Meeting with Governor

(B)

14 May 1985

PRIME MINISTER

JMB

The announcement of total provisions of £245 million against total loans of £450 million at Johnson Matthey Bankers comes as no surprise - we knew the news was going to be bad. The original suggestion by the Bank that they would return JMB early to the private sector has slipped, and the cost has mounted. It is doubtful whether the Bank will recover the £100 million of special deposit which it made last year, and which it is now converting into equity and loan capital. Nonetheless, the Bank should be encouraged to press on with the task of restructuring and returning to the private sector as soon as possible, and writing off any loss as an unfortunate episode in its history as a regulator.

The Bank's Press Notice publicly denies this.

Walter Salomon has sent me the attached memorandum concerning banking supervision, which he has asked that I show to you.

He is right that the system of banking supervision needs a substantial overhaul, and it may well need new blood to strengthen the vigilance of the regulators. At the moment we have the worst of all possible worlds. The system is reluctant to take early action to limit banks building up unreasonable exposure. And yet, when the position becomes obvious - as with JMB - the Bank is all too ready to take it over and to pump public money in to pay for the costly mistakes that have been made.

This ignores the fact that Johnson Matthey PLC lost £180 million, though it is not clear whether all the guilty executives have lost their jobs.

This means that for many banks there is no encouragement in the system to be prudent, as they know that ultimately they can be bailed out by the Bank of England; whilst the effort that goes in to monitoring and regulating is wasted for most of the time, as nobody is prepared to take a hard decision early enough to prevent disaster.

I suggest that I say to Sir Walter that you are interested in his views, and that the appropriate time to review it is when the Report is available on JMB.

JR

JOHN REDWOOD

M E M O R A N D U M

1. There can be no doubt that the Banking Act and Banking Supervision need a thorough overhaul.

2. The first point is that it should be seriously considered (as in other countries) that banking supervision is taken out of the hands of the Bank of England and an independent authority set up to deal with it.

3. When the Banking Act was originally introduced I gave an address at The Institute of Bankers City of London Centre on 1st April, 1980, a copy of which I have already sent to you, in which I explained my reservations about it. I think events have proved how right I was.

4. The present supervisory authority consists of a number of people hardly any of whom can be called "practical bankers".

5. When I challenged Peter Cooke as to where they got their knowledge to enable them to make their judgments, he said they learned it by doing it, to which I retorted that this might be an extremely costly and not necessarily successful cooperation. Again, I have not been far off the mark.

6. The recent case concerning Johnson Matthey is, in my opinion, a glaring example of total inefficiency and inexperience. Those responsible are still in charge of banking supervision. If this were a private enterprise business I assume the Board would have dismissed them straight away.

7. However, as our friend does not like criticism without practical suggestions as to what should be done, here are my practical suggestions which are, of course, open to discussion.

- A separate supervisory body should be formed.
- In the first instance this should be by way of a loose consultant committee, and here are the names of those I would suggest:

Apart from Sir Peter Middleton and his officials -

From the Bank of England - one should call on Mr. George Blunden and, of course, the Governor could ex gratia always attend every meeting.

From the banking side - I would suggest Sir Timothy Bevan, Chairman of Barclays Bank, and as well Mr. D. Vander Weyer, formerly Deputy Chairman of Barclays Bank.

From the industrial side - I would suggest Dr. David V. Atterton of Foseco Minsep.

A further member should be Mr. Robin Hutton, Director General of the Accepting Houses Committee, and he should be appointed Secretary to the Committee.

As temporary consultants before the thing is finalised I would recommend Lord Seebohm and, with due humility, myself as both he and I have got the practical experience which might be helpful to the committee.

I recommend also The Rt Hon Sir Patrick Nairne, GCB MC, formerly Permanent Secretary at the Ministry of Pensions, and now Master of St Catherine's College, Oxford.

WHS
22.4.1985

File

JOHNSON MATTHEY BANKERS : CAPITAL REORGANISATION

Background

1. The capital reorganisation is intended to provide JMB with a capital base on which it can reasonably continue business and to facilitate its return to the private sector as soon as practicable. The reorganisation entails the injection of £100m of capital (£50m ordinary, £25m redeemable and £25m subordinated loan stock). Existing capital will be cancelled. The Bank's announcement yesterday explained that the capital injection does not involve a fresh commitment of resources since the provision of new capital will allow the deposit of £100m made by the Bank last year to be repaid. (Deposit was public knowledge at the time.)

2. The Bank also announced that on the latest estimate of JMB's losses existing capital will be absorbed and the indemnities provided by the Bank and the private sector banks called to be extent of £65m. Half of this figure will be met by the Bank. The £100m of new capital therefore represents full value in the company, not offset by provision for losses.

Line to take

Q: More public money at risk?

A: No. The Bank became responsible for JMB last year. Recapitalisation no more than a visible expression of that commitment. Will also enable repayment of £100m deposit with JMB made by the Bank last year.

Q: If nothing has changed, why has it been done?

A: To provide confidence and enable JMB to continue business on a proper footing, and to facilitate sale back to private sector as soon as practicable and for the best possible price.

Q: Public entitled to full account of JMB affair?

A: Chancellor to report to House soon on review of banking supervision. Bank of England's annual report will include account of events at JMB and rescue operation.

HMT 14 May 1985

Bank of England
Press Notice

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JOHNSON MATTHEY BANKERS: CAPITAL REORGANISATION

After six months' ownership of Johnson Matthey Bankers (JMB) and in order to facilitate its return to the private sector as soon as practicable, the Bank of England intends to reorganise the capital of JMB. The reorganisation will entail the injection of £50 million of Ordinary £1 shares, £25 million of Redeemable £1 shares and £25 million of subordinated loan stock with a final maturity date of 1995. At the same time there will be a cancellation of £59,999,900 existing issued shares and £15 million unissued shares of £1 each.

The reorganisation will provide JMB, a recognised bank, with a capital base appropriate to its continuing business.

This capital restructuring does not involve a fresh commitment of resources by the Bank of England since the provision of new capital will allow the deposit of £100 million made by the Bank of England in November 1984 to be repaid. The Bank expects its £100 million investment to be returned intact when the Bank's present involvement comes to an end.

The review of JMB's loan portfolio has been largely completed. As at 30 April £225 million of fresh provisions had been identified; taken with the provisions of £20 million made by the previous management, the total of provisions presently recognised by the board of JMB amounts to £245 million. Approximately £130 million of the resources of the JMB Group (prior to the capital reorganisation) and the £50 million contributed by Johnson Matthey PLC have already been absorbed in meeting these losses; the balance is to be met by the indemnity agreement signed in March. The call under the indemnity to be made as at 31 March will be of the order of £65 million of which half would fall to be met by the Bank of England and half by the other indemnitors.

13 May 1985

NOTES FOR EDITORS

In order to carry out this restructuring an order from the High Court is required. The necessary steps to seek such an order are being taken.

2 As a result of these changes the JMB Group will be able to produce a balance sheet as at 30 June 1985 which properly reflects its renewed capital position.

3 The setting of provisions reflects judgments at a particular time. Changing circumstances will indicate whether or not any adjustment of the provisions needs to be made. At the present time, however, and from the information currently available to the board, it is thought that JMB's loan losses are adequately provided against.

4 JMB's problems were brought about by inadequately controlled and imprudent lending to an over-concentration of injudicious loans. Other parts of its business continue to trade profitably.