PRIME MINISTER

TIN

Today's meeting of the International Council made tiny progress. They agreed to meet again on Monday, 2 December, to allow time for delegates to get authority from their capitals to commit resources. They will then stay in session until an agreement has been reached. DTI officials are, however, pessimistic about the outcome.

EEC countries are to have a coordinating meeting in Brussels on Tuesday.

The Japanese do not believe they have a legal liability. The French are also fairly clear that they have no legal liability, but they have said they will look again at the position. The Germans doubt that they can take decisions quickly enough.

The LME still plan to reopen on Monday. There is a chance that they may postpone this in the light of today's meeting of the ITC.

Mr Brittan is likely to hold a further meeting on Friday. It is possible that the Bank of England may come forward with a rescue package "costing in the tens of millions rather than in the hundreds of millions". I have told DTI that you would wish to have an opportunity to consider any proposals which may come forward, before any final decision is taken.

The Chairman of the London Metal Exchange asked earlier for a meeting with you. He has, however, already seen Mr. Brittan, and Mr. Brittan may well decide to see him again in the next day or so.

An account of the developments of the past week is attached in case you wish to follow the story in greater detail.

DRN

(DAVID NORGROVE)

20 November 1985

[redacted]

CONFIDENTIAL

THE DEPUTY GOVERNOR

BANK OF ENGLAND
LONDON
EC2R 8AH

20 November 1985

NBRM.

TO Mr Lunn
FOR ADVICE (AND DRAFT REPLY IF APPROPRIATE)
PLEASE BY: ASAP
IF DEADLINE CANNOT BE MET PLEASE PHONE 215 5420

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Mr Hilton/FS
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Mr Lane/ITP
Mr Malliwan/Sol
Mr Mathers/Sol
Mr Murray/MM

The Rt Hon Leon Brittan QC MP
Secretary of State for Trade & Industry
1 Victoria Street
London SW1H OET

Dear Secretary of State,

TIN

I understand that you may be convening a further meeting of Ministers to review policy after this week's meeting of the International Tin Council. The Bank has, of course, been strongly supportive of the efforts which you have been making to bring the members of the ITC to accept a responsibility for the Council's debts. So long as that appears to be a credible outcome within a reasonable time I would not wish to depart from that approach. This letter, which I am sending in the Governor's absence abroad, is addressed to the possibility that that outturn may soon appear not to be realistic.

As the Governor and I have both made clear in previous rounds of discussion, the potential consequences if the LME reopens tin trading with the ITC in default are extremely difficult to assess. It is likely that a small number of brokers would immediately be thrown into default. The number would rise if parent companies which were in a position to stand behind their subsidiaries decided not to do so. Failures of brokers caused directly by the default of the ITC will, in their turn, impose further losses on other members of the market. The risk, therefore, is that those further losses will result in consequential failures. These losses could spread out into other commodity markets in which the companies or their parent groups are also engaged. In these inevitably uncertain circumstances it is realistic to expect that banks would be cautious in the scale of finance that they would make available to companies which face liquidity problems from the failures in the market. Because the scale of failure and the consequential effects depend so heavily on the price for tin which would be established in the reopened market, and on the attitude of parent companies, most of them not British, any assessment of the fall out effects can only be conjectural. However, we start from the fact that London is a major commodity dealing centre and that the invisible earnings whic these activities bring in are measured in hundreds of millions so that consequential damage to the commodities trading sector as a whole would be serious indeed.

Because of this prospect Bank staff have endeavoured, in consultation with your officials, to draw up possible arrangements for financial assistance to LME brokers to avoid failures as a consequence of the ITC's default. The appendices to this letter describe two possible schemes. Fundamental to both schemes is that assistance should be provided by way of loans at a severe rate of interest which should be recoverable from any court judgement which may be enforced against the ITC. While I appreciate that the legal position is complex, advice has in the past been that HMG should regard it as a strong possibility that enforcement could indeed be obtained against Britain and, hopefully other ITC members. If this is the case there certainly seems to be an argument for making some payments to avoid the damage to the City envisaged above, rather wait until such payments - or even larger ones - are required in settlement of court judgments later.

The proposal does not envisage any assistance being offered to bankers who will also suffer losses as a result of the default of the ITC. They hold substantial security and I see no reason to believe that any British banks would be seriously threatened by these losses.

While I well understand the political difficulty of assistance to City firms, I believe that, in the circumstances, these propositions should be very seriously considered.

I am sending copies of this letter to the Chancellor of the Exchequer, the Foreign Secretary and the Solicitor General.

Yours sincerely

Kit McMahon

SCHEME A - BROAD CONCEPT

Objective: to provide, on a non-selective basis, on demand, but at a commercially uncompetitive rate of interest, immediate support in the form of loans to LME Ring-Dealing members to meet up to 50% of trading losses arising directly from closing out at market prices positions left uncovered by defaults by the ITC Buffer Stock on fixed price purchase contracts.

Assumption: on re-opening of the tin market there is no other form of financial or price support; prices are established in free open market conditions.

Maximum exposure: estimated maximum funding requirements to meet 50% of losses incurred by trading out at freely established price levels would be:

£70mn at £6,000 a tonne
£95mn at £5,000 a tonne
£120mn at £4,000 a tonne
£145mn at £3,000 a tonne

Possible utilisation: very difficult to assess since it depends upon such variables as price level established in the market and the preparedness and ability of parent companies to underwrite their subsidiaries' losses. It appears likely that the facility would be little used if the tin price were to fall no further than £6,500. Below this figure demand for loans would be expected to increase steadily with decreasing price as far as perhaps £4,000. Below £4,000 support loans may not stave off all insolvencies and doubts as to ultimate recoverability of ITC debts may persuade one or more companies that they should not seek to defend themselves against compulsory winding up orders.

Companies generally are unlikely to use expensive money if any other course is open to them. Given the fact that some of the brokers concerned have parent companies of high standing it seems unlikely more than 75% of the facility would be drawn upon and a more realistic estimate would probably be 40-50%. If the loan was only repayable to the extent that the company was able to enforce a court judgment this would make it attractive even at a high rate of interest, and thus increase the take-up.

Rate of interest: to be commercially uncompetitive but to be sufficiently reasonable for a loan to be regarded as a viable and attractive alternative to the declaration of insolvency. This would imply a rate of 3-5% above that readily available from banks to a first class commercial borrower. Interest payable 6 monthly. (Alternative: interest rolled-up for the period of the loan).

Security for loan: minimum: first call on funds made available by court order following action for recovery of debts due by the ITC. A condition of granting the loan would be an undertaking to pursue such action individually or with others and to assign to the lender all or an agreed proportion of rights in ITC debt prior to voluntary liquidation. [Consideration might be given to requiring in addition a parent company or bank guarantee in appropriate cases.]

Term of loan: maximum three years or settlement of court case, whichever is the earlier - no penalty on early repayment.

Loan agency: a body, to be determined, but independent of the LME and of any company or firm with direct or indirect financial or commercial interest in any potential borrower (referred to hereinafter as "LA") responsible for:

(a) making funds available following verification of establishment of losses (highest priced buffer stock contracts maturing on any given date before lodgement of application for loan to be deemed to be traded out first);

(b) documentation, legal checks and general administration;

(c) establishing adequacy of and beneficial rights in prescribed or other security given for the loan;

(d) ensuring receipt of interest in accordance with the terms of the loan agreement and adherence to all general conditions of the loan;

(e) monitoring steps taken by borrowers to pursue by legal process recovery of debts due by the ITC.

Advantages:

(a) simple to administer;
(b) easy to present to potential users
(c) involves no arbitrary decisions on elegibility by LA;
(d) availability is likely to encourage more orderly trading out of positions by removing intense pressure to sell before or at the theoretical margin of solvency;
(e) the scheme is likely to be viewed externally as underpinning the Exchange as a whole and will have beneficial effects on general confidence in trading other metals and indeed in commodities in other markets;
(f) it will allow parent companies time to consider how best to provide for their subsidiaries' future activity or, alternatively, to organise an orderly withdrawal from the market place;
(g) the scheme provides support during a possibly extended period in which inter-governmental exploration of the legal obligations of the ITC may be carried to a conclusion, following which firms may, if necessary, mount individual actions for recovery of debts.

Disadvantage: presentationally, it may be seen as a "bailing out" of a complete and arguably imprudent group of traders. The possible cost is higher than for a selective scheme.

SCHEME B - NARROW CONCEPT

Objective: to provide by loan to LME Ring-Dealers at a commercially uncompetitive rate such support as is necessary to avert insolvency of firms financially embarrased by losses directly attributable to the default on payment by the ITC Buffer Stock on fixed price purchase contracts. As far as possible to ensure that parent companies' support is exhausted before such loans are provided.

Assumption: on re-opening of the tin market there is no other form of financial or price support; prices are established in free open market conditions.

Cost profile: highly problematical. Best available market intelligence suggests that perhaps three companies are "high risk" if prices fall below £6,000 - £6,250; thereafter these companies might need, together, support of around £10mn per £1,000 fall in price. With lower levels of price a further two "medium risk" companies might reach a critical point but there is nothing to indicate at what price this would occur. The combined requirement of these two companies would be some £8.5mn per £1,000 fall in price. Remaining companies would be regarded as "low risk". Funding requirements at various price levels must be purely conjectural with the margin of error increasing sharply at lower levels. Estimates are:-

£ 2.5-5mn at £6,000 a tonne
£15-20mn at £5,000 a tonne
£40-50mn at £4,000 a tonne
£75-100mn at £3,000 a tonne

Probable utilisation: wholly dependent on ultimate price levels of tin and support from parents but likely to be a high percentage of funding requirements estimated above.

Rate of interest: to be commercially uncompetitive but to be sufficiently reasonable for a loan to be regarded as a viable and attractive alternative to declaration of insolvency. This would imply a rate of 3-5% above that readily available from banks to a first class commercial borrower. Interest payable 6 monthly. (Alternative: interest rolled-up for the period of the loan).

Security for loan: minimum: first call on funds made available by court order following action for recovery of debts due by the ITC. A condition of granting the loan would be an undertaking to pursue such action individually or with others and to assign to the lender all or an agreed proportion of rights in ITC debt prior to voluntary liquidation.

Term of loan: maximum three years or settlement of court case - no penalty on early repayment.

Loan agency: a body independent of the LME and of any company or firm with direct or indirect financial or commercial interest in any potential borrower (to be determined - referred to hereinafter as "LA") responsible for:

(a) making funds available following verification that insolvency is inevitable and that all possible assistance has been obtained from any parent entity;

(b) documentation, legal checks and general administration;

(c) establishing adequacy and beneficial right in prescribed or other security given for the loan;

(d) ensuring receipt of interest in accordance with the terms of the loan agreement and adherence to all general conditions of the loan;

(e) monitoring steps taken by borrowers to pursue through legal process recovery of debts due by the ITC.

Advantages:

(a) Concentrates assistance on the weak links in the market.

(b) There is the ability to take a forward view of requirements, there being no test of "established losses" but rather an assessed financial requirement to achieve and maintain solvency.

(c) Assistance is on a "100% of need" basis and therefore theoretically effective regardless of the price of tin.

(d) In common with scheme A it will allow parent companies time to consider how best to provide for their subsidiaries' future activity or, alternatively, to organise an orderly withdrawal from the market place.

(e) In common with scheme A, the scheme provides support during a possibly extended period in which inter-governmental exploration of the legal obligations of the ITC may be carried to a conclusion, following which firms may, if necessary, mount individual actions for recovery of debts.

(f) Amount drawn likely to be much smaller than under A.

Disadvantages:

(a) The need to assess in a very short period of time both the company's own financial position and that of its parent.

(b) Since assistance is at a marginal point and companies will be reluctant to take expensive money in excess of absolute requirements, unforeseen events probably remote from the LME may precipitate insolvency before further assistance can be given.

(c) Singles out for assistance those who have been most commercially imprudent.

(d) None of the companies most likely to take up the assistance has a British passport.

SOME GENERAL POINTS FOR CONSIDERATION IN WORKING UP SCHEMES A OR B

1 There will be a clear need to provide adequate publicity in the potential user area for the facilities to be made available in advance of re-opening of the tin market. Failure to do so will risk development of avoidable insolvency situations and/or squander the probable market-calming effects of known availability of under-pinning.

2 The rate of interest charged is quite critical. It should be high enough that the facility is unattractive to a company which has access to money on commercial terms, but not so penal as to undermine the company making use of the assistance.

3 The complete independence of the lending agency (LA) is most important. The information necessary for it to carry out its function will be highly sensitive commercially and even in the very difficult conditions following re-opening it is to be expected that firms will not seek to extend any favours to competitors and will demand absolute confidentiality. LA would ideally be a firm of accountants with good expertise in commodity company audit work but not retained by any potential users of loans. Scheme B in particular would demand availability of expert knowledge.

4 Provision should be made for acceptance at any stage of alternative security for the loan. Companies making use of the facilities will doubtless be considered as being in a "lifeboat". This has a slightly sour taste commercially and parent companies are likely to seek to take subsidiaries out as soon as possible. An intermediate step to full refinance may well be provision of a first class bankers guarantee. This should be welcomed since it would relieve LA of the major proportion of its monitoring role and reduce almost to nil the reporting by the borrower called for under the initial loan arrangements.