

PO-CH/NL/0170



PART A

Part A.

SECRET
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Begins: 22/9/87.
Ends: 19/11/87.

COMMERCIAL - IN - CONFIDENCE.


PO -CH /NL/0170

PART A

Chancellor (Lawson) Papers:

LOSSES TO GILT EDGED
MARKET MARKERS

PO -CH /NL/0170
PART A

Disposal Directions: 25 Years



4/9/95

SECRET

12

FROM: D L C PERETZ

DATE: 22 SEPTEMBER 1987

MR CASSELL

cc PPS
PS/EST
Sir P Middleton
Mr Kelly
Mr Culpin
Mr Richardson

Mr Lomas

GEMM LOSSES

I understand from the Bank that the attached report in today's Independent - that GEMM net losses since Big Bang have now reached around £75m - is a figure that the Bank of England gave to Kleinwort Benson in the course of their last (confidential) supervisory interview. The Bank are pretty cross with Kleinworts for revealing the figure (though in fact I doubt whether too much harm is done: the figure is a good deal lower than some of the estimates going around the gilts market).

2. The Bank's Press Office is declining to comment. If IDT were asked about the figure they should say that it is a matter for the Bank of England.

3. I understand that the true figure, as of today, and including Lloyds (who have of course pulled out of the market) is around £100m. The trading loss will be a good deal less than this: this is the figure after allowing for overheads, start-up costs, etc. It compares with the figure of £70m the Bank reported at the end of July, against a (then) capital asset figure of around £550m.

DLC

D L C PERETZ

New-style gilts lose firms £75m/8

By Peter Wilson-Smith
Financial Editor

THE 26 FIRMS which make markets in British Government securities chalked up combined losses of about £60m during the second quarter of this year, it emerged yesterday.

Since Big Bang in October last year, accumulated losses are believed to stand at about £75m. This compares with the total capital backing of about £600m which went to support the new-style gilts market last October.

The figure for the combined second quarter losses comes indirectly from the Bank of England, which has access to the confidential accounts of individual firms. It was disclosed yesterday by Kleinwort Benson, the merchant banking group which has a gilt-edged market maker and said it was told the figure during discussions with the Bank.

The Bank of England declined to comment.

Kleinwort, which yesterday reported half-year results and announced a £143.6m cash call, said it was among those which had

made losses in the gilts market and conditions had been difficult since the end of the first half.

The scale of the overall loss during the second quarter suggests that most, if not all of the 26 market makers, were in the red during the period.

It was a difficult time in the gilts market because it was volatile either side of the election. And since polling day, gilt-edged stocks have fallen steadily. Many market makers are believed to have been long of gilts at the time of the election in the hope that the market would rise subsequently on the back of foreign investment.

The fierce competition in the gilts market was highlighted in June when Lloyds Bank pulled out of market making in gilts because it could not see any prospect of earning a respectable return.

New plan to help 29 unit buyers

By JULIA FINCH

THE City's watchdog is to consider a new system designed to help investors choose between the 1,086 unit trusts on offer.

The risk-rating idea could rank funds on a 1-10 basis, according to the likelihood of investors losing their money. It follows correspondence between the watchdog Securities and Investments Board and the Association of Investment Trust Companies.

However, no definite proposals have been made yet, and a spokesman said the SIB is anxious "to avoid getting into the business of giving investment advice."

Harry Littlefair of Allied Dunbar, which manages 25 unit trust funds, welcomed the possibility. "It sounds like an excellent idea," he said. "It would definitely be beneficial to investors."

But MIM Britannia is far less enthusiastic. Marketing director Keith Crowley described the idea as "yet another example of bureaucratic nonsense" from SIB.

Unit Trust Association chairman Bill Stuttford was also lukewarm about the idea. If ratings were to be fair, he said, they should not be limited to the risks of unit trusts but extended to all rival insurance products.

Five-year-olds 24

The speed with which a futures exchange sorts out who's traded what with whom each day is always a matter of pride.

But this week it will also be

a matter of grim necessity at the London International Financial Futures Exchange if members and staff are to fulfill a rigorous social calendar.

Liffe is five years old on September 30. To mark the occasion, it is holding no fewer than five parties on successive nights on its trading floor under the dome of the Royal Exchange, its distinguished home in the City.

"We thought that as we're in the business of selling risk management instruments, we should take some risks ourselves," says Michael Jenkins, chief executive since Liffe's foundation.

Each day, as the raucous cries of the pit traders dressed in their coats of many colours, fade away when the market closes at 4.30 pm, an army of movers and cooks will invade the exchange to prepare it for the festivities. A special floor will be laid over the pits each evening, and then removed for the next day's trading.

Meanwhile, the back office staff will be working furiously to get all the day's trades matched and cleared by the 7.45 pm deadline — a tall order if there should be a surge in volume, as their could be, for example, when the Bank of England holds its second experimental gilts auction tomorrow.

The atmosphere will be informal. "No speeches, but a little surprise at the end of each evening," promises Brian Williamson, Liffe's chairman.

Friday will be reserved for a free-for-all bash for 750 people with "entertainment" — the nature of which is a secret that even I have not been able to penetrate.

If you haven't been invited

yet don't despair. Liffe traders can be relied upon to operate a futures market in invitations.

Lloyds broker for PWS

INSURANCE broker PWS is acquiring Lloyds broker Craven Farmer Holdings for a maximum payment of £5m.

Craven Farmer is the holding company of a Lloyds' broker specialising in London market excessive loss reinsurance.

An initial consideration of £4m

will be satisfied by the allotment of 1.15m new ordinary shares — which represents 5.6 per cent of the issued capital — of which 638,576 shares are being placed.

The balance is being retained by the vendors who have undertaken not to dispose of them for at least 6 months.

Hogg acts to stop 23 'defection'

By Alison Eadie

Hogg Robinson & Gardner Mountain, the Lloyd's broker, is holding discussions this week with 17 employees from its political risk and credit insurance division to try to avert a mass defection to Lloyd Thompson, another Lloyd's broker.

Mr Andrew Alers-Hankey, Hogg's finance director, said: "We are nursing the situation to save who we can."

He said the 17 employees were not a top business-producing team, but included support staff and secretaries.

Hogg's political risk division was not successful last year and, while business is recovering, it is still below its best. Cutbacks had been considered for the department and this was thought to have prompted staff to look for other jobs.

Mr Alers-Hankey said the key relationships with business-producing brokers were secure, but Hogg's main concern was with its ability to service accounts.

col3

peretz

From : D L C Peretz
Date : 2 October 1987

ECONOMIC SECRETARY

cc PPS
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr C W Kelly
Mr Richardson o/r

HILL SAMUEL : GEMM

We have known for some time that the Hill Samuel gilt-edged market making activity was one of the weakest of the 26 GEMMs. The TSB, in their takeover announcement this morning, said it has "no intention of developing a securities market-making business of its own, and would divest or close down the loss-making debt trading activities" of Hill Samuel.

2. It is possible - but the Bank thinks unlikely - that the TSB will have a change of heart. It is also possible, but again probably unlikely, that the TSB will find someone wishing to purchase the Hill Samuel GEMM as a going concern. In either case, the Bank would have to consider afresh whether or not to allow the operation continuing gilt-edged market maker status under the new ownership.

3. For the time being, until the takeover is complete, the GEMM will continue in business. But after that, by far the most likely outcome is that it will cease trading, and that its staff will go elsewhere. The Bank think the back office staff will find no difficulty at all in finding alternative employment : but that the traders will.

4. This would reduce the number of gilt-edged market makers to 25. The Bank currently expect perhaps two or three further dropouts in due course, but not more than that : and of course there are others, including the Japanese, who will seek market maker status when the Bank is prepared to consider new applications (after the anniversary of Big Bang).

DLCP



NS

FROM: CATHY RYDING

DATE: 5 October 1987

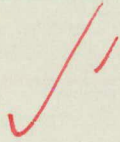
MRS R LOMAX

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Peretz**HILL SAMUEL**

The Chancellor has seen and noted your note for the record of 2 October. He has commented that it was not very clever of TSB to have moved so slowly: if they were interested in Hill Samuel, they ought to have been able to pick it up cheaper at an earlier stage.

A handwritten signature in cursive script, appearing to be "CR".

CATHY RYDING



Ch

Raidel tells me that Samuel is to be broken up, with the Corporate Finance Dept going to BZW, & the rest to TSB. TSB will probably sell off Wood Mackenzie in due course (& WM may pull out of being gilt edged market maker before that).
Announced tomorrow

AA

CONFIDENTIAL UNDER PART V OF THE 1987 BANKING ACT

FROM: MRS R LOMAX
DATE: 2 October 1987

NOTE FOR THE RECORD

cc PPS
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Peretz

*NOTE. (Not v. clear
of TSB to have
moved so slowly:
if they were
wondering in
HS, they might
to have the
all to push it up
cheaper @ an stage.)*

HILL SAMUEL

Brian Quinn rang to say that the sale of the Hill Samuel Corporate Finance Department to BZW has finally fallen through this morning, as a result of which the whole operation is going to the TSB. There is now no more talk of breaking it up, though the future of Wood McKenzie is still not certain. It is conceivable, though not likely, that it will stay within the group, though if it stays, the chances are that it will be confined to agency broking. The Bank are in touch with David Peretz about the Wood McKenzie gilt-edged market maker.

2. I understand that Kerry Packer has already sold out to the TSB, as have one or two insurance companies: but there is no word yet from Larry Adler, who stands to make a tidy profit (the TSB price is 810p per share, as compared with Adler's purchase price of 550p).

3. Brian Quinn clearly feels pretty happy about the way this has turned out. So too, no doubt, do the Australians, who may well feel that speculating in UK merchant bank shares at the present time is like picking money up off the pavement. I would be a little bit surprised if their attention does not now switch to Morgan Grenfell. ✓

RACHEL LOMAX

1. Alex
OC
OK?

CONFIDENTIAL

From: Sir G. Littler
Date: 9 October 1987

CHANCELLOR

*I am quite
with this advice,
see we need to
keep JTI on
board. If you have
any interest
in this matter,
we need
blame
quickly
what
one, + decide
whether
have
validity.*

c.c. Economic Secretary
Sir P. Middleton
Mr Cassell
Mrs Lomax
Mr Ilett

GEMMS AND THE JAPANESE

As we approach the 27 October anniversary of Big Bang, we have to consider possible new market-makers. Only the four big Japanese securities houses are expressing interest. This is not surprising as they were the only significant group who decided not to apply at the beginning. They are now busily at various stages of preparation for entry, and are making regular enquiries.

2. I had a long talk yesterday with Eddie George on what our response should be.

Gilts Market Considerations

3. Under this heading no problem. These Japanese houses are potentially well-qualified. They would be welcome from the point of view of our interests in a thriving market for our borrowing. Their absence would indeed look increasingly odd as time passes.

4. The natural line for the Bank to take would be to indicate very soon willingness to entertain applications after 27 October from the two best-prepared (Daiwa and Nomura) and to engage in preliminary discussions with the others (Yamaichi and Nikko). It seems that Daiwa might be ready for very early entry, but Nomura have been slower in building up their team and would probably be well-satisfied to get in around March/April next year. The Bank could (and would intend to) take a little time considering the applications, and then approve for an appropriate subsequent date.

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"Reciprocity" Considerations

5. I think the only problem which must concern us is what new seats the Japanese are going to allow in their Stock Exchange. On some other fronts we can be well-satisfied with progress made: as in the licensing of securities operators and, particularly valuable, the licensing of our fund managers. Elsewhere there are still some worries, notably on the organisation of Japanese money markets and savings and the difficulties this creates for foreign houses seeking local finance; but progress is slowly being made and there is little point using our "reciprocity" weapons to get advantages which would favour other foreigners as much as or more than the British!

6. In his recent visit to Tokyo Eddie George talked with representatives of ten British houses operating there and their reactions confirmed these judgments. They also are in general anxious that we should not lightly undertake any hostile action against Japanese interests - they have invested heavily in Tokyo, reckon that the Japanese could devise all kinds of impediments if they wanted, and hope we will not do anything to provoke that and so undermine their growing and increasingly profitable business.

7. On Tokyo Stock Exchange Membership the latest reported time-table is that an announcement will be made early in November about the intended number of new seats and the terms. Formal applications will then be invited (and we at present think that all five interested British houses will apply). Decisions on individual names are expected before the end of the year.

CONFIDENTIAL

Immediate Action

8. We cannot decide now how we would want to react to whatever the Japanese offer on their Stock Exchange. We are still hoping for satisfactory treatment, might have to accept something less than the ideal, or might have to face something unacceptable and consider hostile action on our own part.

9. Our immediate problem is how to handle Japanese interests here while we wait for the Tokyo Stock Exchange outcome. There are two groups of interests: banking licences and GEMM entry. We cannot decide now whether we might want to use either, both or neither. What does seem obvious now is that we should keep all our options open. Therefore, for the two groups:

- Banking Licences: Nikko and Yamaichi have applied and know that they must wait until towards the end of the year (and we know that they understand the connection);
- GEMMS: There can be no question of granting entry yet. The question is simply: do we refuse to receive applications at all yet, or do we take the natural course outlined in paragraph 4 above, on the clear understanding that decisions will be delayed.

10. Eddie George and I consider that the 'natural course' is much the better. Not only is it more in keeping with our own normal standards and past statements. It is also in our view the line which will most strengthen our hand if we later find we need further pressure, argument and even action to deny entry.

11. If you agree, Mr Cassell in my absence will invite the Bank to proceed on the basis I have described. When they speak to any

CONFIDENTIAL

of the potential applicants, they will of course make the point that we are continuing to act in a friendly way in the expectation of satisfactory treatment of our interests in Tokyo, and make it clear that final decisions will have to wait.



(Geoffrey Littler)

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From: Sir G.Littler
Date: 9 October 1987

CHANCELLOR

c.c. Economic Secretary
Sir P.Middleton
Mr Cassell
Mrs Lomax
Mr Ilett

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(Geoffrey Littler)

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COMMERCIAL IN CONFIDENCE

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From : D L C Peretz
Date : 9 October 1987

ECONOMIC SECRETARY

cc PPS
Sir P Middleton
Mr Cassell o/r
Mrs Lomax
Mr C W Kelly
Mr Richardson o/r

✓

- You have this

ORION ROYAL : GEMM

My minute of 8 October. I now understand from the Bank that an announcement from Orion Royal is likely to be delayed for some, unspecified, period. I imagine this is partly to give time to break the news to their staff : who - apparently - do not yet know (for which reason this information is extremely sensitive).

DLCP

D L C PERETZ



FROM: CATHY RYDING
DATE: 30 October 1987

SIR G LITTLER

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Ilett

GEMMS AND THE JAPANESE

The Chancellor was grateful for your minute of 9 October.

2. The Chancellor is content with your advice, but thinks we need to keep DTI on board. If they have any reservations about this strategy, we need to know quickly what they are and decide whether they have any validity.

A handwritten signature in cursive script, appearing to be 'CR'.

CATHY RYDING

C O N F I D E N T I A L
C O M M E R C I A L I N C O N F I D E N C E

FROM: C W KELLY

DATE: 30 October 1987

ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
Sir G Littler o.r
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Richardson

ORION ROYAL : GEMM

We warned you earlier that Orion Royal had decided to pull out of gilts market making. They will now be making an announcement on Monday morning.

2. Orion have been contemplating this for some time. They have not made enormous losses. But nor have they built up any convincing business. They have come to the conclusion that it is better to concentrate their resources elsewhere.

3. It is possible that some of the other GEMMs will watch very carefully to see what sort of publicity the decision generates. There are a few who might like to follow suit if they thought they could do so without losing too much face.

4. The move is unlikely to have any significant effect on the gilts market. There will still be more than enough market makers; and we are, of course, contemplating adding to their number.

5. In response to any questions, the Bank will say that this is a commercial matter for Orion to decide and that the implications for the gilts market are likely to be minimal. We should clearly do the same.

CWK
C W KELLY

pmp

From : D L C Peretz
Date : 19 November 1987

ECONOMIC SECRETARY

✓

cc Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr R I G Allen
Mr Kelly
Ms Ryding
Mr Cropper

HILL SAMUEL : GEMM

Following the TSB takeover, Hill Samuel/Wood McKenzie have been investigating the possibility of selling their gilt-edged market making operation to another buyer. The business has meanwhile been run on a care and maintenance basis only.

2. No buyer has been found, however, and they have now decided to close the business down. The announcement will be at 4.30 pm this afternoon.

3. This reduces the total number of market makers to 24 - with 2 (Japanese) applications for market maker status now on the table.

4. If asked, the Bank of England press office will say that the Bank's concern, which will be met, is that Hill Samuel's withdrawal as a gilt-edged market maker should be carried out in an orderly way. I suggest that IDT refer any enquiries they receive to the Bank of England.

DLCP

D L C PERETZ