

Review of the Cash Ratio Deposit Scheme: summary of responses

April 2008



HM TREASURY



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INTRODUCTION

1.1 The Treasury issued a consultation paper in August 2007¹ on the conclusions and recommendations arising from the review of the cash ratio deposit (CRD) scheme conducted earlier in the year. This document summarises the responses received to the consultation and sets out the next steps.

1.2 Under the CRD scheme, certain institutions authorised under the Financial Services and Markets Act 2000² to accept deposits (such as banks and building societies) place non-interest bearing deposits at the Bank of England. The Bank of England invests these deposits and spends the income earned on its monetary policy and financial stability functions, which benefit sterling deposit takers. As part of the last review of the cash ratio deposit scheme (which took place in 2003) the Government made a commitment to conduct a further formal review at the latest in five years time.

1.3 As part of the review, the Treasury had already consulted all institutions that are currently eligible institutions under the CRD scheme. Two representative bodies and 66 institutions responded (44 of which currently make a Cash Ratio Deposit).

1.4 As set out in the consultation paper in August 2007, the review reached the following conclusions:

- The CRD scheme continues to be a suitable method of funding the Bank of England's monetary policy and financial stability operations.
- The ratio should be changed from 0.15 per cent to 0.11 per cent, benefiting all institutions with eligible liabilities above the £500 million threshold by reducing the level of cash ratio deposits they must hold with the Bank of England. It is estimated that this will be a one-off reduction of around £700 million fewer deposits that the sector will hold at the Bank of England.
- All other parameters, including the minimum threshold for making deposits, should remain unchanged but be kept under review during the following five year period.
- In response to the conclusion in the 2003 review, the Bank of England has taken positive steps to enhance disclosure its expenditure on its monetary policy and financial stability operations, funded by the CRD scheme.
- The Government will continue to monitor the effect of the CRD scheme and will conduct a further formal review at the latest in five years' time.

1.5 In summary, the consultation document invited interested parties to make representations on the following issues:

- The proposal to reduce the CRD ratio from 0.15% to 0.11% but leave all other parameters of the scheme unchanged;
- Whether there are any technical aspects of the operation of the scheme that could be improved; and

¹ http://www.hm-treasury.gov.uk/consultations_and_legislation/crd/consult_crd2_index.cfm

² The Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 – article 163 – Amends the definition of eligible institutions for the purposes of the CRD scheme.

- How the transparency of the CRD scheme could be further improved, either through the release of further information or through the release of information through different communication channels.

2

SUMMARY OF RESPONSES

2.1 A total of four responses were received to the consultation, which included two representative bodies responding on behalf of their members. A list of those who responded is attached at Annex A. The responses are summarised below under each of the elements being consulted upon.

The proposal to reduce the CRD ratio from 0.15% to 0.11% but leave other parameters unchanged

2.2 All respondents supported the proposal to reduce the CRD ratio from 0.15% to 0.11%. However, respondents also advocated either changes that could be made to other parameters of the scheme or the replacement of the CRD scheme with alternative arrangements.

2.3 Three respondents suggested that the minimum threshold for eligible liabilities (currently £500 million), above which CRDs must be held with the Bank of England, should be adjusted by reference to a suitable index in future years. This would make it less likely for smaller institutions to reach the minimum threshold. However, the other respondent said the burden of the CRD scheme fell disproportionately on larger financial institutions.

2.4 One respondent suggested that the CRD scheme should be replaced, proposing an alternative whereby the costs of the Bank of England's monetary policy and financial stability functions should be met by seigniorage income from the issue of banknotes. It argued that such an approach would be simpler to administer and would shift the burden of financing the Bank of England's functions from the financial sector specifically to society in general, because the resulting shortfall in seigniorage income to the Exchequer would be met from general taxation. It argued that this funding base would be more appropriate because society in general benefits from the Bank's monetary policy and financial stability activities. Two other respondents proposed funding the Bank of England directly through general taxation as an alternative to the CRD scheme. One respondent commented that the Government itself is a beneficiary of monetary policy and financial stability and should therefore contribute a proportion of the costs. One respondent held that the CRD scheme reduced the attractiveness of the City of London for financial institutions.

Government Response

2.5 The Government welcomes the positive response from the industry to its intention to reduce the CRD ratio from 0.15% to 0.11%, which is expected to release an estimated £700 million of CRDs back to eligible institutions.

2.6 The review of the CRD scheme considered the desirability of changing the minimum threshold for eligible liabilities, including whether to introduce a suitable index to increase it. As stated in the consultation document, there was no consensus on this issue among the many institutions that responded to the initial consultation with the industry. Within that consultation, some institutions called for the minimum threshold to be raised whereas others argued for it to be abolished. The review concluded that a change to the minimum threshold in either direction would have a disproportionate negative impact, either in terms of introducing a new regulatory burden on smaller institutions if decreased or further focusing the financial burden on larger institutions if increased. A change would also impact on availability to remunerated reserves and standing facilities at the Bank of England.

2.7 The Government therefore intends to keep the minimum threshold unchanged at £500 million for the time being but to keep it under review over the next five years.

2.8 The review considered carefully the responses proposing an alternative to the CRD scheme. The review found that the CRD scheme has continued to meet its objective of funding the Bank of England's policy functions and continues to be a suitable method of funding the Bank of England's monetary policy and financial stability operations. By taking deposits from banks and building societies, the Bank of England's functions are effectively being financed by bank and building society customers (business and individuals) and shareholders, a broad base of beneficiaries of the Bank's activities. The scheme also provides the Bank of England with a degree of financial independence from Government that would be removed were it to be replaced by some form of general taxation.

Whether there are any technical aspects of the operation of the scheme that could be improved

2.9 There were no unifying messages in response to this question. Some felt that the technical and operational aspects of the scheme continue to work effectively whereas others highlighted specific areas where they put forward possible improvements.

2.10 Linked to the issue of applying an index to the minimum threshold, one respondent suggested that small institutions below the threshold might like to be given a choice to join the scheme, as eligible status would then give them access to the Bank of England's remunerated reserves and standing facilities.

2.11 One response suggested that the Bank of England should invest a significant proportion of CRDs directly with eligible institutions within the scheme rather than in gilts. It was argued that this would provide the Bank of England with a higher rate of return than it currently receives and would provide an additional source of funds for eligible institutions. One respondent proposed that any excess income over costs generated by the scheme should be returned to eligible institutions rather than at present where any excess is retained as profit and contributes to the Bank's reserves, corporation tax and the Treasury's dividend as Bank shareholder, according to a formula.

Government Response

2.12 Access to remunerated reserves and standing facilities is available to all banks and building societies that are required to place CRDs at the Bank of England. Eligibility to participate in these facilities is described in detail in the framework document available on the Bank of England's website. As a result of changes to this framework since the review of the CRD Scheme in 2003, more banks have been given direct access to the Bank of England, through holding reserves and/or having access to standing facilities and/or settling payments directly across Real Time Gross Settlement accounts with the Bank of England.

2.13 The adjustments proposed to the CRD scheme are aimed at generating income sufficient to fund the policy functions of the Bank of England under prudent assumptions. There is no intention that the scheme should generate any excess income and the parameters of the scheme are set according to forecasts of Bank of England costs, growth in eligible liabilities and the rate of return likely to be achieved. These forecasts are subject to uncertainty and either an excess or shortfall of income could arise. It is the responsibility of the Court of Directors of the Bank of England to ensure that it makes the most efficient use of the Bank's resources, including the CRDs it holds and the assets in which they are invested, and to ensure that spending on its policy functions is effective.

2.14 For the forthcoming five year period, the Government will keep the parameters of the CRD scheme under active review and if either a sustained excess or shortfall in income materialises will consider bringing forward changes, so as to return the excess or make good the shortfall.

How the transparency of the CRD scheme could be further improved

2.15 The responses were interested in the transparency of the CRD scheme. The main focus was in wishing to have more information on how the money raised by the CRD scheme was used. One response proposed an evaluation of how the Bank of England's activities have helped achieve its objectives and how they have provided benefits to members of the CRD scheme. One response suggested that such information might best be communicated directly to eligible participants in the CRD scheme. Yet another response proposed that eligible institutions should be given some influence over the Bank's spending plans, perhaps through a meeting with the Bank before its annual budget was agreed.

Government Response

2.16 The Government notes the request for greater transparency, focused on the operations of the Bank in general rather than the CRD scheme in particular. Much of the information specifically requested in responses, such as a breakdown in spending between monetary policy and financial stability and an evaluation of performance against its objectives, is already published as part of the Bank of England's Annual Report. This suggests that there may be scope for better communication of the available information direct to eligible participants and other interested parties.

3

NEXT STEPS

3.1 The Government is to lay secondary legislation before Parliament to implement the change of the CRD ratio from 0.15% to 0.11%. It is the intention for this legislation to come into force on 2 June 2008. The Government will then keep the parameters of the scheme under active review for the following five year period. Consideration will also be given to steps to improve communication about the Bank's spending plans to eligible participants and other interested parties. The Government will review the CRD scheme after a further five years at the latest.

A

LIST OF RESPONDENTS

British Bankers Association (BBA)
Building Societies Association (BSA)
Furness Building Society
Nationwide Building Society

B

IMPACT ASSESSMENT

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of Changes to the Bank of England's Cash Ratio Deposit Scheme	
Stage: Implementation	Version: 2.0	Date: 18 March 2008
Related Publications: Review of the cash ratio deposit scheme: consultation on proposed changes (August 2007).		

Available to view or download at: <http://www.hm-treasury.gov.uk>

Contact for enquiries: Roopal Khoda

Telephone: 020 7270 5832

What is the problem under consideration? Why is government intervention necessary?

The Government committed to review the Cash Ratio Deposit (CRD) scheme by 2008 at the latest. The CRD scheme is the means by which the Bank of England (the Bank) funds its work on monetary policy and financial stability. The review found that the scheme has been raising greater income than required to finance the Bank of England's monetary policy and financial stability activities. It is therefore necessary to reduce the contribution that financial institutions must make to reduce unnecessary burden on the financial sector. Under the Bank of England Act 1998 this must be done through secondary legislation.

What are the policy objectives and the intended effects?

The Cash Ratio Deposit scheme is intended to finance the Bank of England's monetary policy and financial stability activities. The intended effects of this change to the parameters of the scheme are to ensure that the income received by the Bank of England is in line with its forecast expenditure.

What policy options have been considered? Please justify any preferred option.

The review concluded that the Cash Ratio Deposit scheme remained an effective way of financing the Bank, but that some changes to its parameters were required to match income with expenditure. It also concluded that the scheme provides the Bank of England with a degree of financial independence from Government that would be removed were it to be replaced by some form of general taxation. Options considered for changing the parameters of the scheme included amending the definition of 'eligible liabilities' for the scheme, altering the threshold above which eligible financial institutions are required to contribute, and altering the amount they are required to contribute. Under the 1998 Bank of England Act, all of these must be effected through secondary legislation. The preferred option is to amend the amount of contribution, as this keeps the base of the scheme broad while not introducing a new regulatory burden on smaller institutions.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

No later than 2013.

Ministerial Sign-off For implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



..... Date: 18 March 2008

Summary: Intervention & Options

Department /Agency: HM Treasury		Title: Impact Assessment of Changes to the Bank of England’s Cash Ratio Deposit Scheme	
Stage: Implementation	Version: 2.0	Date: 25 March 2008	
Related Publications: Review of the cash ratio deposit scheme: consultation on proposed changes (August 2007).			

Available to view or download at: <http://www.hm-treasury.gov.uk>

Contact for enquiries: Roopal Khoda

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Signed by the responsible Minister:

..... Date:

Summary: Analysis & Evidence

Policy Option:

Description: Secondary legislation to adjust the ratio of eligible liabilities that eligible institutions must hold with the Bank of England above the threshold level of the CRD scheme.

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' The only cost incurred will be as a result of systems updates required to administer the new parameters of the scheme. This is likely to be very small but is difficult to estimate.
	One-off (Transition)	Yrs	
	£ Negligible		
	Average Annual Cost (excluding one-off)		
	£ 0		Total Cost (PV) £ Negligible
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' A reduction in the amount that eligible institutions (broadly, circa 150 of the largest banks and building societies) are required to hold at the Bank of England on a non-interest bearing basis of around £700 million, making these funds available for investment. Using the Bank of England base rate (5.25%) as the assumed return that the banks and building societies will receive this will generate circa £36.75 million interest per annum. The 10-year present value (10 years being the "typical" time horizon advised in the Impact Assessment guidance), with an assumed discount rate of 3.5% is £316.33 million.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 36.75 million	10	Total Benefit (PV) £ 316.33 million
Other key non-monetised benefits by 'main affected groups'			

Key Assumptions/Sensitivities/Risks The calculated return of £700 million to eligible banks and building societies (institutions with £500 million or more in eligible liabilities) is based on an assumed growth in eligible liabilities of 4.5% between 1st June 2007 and 2nd June 2008 when the revised scheme will be implemented. The key monetised benefits are also based on an assumed return on investment to eligible institutions equal to the current Bank of England base rate.

Price Base Year 2007	Time Period Years 10 yrs	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ 316.33 million
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	2nd June 2008
Which organisation(s) will enforce the policy?	Bank of England
What is the total annual cost of enforcement for these organisations?	£ Negligible
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	N/A
What is the value of the proposed offsetting measure per year?	£ N/A

What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro 0	Small 0	Medium 0	Large 0
Are any of these organisations exempt?	Yes	Yes	No	No
Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)	
Increase of £ 0	Decrease	£ 0	Net Impact	£ 0

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

The Bank of England Act 1998 put the cash ratio deposit scheme (by which the Bank of England's monetary policy and financial stability activities are financed) on a statutory footing. Under the Act, eligible institutions (deposit-taking institutions such as banks and building societies) with "eligible liabilities" (broadly equivalent to sterling deposits) are required to place a certain percentage of the amount above a threshold at the Bank of England on a non-interest bearing basis. A review of the scheme in 2003 set the threshold at £500 million and the ratio at 0.15%, committing the Treasury to review the scheme again in no later than 5 years. Under the Act, secondary legislation is necessary to establish the threshold and the ratio. The rationale behind the scheme is that the financial services sector benefits the most from the Bank of England's monetary policy and financial stability activities and so should therefore bear the burden of the payments.

The 2007 review of the cash ratio deposit scheme assessed how the scheme had met its primary aim of meeting the Bank's financial needs over the period. Its findings are outlined in detail in the consultation document "Review of the cash ratio deposit scheme: consultation on proposed changes – August 2007" and associated consultation response available on the Treasury website. Broadly speaking, the review noted that:

- the scheme had generated greater income than forecast in 2003 (£613m compared to £575m), due to faster than expected growth in eligible liabilities;
- the Bank's expenditure had been lower than forecast in 2003 (£531m compared to 375m), due to steps taken by the Bank to focus on core activities and increase efficiency.

The 2007 review looked at possible mechanisms for realigning income and expenditure, in order to ensure that the opportunity cost to financial institutions from holding CRDs at the Bank of England were kept to a minimum. It looked into the possibility of changing the threshold at which institutions are required to contribute and at changing the ratio.

The review considered the case for altering the threshold at which institutions were required to place CRDs at the Bank of England. It concluded that:

- keeping the ratio constant and increasing the threshold would require such a significant increase in the threshold to align income and expenditure that the burden of the scheme would fall on a very small number of institutions. This would not be justifiable given that the rationale behind the scheme is that the banking sector as a whole benefits from the Bank's monetary policy and financial stability activities;
- reducing the threshold would result in only a marginal increase in the income generated by the scheme (even if it were abolished), but would impose a regulatory burden on a considerable number of smaller institutions. It would therefore not be justifiable.

The review therefore concluded that the threshold should be kept constant at £500 million, and that the ratio that institutions should be required to contribute above that level should be reduced from 0.15% to 0.11%. This will result in a one-off repayment to the banking industry of CRDs currently held at the Bank of England of around £700 million. As the existing infrastructure and payment systems will remain unchanged, there will be no

change in the annual costs of administering the scheme either from the Bank of England or the banking sector's perspective.

It has been concluded that the implementation of this policy proposal would not have a negative impact on race, disability or gender equality.

More detailed analysis underpinning this change to the CRD scheme can be found in the consultation document and associated Treasury response.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes/No	Yes/No
Sustainable Development	Yes/No	Yes/No
Carbon Assessment	Yes/No	Yes/No
Other Environment	Yes/No	Yes/No
Health Impact Assessment	Yes/No	Yes/No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes/No	Yes/No
Rural Proofing	Yes/No	Yes/No

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