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From: D R H BOARD
Date: 9 January 1985

NOTE OF A MEETING HELD AT 4.30 PM, FRIDAY 21 DECEMBER 1984, IN SIR PETER MIDDLETON'S ROOM, HM TREASURY

Present:	Sir Peter Middleton	(Treasury)
	Mr Cassell	
	Mr Hall	
	Deputy Governor	(Bank of England)
	Mr Cooke	
	Mr Quinn	

JOHNSON MATTHEY AND CROCKER

The meeting was held at the Deputy Governor's request.

Johnson Matthey

2. The Deputy Governor asked whether the Treasury were content with the letter which the Governor proposed to send that day to Dr David Owen MP. Sir Peter Middleton said the letter was a forthright rejection of Dr Owen's points. The Treasury's only concern was that its terms should be fully justified by the facts about Johnson Matthey's operations. The Deputy Governor confirmed that the proposed letter was accurate.

Crocker

3. The Bank reported that following the annual routine examination of Crocker, the Office of the Controller of the Currency (OCC)

had told Crocker representatives on Wednesday that they were looking for an extra $200 million of general provisions in addition to the specific provisions already contemplated. The OCC were broadly content with the latter: indeed they felt that Crocker's approach to specific provisions had been good. However the already poor quality of Crocker's loan book had been badly hit by renewed difficulties in the wine growing and agricultural sectors in California, with recent rapid declines in land and real estate values in particular (agricultural land had fallen from appproximately $10,000 to $3,000 per acre over the last year or so).

4. The new provisions would directly affect Crocker's profit and loss account. Without them Crocker's outturn for Q4 1984 - expected to be published around 15 January - would probably have been a small loss, compared with a small profit in Q3. The effect of the extra provision in Q4 would be to produce a substantial loss. This would equally affect Midland Bank, who presently held 57 per cent of Crocker. The effect would be to reduce the Midland Bank Group's expected profits from around £230-250 million - somewhat better than in 1983 - to less than £100 million pre-tax.

5. The figures were subject to further discussion. But the Bank did not think the OCC's assessment was unreasonable.

6. The most pressing worry was the risk of a leak, suggesting that Crocker's situation was deteriorating and slipping beyond control, before a proper response was marshalled. Non-performing loans had been 7.3 per cent of Crocker's loan book at end-September and were projected to rise to 8.8 per cent, or more than twice its nearest US 'top 20' bank rival, by end-December. Scare stories could rapidly tip Crocker into severe liquidity and funding problems, possibly affecting Midland. However a sizeable part of Crocker's liabilities were retail deposits, which (arguably) could be kept stable by prompt assurances of protection for small deposits. If Midland ran into similar difficulties the Bank's preliminary view was that inter-clearer solidarity was the best line of defence, with the authorities staying in the background. Midland had had a very discreet word with the other clearers.

7. The possibility of a leak could not be ruled out. Crocker had encountered refusals in the US foreign exchange markets, though that was possibly just a reflection of thin holiday markets with senior officials on leave*. The OCC was that day briefing the Federal Reserve Bank and the FDIC on the position. If, as seemed likely, the FDIC sent in an investigative team the risk of rumours was heightened.

8. The Bank observed that the picture was less bleak if confidentiality could be maintained at least until around 15 January, when Crocker's Q4 results would be expected by the market. Crocker's capital ratios were reasonable and in September reserves amounted to 1.4 per cent of the loan book. However the key would be the rating agencies. Analysts would probably reduce Crocker's money market rating from C to C/D or D. Provided the situation as a whole remained containable, this could produce a drain of up to $3.5 billion on Crocker's liquidity in Q1 1985. In recent weeks Midland had moved to guard against a liquidity drain and had a net long position of around $2 billion. Crocker had lines out to other US banks.

9. The results themselves would have unavoidably bad consequences. Although Midland would still be able to declare a dividend, its chances of raising a rights issue in 1985 would be damaged. And they could well prejudice the prospects of persuading the shareholders at their meeting in April to acquire the remaining 43 per cent of Crocker not already in Midland's hands. There were some measures - eg transferring some of Crocker's non-performing assets to Midland - which could more readily be contemplated with 100 per cent ownership. However even with the shareholders' assent, it appeared that 100 per cent ownership could not be accomplished before mid-May.

10. In the worst circumstances the question could arise of other potential purchasers of Crocker. The Bank had wondered whether

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*Note: subsequent enquiry confirmed that there had only been minor problems.

the Bank of America might be one possibility, but this looked unlikely. In principle some Japanese bank could be a possibility.

11. It was noted that Crocker had a loan book of about $16 billion and a balance sheet of about $20 billion, compared with Midland's total group assets of about £52 billion. In the coming week, US banks were closed only for Christmas Day.

12. Sir Peter Middleton thanked the Deputy Governor for this warning of a potentially difficult situation. The Treasury would report it to the Chancellor. The earliest possible notice of any question of official statements in London was desirable.

D R H BOARD
Private Secretary

cc Those present