Overseas and foreign banks in London: 1962-68

An article in the September 1961 *Bulletin* described the history and development of the overseas and foreign banks in London. This article traces the rapid growth in their business in more recent years. Comprehensive statistics are available only from 1962 when, partly as a result of the Radcliffe Committee's recommendations, the returns provided by certain banks were extended to cover all the overseas and foreign banks with branches in London.[1] Since then, the number of contributors has increased from 82 to 108 and gross deposits have more than trebled. These banks now account for 34% of net deposits with banks in the United Kingdom – compared with 19% in 1962.

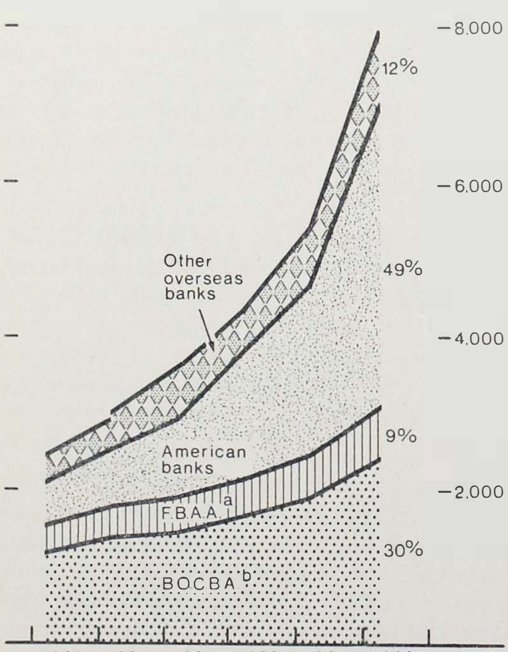
The overseas and foreign banks (from now on referred to as the overseas banks) comprise about 15 head offices of British banks, most of which operate mainly overseas, and more than 90 London branches or subsidiaries of Commonwealth and foreign banks. In the published figures they fall into four groupings: the British Overseas and Commonwealth Banks Association (B.O.C.B.A.), the American banks in London, the Foreign Banks and Affiliates Association (F.B.A.A.), and other overseas banks. The last group (figures for which are now shown separately in the annex)[2] is particularly heterogeneous, including as it does such diverse elements as the Japanese banks and, for example, Barclays Bank (France) and Moscow Narodny Bank. All the groupings have grown since 1962, but the numbers of the American and "other overseas banks" have increased most (the Americans by six and the "other overseas banks" by 14); and the American banks' deposits have risen fastest. New offices are still being opened; as many as 20 more banks, three quarters of them American, have recently made enquiries about setting up London branches. A further sign of expansion is the opening of second branches; ten of the existing American banks now have offices in the West End as well as the City, and several banks have opened branches outside London. The business of these branches is included in the statistics quoted in this article.

Even allowing for the increase in numbers, the rate of growth in the business of the overseas banks has been extremely rapid, as Chart A shows.[3] An important reason – particularly in the case of the American banks – has been London's development as one of the main centres of the euro-dollar market. Business has also been attracted by the development during the last few years of 'secondary' or 'parallel' sterling money markets, mainly the inter-bank and local authority temporary markets, which have added considerable range and flexibility to the call-money facilities already available in London.

A more detailed analysis follows of the overseas banks' main liabilities and assets.

Chart A £ millions

Total reported liabilities

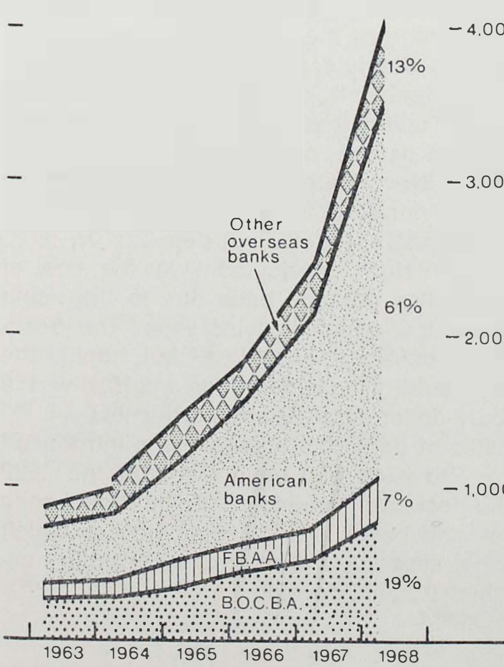


a Foreign Banks and Affiliates Association.
b British Overseas and Commonwealth Banks Association.

1 See the note "New banking statistics" in the December 1962 *Bulletin*.
2 Table 10 of the annex distinguishes, for the first time, between "other overseas banks" and certain other banks in the United Kingdom.
3 In this, as in succeeding charts, all annual figures relate to returns at the end of March.

Chart B £ millions

Currency deposits of non-residents



Liabilities

Gross deposits of the overseas banks were close on £8,000 million in March 1968 and, if they continue to grow as they have recently, they will soon rival those of the clearing banks – some £10,000 million at mid-May 1968. But this comparison is in some ways misleading; about one quarter of the overseas banks' deposits represents inter-bank balances (mostly with each other), compared with only $2\frac{1}{2}$% of the deposits of the clearing banks. It must also be borne in mind that about three quarters of the deposits are in foreign currency, the value of which was considerably increased in sterling terms by devaluation; by contrast, the clearing banks' foreign currency deposits are very small.

Foreign currency deposits

Two thirds of the banks' foreign currency deposits (nearly £6,000 million at end-March 1968) come from overseas residents, a quarter from other banks in the United Kingdom, and the rest from other U.K. residents. The greater part of the total consists of euro-dollars, that is, dollar balances held outside the United States. The rapid development of the London banks' foreign currency business was described in an article in the June 1964 *Bulletin*.[1]

Overseas residents Over half these banks' non-resident deposits come from Western Europe, with Switzerland (including the Bank for International Settlements) the largest single contributor; the United States and Canada are other important sources of funds. In all, about 75% of overseas residents' deposits are from banks (including a comparatively small amount from central monetary institutions), and there is a growing proportion from companies, for example, international oil companies. The American banks attract over half of all non-resident deposits; nearly two thirds of their total liabilities are now of this kind. Chart B plots the increase of non-resident deposits over the last six years; its similarity to Chart A (total liabilities) shows that the growth of the overseas banks' business owes much to the evolution of the euro-dollar market.

U.K. residents Currency deposits of U.K. residents other than banks are small (about £150 million at end-March 1968) because the amount of foreign currency that U.K. residents may hold is strictly regulated by exchange control. Resident deposits consist largely of holdings of investment and property currency[2] and the permitted working balances of British oil, mining, insurance and shipping companies with overseas interests.

U.K. banks The remaining currency deposits come from other U.K. banks. They amount to about £1,500 million, and mostly represent sums that are being employed in the inter-bank euro-dollar market. The market serves to absorb or supply funds when an individual bank is unable from its own resources to match available funds with requirements; interest rate margins between banks are, naturally, narrower than those between bank and customer. The American and the Japanese banks have for some time been net borrowers

1 "U.K. banks' external liabilities and claims in foreign currencies."
2 See the article "The U.K. exchange control: a short history", in the September 1967 *Bulletin*, pages 258-9.

in the market, because they have a ready demand for funds from their head offices. The banks which on balance supply funds to the euro-dollar market are mainly the members of the F.B.A.A. (about £90 million at end-March 1968) and the B.O.C.B.A. (£80 million). However, many other banks may choose to make temporary deposits in this market.

Certificates of deposit

The most recent development in the euro-dollar market has been the issue of certificates of deposit. In May 1966 First National City Bank introduced to London the negotiable dollar certificate of deposit – a type of instrument that had been well received in New York. Certificates are issued with a comparatively low minimum denomination ($25,000) and yield about $\frac{1}{8}$% less than the corresponding euro-dollar maturity. Most are for terms up to one year, though some are longer-dated. The London market consists mainly of certificates issued by American banks, but other banks have been quick to follow their lead. At the end of March 1968 11 American and 15 other banks had issued certificates. There is also a secondary market dealing in the certificates.

The merit of the certificate of deposit is that the holder can earn rates very little below those offered for a fixed term deposit, but can still, if necessary, draw on the funds before the deposit matures, by negotiating the certificate in the secondary market. Negotiability proved a particularly attractive feature when the certificates were introduced in New York, where under regulation Q no interest can be paid on deposits under 30 days and strict limits are set on all time deposit rates. The introduction of certificates of deposit has added to the facilities available for the investment of short-term funds in London. But it is difficult to say to what extent it has brought in new money, for many holders will have switched out of ordinary euro-dollar deposits to take advantage of the certificates' liquidity and of the fact that they are widely accepted as good collateral. In the two years since their introduction, certificates to the equivalent of over £300 million have been issued (over £200 million by the American banks), of which £70 million are at present held by banks. Nevertheless, this compares with an increase over the same period of more than £2,000 million in ordinary currency deposits (excluding deposits by U.K. banks). The relatively slow development in the use of certificates of deposit has perhaps been due to the rising trend in euro-dollar rates, which has increased the desirability of lending euro-dollars at short-term; but, should the trend be reversed, liquidity considerations might divert a higher volume of euro-dollar deposits into certificates.

Sterling certificates of deposit are likely to be introduced in the near future. Provision has been made in the 1968 Finance Bill for the necessary amendment of the exchange control regulations, and banks and discount houses which are likely to make a secondary market are currently considering ways in which it could develop.

Sterling deposits

Sterling deposits with overseas banks fall into two main categories: the working balances of traders or customers with overseas connections (for instance British subsidiaries of American companies); and sums deposited primarily as investments to earn interest. The overseas banks are able to operate on narrow margins. They hold comparatively few personal accounts, the average deposit with them is much larger than is found in a clearing bank, and the accounts work less frequently – all of which bring savings in costs. They are also prepared to offer an appreciably higher return than the two points below Bank rate traditionally paid by the clearing banks on deposit accounts. At the same time, the overseas banks take a greater proportion of their deposits at relatively long term, as compared with the non-interest-bearing current accounts which provide the clearing banks with so much of their funds. Excluding balances held on behalf of other banks, about 75% of resident sterling deposits with the average overseas bank are on deposit account: for deposits from overseas, the proportion is probably higher. Only some 40% of the deposits with the clearing banks are on deposit account; even these are at only seven days' notice.

U.K. residents U.K. residents provide 40% (about £600 million) of the sterling deposits with the overseas banks – again, excluding inter-bank business. The overseas banks compete keenly both among themselves and with the merchant banks for the medium-term funds that are offered – mostly by industrial and commercial companies, but also by investment trusts, finance houses and insurance companies. Until recently there was some evidence that these banks were gaining deposits at the expense of the clearing banks, which – as already noted – pay lower rates of interest on deposit accounts; but the clearing banks now appear to have checked this trend by setting up special subsidiaries offering higher rates for deposits.

Overseas residents The sterling deposits of overseas residents with the overseas banks amounted to about £1,000 million at the end of March 1968, but can fluctuate substantially over short periods. They are held by foreign banks or central monetary institutions and by commercial clients of overseas branches, in particular foreign exporters who place funds in London for investment or trading purposes. Some of these funds may be quickly removed when higher rates are available elsewhere. The gross interest offered (usually around Bank rate on a three months' deposit) is not necessarily the rate that will determine whether such an investment is profitable, since, in periods of pressure on sterling, the cost of forward cover may have to be allowed for. Nevertheless, even when covered forward a sterling deposit often yields a return comparing favourably with rates in other European centres or with the yields offered on euro-dollars.

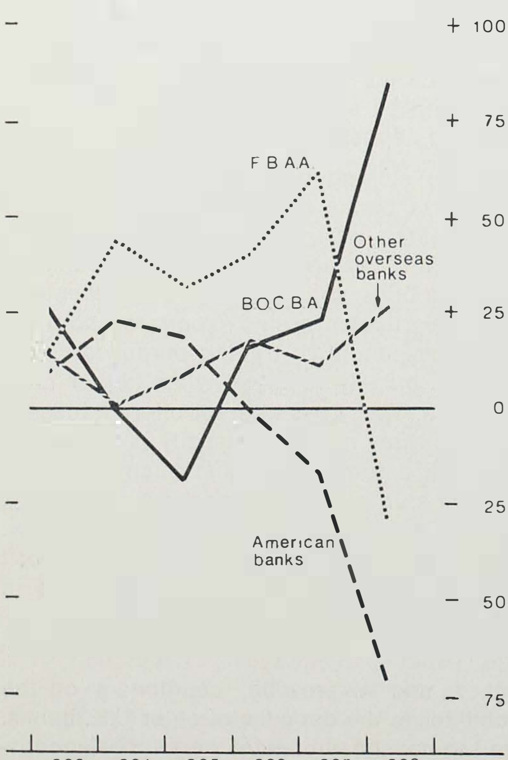
U.K. banks Another, and a growing, component of the banks' sterling liabilities is the deposits of other U.K. banks. Such deposits used to consist entirely of working balances – mainly with the clearing banks. In recent years, however, there has been a sharp increase, reflecting the growth of the inter-bank sterling market, in which the overseas banks and the accepting houses are the main operators. The growth of this market can be linked with the development of the local authority temporary money market (described later in this article), in which the overseas banks place much of their non-resident money. Whereas local authority loans are sometimes for a three months' term or more, overseas funds are often highly volatile. The inter-bank market in sterling, with its facilities for very short-term – if necessary overnight – borrowing, provides a convenient buffer against unexpected withdrawal of such deposits. At the same time there has been a ready supply of short-term funds from banks wishing to earn more than can be obtained on the more conventional call money with the discount market. Some of these banks choose not to invest direct in the local authority market, but are glad to be able to obtain broadly comparable terms in the inter-bank market.

Rates in the inter-bank market in sterling are usually close to those charged to local authorities, but may be considerably higher, for example, at the end of the half year when balance sheets are made up, or at times when there is a general shortage of sterling in the London market.[1] As suggested earlier these rates are nearly always above those which would be offered by the discount market for money at call. The minimum transaction is usually £50,000 and, in contrast to practice in the discount market, lending is unsecured. The total liabilities outstanding in the market, although increasing year by year, are prone to sharp seasonal fluctuations; for example the volume of funds increases by about £50 million towards the end of each quarter, and falls again in the first month of the following quarter.

The aggregate totals of deposits by U.K. banks published in the annex[2] are gross figures. This needs to be remembered when assessing the size of the market, because funds may be on-lent several times and thus feature in more than one bank's return. On balance, the overseas banks collectively are net lenders of funds in the inter-bank market. Chart C illustrates the net position of the various groupings; the members of B.O.C.B.A. and the other overseas banks on balance provide funds, whereas the F.B.A.A. banks and the American banks are net borrowers. This has not always been the case however. The F.B.A.A. banks and the American banks were both formerly net lenders; for American banks, the change reflects decisions by a number of them to invest more in the local authority market, at the expense of inter-bank lending.

Chart C £ millions

Net lending in the sterling inter-bank market *



* The figures include working balances with clearing and other deposit banks.

Assets

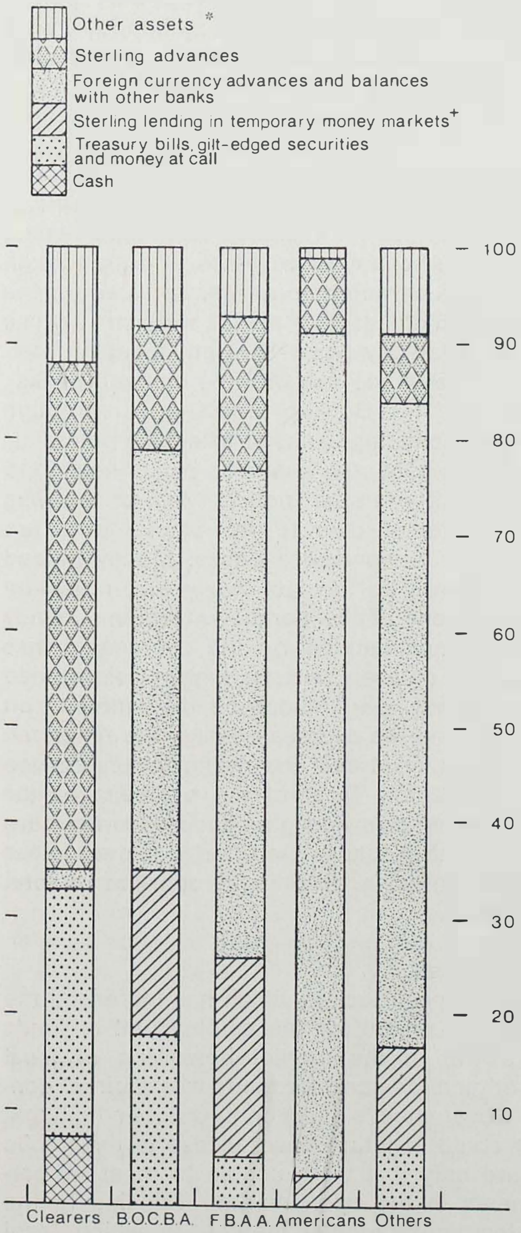
The assets structure of an overseas bank differs fundamentally from that of a clearing bank (Chart D). Just as an overseas bank pays more for its funds, so it generally seeks a somewhat higher return from its assets. There is no standard liquidity ratio, and advances, most of which are for longer terms than a clearing bank would offer, are often about 60%, and can be over 90%, of total assets. Moreover, in place of the traditional readily marketable assets (cash,

1 Such a shortage may result when heavy settlements are being made for foreign exchange: on 21st November 1967, the first working day after devaluation, exceptional rates up to the equivalent of 600% a year were quoted.

2 Table 10.

Chart D Per cent

Assets structure at March 1968



* Commercial bills, special deposits and other investments.
\+ Mostly the local authority and inter-bank markets.
"Others" means other overseas banks.

bills, gilts, money at call), the overseas banks specialise in the inter-bank and local authority markets, where yields are higher but funds are not necessarily realisable on demand. On the other hand, whereas all but their shortest assets are liable to be less liquid than those of a clearing bank, the placing of short-term funds can be highly flexible. The existence of several temporary money markets makes it easy for an overseas bank to move funds from one to the other as the pattern of interest rates shifts, or to arbitrage by borrowing in one market and lending in another. Accordingly the structure of assets may change rapidly.

Banks are also able to 'switch' foreign currency funds into sterling and out again (though under exchange control regulations what they have switched into sterling must, within narrow limits, be covered in the forward exchange market). The extent to which they switch in varies considerably from time to time, and is influenced by international interest rate comparisons, the cost of obtaining forward cover, and other considerations such as the state of confidence in particular currencies. At the end of March 1965, a net £250 million which had been deposited with the overseas banks in foreign currency was being employed in sterling assets. In March 1966 and 1967 the equivalent figure was about £100 million. But in March this year the banks' currency assets and liabilities were broadly in balance.

It is difficult to justify any particular liquidity ratio for an overseas bank. The clearing banks' conventional level of 28% is not necessarily appropriate. Foreign banks, which have the backing of their head office or parent abroad if money should become tight, can afford to have a relatively illiquid structure, although they normally like to retain a degree of flexibility so as to be able to take advantage of any change in interest rates and to avoid being forced to bring in funds from abroad at times or on conditions that may be disadvantageous. The position of the British banks with branch networks overseas is quite different; they have to be ready to provide immediate support for any of their branches, in addition to maintaining the degree of liquidity dictated by their London business. Partly for this reason, and partly for banking prudence, they must retain a higher proportion of conventional liquid assets.

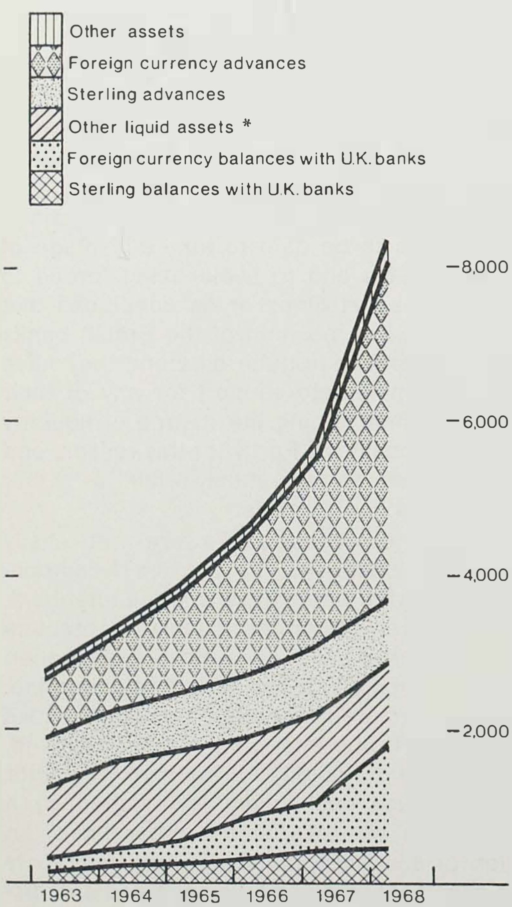
The liquid assets of overseas banks are not easily identified by the outside observer. The two main components, balances with other U.K. banks (loans in the inter-bank market) and loans to local authorities, consist in practice of a wide range of maturities. Without a close examination of each portfolio, its true liquidity is impossible to determine. It also needs to be remembered that while individual banks may regard funds placed in the inter-bank market as liquid, the market is not a source of liquidity for the banking sector taken as a whole, because each claim is matched by a liability elsewhere in the system. On the other hand, an unknown proportion of advances, which are not commonly regarded as liquid assets, constitutes bills accepted and discounted, which may be fully negotiable. This is because it is customary, when a bank discounts its own acceptances, for the sums involved to be included among advances.

Even with an apparently low liquidity ratio, it is possible for an overseas bank to retain its manoeuvrability by ensuring that any long or medium-term liability that falls due is matched by simultaneously maturing assets. The development of overnight facilities in the inter-bank market has now made it possible to match a much higher proportion of liabilities, because small discrepancies in maturities can be tided over at little cost.

As Chart D shows, the asset structures of the various groups of banks vary widely. But the groups themselves are not homogeneous, and there are large variations between the banks included within them. For instance, ten banks (including seven American) account for 50% of the reported assets of all the overseas banks; and it may happen that a large bank with a high proportion of the funds in a particular group in effect determines the pattern for that group.

Chart E £ millions

Total reported assets



* Cash, bills, money at call, loans to local authorities, and gilt-edged securities.

Liquid assets

Notes, coin and balances with the Bank of England are very small. The counter business of British overseas banks is restricted mainly to services for overseas customers visiting the United Kingdom on holiday or business, and the foreign banks confine themselves mainly to similar services for the customers of their head offices. Companies will normally use a clearing bank for everyday business. Settlement of inter-bank transactions is not made (as with the clearing banks) through accounts with the Bank of England, but through balances held with the clearing banks or with each other.

At the end of March 1968, the overseas banks held £115 million in money at call and short notice. Most of this was lent to the discount market, over 10% of whose funds are generally provided by the overseas banks. Money placed at call has fallen sharply in the last two years, reflecting the increasing attractions of the parallel short-term money markets. The rates commanded by the overseas banks naturally vary, but tend on average to be slightly below those on clearing bank money, partly because the amounts on offer are smaller. Among the overseas banks, the American banks lend relatively little at call and the main lenders are the members of B.O.C.B.A. Most of the overseas banks' investments in Treasury bills and gilt-edged securities are also held by the B.O.C.B.A. banks. As Chart E shows, 'other liquid assets' have formed a declining proportion of total assets in recent years.

Loans to local authorities

A development in the past decade which has increased the facilities available in London for the employment of funds has been the growth in the market borrowing of local authorities. The original demand for funds was a direct consequence of the Government's decision in October 1955 that a local authority could in future have access to the Public Works Loan Board only if it were unable to meet its borrowing requirements in the open market. This led to the evolution of a temporary money market[1] in which local authorities raised a significant proportion of the funds they required. The success of the market was soon assured; lenders were keen to place liquid funds with first class

1 See pages 341-3 of the December 1966 *Bulletin*.

names who were prepared to offer yields above those in the call money market; while local authorities were content to pay lower rates of interest than they would be charged on most longer-term borrowing. As much as 80% of temporary borrowing is currently for seven days or less. The normal unit is £50,000 (although smaller amounts may be accepted at marginally lower rates) and loans are secured on local rate revenue.

The overseas banks' loans to local authorities consist predominantly of funds placed in this temporary market, although lending on overdraft is classified under the same heading. The money lent often represents currency deposits that have been switched into sterling, particularly when the local authority rate (after adjustment for the cost of forward cover) compares favourably with rates in the euro-dollar market.[1] At the end of March 1968, loans by the overseas banks amounted to £360 million, about one sixth of all temporary money borrowed by local authorities. The members of B.O.C.B.A. provided about half this amount, and the F.B.A.A. banks a further quarter. By contrast, the clearing banks do not place funds in this temporary money market, although they make advances to local authorities. Their subsidiaries, however, are now taking an increasing part in the market.

The other main type of liquid sterling asset held by the overseas banks is "balances with other U.K. banks". This category consists mostly of loans in the inter-bank market described earlier, but it also includes sterling working balances with other London banks. Similarly, foreign currency advances to other U.K. banks reflect loans made in the euro-dollar market, which has also been described, and working balances in currency.

Advances

The finance of overseas trade – whether between the United Kingdom and other countries, or wholly between other countries – remains the prime purpose for which the overseas banks advance money to the private sector; and the growing size and range of the foreign banks mean that this service is becoming increasingly international in scope. Other kinds of finance are, however, being provided on a growing scale, for instance in the form of euro-dollar loans to the foreign banks' head offices abroad or to large international companies operating in Europe.

The terms on which an advance is made differ in some respects from those which would be acceptable to a clearing bank; the duration of the loan is often considerably longer and the minimum amount usually much higher than the quite small sums that a clearing bank may on occasion grant to an individual borrower. Furthermore the range of rates is wider, depending on the borrower and the type of business involved. The foreign banks may offer particularly favourable terms to long-standing customers of their head offices, and in these cases security is often deposited with the head office, or a charge taken on the parent company. Over 80% of the overseas banks' total advances are denominated in foreign currencies, euro-dollar loans to non-residents being by far the largest element.

1 Table 23 of the annex.

U.K. residents Advances to U.K. residents other than banks amounted to £800 million at the end of March 1968, mostly in sterling. Official restrictions, first imposed early in 1965, have limited the rate of growth of sterling advances, but several of the overseas banks have been able to accommodate new demands for funds by lending in foreign currencies to U.K. residents who have obtained the necessary exchange control permission to borrow. The American banks in particular have expanded their euro-dollar lending to the subsidiaries of U.S. companies operating in the United Kingdom, and their currency advances to U.K. residents increased from almost nothing at the beginning of 1965 to £125 million in March 1968. Despite this growth, foreign currency advances still account for only one fifth of total advances to U.K. residents by the overseas banks.

The breakdown of the banking sector's assets[1] and the quarterly analysis of banks' advances[2] suggest that most of the overseas banks' domestic lending goes to companies and a relatively small share to the personal sector. Proportionately little is advanced to agriculture, textile manufacturing or retail distribution, but an above average amount to local government, other forms of distribution, chemical manufacturing and mining.[3] The last two are sectors in which subsidiaries of U.S. corporations are strongly represented. Substantial amounts are also lent to the financial institutions, both through advances and a temporary money market, which is run alongside the local authority market, to channel funds to the hire purchase finance companies.

Overseas residents Advances to overseas residents – over £4,000 million at end-March 1968 – make up the bulk of the overseas banks' advances and, indeed, about half their total assets. About 95% of these advances are denominated in foreign currency, mainly euro-dollars. Only one fifth of the total goes to commercial customers. Advances range from short-term bridging and trade finance to loans of up to five years or perhaps longer – when bank borrowing becomes an alternative to euro-bond issues. The remainder is lent to banks overseas, representing mainly loans to the head offices of the American and Japanese banks. The American banks have been keen to take funds through their London offices,[4] because such funds are then not subject to the Federal Reserve Board's reserve requirements or other charges; whereas the Japanese have been able to finance part of their economic expansion with euro-dollars, in the same way as Western Germany and Italy were able to do in the early 1960's. Sterling advances (about £200 million at end-March 1968) are mostly made by members of the B.O.C.B.A. and are for the finance of Commonwealth trade, and operations in those overseas territories where the banks have branch networks.

The American banks account for over 65% of currency advances to overseas residents, reflecting not only the provision of funds to their head offices described above but also finance for the growing industrial investment by the

1 Table 8 of the annex.
2 Table 11.
3 Mining includes exploration for North Sea gas.
4 Especially at times when money has been tight in the United States.

United States on the Continent. The members of B.O.C.B.A. and the "other overseas banks" as groups each contribute about 15% of the total; but whereas the "other overseas banks" lend almost entirely in euro-dollars, advances by the members of B.O.C.B.A. include some in other sterling area currencies – mostly by the Australian banks. A broad indication of the direction of lending to overseas residents can be obtained from the annex[1] which provides an analysis by countries of the external claims of U.K. banks (predominantly the overseas banks). Lending in sterling is fairly small and, as would be expected, mostly to sterling area countries. Currency claims are predominantly in U.S. dollars and mainly represent advances to the United States and to Western Europe, especially Western Germany, France, Italy, Switzerland and Belgium.

Commercial bills and acceptances

Besides making advances to importers and exporters, the overseas banks also accept bills (which they may themselves discount) on behalf of trading customers, and discount bills drawn on other traders, merchants, or banks. There has been no pronounced change in reported holdings of commercial bills in the past few years, and the B.O.C.B.A. banks are the only group to hold them in any quantity; but, as mentioned earlier, bills both accepted and discounted by the same bank are classified under advances, and the figures for acceptances give a better indication of the amount of trade being financed. There has been a moderate but steady increase in acceptances in the last few years. With sterling acceptances subject to credit restrictions, the growth that has occurred has been in currency business.

Other business

The world-wide scope of the overseas banks means that they are able to provide services on an international scale. The British banks operating overseas give advice on investment opportunities in the territories in which they specialise and do much to foster trading contacts; the foreign banks in London provide similar services for their own nationals, or for British customers trading with the banks' home countries. They provide travel and foreign exchange facilities and, as dealers, arrange the transmission of funds from centre to centre. Transactions in foreign shares are undertaken, and security departments will hold documents of title, if necessary, for exchange control purposes, and will collect interest. Advice on taxation, and investment and trustee facilities may also be provided.

In the past few years, the financial facilities offered by the City of London have been further refined and developed; to this process the overseas banks have contributed in no small degree. As their number and range have grown, the services they offer have been extended, and a stimulus has been given, not only to their direct competitors, but ultimately to the banking system as a whole.

1 Tables 19 and 20.