Bank of England
London EC2R 8AH

The Governor

9 November 1984

CH/EXCHEQUER

REC.	- 9 NOV 1984
ACTION	MR HALL
COPIES TO	SIR P. MIDDLETON
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	MR CASSELL
	MR MONCK

MR LANKESTER
MR ILETT
MR CULPIN

The Rt Hon Dr David Owen MP
House of Commons
London
SW1A 0AA

Dear Dr Owen

I know the Chancellor has written to you in response to your letter of 2 November concerning Johnson Matthey Bankers, indicating that he believes it would be right for me to reply to the points which you raise. As he said in his reply to your letter, the decision to intervene to rescue Johnson Matthey Bankers was a matter for the Bank of England, although the Chancellor was informed before the decision was implemented.

I will deal with the points which you make in your letter in the order in which you raise them.

It is not correct to say that Johnson Matthey Bankers' principal earnings were made on commercial loans, nor that the profits of these loans compensated for losses made on its bullion business. Johnson Matthey Bankers has made profits in every year from its dealing operations since at least 1980, and indeed for each of the years between 1980 and 1984 these operations, which primarily reflect its bullion business, were responsible for over three-quarters of the total. It is true that Johnson Matthey PLC experienced losses in its jewellery business during 1983 and that knowledge of these losses was widespread. That business and these losses, however, had nothing to do with Johnson Matthey Bankers.

We do not agree that all the available evidence suggests that bullion business is generally unprofitable for participants in these markets. Trading in bullion markets has been quiet for the last year or so and opportunities have been correspondingly reduced. It remains to be seen how long the quieter conditions in these markets will persist. Notwithstanding the quieter conditions, however, the published reports of all of the principal bullion dealers in the UK indicated that they traded profitably in 1983, in some cases in substantial degree.

You suggest that the Bank has failed to give an affirmative answer to the question whether it is prepared to stand behind the subsidiaries of Johnson Matthey Bankers. In the immediate aftermath of the rescue of the bank, we naturally received enquiries from its counterparties in many countries regarding our relationship with it and its subsidiaries. We have replied on the following lines:

> "Johnson Matthey Bankers and its subsidiaries are now wholly-owned by the Bank of England and as such may be considered undoubted for all their engagements."

We do not accept that the outlook for nearly all of the subsidiaries is poor. The subsidiaries have consistently made a significant contribution to the profits of the group and our preliminary examination gives no grounds to believe that they will not continue to do so.

You have been misinformed that a number of other bullion dealers and banks involved in the rescue did not believe that the London gold market was in danger. None of the banks involved expressed this view at the time of the rescue and it was and remains the unanimous view of the members of the London gold market that the market would have been badly damaged by the failure of Johnson Matthey Bankers.

An indemnity agreement, of which the Bank's share is 50%, has now been agreed to cover up to £150 mn of possible losses over and above those of £167 mn matched by the bank's capital and provisions. This indemnity covers only losses on the commercial loan book, since this is the particular area of the bank's business where losses are expected to arise. Since the Bank stands behind JMB as owner, any sharing of possible losses reduces the potential cost to the Bank correspondingly. The increase in the indemnity from that originally discussed does not imply an expectation of increased losses on the commercial loan book. The work to establish the scale of these losses has not been completed and in the meantime it seems prudent to put in place an indemnity which limits the Bank's exposure to loss and demonstrates the support of the banks for the system.

At the time of the rescue Johnson Matthey PLC acknowledged their responsibility for Johnson Matthey Bankers, but they were clear that they could not by themselves re-establish its net worth. It was against this background that the package involving an injection of capital from Johnson Matthey PLC was decided upon as the most appropriate and effective arrangement in the time available. At no time was Johnson Matthey PLC asked by the Bank to give an unlimited guarantee nor did it ever agree to do so.

It is incorrect to state that Johnson Matthey Bankers' difficulties arose from the Bank of England's failure to regulate the bullion and commodities markets. The difficulties of the bank arose exclusively from its commercial lending operations.

The Bank has not claimed to have known for more than a year that Johnson Matthey Bankers was getting into difficulties. Whilst we had some general concerns about the bank, the existence of problems in its commercial loan book became apparent only during the summer of this year.

Yours sincerely,

R. Leigh-Pemberton