STRICTLY CONFIDENTIAL

MEETING BETWEEN THE CHAIRMEN
OF THE LONDON CLEARING BANKS AND THE GOVERNORS

WEDNESDAY 21 APRIL 1982 AT 3.30 PM

AT THE BANK OF ENGLAND

The following attended:

CLEARING BANKS

Sir David Barran	Midland Bank plc
Sir Lindsay Alexander	Lloyds Bank plc
T H Bevan Esq	Barclays Bank plc
Robert Leigh-Pemberton Esq	National Westminster Bank plc
Sir George Kenyon DL	Williams & Glyn's Bank plc

BANK OF ENGLAND

The Governor
The Deputy Governor
A D Loehnis Esq
E A J George Esq
A L Coleby Esq

Secretariat	L W Priestley Esq	(CLCB)
	T E Allen Esq	(Bank of England)

1 The minutes of the previous meeting were agreed. There were no matters arising.

2 Monetary situation and prospects

The Governor briefly reviewed the note that had been circulated in advance of the meeting. Having highlighted the major points, he said that the most puzzling phenomenon was the strength of bank lending to the corporate sector. He asked the Chairmen for their views on why companies were borrowing on such a scale at a time when activity was low and pay rises were moderate.

Mr Leigh-Pemberton referred to the increase in lending by his own bank during the four months to March. The increase had been made up by the various sectors as follows.

Manufacturing	33%
Other production	11%
Financial services	-
Services	32%
Personal,excluding housing	7%
House lending	17%

The great bulk, 76% of the increase, had thus been to manufacturing, other production and services, and only 24% was in lending to persons. In seeking an explanation for these trends it was clear that destocking was now over and it seemed that companies were perhaps beginning to build up stocks again. There had been notable rises in lending to road haulage (after the rail strike), to high technology firms and, among the service industries, to the hotel trade. Utilisation of limits was at present some 3%-4% higher than in 1981. As for the increase in bank deposits held by companies, Mr Leigh-Pemberton thought that this reflected a desire for greater liquidity on the part of corporate treasurers and was also perhaps associated with the potential for arbitrage.

Turning to wider issues, Mr Leigh-Pemberton went on to say that he entirely agreed with the assessment in the paper which had been circulated that domestic economic developments were indeed promising. As for likely trends in US interest rates, he had conflicting reports.

One view was that US interest rates were likely to fall by the end of the year - but only because of the level of recession expected to have been reached by then.

Mr Bevan thought that the growth in bank lending to which the Governor had referred reflected a number of factors - destocking had stopped, mortgage lending continued, tax payments were being made, and quarterly interest charges had had some effect. As to the breakdown between the different sectors the increase in Barclays' lending, in money terms, in March had been as follows:

	£ million
Manufacturing	+120
Financial services	+ 54
Services	+ 70
Personal	+ 70

The proportion of limits drawn was steady at some 61% or 62%. The increase in deposits probably reflected accumulation of funds to pay tax and the influence of bill arbitrage.

Sir David Barran said that the most puzzling feature of Midland's lending figures for March was the disappearance of demand from the "other production" category. There was no clear explanation of this - over the past year such lending had risen by about 13%. There had been a small increase in lending to manufacturing and, in proportional terms, a larger increase in lending to services and to persons.

Sir Lindsay Alexander confirmed the previous reports of an end to destocking but said that there was little sign of any actual increase in stocks. There had been some switching from money market borrowing to overdraft loans. Tax payments had also been a factor in the increase in lending. He also noted an unexplained increase in lending to insurance companies and pension funds.

Sir George Kenyon said that Williams & Glyn's personal lending had not increased - partly because they had ceased mortgage lending for the time being, having done enough. The biggest increase had been in lending to services, which category included British Rail, road transport and the professions. Some 30% of the increase was in lending to manufacturing. Industry was, he said, slowly increasing its borrowing from the banks. Even in the North there was a distinctly better feeling. There was demand for funds for restocking and more working capital. He had seen no real evidence of arbitrage.

Mr George took up this last point and said that the Bank of England had been studying the question of arbitrage very closely. A detailed study had been made of relative levels of interest rates and it had been difficult to identify much opportunity for arbitrage. The Bank had also been seeking, without success, specific evidence of arbitrage by clearing bank customers. Mr George emphasised the importance of ascertaining the true position. If arbitrage was indeed occurring on a major scale there were worrying implications for the system of monetary control. But, on the other hand, if the amount of arbitrage undertaken was insignificant it would be useful to be sure that this was the case. He therefore asked the Chairmen if they would arrange for any clear evidence of arbitrage to be drawn to his attention. It would be very helpful if he were able to discuss, on a confidential basis, any relevant movements of funds - without names necessarily being mentioned. The Chairmen agreed, but Mr Leigh-Pemberton emphasised the extreme difficulty of identifying particular transactions.

Mr Bevan then raised the question of whether the Bank would consider extending its money market dealing beyond 3.00 pm to, say, 3.15 pm, so as to reduce the problems of the clearing banks' Treasurers. Mr Coleby responded that this question had been discussed in the Treasurers' Group. The question was far from straightforward and he was inclined to think that the primary problem to tackle was the adequacy of the information systems of those involved in the markets. Mr George pointed to the natural tensions that existed between the clearing bank Treasurers and the Bank of England. There was a danger that if dealing were extended to 3.15 pm the Treasurers would be tempted to lean on their ability to deal late and thus be less inclined to call money from the system, hence making more difficult the Bank's normal methods of money market operations.

In concluding this part of the discussion, the Governor said that the exchanges between the Bank and the clearing banks on the pace of bank lending would, no doubt, be continued.

3 Argentina

The Governor said that the invasion of the Falkland Islands by an Argentine force on 2 April had called for a strong and immediate reaction by the British Government. In the less than three weeks which had passed since then, the Government had not only despatched a naval task force to restore the legitimate government of the Islands, but had also taken a number of steps to bring diplomatic, financial and economic pressure to bear on the Argentine Government in order to persuade it to withdraw its forces from the Islands. What was at stake was, as he had made clear to his central bank colleagues in Basle, not just the fate of some small Islands but the whole question of international order. If the invader were to be allowed to benefit, an important principle would have been lost and wider issues than the Falklands put at risk.

In the UK the freeze had been accompanied by the suspension of ECGD cover for credits on new export contracts and a ban on the export of military equipment from the UK to Argentina. Since then the import of all goods from Argentina, other than those already in transit, had been banned. At the same time, international support had been co-ordinated. The Governor referred to the Security Council Resolution and the EEC decision to introduce economic sanctions. He noted that the EEC steps had been taken with most commendable speed and had given a great boost to the image of the Community in this country.

As to the freeze on Argentine assets, the Governor considered that it would have been unthinkable to have left financial and economic relations with the Argentine untouched after the invasion and at a time when the task force was sailing for the South Atlantic and the possibility of active hostilities loomed. It was not the case that a foreign country's assets had been frozen because of some trivial incident or minor offence. On the contrary, in circumstances amounting to war or near war and (as Mr Yassukovich had commented in his letter to the Financial Times) with London not being an offshore centre, the Government's action had been entirely understandable and justifiable.

The Governor continued that, apart from an initial frisson following the Foreign Secretary's resignation, the markets had stood up extremely well to the strain. In discussions with his colleagues in Basle there had been no criticism whatever of the measures which had been taken. He hoped that the Chairmen agreed that what had been done was right and sensible. The Bank had sought to minimise any risk of unsettling the financial framework in which the international markets worked - for example, by allowing existing loans to be rolled over in accordance with the terms of loan agreements and by making no attempt to impose statutory prohibitions on extra-territorial banking activities. The measures that had been taken were designed neither to prevent Argentina from honouring its commitments nor to encourage banks to call a default in the event of delayed interest or capital payments. But, in conjunction with the damage to Argentina's credit standing which that Government's own actions had brought about, the asset freeze and the other financial and commercial sanctions imposed on Argentina would make life very difficult for the military Junta, adding materially to the many other pressures it faced, and might help towards a speedy and peaceful solution to the crisis. In conclusion, the Governor stressed his gratitude to the banks for the response they had made to the regulations and to his own letter.

Mr Leigh-Pemberton endorsed what the Governor had said. The Governor's letter had been well received by the banks and it eased their own task of instructing their overseas subsidiaries.
He added that some payments on Argentinian loans were now becoming overdue and the banks were about to invoke the pro rata clauses which were included in most syndicated loan agreements. The Governor confirmed that he had no objection to this step.

Mr Loehnis observed that one answer to any criticism of the steps which the authorities had taken was to point to the poor state of

Argentine credit even before the invasion. He said that the Bank of England was very conscious of the problems which arose for the commercial banks. The Bank was represented by an observer on the Committee chaired by Mr Ardron which was meeting that day and it stood ready to listen to any particular difficulties which the banks might wish to raise.

Sir Lindsay Alexander said that he, too, much appreciated the pragmatic and sensible way in which the Bank of England had handled the issue. Its conduct had been exemplary. Turning to his own bank's particular experience, he said that payments were now becoming overdue and consideration was being given to invoking pro rata clauses. Some $2 mn was already in a nominal escrow account in New York. He then went on to describe the situation within Argentina. The Argentine central bank was showing a most co-operative attitude to LBI's subsidiary in Argentina, allowing it unrestricted access to the discount window. Its dollar deposits were being repaid by drawing on an overdraft in New York. There had been something of a run - but not of alarming proportions - on both peso and dollar deposits. In the last two days there had actually been an inflow of deposits. There had been no significant hostility towards the 38 branches in Argentina and the locally-recruited staff had proved completely loyal. The expatriate staff had been withdrawn and the South American operation was now being controlled from Montevideo. On the whole there was as yet no cause for great anxiety. The bank was "playing it cool" and carefully abiding, as it had to, by the rules of the two sides. Sir Lindsay thought that, but for the invasion, the economic policies of Dr Roberto Allemann had had a chance of success, but now he was not optimistic. On the political side he expected that within South America (with the exception of Chile) there would be a slow drift of opinion to the Argentinian side. Lloyds' interests elsewhere in South America might therefore come under pressure in due course.

In conclusion, the Governor said that he hoped that the banks would keep in close contact with the Bank of England as the crisis continued.

4 East European indebtedness

On Poland, the Governor welcomed the fact that Poland had, on 6 April, signed the agreement to reschedule the 1981 commercial bank debt. He imagined that there would be no difficulty in securing the signature of enough banks to make the agreement effective on 10 May. There was, however, less certainty about Poland's ability to meet other criteria, notably the elimination of remaining interest arrears which had arisen since the end of 1981 on the debt covered by the agreement. The Poles would no doubt continue to strive to meet this objective and to meet the first payment of the remaining 5% of principal which was deferred from 1981. Another important stage would be the negotiations on the 1982 commercial bank debt, which were due to start on 29 April. As for official debt, negotiations on rescheduling 1982 maturities were held in suspense by the creditor governments in the hope that the Poles would lift martial law, release detainees and resume a meaningful dialogue. Thus, paradoxically, Poland was now in fact enjoying a 100% moratorium on 1982 payments to Western creditors.

Turning to Romania, the Governor said that the Romanians had not yet circulated more detailed rescheduling proposals or a detailed information memorandum on their economic performance and prospects. Discussions were being held in the US between the Romanians, the IMF staff and the group of nine commercial banks. One major area of concern was the extent to which the relief sought from commercial suppliers should be comparable to that provided by commercial banks. Rescheduling by the Paris Club of the (relatively modest) officially guaranteed debt in arrears from 1981 or maturing in 1982 depended on Romania's IMF programme being reactivated and this in turn depended on a solution of the debt problems. There was no reason to suppose, however, that these various requirements could not be reconciled without too much delay, given goodwill on all sides.

The position of Yugoslavia remained very difficult, with arrears arising on the liabilities of one or two Yugoslav banks. Yugoslavia had undoubtedly made severe cuts in imports and it seemed that there was further progress last year towards the elimination of the convertible currency account deficit. But, the Governor continued, Yugoslavia had unfortunately not been insulated from the reluctance of banks to lend to CMEA countries proper, whether or not they had access to the resources and guidance of the IMF. The outcome of discussions in Germany and France on new credits would clearly be of considerable significance as Yugoslavia attempted to stem the outflow of short-term deposits and finance the very large debt maturing in 1982.

The Governor then referred to the position of Hungary. All was going well with its application to join the IMF. The voting arrangements were in place and it was hoped that the signing would take place in early May. The Governor emphasised his concern that a country which was so economically successful and which was run so sensibly should not be damaged by any blanket response from banks to Eastern bloc countries as a whole. Hungary was a prime example of the proper working of detente. If these gains were to be preserved and if a resolidification of the bloc around the USSR was to be avoided, the commercial banks would need to act with the very greatest care.

Emphasising the confidentiality of the matter, the Governor told the Chairmen that a group of central banks, both individually and collectively in Basle, were looking closely at the Hungarian situation and had given a measure of short-term help to the Hungarian central bank. He and his central banking colleagues were extremely keen that there should be a proper differentiation between the different Eastern European countries. The Governor emphasised that any action - whether active or passive - on the part of the commercial banks that aggravated the situation could prove most damaging for the banks themselves and for the euro market as a whole. He believed that the Chairmen themselves had been giving thought to this problem and said that he would be interested to learn of their reactions. He believed that the most important objective was to achieve the greatest orderliness of approach possible so as to prevent, or at least minimise such damage.

The Governor continued that the ad hoc Task Forces had proved their worth during the negotiations with individual problem countries, in widening the co-ordination which was developing at the national level. It should not be forgotten that a reduction in exposure, imposing a severe liquidity squeeze, could result automatically from the simple failure to renew maturing facilities. It would not necessarily require deliberate decisions to withdraw deposits. The Governor said that "passive" withdrawal should be as carefully considered by banks as "active" decisions. "Natural wastage" might be a benign approach to manpower policy - but it was not a safe way out in the realm of finance. The present was a situation which called for alertness, sensitiveness and proper consideration of where real prudence lay.

Mr Leigh-Pemberton agreed that in dealing with Eastern bloc countries it was necessary to practise a policy of deferentiation. He said that his own Group's policy had been that exposure to individual Comecon countries should not rise significantly above present levels. Sir Lindsay Alexander drew attention to what Sir Jeremy Morse had said at his recent Annual General Meeting.

In conclusion the Governor emphasised that he thought these questions deserved much thought and attention at Chairman and Board level.

5 Industrial rescue operations

The Governor referred to the recent Stone-Platt receivership. It was, he said, important not to dwell on the somewhat over-excited immediate comment that it had evoked, but to draw lessons for the future from it. He hoped that the understandable differences of view that had arisen would not be allowed to jeopardise in any way the need for co-operation which would undoubtedly arise in other cases. He noted that Stone-Platt was in any event a particularly unusual case in that the clearing banks had been involved for considerably longer than the institutions in efforts to save the company. The case had highlighted the need for more efficient communication among the various financial institutions involved with a company in difficulties. There were clear difficulties about the involvement of the long-term institutions in problem cases - notably the "insider" problem and the fundamental differences of interest in some cases between the shareholders and the secured lenders. He thought that the importance of these difficulties should not be exaggerated. In many cases, the interests of secured lenders and equity holders were for the most part convergent. The need was to try to control the divergences. With more effective communication it would be possible to minimise the difficulties. In the industrial cases in which it was involved, the Bank would have particularly in mind the potential scope and merit of bringing banks and the larger institutional shareholders together for discussion where it seemed that doing so might yield better mutual understanding and assist the way forward. The merchant banks involved and the top managements of the companies concerned should also be involved in such discussions. The Governor wondered whether the Chairmen considered that it would be possible to make progress in this direction through prior discussion or whether it would be necessary to wait for further individual cases and to work out improved arrangements as events developed.

Sir David Barran thanked the Governor for his very fair presentation of the Stone-Platt case and the issues that arose from it. He wondered initially whether there had in fact been any possibility of a "better" outcome for Stone-Platt than that which had in the event been achieved. Beyond that, however, he believed that the Governor's emphasis on the importance of communications was entirely right. There was a need for full understanding and mutual confidence. But the "insider" problem did exist and this was part of the reason for the large part played by the merchant banks in such cases. On the other hand, the Stone-Platt episode had suggested to him that the clearing banks should now look carefully at the role of the merchant banks in such cases. The clearing banks were now themselves sufficiently expert to understand a company's situation without necessarily calling on the help of an outside merchant bank. They should be more prepared to deal face to face with the company concerned. A further lesson of Stone-Platt was the need for the banks and the institutions to become involved in the rescue situations at the same time. With Stone-Platt the institutions had come in much later than the clearing banks and communication between the two groups had been inadequate.

The Governor responded to Sir David's remarks about the role of the merchant banks. While he very much welcomed the increased expertise of the clearing banks in dealing with their industrial customers, he felt that it was important not to allow competitive jealousy between the clearing banks' merchant banking subsidiaries and the individual merchant banks to dominate the situation. In many cases the industrial company concerned would have its own merchant bank adviser on which it would wish to lean in time of difficulty. It would be a pity to allow professional jealousy, over what would be a relatively small piece of business for an individual bank, to jeopardise relations. On the question of involving the clearing banks and the institutions at the same time, the Governor felt that in most cases it was inevitable that the clearing banks would be in first. The important thing was that full and co-operative discussions should take place once the institutions also became involved.

Sir George Kenyon supported Sir David Barran's point about the difficulties of dealing through merchant banks, but went on to say that, speaking from long experience of Stone-Platt, this case was a somewhat misleading example to take. It had been clear to everyone involved that the second attempt to rescue this particular company had been doomed from the start. He paid tribute to the role that the Bank of England was playing in industrial rescue cases.

In conclusion, the Governor said that he hoped this discussion could continue both between the Chairmen themselves and with the Bank of England.

6 Advertising Regulations under the Banking Act

The Governor said that he was not sure that the Treasury would be prepared to implement the section of the Banking Act which governed the content of advertising. He added that, against the possibility that the Treasury did decline to act, the Bank of England was giving consideration to itself issuing a circular to all institutions requiring any reference to the Deposit Protection Scheme to be made in a prescribed form stating the limited nature of the protection offered.

7 Measurement of Liquidity

The Governor said that the final paper and the Bank of England's responses to the comments made by the clearing banks on the discussion document had been delayed by consultations within the Bank. These had now been completed and replies to the clearing banks' comments had recently been sent to the Chairmen of the CEO's. A final version of the paper was being prepared. Its application to particular banks would require detailed technical discussion and it was proposed to begin in due course the process with each individual clearing bank.

8 Any other business

(i) FFI's borrowing powers

The Governor said that he understood that the clearing banks had already agreed on certain conditions to the FFI proposals for an increase in its borrowing powers and for a rights issue. The Bank of England itself was still considering the question. The Bank would almost certainly go along with what was proposed, but wanted first to establish clearly satisfactory checks on FFI's funding mix.

(ii) At the conclusion of the meeting, the Governor noted that this was the last occasion on which Sir David Barran would attend and expressed his gratitude for the part that Sir David had played in the discussions between himself and the Chairmen.