarantees or other off-balance-sheet exposures) and tax liabilities. The Bank regards the accurate valuation of assets and the establishment of provisions of fundamental importance. The Bank would expect liabilities and losses (including contingent losses) to be recognised in accordance with accepted accounting standards (as embodied in the Statements of Standard Accounting Practice and Financial Reporting Standards).

2.24 In assessing the adequacy of an institution's provisions, the Bank has regard to its provisioning policy, including the methods and systems for monitoring the recoverability of loans (for example, the monitoring of the financial health of counterparties, their future prospects, the prospects of the markets and geographical areas in which they operate, arrears patterns and credit scoring techniques), the frequency with which provisions are reviewed, the policy and practices for the taking and valuation of security and the extent to which valuation exceeds the balance-sheet value of the secured loans. In some cases, clear objective indicators will be available to assist in the determination of the appropriate level of provisions; in others, more subjective judgments will need to be made. The Bank considers that it is essential that provisions be reviewed regularly.

2.25 The Bank considers that an adequate level of provisions against country debt should be made. In February 1993 the Bank issued a paper setting out a revised framework for determining the level of such provisions, which institutions could use in establishing an adequate level of provisions against country debt.

**Schedule 3, paragraphs 4(7) and (8): requirement for a bank to maintain adequate accounting and other records and adequate systems of control of its business and records**

2.26 The nature and scope of the records and systems which an institution should maintain should be commensurate with its needs and particular circumstances, so that its business can be conducted prudently. In judging whether an institution's records

and systems are adequate the Bank has regard to its size, to the nature of its business, to the manner in which the business is structured, organised and managed, and to the nature, volume and complexity of its transactions. The requirement applies to all aspects of an institution's business, whether on or off balance sheet, and whether undertaken as a principal or as an agent. The Bank's detailed interpretation of the paragraph 4(7) requirement is set out in the *Guidance notes on accounting and other records and internal control systems and reporting accountants' reports thereon* (BSD/1987/2 and BSD/1992/4), issued in September 1987 and July 1992 respectively.

2.27 Paragraph 4(8) of the Schedule provides, inter alia, that an institution's records and systems shall not be regarded as adequate unless they are such as to enable the business of the institution to be prudently managed and the institution to comply with the duties imposed on it by or under the Act. In other words, the records and systems must be such that the institution is able to fulfil the various other elements of the prudent conduct criterion (including appropriate systems to combat money laundering), and to identify other threats to the interests of depositors and potential depositors. They should also be sufficient to enable the institution to comply with the notification requirements which apply to it under the Act (for example, sections 36 and 38) and with requirements for the provision of information and documents under section 39 and section 41. Thus delays in providing information, or inaccuracies in the information provided, will call into question the fulfilment of the requirement in the sub-paragraph.

2.28 In assessing the adequacy of an institution's records and systems the Bank takes into account the complexity of the branch structure of the institution, and the nature of the institution's overseas operations. Owing to the difficulties of controlling overseas operations the Bank requires all UK incorporated institutions to notify it before establishing such operations. In such cases the Bank will need to be satisfied that, inter alia, the institution's systems and controls are adequate to ensure the prudent management of its overseas operations. UK incorporated credit institutions which propose to establish a branch in another EC member State in order

to carry on activities listed in Schedule 1 of the Regulations<sup>(1)</sup> are required under those Regulations to give prior notice to the Bank. Under the Regulations the Bank has power to prevent a UK institution from opening such a branch in another EC member State if, having regard to the activities proposed to be carried on, it doubts the adequacy of the administrative structure or the financial situation of the institution.

2.29 Where an authorised institution proposes to establish another operation either in the UK or overseas, the Bank will require the authorised institution to have adequate internal control mechanisms for the production of any data and information which may be relevant for the purposes of supervision on a consolidated basis. This is in accordance with the Bank's notice on the *Implementation in the United Kingdom of the directive on the Consolidated Supervision of Credit Institutions*.

2.30 Paragraph 4(8) also provides that the Bank, in determining whether an institution's systems are adequate, 'shall have regard to the functions and responsibilities in respect of them of any such directors of the institution as are mentioned in paragraph 3 above'. The Bank interprets this provision as referring to the role of non-executive directors of authorised institutions acting in a control capacity. (This is also discussed below in the context of the requirement relating to non-executive directors in paragraph 3 of Schedule 3.)

#### **Schedule 3, paragraph, 4(9): the 'general prudent conduct' requirement**

2.31 As noted above, the list of specific points in Schedule 3 relevant to prudent conduct is not exhaustive. Examples of other relevant considerations include the institution's management arrangements (such as those for the overall control and direction by the board of directors); the institution's general strategy and objectives; planning arrangements; policies on accounting, lending and other exposures, and bad debt and tax provisions; policies and practices

on the taking and valuation of security, on the monitoring of arrears, on following up debtors in arrears, and interest rate matching; and recruitment arrangements and training to ensure that the institution has adequate numbers of experienced and skilled staff in order to carry out its various activities in a prudent manner.

#### **Schedule 3, paragraph 2: requirement for the business of a bank to be effectively directed by at least two individuals**

2.32 This criterion—sometimes known as the 'four eyes' requirement—provides that at least two individuals must effectively direct the business of the institution.<sup>(2)</sup> In the case of a body corporate, the Bank normally expects that the individuals concerned will be either executive directors or persons granted executive powers by, and reporting immediately to, the board; and, in the case of a partnership, the Bank will look for at least two general or active partners.

2.33 Paragraph 2 requires at least two independent minds to be applied to both the formulation and implementation of the policies of the institution. Where there are just two individuals involved the Bank does not regard it as sufficient for one of them to make some, albeit significant, decisions relating only to a few aspects of the business—each must play a part in the decision-making process on all significant decisions. Both must demonstrate the qualities and application to influence strategy, day-to-day policy and their implementation. This does not require their day to day involvement in the execution and implementation of policy. It does however require involvement in strategy and general direction, as well as a knowledge of, and influence on, the way in which strategy is being implemented through day to day policy. Where there are more than two individuals directing the business, the Bank does not regard it as necessary for all of these individuals to be involved in all decisions relating to the determination of strategy and general direction. However at least two individuals must be involved in all such decisions.

(1) The Banking Co-ordination (Second Council Directive) Regulations 1992.

(2) This requirement relates to the institution as a whole. Thus, in the case of an overseas incorporated authorised institution the Bank assesses whether at least two individuals effectively direct the business of the institution (and not just the business of its branch in the United Kingdom). The Bank would also take into account the manner in which management decisions are taken in the UK branch in assessing whether the institution fulfilled the criterion relating to the adequacy of its systems and controls set out in paragraph 4(7) of Schedule 3.

Both individuals' judgments must be engaged in order that major errors leading to difficulties for the institution are less likely to occur. Similarly, each individual must have sufficient experience and knowledge of the business and the necessary personal qualities to detect and resist any imprudence, dishonesty or other irregularities by the other individual. Where a single individual, whether a chief executive, managing director or otherwise, is particularly dominant in an authorised institution this will raise doubts about the fulfilment of the criterion.

### **Schedule 3, paragraph 3: composition of board of directors**

2.34 This provides that, in the case of an institution incorporated in the United Kingdom, the directors include such number (if any) of non-executive directors as the Bank considers appropriate having regard to the circumstances of the institution and the nature and scale of its operations.

2.35 The Bank considers that non-executive directors can play a valuable role in bringing an outsider's independent perspective to the running of the business and in questioning the approach of the executive directors and other management.<sup>(1)</sup> The Bank sees non-executive directors as having, in particular, an important role as members of an institution's audit committee or in performing the role which such a committee would otherwise perform.

2.36 The Bank recognises that some small authorised institutions may find it difficult to appoint sufficient suitable non-executive directors for an audit committee to be established. The Bank is nevertheless committed to the principle that UK-incorporated institutions and UK-based banking groups should have an audit committee and that, unless there are sound reasons to the contrary, all authorised institutions should appoint at least one non-executive director to undertake some audit committee functions. The Bank may consider it unnecessary for an authorised institution to have non-executive directors or an audit committee, if, for example, there is an audit committee of non-executive directors of the institution's holding company which

undertakes the functions of an audit committee in respect of the authorised institution itself. (The Bank has expressed its views on the role of audit committee and non-executive directors in the consultative paper on the *Role of audit committees in banks* issued in January 1987, and in the Bank's report under the Banking Act for 1987/88.)

### **Schedule 3, paragraph 5: requirement for the business of a bank to be carried on with integrity and skill**

2.37 This criterion is, like the prudent conduct criterion, concerned with the manner in which the business of the institution is carried on (which will partly determine its exposure to 'reputational risk') and is distinct from the question of whether its directors, controllers and managers are fit and proper persons. It covers two elements: whether the institution's business is carried on with integrity; and whether it is carried on with the professional skills appropriate to the nature and scale of the activities of the institution concerned.

2.38 The integrity element of the criterion requires the institution to observe high ethical standards in carrying on its business. Criminal offences or other breaches of statute will obviously call into question the fulfilment of this criterion. Particularly relevant are contraventions of any provision made by or under enactments designed to protect members of the public against financial loss due to dishonesty, incompetence or malpractice. (Examples of such enactments are the Theft Acts of 1968 and 1978, the Consumer Credit Act 1974, the Companies Act 1985 (as amended), the Company Securities (Insider Dealing) Act 1985, the Financial Services Act 1986, the Banking Acts of 1979 and 1987 and foreign legislation dealing with similar matters.) Doubts may also be raised if the institution fails to comply with recognised ethical standards of conduct such as those embodied in various codes of conduct. (Examples of such codes would be the London Code of Conduct for the wholesale markets in sterling, foreign exchange and bullion, the guidance notes on money laundering,<sup>(2)</sup> the Code of Banking Practice, and the Take-over Code.) As with breaches of statutes, the Bank would have regard to the

(1) See also paragraph 2.30 above concerning the role of non-executive directors.

(2) Issued by the Joint Money Laundering Working Group.

seriousness of the breach of the Code, to whether the breach was deliberate or an unintentional and unusual occurrence, and to its relevance to the fulfilment of the Schedule 3 criteria and otherwise to the interests of depositors and potential depositors.

2.39 Professional skills cover the general skills which bankers should have in conducting their business as bankers, for example, in relation to accounting, risk analysis, establishing and operating systems of internal controls, ensuring compliance with legal and supervisory requirements, and in the standard of the various financial services provided to customers. The level of skills required will vary according to the individual case, depending on the nature and scale of the particular institution's activities.

#### **Schedule 3, paragraph 6: requirement for a bank to have minimum net assets or minimum initial capital**

2.40 This provides that a UK incorporated credit institution must have at the time it is authorised initial capital<sup>(1)</sup> amounting to not less than ECU 5mn (or an amount of equal value determined wholly or partly in another unit of account).<sup>(2)</sup>

2.41 An institution which is not a UK incorporated credit institution must have at the time it is authorised net assets of not less than £1 million (or an amount of equivalent value denominated wholly or partly otherwise than in sterling).<sup>(3)</sup>

#### **Schedule 3, paragraph 1: requirement for directors, controllers and managers to be fit and proper persons**

##### **General**

2.42 This provides that every person who is, or is to be, a director, controller or manager of an authorised institution must be a fit and proper person to hold the position which he holds or is to hold.

2.43 In considering whether a person fulfils the criterion, the Bank has regard to a number of general considerations, whilst also taking account of the circumstances of the particular position held and the institution concerned.

##### **Directors, chief executives, managing directors and managers**

2.44 With regard to a person who is, or is to be, a director, chief executive, managing director or manager (as defined in section 105 of the Act), the relevant considerations include whether he has sufficient skills, knowledge, and soundness of judgment properly to undertake and fulfil his particular duties and responsibilities. The standards required of persons in these respects will vary considerably, depending on the precise position held by the person concerned. Thus a person could be fit and proper for one position but not fit and proper for a position involving different responsibilities and duties. The diligence with which he is fulfilling or is likely to fulfil those duties and responsibilities is also considered, so that the Bank can assess whether the person does or will devote sufficient time and attention to them.

2.45 The probity of the person concerned is very important: it is essential that a person with responsibility for the conduct of a deposit-taking business is of high integrity. In contrast to the other elements of the fitness and properness criterion, the level of probity required will tend to be much the same whatever position is held.

2.46 In assessing whether a person has the relevant competence, soundness of judgment and diligence, the Bank considers whether the person has had experience of similar responsibilities previously, his record in fulfilling them and, where appropriate, whether he has appropriate qualifications and training. As to his soundness of judgment, the Bank looks to, inter alia, the degree of balance, rationality and maturity demonstrated in his conduct and decision-taking.

(1) Initial capital is defined in regulation 2 of the Regulations.

(2) Such institutions must also continue to fulfil the capital adequacy requirements set out in paragraphs 4(2) and 4(3A) of Schedule 3 (see paragraphs 2.5-2.19 above).

(3) Such institutions must also continue to fulfil the capital adequacy requirement set out in paragraph 4(2) of Schedule 3 (see paragraphs 2.5-2.19 above).

2.47 More generally, the Bank takes into account the person's reputation and character. It considers, *inter alia*, whether the person has a criminal record<sup>(1)</sup>—convictions for fraud or other dishonesty are obviously relevant to probity. The Bank gives particular weight to whether the person has contravened any provision of banking, insurance, investment or other legislation designed to protect members of the public against financial loss due to dishonesty, incompetence or malpractice. (Examples of such legislation include the Theft Acts of 1968 and 1978, the Consumer Credit Act 1974, the Companies Act 1985 (as amended), the Company Securities (Insider Dealing) Act 1985, the Financial Services Act 1986, the Banking Acts of 1979 and 1987 and foreign legislation dealing with similar matters.) In addition, it considers whether the person has been involved in any business practices appearing to the Bank to be deceitful or oppressive or otherwise improper or which otherwise reflect discredit on his method of conducting business. Some of the relevant considerations here are dealt with by the legislation referred to above. However, not all are spelt out in statute. In this connection, the Bank has regard to the person's record of compliance with various non-statutory codes, such as the Take-over Code, the guidance notes on money laundering,<sup>(2)</sup> the Code of Banking Practice and London Code of Conduct for the wholesale markets in sterling, foreign exchange and bullion, in so far as they are relevant to the fulfilment of the Schedule 3 criteria and otherwise to the interests of depositors and potential depositors.

2.48 The standards required are particularly high for those persons with the main responsibility for the conduct of an institution's affairs, although they will depend in part on the nature and scale of the business concerned.

2.49 Once an institution is authorised, the Bank has continuing regard to the performance of the person in the exercise of his duties. Imprudence in the conduct of an institution's business, or actions which have

threatened (without necessarily having damaged) the interests of depositors or potential depositors will reflect adversely on the competence and soundness of judgment of those responsible. Similarly, failure by an institution to conduct its business with integrity and professional skills will reflect adversely on the probity and/or competence and/or soundness of judgment of those responsible. This applies whether the matters of concern have arisen from the way the persons responsible have acted or from their failure to act in an appropriate manner. The Bank takes a cumulative approach in assessing the significance of such actions or omissions—that is, it may determine that a person does not fulfil the criterion on the basis of several instances of such conduct which, if taken individually, may not lead to that conclusion.

### Shareholder and indirect controllers<sup>(3)</sup>

2.50 Shareholder controllers and indirect controllers (as defined in section 105 of the Act) may hold a wide variety of positions in relation to an authorised institution, and the application of the fit and proper criterion must take account of this.<sup>(4)</sup> A key consideration is the likely or actual impact on the interests of depositors and potential depositors of a person holding his particular position as controller. This is viewed in the context of the circumstances of the individual case, and of the particular position held. The general presumption is that the greater the influence on the authorised institution the higher the standard will be for the controller to fulfil the criterion. Thus, for example, higher standards will normally be required of shareholders who hold 20-33% of its shares than those shareholders who hold only 10-20%. However, in certain instances, a 10% shareholder controller would exert more influence than would normally be implied by a shareholding of this size and such a shareholder would be subject to a higher standard of assessment.

(1) The Bank is permitted by section 95 of the Act to have regard to certain spent convictions under the Rehabilitation of Offenders Act 1974.

(2) Issued by the Joint Money Laundering Working Group.

(3) The definitions of a shareholder controller applying to institutions under the Banking Act depend upon whether the institution is or is not a UK incorporated credit institution. The considerations the Bank takes into account in considering the fitness and properness of a controller, however, apply equally to both categories of institution.

(4) For UK incorporated credit institutions, the thresholds of shareholding at which the fitness and properness of shareholder controllers must be assessed are 10%, 20%, 33%, 50% and 75%, together with shareholdings of less than 10% where the person is a minority shareholder, as defined in section 105(4) (a) of the Act. For other authorised institutions, the thresholds are 15%, 50% and 75%.

2.51 In considering the application of the criterion to shareholder controllers (and, in the case of UK incorporated credit institutions, parent controllers)<sup>(1)</sup> or persons proposing to become such controllers, the Bank has particular regard to two main factors. These are relevant whether the person is a shareholder controller or a parent controller by virtue of a shareholding in the authorised institution or by virtue of a shareholding in another institution of which the institution is a subsidiary or subsidiary undertaking.

2.52 First, it considers what influence the person has or is likely to have on the conduct of the affairs of the institution. If the person does, or is likely to, exercise a close control over the business, the Bank would look for evidence that he has soundness of judgment and relevant knowledge and skills for running an authorised institution. The Bank would look therefore for the same range of qualities and experience that it would expect of the executive directors of an authorised institution. On the other hand, if the shareholder does not, and is not likely to, influence the directors and management of the authorised institution in relation to the detailed conduct of the business, it would not be necessary to require such a level of relevant qualities and experience. In general, 10% shareholder controllers are not likely to exercise much, if any, influence or control in relation to the conduct of an authorised institution's business. Accordingly, in general the standards of competence, soundness of judgment and diligence required of such controllers will be lower than that for 20% shareholder controllers and for other controllers which hold a higher percentage of the shares of an authorised institution and to parent controllers. As regards probity, the Bank will give similar consideration to shareholder controllers as it would to managing directors, chief executives, directors or managers. The Bank also has regard in this context to whether there could be conflicts of interest arising from the influence of the shareholder on the authorised institution—this could, in particular, arise from too close an association with another company, the business or affairs of which could have a bearing on the institution's position.

2.53 Second, it considers whether the financial position, reputation or conduct of the parent controller or shareholder controller or prospective controller has damaged or is likely to damage the authorised institution through 'contagion' which undermines confidence in it. For example, if the holding company, or a major shareholder, or a company connected to that shareholder were to suffer financial problems it could lead to a run on the authorised institution, difficulties in obtaining deposits and other funds, or difficulties in raising new equity from other shareholders or potential shareholders. Generally, the higher the shareholding the greater the risk of 'contagion' if the shareholder encounters financial difficulties. The risk of contagion is not confined to financial weakness: publicity about illegal or unethical conduct by the holding company or another member of the group or a company connected to the institution in some other way may also damage confidence in the authorised institution.

2.54 In the case of shareholder controllers holding 10% or more of the non-voting shares<sup>(2)</sup> in an authorised institution or an institution of which it is a subsidiary institution the Bank takes into account the degree of influence they exert or may be able to exert. In general, because the shares are non-voting, these persons are not likely to exert much influence on authorised institutions and, therefore, the standard which they are required to meet is lower than for voting shareholders. However, situations may arise where non-voting shareholders can exert a material influence over the institution, whether by suasion or any other means, and these persons will be considered in the light of the nature of the influence which they are able to exert then.

2.55 The fitness and properness of minority shareholder controllers of UK incorporated credit institutions are also subject to assessment by the Bank. Minority shareholder controllers are persons who hold less than 10% of the shares and are entitled to exercise or control the exercise of less than 10% of the voting power (whether directly or indirectly) of the institution and, by virtue of their holding, are able to exercise a significant influence over the management of the institution or of the institution's parent company. The

(1) That is a parent undertaking as defined in regulation 2 (2) of the Regulations.

(2) Applies to shares in UK incorporated credit institutions only.

Bank's consideration of these persons will take into account the nature of the influence which they are able to exert—issues similar to those taken into account in the assessment of other categories of shareholder controller will be considered.

2.56 In considering the fitness and properness of indirect controllers it is also necessary to have regard to the precise position held.

2.57 In the case of an indirect controller who 'directs' or 'instructs' a shareholder controller, in terms of section 105(3)(d), similar considerations apply as those relevant to assessing the fulfilment of the criterion in relation to shareholder controllers. In other words, the standards which an indirect controller will need to satisfy are likely to be at the minimum the standards also required of the person who is indirectly controlled.

2.58 Where a person is an indirect controller by virtue of 'directing' or 'instructing' the board of an authorised institution, in terms of section 105(3)(d), the standards required will be high. The indirect controller would have to have the probity and relevant knowledge, experience, skills and diligence for running an authorised institution. The qualities required would be those which are also appropriate for the board of directors of an authorised institution.

2.59 The Bank expects both authorised institutions and the controllers themselves to inform it of any material developments which may cast doubt on the continued fitness and properness of the controllers or which otherwise indicate a possible threat to the interests of depositors and potential depositors.

### 3 The discount houses

3.1 The discount houses are counterparties of the Bank in its operations in the sterling money market. They are authorised under the Banking Act, and are supervised by the Wholesale Markets Supervision Division of the Bank. While this statement generally applies to the discount houses, as well as to other institutions authorised under the Banking Act, the sections on capital adequacy and liquidity do not. This is because of the distinct nature of the business they conduct and the risks to which this gives rise. The

Bank's arrangements for the supervision of the discount houses are those described in its 1988 paper, *Bank of England operations in the sterling money market* (the 'Red Paper'), although minor refinements have been made from time to time. The most significant of these have been the introduction of a revised treatment of certain off-balance-sheet instruments for the purposes of capital adequacy, and the formalisation of the Bank's policy on the types of business which it believes are appropriate for discount houses to undertake.

3.2 The EC directives relating to banking and the completion of the internal market have consequences for the Bank's supervision of the discount houses. Implementation of the Second Banking Coordination Directive and of the Consolidated Supervision Directive with respect to the discount houses has been largely in line with that for authorised institutions generally. The Bank continues to monitor the compliance of the discount houses with the terms of their exemption from the full provisions of the Solvency Ratio Directive. Because of the availability of this exemption, the discount houses are included by the Bank in the consolidation which is required by the Consolidated Supervision Directive on the basis of the solvency test set out in the Red Paper. The Bank is considering the implications of the Large Exposures Directive and the Capital Adequacy Directive for the discount houses.

## 4 Principles relating to the grant of authorisation

### General

4.1 In order to be able to grant authorisation the Bank must be satisfied that all the minimum authorisation criteria in Schedule 3 are fulfilled with respect to the applicant. It cannot be so satisfied if the applicant institution and other relevant parties have not provided all the information and documents which the Bank has requested in connection with the application. Where the Bank is satisfied that the criteria are fulfilled, it can then decide whether to grant authorisation. It will not do so if it considers for any reason that there are any significant threats to the interests of the depositors and

potential depositors, notwithstanding that the criteria are fulfilled.

4.2 The Bank also considers, in exercising its discretion to grant authorisation, whether it is likely that it will receive adequate flows of information from the institution and relevant connected parties in order to monitor the fulfilment of the criteria and to identify and assess any threats to the interest of depositors and potential depositors. In assessing this issue, the Bank requires to be satisfied that the institution and the group to which it may belong will be subject to consolidated supervision in accordance with the Basle Minimum Standards.<sup>(1)</sup> The Bank will take account of any factors which might inhibit effective supervision, including in particular whether the structure and geographical spread of the bank, the group to which it may belong and other connected companies might hinder the provision of adequate and reliable flows of information to the supervisors. In particular, such flows can be hindered where there are branches or other connected companies in poorly supervised centres or centres with very restrictive secrecy laws. The Bank may also have concerns about the reliability of information if the institution's head office is located in a different country from its registered office or if different group companies have different financial years and accounting dates (thus making it difficult to assess with confidence the overall position of a group at any particular time). In addition, the Bank would have regard to whether the companies in the same group shared common auditors. The Bank's ability to assess a banking institution's exposure to risks elsewhere in the same group may be assisted where there are common auditors and, as with the case where different group companies have different financial years, the Bank would need to be persuaded that there are good reasons for this arrangement not to be adopted and that it would not in the circumstances of the particular case hinder effective supervision.

4.3 The Bank's experience has been that newly-formed institutions which are not directly associated with an established and proven deposit-taking institution can be susceptible to early difficulties. These difficulties on the whole have

tended to arise from lack of relevant expertise and judgment, particularly in lending, or from ill-constructed and insufficiently-tested business strategies. The Bank has therefore found it difficult to be satisfied that an applicant institution which is not supported by an established deposit-taking institution will carry on a deposit-taking business in a prudent manner, unless the applicant institution has already for some time been carrying on successfully a business similar to that planned (even if on a lesser scale) but financed either by bank borrowing or from other sources not involving the acceptance of deposits as defined in the Act.

#### Overseas institutions

4.4 In the case of an institution whose principal place of business<sup>(2)</sup> is in a country or territory outside the United Kingdom, the Bank, under the terms of section 9(3), may regard itself as satisfied that the criteria relating to fit and proper persons, prudent conduct, and integrity and professional skill (see paragraphs 1, 4 and 5 of Schedule 3) are fulfilled if:

- (a) the banking supervisory authority in that country or territory informs the Bank that it is satisfied with respect to the prudent management and overall financial soundness of the applicant; and
- (b) the Bank is satisfied as to the nature and scope of the supervision exercised by that authority.

4.5 The Bank has to form its own view directly on whether the 'four eyes' and minimum net assets criteria (paragraphs 2 and 6 of Schedule 3) are fulfilled with respect to the applicant.

4.6 The principal place of business of an institution will normally be where the mind and management, its central direction, resides.

4.7 Despite the reliance that the Bank may place on assurances from overseas supervisory authorities with respect to certain criteria, the Bank must make its own judgment on an institution's suitability for authorisation. In this connection, the Bank examines

(1) *The minimum standards for the supervision of international banking groups and their cross-border establishments*, issued in June 1992.

(2) See paragraph 5.13.

the planned business of the proposed UK branch of the applicant, its business plan, its liquidity policies, its internal controls, its accounting and other records, and staffing and management arrangements. If there are any concerns, the Bank will discuss these with the applicant and, where necessary, with the overseas supervisory authority. Unless suitable assurances are received, or remedial action taken, the Bank may decide that it cannot be satisfied that all the criteria are fulfilled, and that therefore authorisation should not be granted.

4.8 Once such an institution is authorised, on-going supervision is conducted in accordance with the principles governing the Bank's approach to the supervision of authorised institutions generally. This is adapted as appropriate to take account of the position of the UK branch in the context of the institution as a whole and with regard to the role and approach of other relevant supervisory authorities in relation to the institution and its activities. In practice, the Bank would normally expect on-going supervision to be a matter of collaboration between the Bank and the relevant supervisory authorities in other jurisdictions, following where appropriate the principles governing the supervision of overseas institutions set out in the Basle Concordat(s)<sup>(1)</sup> and the Basle Minimum Standards.<sup>(2)</sup>

## 5 Section 11: grounds for the revocation of authorisation

5.1 Section 11 sets out the grounds on which the Bank's powers to revoke authorisation or restrict an authorisation become exercisable. Whether such a ground exists generally depends on the Bank's judgment of the circumstances relating to the authorised institution concerned and of the application of provisions of the Act to those circumstances. The following focuses on the Bank's interpretation of the section 11 grounds.

5.2 Although there are other circumstances in which the Bank's powers may be exercisable, as a general

matter, the Bank is able to exercise its powers when the interests of depositors and potential depositors are threatened. The threat may be relatively slight or remote, or it may be both immediate and serious. The Act recognises that the immediacy and severity of such threats may vary by, as a general rule, giving the Bank discretion to decide whether to revoke, impose restrictions or take some other action. The main principles underlying the exercise of this discretion are set out in Part 6 below.

### Section 11(1)(a)

5.3 This provides that the Bank's powers become exercisable if it appears to the Bank that any of the criteria in Schedule 3 is not or has not been fulfilled, or may not be or may not have been fulfilled. This represents quite a low threshold. The Bank would consider that a criterion 'may not be ... fulfilled' in circumstances where it had evidence that a criterion may not be or may not have been fulfilled, albeit that the evidence was not sufficient to enable it to satisfy itself that the criterion is not or has not been fulfilled. In other words, where the evidence available raised a material doubt about whether the criterion was or had been in fact fulfilled.

### Section 11(1)(b)

5.4 Under this, the Bank's powers become exercisable if the institution fails to comply with any requirement imposed by the Act: for example, if it fails to notify a change of director under section 36. The Bank's powers also become exercisable if the institution fails to comply with any requirement imposed by secondary legislation under the Act (for example, advertisement regulations) or imposed by the Bank using its powers under the Act (for example a condition imposed under section 12 or a requirement for information under section 39).

(1) *Principles for the supervision of banks' foreign establishments*, issued in May 1983 (as amended).

(2) See footnote (1) page 15.

### **Section 11(1)(d)**

5.5 This provides that the Bank's powers become exercisable if it is provided with false, misleading or inaccurate information by or on behalf of the institution. The mere provision of inaccurate information will render the power exercisable. In practice, however, the Bank is likely not to contemplate exercising its powers just because of a minor inaccuracy. There would generally have to be a wider prudential concern, of which the inaccuracy may be a symptom.

5.6 The Bank's powers also become exercisable under this paragraph if false, misleading or inaccurate information has been provided, in connection with an application for authorisation, by or on behalf of a person who is, or is to be, a director, controller or manager of the institution.

### **Section 11(1)(e)**

5.7 Although the Schedule 3 authorisation criteria and the other circumstances specified in sections 11(1)(b)-(d) and 11(1A) (below) cover most of the range of circumstances which could pose a threat to the interests of depositors and potential depositors, they do not cover all—for example, a sudden external threat, unconnected with the institution's conduct, such as a natural catastrophe or the imposition by a government of a debt moratorium. Paragraph (e) ensures that the Bank may act by using its revocation or restriction powers in all circumstances where the interests of depositors and potential depositors are in any other way threatened, whether by the manner in which the institution is conducting or proposes to conduct its affairs or for any other reason.

### **Section 11(2)**

5.8 This enables the Bank to revoke in certain circumstances if an institution has failed to make use of its authorisation. Authorisation under the Act is intended to enable a person to accept deposits in the United Kingdom in the course of carrying on a deposit-taking business. Provided that deposits are accepted in the United Kingdom, it is irrelevant where the institution carries on a deposit-taking business.

5.9 Section 5 of the Banking Act defines the meaning of 'deposit'. An institution which accepts deposits as there defined will carry on a deposit-taking business as defined in section 6 of the Act if it (a) lends money received by way of deposit to others; or (b) finances any other activity of the business to any material extent out of the capital of or the interest on money received by way of deposit. However, an institution which utilises deposit money in these ways will not carry on a deposit-taking business if it does not hold itself out as accepting deposits on a day-to-day basis and if any deposits which are accepted are accepted only on particular occasions.

### **Section 11: subsections (1)(c), (3), (4), (6), (7), (8) and (9)**

5.10 These subsections set out other circumstances in which the Bank's powers become exercisable, because of certain specified events occurring. These include withdrawal of authorisation (in respect of an overseas institution) by the banking supervisory authority of the country or territory in which the institution has its principal place of business; revocation of authorisation under the Financial Services Act 1986 or a licence under the Consumer Credit Act 1974; and the commencement of certain formal insolvency procedures in relation to an authorised institution, such as the making of a winding-up order or the passing of a resolution for voluntary winding-up or the making of an administration order.

5.11 There are two circumstances in which revocation is mandatory rather than discretionary. First, in the case of an authorised institution which is not a credit institution and which has its principal place of business in another Member State of the European Community and the banking supervisory authority there withdraws the institution's authorisation. Second, where a winding-up order has been made against the institution in the United Kingdom or a resolution for its voluntary winding up in the United Kingdom has been passed or where analogous proceedings have occurred in other jurisdictions.

### **Section 11(1A)**

5.12 Section 11(1A) sets out additional grounds on which the Bank's powers to revoke or restrict the

authorisation of a credit institution incorporated in the UK become exercisable.

#### **Section 11(1A)(a)**

5.13 This provides that the Bank's powers become exercisable if it appears to the Bank that the institution's principal place of business is or may be outside the United Kingdom.<sup>(1)</sup>

#### **Section 11(1A)(b)**

5.14 This provides that the Bank's powers become exercisable if it appears to the Bank that the institution has carried on in the United Kingdom or elsewhere a listed activity (ie an activity listed in Schedule 1 of the Regulations) other than the acceptance of deposits from the public, without having given prior notice to the Bank of its intention to do so.

#### **Section 11(1A)(c)**

5.15 This provides that the Bank's powers become exercisable where it is informed by The Securities and Investments Board or certain other UK regulatory authorities that the institution has contravened any provision of the Financial Services Act 1986 or any rules or regulations made under it, or certain other related provisions set out in the section.<sup>(2)</sup>

#### **Section 11(1A)(d)**

5.16 This provides that the Bank's powers become exercisable where it is informed by the Director General of Fair Trading that the institution or certain other persons connected to the institution has done any of the things specified in paragraphs (a) to (d) of the section 25(2) of the Consumer Credit Act 1974.

#### **Section 11(1A)(e)**

5.17 This provides that the Bank's powers are exercisable where it appears to the Bank that the institution has failed to comply with any obligation

imposed on it by The Banking Coordination (Second Council Directive) Regulations 1992.

#### **Section 11(1A)(f)**

5.18 This provides that the Bank's powers are exercisable where it is informed by a supervisory authority in another member State that the institution has failed to comply with any obligation imposed on it by or under any rule of law in force in that State for purposes connected with the implementation of the Second Council Directive (ie the Second Banking Coordination Directive).

## **6 Principles relating to the revocation of authorisation and to the restriction of authorisation**

6.1 As noted above, the Bank's powers to revoke or restrict an authorisation may become exercisable in a wide range of circumstances.

6.2 The wide diversity of grounds in the Act for the exercise of the Bank's powers enables the Bank to exercise its powers before the threat to the interests of depositors or potential depositors becomes very great or immediate. The Bank can, therefore, where necessary, intervene before the deterioration in the institution's condition is such that there is a serious likelihood that depositors will suffer a loss.

6.3 In view of the need for flexibility in dealing with problem cases, the Act gives the Bank discretion—except in the case of mandatory revocation referred to in paragraph 5.11 above—to decide whether to revoke or restrict the authorisation or seek remedial action by some other means, through persuasion and encouragement. Where the Bank considers that adequate and speedy remedial steps are likely to be taken by an authorised institution (or its shareholders, for example by injecting new capital or appointing new directors) it would generally be reluctant to revoke or restrict the authorisation.

(1) The Bank will expect an institution's mind and management, its central direction, to remain in the United Kingdom.

(2) In the case of an institution which is a member of a self-regulatory organisation, the reference to rules and prohibitions includes the rules of any recognised organisation of which the institution is a member and any prohibition imposed by virtue of those rules.

6.4 The Bank would generally consider revocation, however, where there was no reasonable prospect of speedy and comprehensive remedial action, even though the situation did not raise matters of immediate concern, for example where the threat to the interests of depositors is not immediate, because the institution currently had adequate capital and liquidity. In so far as this is consistent with the interests of depositors, actual and potential, the Bank will explore fully the prospects of remedial action; if, however, the financial position of the institution is weak or is deteriorating rapidly, the scope for such inquiries will be limited. The Bank has to balance the interests of existing depositors, for whom it may be desirable to continue the authorisation in order to allow more time for the scope for remedial action to be explored, and the interests of potential depositors who could be exposed to a risk of loss.

6.5 The circumstances in which a restricted authorisation rather than revocation is likely to be appropriate are where the Bank considers that the imposition of conditions is necessary to underpin the institution's efforts to improve matters, and that there is a reasonable prospect that all the relevant criteria for authorisation will be fulfilled again within a reasonable period. Such a restricted authorisation would normally be without time limit but the Bank's intention would be that the conditions would be removed once the remedial action was taken. The Bank would thus look for a sound and viable programme for swift remedial action.

6.6 Alternatively, the Bank may impose a restricted authorisation with a limited life. The Bank may impose such a time limit for a maximum of three years; it may also extend the life of a time-limited authorisation, but only provided the total duration is not more than three years. The Bank would generally impose a time-limited authorisation in order to facilitate an orderly repayment of deposits by avoiding liquidity pressures which could arise from a sudden loss of authorisation.

6.7 On occasion, when concerns arise, it may also be desirable to restrict the authorisation as a holding measure to protect depositors and potential depositors while further information is sought.

6.8 Where the Bank considered that a Schedule 3 criterion may not be fulfilled and therefore that its powers were exercisable, its response would depend on the overall circumstances of the case, and, in particular, on its assessment of the actual or potential threats to the interests of depositors. The Bank would also have regard to any perceived deficiencies in the information available to it. Where further information was required in order to determine whether or not the criterion was in fact fulfilled, the Bank would generally not exercise its revocation or restriction powers where it was satisfied that there was no substantial threat to depositors. (An example would be the case where there was a doubt about the fitness and properness of a manager but otherwise the Bank was satisfied that all the Schedule 3 criteria were met.) In other cases, the Bank would be inclined to use its restriction powers in order to protect depositors and potential depositors pending clarification of whether or not there was in fact a material threat to depositors, unless it was satisfied that adequate protective measures had been put in place.

6.9 In the case of a UK incorporated credit institution which fails to meet the requirement in paragraph 4(3A) of Schedule 3 to maintain own funds which amount to not less than ECU 5mn the Bank will exercise its discretion to take action on this ground consistent with article 10(5) of the Second Banking Coordination Directive which, where the circumstances justify it, allow an institution which fails to meet the requirement a limited period in which to do so or to cease its activities. Where an institution fails to meet the ECU 5mn requirement the Bank requires the institution to produce a viable plan to restore the capital requirement within a limited period.

6.10 The Bank will always review the fulfilment of the Schedule 3 criteria whenever a UK-incorporated bank is considering establishing, for example, an overseas branch in a particular country for the first time or another group company or a substantial expansion or change in its business. It will be particularly concerned to be satisfied that the staffing and management arrangements as well as the proposed systems and controls are adequate for the new business so that there would be, for example, adequate flows of information both to the bank's head office and, where appropriate, to the supervisors. If the arrangements seemed

inadequate, the Bank would be likely to conclude that at least one of the Schedule 3 criteria is not met. In which case it is likely to decide to exercise its powers to prevent the establishment of the branch or whatever other new business was envisaged. (See also paragraph 2.28 above.)

## 7 Conclusion

The principles set out in this statement are of general application, and take account of the wide diversity of institutions authorised under the Act and differing

circumstances. Nevertheless, there is likely to be a need for the principles to be developed over time. Section 16(2) of the Act requires the Bank to record in its annual reports under section 1(3) of the Act if it makes a material change in the principles in accordance with which it is acting or proposing to act. This will complement the more detailed papers the Bank publishes on particular aspects of its supervisory requirements. In addition, the Bank will continue to issue revised versions of the statement of principles when there have been significant developments in its approach.

# The Banking Coordination (Second Council Directive) Regulations 1992: Schedule 3 (paragraph 5)

## 1 Introduction

1.1 This statement is made pursuant to Schedule 3 (paragraph 5) of The Banking Co-ordination (Second Council Directive) Regulations 1992 (the 'Regulations'). This requires the Bank to publish a statement of the principles in accordance with which it is acting or proposing to act in exercising its power to impose a prohibition on or to restrict the listed activities of a European institution.<sup>(1)</sup>

1.2 This statement of the principles the Bank has adopted for determining when, and, if so, in what way, to exercise its powers to impose a prohibition and/or a restriction on a European institution, encapsulate the main standards and considerations to which the Bank has regard in exercising its supervisory responsibilities in respect of European institutions consistent with the allocation of supervisory responsibilities set out in the Second Banking Coordination Directive (the Directive). The principles are likely to require development over time in the light of, inter alia, the Bank's experience in cooperating with EC home State authorities within the framework of the memoranda of understanding which are being agreed with those authorities, and any further clarification of the interpretation of the Directive by the EC or the Courts. The Bank will publish revised versions of this statement should there be significant developments in its approach.

1.3 Part 2 of this statement sets out the general principles underlying the exercise of the Bank's discretion to impose a prohibition and/or to restrict the listed activities of a European institution. Part 3 considers the various grounds in regulations 9 and 10 of the Regulations for imposing a prohibition and/or a restriction on a European institution and expands upon the principles set out in Part 2.

## 2 General Principles relating to the imposition of a prohibition and/or a restriction on a European institution

2.1 The Bank uses its discretion to exercise its powers under the Regulations consistent with the provisions of the Directive. The Bank's powers in relation to European institutions are limited as under the Directive the competent authority in the home State has primary responsibility for the supervision of credit institutions incorporated in that State and certain of their subsidiaries (the 'Article 18.2 subsidiaries'). The host State authority, however, has a specific responsibility to cooperate with the home State authority in ensuring that branches of European credit institutions from that State maintain adequate liquidity in the host State. It also has responsibility to collaborate with the home State authority in ensuring that the credit institutions and their Article 18.2 subsidiaries carrying on listed activities in the host State take sufficient steps to cover risks arising from their open positions on financial markets in the host State.

2.2 As set out below the Bank's powers to impose a prohibition and/or a restriction may become exercisable in a wide range of circumstances. In view of the need for flexibility with problem cases, the Regulations give the Bank discretion whether or not to exercise them or to seek remedial action by some other means, for example, through persuasion and encouragement. Where the Bank considers that adequate and speedy remedial steps are likely to be taken by a European institution, it would generally not find it necessary to impose a prohibition or a restriction in relation to the home-regulated activities which the institution carries on in the United Kingdom.

(1) 'European institutions' consist of 'European authorised institutions' and 'European subsidiaries'. These are defined in regulation 3 of the Regulations.

2.3 Consistent with the allocation of supervisory responsibility in the Directive, the Bank will usually only exercise its powers after consulting the home State authority, and indeed, in certain circumstances, the Regulations explicitly require the Bank to do this. In most cases, the home State authority will be best placed to take action to ensure that the institution rectifies a situation which might otherwise provide grounds for the Bank to exercise its powers. In many cases too, the information the Bank would have regarding the activities and state of affairs of European institutions will be limited, reflecting the Bank's restricted role in relation to such institutions. Thus for example although the Regulations give the Bank power to impose a prohibition or a restriction in circumstances where it is informed by the supervisory authority in the home State that the institution is failing to take adequate steps to cover market risk in the UK the Bank, consistent with the terms of the Directive, would collaborate with the home State authority to determine the appropriate action to take in such circumstances.

2.4 To assist the home State authority, and in order to ensure that the Bank is better able to determine whether its powers are exercisable and should be exercised, the Bank has signed memoranda of understanding with a number of the other EC authorities (and is currently in the process of agreeing memoranda with the remaining EC authorities). The memoranda, inter alia, express the willingness of the respective authorities to exchange information in order to facilitate the effectiveness of the supervision of EC credit institutions and their Article 18(2) subsidiaries. They also provide for the exchange of information in crisis situations and in cases where the authorities become aware of contraventions of the law by institutions covered by the Directive operating in their territory.

2.5 In considering whether to exercise its powers the Bank would take into account the nature of the contravention in question and the action taken or to be taken by other relevant authorities in the UK. Thus where another UK regulator has taken action to restrict the activities of a European institution in the UK and

the Bank considers that this action, if complied with, is sufficient to remedy the situation the Bank would be unlikely to take further action itself. The Bank expects this to be normally the case where the institution's activities in the UK are, for example, largely confined to investment business. It would only be necessary to consider whether to impose a prohibition on deposit-taking in such a case where the institution has notified its intention to accept deposits in the UK.

### 3 Regulations 9 and 10: grounds for the imposition of a prohibition and/or a restriction on a European institution

3.1 Regulation 9 sets out the grounds upon which the Bank's power to impose a prohibition in relation to a European institution becomes exercisable. A prohibition means a prohibition on accepting deposits in the United Kingdom. These grounds also determine whether the Bank's power under regulation 10 to impose a restriction has become exercisable in relation to a European institution. A restriction means a direction that a European institution may not carry on any specified home-regulated activity (other than the acceptance of deposits) in the UK or that the European institution may not carry on a specified home-regulated activity in the UK other than in accordance with specified conditions.<sup>(1)</sup>

#### Regulation 9(2)(a)

3.2 This ground applies only in relation to European authorised institutions which have established a branch in the UK.<sup>(2)</sup> Under this, the Bank's powers become exercisable if it appears to the Bank that the UK branch of a European authorised institution is not or may not be maintaining or, as the case may be, will not or may not maintain adequate liquidity.

3.3 In considering the liquidity of a branch the Bank has regard to the relationship between its liquid assets and its actual and contingent liabilities, to the times at which those liabilities will or may fall due and its

(1) Section 12(4) of the Act (examples of conditions that may be imposed) applies for the purposes of regulation 10.

(2) The Bank's powers under regulation 9(2) (a) are only exercisable in relation to such institutions. Its powers under regulations 9(2) (b)-(f) are exercisable in respect of all European institutions including those institutions which have not established a branch in the UK.

assets mature. Each institution is assessed in the light of its own particular circumstances. In considering whether the liquidity of the UK branch of such an institution is adequate it is also necessary for the Bank to have regard to the liquidity of the institution as a whole. This is because the branch may be called upon to use its liquid funds to finance maturing liabilities of the institution's other branches and head office. Conversely it may not be possible to judge the adequacy of the branch's liquidity without knowledge of the extent to which the institution as a whole at any one time is able to meet maturing liabilities in the UK. Therefore, in order to assist the Bank to determine whether this power is exercisable in relation to European authorised institutions, the Bank will seek from each of the relevant home State authorities an undertaking to notify the Bank immediately should there be any changes in the circumstances of European authorised institutions incorporated in that State which might have an impact on the liquidity of their UK branches.

3.4 The Bank also expects to agree with each institution a statement of liquidity policy covering, inter alia, strategy, management, systems and key variables used for monitoring liquidity, the role of a stock of high quality liquid assets and contingency plans in respect of abnormal circumstances. Once an acceptable liquidity policy is in place the Bank would agree individual liquidity mismatch guidelines with each bank, and subsequently monitor adherence to them on a quarterly basis (although the guidelines apply throughout the period on a continual basis). The appropriateness of the guidelines is also kept under review by the Bank. In order to ensure that the guidelines are appropriate to the institution's overall position the Bank will additionally consult the relevant home State authority on a regular basis.

3.5 In cases where the home State authority and the Bank are satisfied that the institution has an adequate global liquidity management programme, the Bank will not find it necessary to set individual liquidity mismatch guidelines. The Bank would expect to agree to such an arrangement where the branch is fully integrated (including its systems) with the head office

for liquidity management purposes, where the head office has assured the Bank that liquidity is available to the branch at all times, if needed, and that there are no known constraints on the provision of liquidity by the head office to the branch. In addition the Bank would on a regular basis consult the home State authority and obtain information from the institution relating to the liquidity of its UK branch.

3.6 The Regulations (regulation 11) require the Bank to comply with the following procedure if the situation as respects a European authorised institution is such that the Bank's powers are exercisable by virtue of the circumstances set out in regulation 11(1) (covering the liquidity requirement in regulation 9(2)(a), and a failure to comply with a requirement imposed under section 39 of the Act for statistical purposes.) The Bank should require the institution in writing to remedy the situation. If the institution has failed to remedy the situation within a reasonable time, the Bank should give notice to that effect to the home State authority requesting that authority to take all appropriate measures for the purpose of ensuring that the institution remedies the situation and to inform the Bank of the measures it proposes to take or has taken or the reasons for not taking such measures. The Bank is only empowered to impose a prohibition or a restriction on a European institution if it is satisfied that the home State supervisory authority has failed or refused to take measures for the purpose of ensuring that the institution remedies the situation or if the measures taken by that authority have proved inadequate for that purpose.

3.7 If the Bank considers that a prohibition or restriction covered by regulation 11(1) should be imposed as a matter of urgency, regulation 11(5) permits the Bank to take steps to impose a prohibition or restriction without first making a written request to the institution to take remedial action, notifying the home State authority or waiting until it is satisfied as to whether the home State authority has taken adequate measures. In such a case, the Bank is required to inform the relevant supervisory authority and the European Commission of the steps taken at the earliest opportunity.<sup>(1)</sup> The Bank only expects to act under

(1) The regulation 11 procedure does not apply in respect of the imposition of restrictions under regulation 8(2) (restriction imposed on an institution proposing to establish a branch in the UK) or in any case where regulation 12 (prohibition or restriction on information from supervisory authority) applies.

regulation 11(5) in extreme cases where, for example, it is impractical or impossible for the home State authority to take sufficient action in time to rectify a sudden liquidity crisis.

#### **Regulation 9(2)(b)**

3.8 This provides that the Bank's powers are exercisable where it is informed by the European institution's home State authority that the institution has failed to take any or sufficient steps to cover market risks arising in the UK. The Bank would generally expect to exercise its powers on this ground in circumstances in which the home State authority agrees that the exercise of such powers is necessary in order to assist it in ensuring that the institution takes adequate steps to cover market risks arising from open positions on the financial markets in the UK. In order to assist the home State authorities in carrying out their responsibilities the memoranda of understanding being agreed between them and the Bank provides that the Bank, on request, will provide information on the UK financial markets. They also provide for the Bank to notify home State authorities of any developments in the UK which might cause major disruption in the UK financial markets as a whole.

#### **Regulation 9(2)(c)**

3.9 This provides that the Bank's powers are exercisable where the European institution has failed to comply with any obligation imposed on it by the Regulations or by or under any of the relevant Acts (ie the Banking Act, the Financial Services Act, the Consumer Credit Act and the Insurance Companies Act).<sup>(1)</sup> The obligations referred to are many and varied. The Bank will assess the circumstances of any failure to comply with such an obligation in order to determine the reasons for the failure and its significance. Any failure to comply with an obligation imposed on a European institution by the Regulations or by or under any of the relevant Acts will render the Bank's powers exercisable. In practice, however, the Bank is not likely to contemplate exercising its powers just because of an isolated failure which did not raise any wider issues of concern. In assessing this, the

Bank is likely to take into account the views of the home State supervisor and if the contravention relates to UK legislation other than the Banking Act and the Regulations, the Bank is likely to seek the views of the other relevant UK supervisory authorities.

3.10 If the failure to comply with an obligation is a failure to comply with a requirement imposed under section 39 of the Banking Act (information and production of documents) for statistical purposes the regulation 11 procedure described in paragraph 3.7 (above) applies. In many cases, the Bank is likely to follow a similar procedure before exercising its powers under regulation 9(2)(c) where the institution has contravened any other obligation covered by that regulation.

#### **Regulation 9(2)(d)**

3.11 This provides that the Bank's powers are exercisable where it is informed by a supervisory authority in the European institution's home State that the institution has failed to comply with any obligation imposed on it by or under any rule of law in force in that State for purposes connected with the implementation of the Directive. In considering whether to exercise its powers under this regulation and the manner in which they should be exercised the Bank would generally seek the views of the home State authority as to the nature of the contravention, the degree to which it raises any issues of supervisory concern, and the action, if any, which it may be desirable for the Bank to take in relation to the institution.

#### **Regulation 9(2)(e)**

3.12 This provides that the Bank's powers are exercisable if it appears to the Bank that it has been provided with false, misleading or inaccurate information by or on behalf of the European institution or by or on behalf of a person who is or is to be a director, controller or manager of the institution. The mere provision of inaccurate information will render the power exercisable. In practice, however, the Bank is unlikely to contemplate exercising its powers just

(1) In the case of a European institution which is a member of a self-regulatory organisation, the reference to any obligation imposed by or under the relevant Acts includes a reference to any obligation imposed by the rules of that organisation.

because of a minor inaccuracy. There would generally have to be a wider prudential concern, of which the inaccuracy may be a symptom.

### Regulation 9(2)(f)

3.13 This provides that the Bank's powers are exercisable if it appears to the Bank that the situation as respects the European institution is such that, if it were authorised by the Bank under the Banking Act, the Bank could revoke its authorisation. The Bank is not able to exercise its powers under this regulation unless the Bank has first requested the relevant supervisory authority in the institution's home State to take all appropriate measures for the purpose of ensuring that the institution remedies the situation. Before the Bank's powers pursuant to section 9(2)(f) are exercisable it must also be satisfied either that the authority has failed or refused to take measures for that purpose or that the measures taken by that authority have proved inadequate for that purpose.

3.14 The principal circumstances in which this power would be available are those in which the grounds for revocation set out in section 11(1)(a) (a failure to fulfil the Schedule 3 criteria), section 11(6) (winding-up) and by section 11(1)(e) (other threats to the interests of depositors), would apply if the institution were authorised by the Bank under the Act.

3.15 The Bank's powers under this regulation are only exercisable in the exceptional circumstances where the home authority for some reason is unwilling or unable to adopt appropriate measures to ensure that remedial steps are taken by the institution (despite having received a request from the Bank to take such action). In such circumstances the Bank is most likely to exercise its powers when the situation of an institution is such that if it were authorised under the Act it would not be able to meet the Schedule 3 criteria. It is likely that any action taken by the Bank pursuant to regulation 9(2)(f) would be taken in cooperation with the other relevant UK supervisory authorities.

### Other grounds for imposing a restriction

3.16 The Bank also has the power to impose a restriction on an institution proposing under the Regulations to establish a branch in the UK. This power is exercisable in the circumstances set out in regulation 8(2) where the Bank considers that its powers under regulation 9(2) are likely to become exercisable in relation to the institution. In this event the Bank may impose such restriction under regulation 10 as appears to it desirable. This power is most likely to be used by the Bank following discussions with the home state authority as to the situation of the institution in that State, and the nature of the institution's proposed activities in the UK.

2.1 Regulation 23 provides that the Bank may impose such restriction as appears to it desirable where it appears that the situation as respects the UK subsidiary is such that, if it were authorised by the Bank under the Banking Act, the Bank could revoke its authorisation on the grounds specified in section 11(1)(a) of the Act. Therefore, the Bank's power is exercisable if it appears to the Bank that, if the UK subsidiary were an authorised institution, any of the criteria specified in Schedule 3 to the Act is not or has not been fulfilled, or may not be or may not have been fulfilled in respect of the UK subsidiary. In respect of UK subsidiaries Schedule 3 to the Act has effect as if paragraph 7 (minimum initial capital) were omitted.

(1) These are financial institutions which are UK subsidiary undertakings of UK authorised institutions which meet the requirements of regulation 23(1) of the Regulations.

(2) As defined in the Regulations.

(3) The Bank's interpretation of the Schedule 3 criteria is set out in relation to authorised institutions under the Banking Act in its policy on the assessment of proposed branch applications. It of the Act can be found on page 22 of the booklet.

# The Banking Coordination (Second Council Directive) Regulations 1992: Schedule 7 (paragraph 6)

## 1 Introduction

1.1 The statement is made pursuant to Schedule 7 (paragraph 6) of The Banking Coordination (Second Council Directive) Regulations 1992 (the 'Regulations'). This requires the Bank to publish a statement of the principles in accordance with which it is acting or proposing to act in exercising its power to restrict the listed activities of a 'UK subsidiary'.<sup>(1)</sup>

1.2 This statement of the principles the Bank has adopted for determining when, and, if so, in what way, to exercise its powers to impose a restriction on a UK subsidiary, encapsulate the main standards and considerations to which the Bank has regard in exercising its supervisory responsibilities in respect of those institutions. The principles are likely to require development over time in the light of, inter alia, the Bank's experience in cooperating with EC home State authorities within the framework of the memoranda of understanding which are being agreed with those authorities, and any further clarification of the interpretation of the Second Banking Coordination Directive by the EC or the Courts. The Bank will publish revised versions of this statement should there be significant developments in its approach.

## 2 Principles relating to the imposition of a restriction on the listed activities of a UK subsidiary

2.1 Regulation 23 grants the Bank power to impose a restriction in relation to the listed activities<sup>(2)</sup> carried on in the UK by UK subsidiaries. The power of the Bank to impose restrictions under regulation 23 is

available only in respect of those UK subsidiaries to which regulation 22(1) applies.

2.2 A restriction means a direction that a UK subsidiary to which section 22(1) applies—

- (a) may not carry on in the UK any listed activity which is specified in the direction; or
- (b) may not carry on in the UK, otherwise than in accordance with such condition or conditions as may be specified in the direction, any such activity which is so specified.

Subsection (4) of section 12 of the Banking Act (examples of conditions that may be imposed) applies for the purposes of this regulation.

2.3 Regulation 23(2) provides that the Bank may impose such restriction as appears to it desirable where it appears that the situation as respects the UK subsidiary is such that, if it were authorised by the Bank under the Banking Act, the Bank could revoke its authorisation on the ground specified in section 11(1)(a) of the Act. Therefore, the Bank's power is exercisable if it appears to the Bank that, if the UK subsidiary were an authorised institution, any of the criteria specified in Schedule 3 to the Act is not or has not been fulfilled, or may not be or may not have been fulfilled in respect of the UK subsidiary. In respect of UK subsidiaries Schedule 3 to the Act has effect as if paragraph 6 (minimum initial capital) were omitted.<sup>(3)</sup>

(1) These are financial institutions which are 90% subsidiary undertakings of UK authorised institutions which meet the requirements of regulation 20(3) of the Regulations.

(2) As defined in the Regulations.

(3) The Bank's interpretation of the Schedule 3 criteria as they apply in relation to institutions authorised under the Banking Act is set out in the Statement of principles issued under section 16 of that Act (see pages 3-20 of this booklet).

