

S41/1

TOP in "Review of Bkg Supervision" file

SECRET AND PERSONAL

28.11.84

The Governor
The Deputy Governor o/r
MR LOEHNIS
MR GEORGE
MR WALKER
MR GALPIN
MR FLEMMING
MR QUINN

I think we have to be ready to deal with a "review" of the understanding established in the correspondence of Nov '83, but it may well be that we shall not find ourselves brought back to the question of why we rescinded J.M.B. I suspect the Chancellor found the arguments pretty conclusive. See my

NOTE OF THE GOVERNOR'S MEETING WITH THE CHANCELLOR, TUESDAY, 27 NOVEMBER 1984

I attach a note of the above meeting prepared by Mr Mallett.

impression of the discussion on p 2 para 3 at the bottom

R.L.P. 29/11

29 November 1984

WPC

3p.
WPC

SECRET AND PERSONAL

NOTE OF THE GOVERNOR'S MEETING WITH THE CHANCELLOR,
TUESDAY, 27 NOVEMBER 1984

Chancellor

- 1 "this is a complex and serious business".
- 2 "I have not studied in detail the paper" /that explains why the Bank rescued JMB/.
- 3 "My concern, and this is more important, is to prevent these things from happening" /again/.
- 4 "I want a review of the whole thing".
- 5 "There are considerable political pressures for an external review but I hope to get by with an internal review".
- 6 The review has to fall into two parts -
 - (a) the "here and now" to be completed before Christmas
 - (b) the legislative framework - which has proved inadequate and requires amending legislation..

Governor

- 1 Reminded the Chancellor that in its long report on the Johnson Matthey affair a number of heads of action had been noted - for example the relationship with and access to auditors.

Chancellor

- 1 Noted that the Bank did not receive a copy of the auditor's management letter as a matter of course.

Governor

1 Confirmed that, routinely, the Bank did not receive the management letter.

2 Pointed out that it could be a very stringent and critical document and that management might be nervous about releasing it.

3 Suggested that there were two ways of dealing with the auditor/supervisor relationship. Either through legislation or by agreement between the three parties concerned.

4 "legislation may be needed to give the auditor a duty to the supervisor".

Chancellor

1 "I want to get the review started and properly set up." It needs to consider whether there "should be a different way of doing things, have you got the right staff and the right techniques and are auditors doing their work." [This is presumably the short-term review.]

2 In the longer term we need to look at the "weaknesses in the Banking Act". The reports from the Bank suggest changes are needed.

3 All this (ie both reviews, Peretz confirms) should be overseen by a joint Bank/Treasury monitoring team, chaired by the Governor with participation by Sir Peter Middleton. Its work should be

"complete by Easter". [ie the second review having been finished]
[This was not the universal understanding. I understood the Chancellor to say that Lancaster should chair a group to look at possible legislative changes. (Clearly there would have at some

4 But, the Chancellor stressed, the "fast track" needs to look at "how we do the job now". It needs a "fresh mind", perhaps a "recently retired banker" to make a "quick enquiry, over the next few weeks" to see how supervision is done.

Time to
Come
up to
Middleton,
the Governor and
the Chancellor.
(W.P.C.'s comment)

I agree with these
comments R.H.

Governor

1 Questioned whether "we need to uproot the system of supervision" and then "to replant" it.

2 He agreed that it was necessary "to look at the detail to ensure that it is watertight".

3 The question is "are we plunging into something different in kind", for example to "second judge assets" which would give us an "inspectors" role.

Chancellor

1 "We have to consider everything"; this has a high political profile.

2 "there are questions about the age(?) of the staff, their numbers and quality, the time they spend on the job", the fact that "high fliers are in and out".

3 We have to consider the position of "auditors", "large exposures", the "timely receipt of information" and the "insistence that meetings are held on time".

4 We also need to consider the "different treatment of deposit takers and ldts".

Governor

1 Doubted whether it would be possible to get someone in and to report within three weeks.

2 There is "no magic" available to supervisors and I would hate to get into the position of US regulators in having to second guess the value of the loan book.

3 Thought the best experience was obtained in the large branch of a clearing bank. Supervisors may have to get that experience by secondment, in and out.

Middleton

- 1 Agreed that the right people were needed.
- 2 Wondered whether ratios mattered, the structure and content of the balance sheet (ie the loans, their size etc) was more central and many countries paid more attention to this.

Chancellor

- 1 Thought overseas countries did look closely at ratios.

Governor

- 1 Confirmed the Bank looked closely at ratios but also set absolute ceilings on the size of loans.

Chancellor

- 1 The concentration of risk in Johnson Matthey was "very notable", the Bank "can't sit back and say everything is all right".

Mr Cooke

- 1 Agreed that there could be a system which set ceilings but it would be in the context of an Act which does not, itself, set guidelines.
- 2 These come from papers etc issued by the Bank but which do not have legal force.

Chancellor

- 1 "do we need more then in the Banking Act".

Mr Quinn

1 Noted his experience in talking to supervisors from other countries was that they were very interested in the flexible manner in which we did things and were moving away from setting strict ratios towards our position.

2 The problem with ratios and limits was that people worked at getting round them.

Chancellor

1 Nonetheless "Johnson Matthey should not have happened and should have been picked up at an earlier stage".

2 It is a "bad story" though he was not "blaming anyone" and "I am not saying that we can't have bank failures".

Governor

1 "perhaps we should have been more aware" but "how do you prevent foolish lending".

2 "the names of borrowers on the returns should have rung a bell with a more experienced banker".

Mr Cooke

1 Noted that there was no signal from the auditors in the March 1984 accounts (signed in June 1984).

Mr Wilson

1 The report was therefore "cock".

Governor

1 You say, Chancellor, that we should do (have done) something but what can we do.

2 We can put conditions on a licence or withdraw all deposit taking authority.

3 If you want us to have powers there must be a better system in which to exercise them (a reference to delays in the Appeal System). There is already a backlog of "difficult institutions".

Chancellor

1 This case is "centre stage" alongside Lloyds and the Stock Exchange.

Mr Walker

1 The Johnson Matthey case was a "disgrace all round" - the shareholders, the board of plc, the management of JMB and the auditors. It represented a "unique conjuncture".

Chancellor

1 I have doubts about the two-tier system and this may bring a need to legislate quickly.

2 I want a Treasury Official (Lankester) to head the "Easter" review of the Banking Act.

3 Will the Governor and Sir Peter Middleton please spell out the issues to be covered by both reviews.

4 There is some pressure for an external review, I will resist this. I will tell the House of Commons that the review will be "serious and thorough".

5 The Select Committee is too busy to conduct an external review, the PAC has locus.

6 I will write to the Governor about the commitment of the Bank's resources, I will need to be "more precise" than in the exchange of letters in November 1983.

Economic Secretary

1 We need to look at all those institutions regarded as recognised banks.

2 Rapid growth from a standing start is a dangerous signal and (recalling Edward Bates) the appearance of large commitments to a few borrowers should have caused concern.

3 Has the Bank been "worrying about depositors" too much. What about those institutions which are part of the financial markets, as lenders of money but are not deposit-takers.

Mr Quinn

He was troubled about the idea of an outside banker who would be expected to have expertise across the board. Merchant banking, clearing banking and managing an ldt all required different experience and expertise. It was unlikely that an outsider could form a view about the whole system in three weeks.

The Chancellor said that perhaps he would have to think about a longer timescale. He recognised the difficulties. At an earlier point he spoke about a "retired merchant banker" when Stewart talked about a clearer.