

SECRET

3

MR TURNBULLA CONTINGENCY PLAN FOR A BANKING CRISIS

- 1. The Treasury Paper "Possible Support Operations..." deals mainly with defaults by a third world borrower with respect to the debt it owes to western banks. The emphasis is on how very little we know either about bank balance sheets or the financial consequences of the erosion of confidence.
2. Similarly, the paper is alarming in revealing the fragility of the degree of international cooperation and agreement (paras 27-36). I am particularly concerned that:

"Treasury officials agree that it seems best to rely on the pressure of a crisis to bring about... agreement" [on which Central Bank is responsible for which subsidy] (para 36).

In a crisis it may be too late.

3. The "Breakdown in the US" is dealt with in a summary way in two paras in Annex C. But this can now be extended and updated in the light of Continental Illinois, Penn Square, Drysdale etc. I think this Annex should also be extended to cover the contingency in a major domestic breakdown - say two MCBs at one time - in the light of FDIC commitments and assets, the likely litigation, and the general operation of the Fed's defence mechanism. In particular the report should examine the apparent effect of the FDIC announcement of the extended guarantee to large depositors in accelerating instead of containing the run on Continental.

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It is essential that we reassess the power and plausibility of the new explicit guaranties and the likely problem of challenge of their lack of constitutional status.

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