

The Bank of England as a bank

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- Much is published about the Bank of England's policy functions and its financial operations. But less is typically known about the Bank's role as a bank in the more traditional sense, offering accounts and banking services to its customers.
- The three main customer groups to which the Bank provides banking services are: the UK Government; overseas central banks; and certain other financial institutions, such as central counterparties.
- The Bank's approach is not to compete with commercial banks, but to provide banking services where doing so supports its mission and in particular its objective to maintain financial stability.

Overview

The public policy functions of the Bank of England are well documented. So too are a number of the Bank's core financial operations. Underpinning these operations is the Bank's capability to set the short-term risk-free interest rate, provide liquidity support to the banking system, facilitate the settlement of interbank payments and safely issue banknotes. These are activities which either the Bank alone can undertake in the United Kingdom, or for which there are clear financial stability benefits of it doing so.

But the Bank also has the capability to provide banking services to customers. This role as a bank in the more traditional sense may be generally less well known. This article provides an outline of the banking services which the Bank provides to its three main groups of customers. These customers are:

- **The UK Government.** The Bank was founded in 1694 to act as the Government's banker and debt-manager. The Bank's role has evolved over time and, focusing on the past two decades, there have been quite marked changes. In this period the Bank ceased to be the Government's agent for debt and cash management and also withdrew from providing it with retail banking services. Today the Bank provides the Government with wholesale banking services.
- **Overseas central banks.** The Bank provides a range of banking services to central banks around the world. Doing so can help those central bank customers to operate safely in sterling markets, which in turn can support international financial stability. Banking relationships are one way in which central banks can maintain a strong network — and this, in

Gold vault at the Bank of England



The Bank is one of the largest custodians of gold in the world, with over 400,000 gold bars stored in its vaults. Safe custody is provided for customers including the UK Government and overseas central banks.

turn, helps to support the Bank's broader financial stability objective.

- **Certain other financial institutions.** One example is central counterparties (CCPs), which can play a key role in maintaining the stability of the financial system. By providing banking services to CCPs, whose systemic importance is expected to increase further, the Bank can facilitate a reduction in risk across the market as a whole.

The banking services that the Bank provides to its customers could, in principle, be provided by commercial banks. Therefore the Bank typically provides these services only where there is a clear financial stability rationale. Its approach is not to compete with commercial banks. As with the Bank's policy roles, the banking services it provides to customers have evolved over time while still remaining a key part of the Bank's functions.

(1) The author would like to thank Ian Dawes for his help in producing this article.

The roles and functions of the Bank of England have evolved and changed over its 320-year history. In the past two decades in particular, the Bank's responsibilities have expanded markedly. The 1998 Bank of England Act saw the establishment of the Monetary Policy Committee, following the Government's announcement in May 1997 of its intention to give the Bank operational responsibility for setting interest rates. In 2009, the Bank was given the role of resolution authority to deal with failing banks and building societies and the Bank's oversight of interbank payment systems was put on a statutory footing.

More recently, the introduction of wholesale changes to the UK regulatory landscape following the financial crisis included significant new responsibilities for the Bank. These came into force in April 2013. They included the microprudential regulation of insurers, deposit-takers and major investment firms through the creation of the Prudential Regulation Authority, as well as macroprudential regulation of the financial system as a whole through the creation of the Financial Policy Committee.⁽¹⁾

Much has been published about these new public policy functions. But in contrast, the Bank's role as a bank in the more traditional sense — providing banking services to specific groups of customers — may be generally less well known. This article outlines this important aspect of the Bank's work. It begins by briefly highlighting some of the Bank's main financial operations used to deliver its mission to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. It then moves on to discuss the Bank's banking activities undertaken for its three broad groups of customers: the UK Government, other central banks and certain other financial institutions.

The Bank's market and banking activities

The Bank's position as the central bank of the United Kingdom is integral to the market and banking activities (together called financial operations) that it undertakes. The Bank is the sole supplier of 'central bank money' in the United Kingdom. Central bank money takes two forms — Bank of England banknotes, and the balances ('reserves') that are held by commercial banks and building societies at the Bank.⁽²⁾ An important property of central bank money is that it is close to risk-free: the risk of the central bank defaulting is generally considered to be the lowest of any agent in the economy, given the central bank is financially supported by its Government.

The Bank has the capability to carry out a number of activities which either it alone can undertake in the United Kingdom (no commercial bank could do so) or for which there are clear financial stability benefits of it doing so. These include:

- **Setting the short-term risk-free interest rate.** The Bank remunerates reserves balances, and in so doing establishes a benchmark short-term risk-free rate. That remuneration rate is typically Bank Rate. From day to day, banks can choose to change their holdings of reserves, and the level of Bank Rate will influence the rates they are willing to charge or pay on short-term loans or borrowings in the market.
- **Providing liquidity support to the banking system.** The Bank, as the supplier of central bank money, is able to be a 'backstop' provider of liquidity, and can therefore provide liquidity insurance to individual, creditworthy institutions and to the banking system as a whole.
- **Facilitating the settlement of interbank payments.** The Bank is the settlement agent to the major sterling UK payment systems, providing accounts to commercial banks that allow them to transfer money to settle interbank obligations.⁽³⁾ Interbank payment obligations arise, for example, whenever payments are made between the accounts of customers at different commercial banks through one of the interbank payment systems. Were a settlement agent to default, account holders would lose the mechanism for settling interbank obligations. This risk is largely eliminated by the Bank fulfilling this role, given that its default risk is generally considered to be the lowest of any agent in the economy.
- **The safe issuance of banknotes.** The high level of public trust in Bank of England banknotes stems from their being a liability of the central bank, financially supported by the Government.⁽⁴⁾
- **Providing banking services to customers.** The Bank provides a number of banking services to specific groups of customers. These services could, in principle, be provided by a commercial bank. However, the Bank's approach is not to compete with commercial banks and typically it provides customer banking services only where there is a clear financial stability rationale. The Bank seeks only to cover its costs from providing these services.⁽⁵⁾ As the central bank of the United Kingdom, the Bank's banking services differ from those of commercial banks in several ways: they are close to credit risk free; they are not likely to be adversely

(1) For more details on the changes to the Bank's responsibilities, see Chancellor of the Exchequer (1997), Murphy and Senior (2013) and the Bank's website at www.bankofengland.co.uk/about/Pages/legislation/default.aspx.

(2) For more information on the different types of money in the modern economy, see McLeay, Radia and Thomas (2014).

(3) The Bank acts as the settlement agent for the CREST securities settlement system and the following payment systems: Bacs, CHAPS, Cheque and Credit Clearing, the Faster Payments Service, LINK, and Visa Europe. For more details see Dent and Dison (2012).

(4) Some Scottish and Northern Ireland commercial banks are authorised to issue their own banknotes, but they must back their note issue with a combination of Bank of England notes, funds in an interest-bearing bank account at the Bank or UK coin.

(5) The Bank's customer banking activities are not financed by cash ratio deposits (CRDs). For more information on CRDs, see www.bankofengland.co.uk/statistics/Pages/faq/faq_crds.aspx.

affected by stressed market conditions; and they are free of profit motives.

The remainder of this article focuses on this latter customer banking activity. It sets out the main groups of customers, gives an overview of what banking services are provided to them and explains how this fits into the Bank's wider mission. The box on page 132 addresses the other activities listed above and how they underpin the Bank's core financial operations.

The Bank's customer banking activities

The Bank provides customer banking services to three main groups of customers. First, it provides the Government with wholesale banking services. This can reduce the credit risk the Government would otherwise face holding sterling deposits overnight in the commercial sector and may help to avoid potential conflict for the Government in discharging its own functions. Second, it provides other central banks with a range of banking services. The provision of these services can help these central bank customers to operate safely in sterling markets which in turn can support international financial stability. Banking relationships are one way in which central banks can maintain a strong network, which can enhance co-operation and contribute to strong working relationships between central banks more generally. This helps to support the Bank's broader financial stability objective. And third, the Bank provides customer banking services to certain other financial institutions such as central counterparties (CCPs), where the provision of such services to them clearly supports the stability of the financial system.

The Bank has to exercise judgement in deciding which customer banking services to provide. This assessment may change over time as circumstances change, and central banks across the world may reach different conclusions on the banking services they are willing to offer to their own customers. In the Bank's case, there have been two significant shifts in recent years: one has restricted the provision of banking services; the other has acted to widen availability to certain customers.

First, there has been a restriction on the types of banking service offered to Government customers. Following a review of its customer banking activities, the Bank decided in 2004 to withdraw from the provision of retail banking services to its customers, including to Government departments (for example, clearing cheques and processing Bacs Direct Credits and Direct Debits). The Bank concluded that the provision of these services did not form an integral part of its role as a central bank and could be carried out by the private sector. The Bank now focuses on those customer banking activities which support its mission and in particular its objective to maintain financial stability; this includes providing wholesale banking services to the Government.

Second, the Bank has increased the availability of intraday banking services offered to CCPs — a type of financial market infrastructure. These are entities that place themselves between counterparties to contracts traded in financial markets, becoming the buyer to every seller and the seller to every buyer. The Bank's provision of banking services to CCPs (discussed in more detail later in the article) can facilitate a reduction in risk for these CCPs and thereby across the market as a whole. Making banking services available to CCPs is consistent with international standards, as set out in the 'Principles for financial market infrastructures' published by CPSS-IOSCO in April 2012.⁽¹⁾ The intraday banking services the Bank offers to CCPs provide distinct benefits from those which banks can gain from accessing the Sterling Monetary Framework (see the box on page 132).

The following subsections outline the range of banking services that the Bank offers to its three main groups of customers: the Government, other central banks and, where there are financial stability reasons to do so, certain other financial institutions.⁽²⁾

Government customers

The Bank was founded in 1694 to act as the Government's banker and debt-manager. From the beginning it had kept the state's banking accounts; the Bank's first transaction — and its reason for being — was to loan money to the Exchequer in order to finance a war with France. The Bank's role has evolved over time and, focusing on the past two decades, there have been two quite marked shifts in relation to banking for Government.

The first came in 1997 when the Chancellor of the Exchequer announced that the Bank's role as the Government's agent for debt and cash management would be transferred to HM Treasury, as part of reforms to the monetary policy framework. The Debt Management Office (DMO), an executive agency of HM Treasury, was established on 1 April 1998 to take up this role and gained full responsibility for Government Exchequer cash management on 3 April 2000.⁽³⁾

The second shift came in 2004 when the Bank announced its intention to withdraw from the provision of retail banking and clearing services to its customers — including to its Government customers. Following a managed transition programme that was completed in 2010, the Bank's Government customers found alternative providers for their retail banking requirements (such as making and receiving payments through Bacs and Cheque and Credit Clearing).

(1) See Committee on Payment and Settlement Systems Technical Committee of the International Organization of Securities Commissions (2012).

(2) A limited range of banking services is also provided to Bank staff and pensioners.

(3) See Chancellor of the Exchequer (1997). For more information on the DMO, see www.dmo.gov.uk/.

The Bank's financial operations

As explained in the main text of this article, there is a set of activities which the Bank alone has the capability to perform, or for which there is a clear financial stability benefit for it doing so. These activities underpin a number of core financial operations which the Bank undertakes today. This box provides a brief outline of three of those: operating the Sterling Monetary Framework; operating the United Kingdom's Real-Time Gross Settlement (RTGS) infrastructure; and issuing banknotes. All of these are well documented in other Bank publications. This box also outlines a core financial operation the Bank can undertake outside the Sterling Monetary Framework, in its capacity as lender of last resort.

Operating the Sterling Monetary Framework

The Bank's operations in the sterling money markets — known as the Sterling Monetary Framework (SMF) — are designed to implement the Monetary Policy Committee's decisions in order to meet the inflation target and to reduce the cost of disruption to the liquidity and payment services supplied by banks and building societies to the UK economy. The SMF has been substantially reformed in recent years as the Bank responded to the financial crisis. In 2012, the Court of the Bank asked Bill Winters to review the Bank's framework for providing liquidity to the banking system. That review made a number of recommendations of which the Bank accepted the majority. Most of the Bank's responses were implemented by early 2014; further work is being undertaken on some issues and the Bank will say more on them in 2014.⁽¹⁾

Operating the United Kingdom's Real-Time Gross Settlement infrastructure

The Bank operates the RTGS infrastructure, which acts as an accounting system in which banks and building societies hold their sterling reserves (central bank money) in reserves accounts. Reserves are among the safest and most liquid assets a bank can hold, are the ultimate means of payment

Today, retail banking services to Government are provided by commercial banks and managed by the Government Banking Service, which was established in April 2008.⁽¹⁾

The role that the Bank has retained in banking for the Government is the provision of wholesale banking services. This includes maintaining a number of sterling accounts which come together in the so-called 'Exchequer Pyramid'.

The Exchequer Pyramid is made up of a total of 35 separate accounts, some of which are operated by HM Treasury, others by the DMO and some by the Government Banking Service. Three key accounts in the Exchequer Pyramid are:⁽²⁾

between banks and form part of the monetary policy transmission mechanism. Whenever sterling payments are made between the accounts of customers at different commercial banks, they are ultimately settled by transferring reserves between the reserves accounts of those banks in RTGS. In this regard, accounts in RTGS are effectively sterling current accounts for banks.⁽²⁾

Issuing banknotes

The Bank's issuance of banknotes, making central bank money available to individuals and organisations, is one of the Bank's most recognisable functions. The public has confidence in banknotes because of the stability in the value of money — through low and stable inflation (the focus of monetary policy) — and also because of confidence that the physical notes in circulation are genuine, can be easily exchanged and are readily available in a variety of denominations.⁽³⁾

The Bank as lender of last resort

In times of stress, the Bank can also provide liquidity insurance outside the SMF by providing Emergency Liquidity Assistance (ELA). An example of the Bank discharging its responsibilities as lender of last resort was at the height of the financial crisis in 2008–09 when it provided ELA on a large scale to Royal Bank of Scotland and HBOS. In 2012, the Court of the Bank commissioned Ian Plenderleith to conduct a review into these operations. That review made a number of recommendations to improve the Bank's capability to conduct ELA operations in the future. The Bank accepted the majority of the recommendations and work to implement them is ongoing.⁽⁴⁾

(1) For more details on the SMF, see Bank of England (2014). For more details on the Winters Review and the Bank's initial response, see Winters (2012) and Bank of England (2013).

(2) For more details, see Dent and Dison (2012).

(3) See Allen and Dent (2010). For information on current security features on banknotes, see www.bankofengland.co.uk/banknotes/Pages/educational.aspx.

(4) For more details on the Plenderleith Review and the Bank's initial response, see Plenderleith (2012) and Bank of England (2013).

- **The Consolidated Fund** operated by HM Treasury. This can be considered as the Government's current account which, for example, receives tax revenues collected by HM Revenue and Customs and makes payments to fund the spending of Government departments.

- **The National Loans Fund** operated by HM Treasury. This is the Government's main borrowing and lending account, the main role of which is to finance outgoings from the

(1) For further information, see www.hmrc.gov.uk/gbs/.

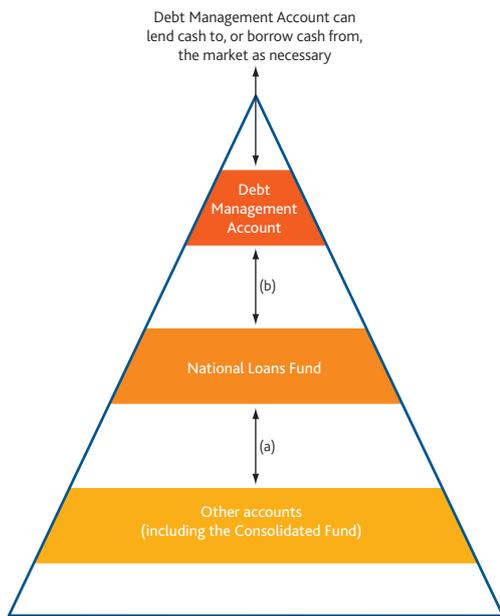
(2) For more details on the Consolidated Fund, the National Loans Fund and the Debt Management Account, see HM Treasury (2013a, 2013b) and United Kingdom Debt Management Office (2013a).

Consolidated Fund where that Fund’s receipts are insufficient.

- **The Debt Management Account** operated by the DMO. The purpose of this account is to fund the requirements of the National Loans Fund. The Debt Management Account undertakes day-to-day borrowing and lending with the market in order to manage the Government’s cash requirements.

A stylised representation of the Exchequer Pyramid is shown in **Figure 1**. Outside the Exchequer Pyramid, during the business day, the Government Banking Service will make and receive payments on behalf of the Government, using commercial banks. At the end of the business day, all of the Government’s significant sterling cash balances are transferred into Exchequer Pyramid accounts so that they can be held at the Bank overnight. Holding these cash balances within the Bank serves to minimise the credit risk that the Government faces from holding sterling deposits overnight.

Figure 1 Stylised representation of the Exchequer Pyramid



- (a) At the end of the business day, any surplus cash balances sitting in accounts within the Exchequer Pyramid are swept into the National Loans Fund. Deficit cash balances are covered by drawing cash down from the National Loans Fund.
- (b) Once these sweeps are complete, any surplus cash sitting in the National Loans Fund is swept up into the Debt Management Account. Any deficit cash balance in the National Loans Fund is covered by drawing cash down from the Debt Management Account.

The Exchequer Pyramid is also designed to make the Government’s daily cash management more efficient by reducing gross funding requirements through the netting of surplus and deficit cash balances across the numerous Government accounts. At the end of the business day, any surplus cash balances sitting in accounts within the Exchequer Pyramid (for example from other Government departments) are swept into the National Loans Fund. Deficit cash balances are covered by drawing cash down from the National Loans

Fund. So, for example, if the Consolidated Fund has a surplus cash balance at the end of the business day, that cash is swept up to the National Loans Fund; any deficit on the Consolidated Fund is covered by drawing cash down from the National Loans Fund.

Once these sweeps are complete, a similar sweep process happens between the National Loans Fund and the Debt Management Account. Based on forecasts of these flows within the Exchequer Pyramid, funds can be lent to, or borrowed from, the market by the Debt Management Account as necessary to reach a targeted credit balance on the Debt Management Account. The workings of the Exchequer Pyramid are designed to minimise the amount of money the Debt Management Account needs to borrow to meet the Government’s daily cash requirements.⁽¹⁾

As well as providing its Government customers with wholesale banking services in sterling, the Bank provides the Government with other banking services, including foreign currency accounts and payment services, and securities custody and settlement services. The Bank also acts as HM Treasury’s agent in the day-to-day management of the Exchange Equalisation Account (EEA). The EEA holds the United Kingdom’s reserves of gold, foreign currency assets and International Monetary Fund Special Drawing Rights.⁽²⁾

Central banks

Another main group of customers is overseas central banks. The Bank currently provides a range of banking services to 154 overseas central banks and official sector financial organisations.

Central banks may hold foreign currency assets, for example to support their monetary policy objectives or reserves management, or may wish to undertake transactions in a foreign currency. The Bank’s provision of banking services to these central bank customers can help them to operate safely in sterling markets, reducing the credit risk they would otherwise face from holding assets at, or transacting directly with, commercial banks. This can support international financial stability.

The banking services provided to central banks include sterling call accounts (broadly similar to a current account) and payment services.⁽³⁾ The Bank also provides a service allowing them to deposit sterling, or certain foreign currencies, for a fixed term to earn an agreed rate of return. The Bank invests these ‘fixed-term deposits’ in money market instruments subject to risk management guidelines. While this service is

(1) For more details on Government cash management, see United Kingdom Debt Management Office (2013a, 2013b).
 (2) For more details on the EEA, see HM Treasury (2013c).
 (3) As part of this sterling service, the Bank also offers central bank customers a foreign currency conversion payment service.

provided for the benefit of central bank customers, it also facilitates market intelligence gathering by the Bank.

The Bank is one of the largest custodians of gold in the world, with over 400,000 gold bars stored in its vaults. A picture from inside a gold vault at the Bank is shown in **Figure 2**. Alongside providing safe custody for the United Kingdom’s gold reserves, the Bank also provides gold custody services to its central bank customers. Gold storage is provided on an allocated basis, meaning that the customer retains the title to specific gold bars in the Bank’s vaults, rather than a claim on the Bank for a certain weight of gold. This means that gold held on behalf of customers does not appear on the Bank’s balance sheet.

Figure 2 Gold vault at the Bank of England



The average gold bar weighs around 13 kilos (or 28 pounds).

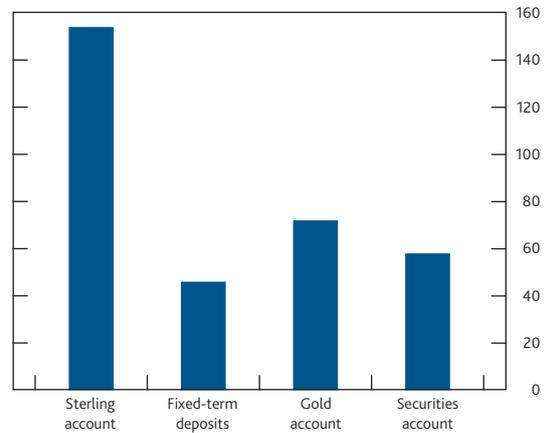
The Bank’s gold custody service also provides an interface for its central bank customers to access the liquidity of the London gold market. Providing this bridge between central banks and the London gold market supports the international network of central banks. This, in turn, helps to support the Bank’s broader financial stability objective.

Just as the Bank holds gold in custody for its customers, it can also provide custody and settlement services for securities. As a direct member of CREST (the securities settlement system operated by Euroclear UK and Ireland) the Bank can hold certain CREST eligible assets on behalf of customers. The Bank can also hold eligible domestic and international bonds on behalf of customers through an International Central Securities Depository. This enables central banks to hold and trade securities without the overheads of being direct members of these securities settlement systems.

The number of central bank customers by banking service is shown in **Chart 1**. The ‘sterling account’ service constitutes the largest number of customers because it is a requirement to hold a sterling account at the Bank in order to access the additional services. **Chart 2** shows the number of these

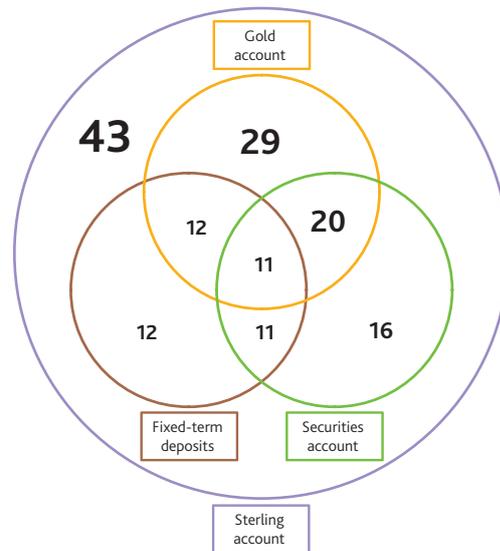
customers with various combinations of banking services. There are only a minority with all three additional services, while around a quarter have only a sterling account.

Chart 1 Number of central bank customers, by banking service^(a)



(a) This includes a small number of official sector financial organisations.

Chart 2 Number of central bank customers, by combination of banking service^(a)



(a) This includes a small number of official sector financial organisations.

Other financial institutions

In addition to the UK Government and other central banks, the Bank also acts as a bank to certain other financial institutions. One example is central counterparties (CCPs). CCPs place themselves between the buyer and seller of an original trade and effectively guarantee the obligations under the contract agreed between the two counterparties. If one counterparty were to fail, the other is protected via the default management procedures and resources of the CCP.⁽¹⁾

(1) For a primer on central counterparties, see Nixon and Rehlon (2013).

CCPs can play a key role in maintaining the stability of the financial system by managing counterparty credit risk and facilitating the smooth settlement of financial market transactions. But a consequence of clearing trades centrally is that CCPs themselves become crucial links in the financial network. The systemic importance of CCPs is expected to increase further as the clearing through CCPs of standardised over-the-counter derivatives becomes mandatory in line with commitments made by G20 leaders following the financial crisis.⁽¹⁾ The ability of CCPs to minimise and manage their risk is therefore a key consideration for the Bank, and the banking services it provides to CCPs are intended to contribute to reducing these risks.

The Bank provides intraday banking services to a number of CCPs, including cash accounts known as 'concentration accounts'. A CCP can receive significant values of cash payments from its clearing members each day which are often collected through a network of commercial banks. Typically, these funds are then 'concentrated' intraday at a single bank — the so-called 'concentration bank'. Similarly, payments can also be made out from the concentration account. The Bank's provision of banking services to its CCP customers can allow them to hold large amounts of near risk-free balances on an intraday basis, thereby reducing the credit risk they would otherwise face holding those balances in the commercial sector.

Providing these banking services to CCPs is in line with international standards which stipulate that a CCP should

settle 'in central bank money where practical and available'.⁽²⁾ The provision of these services is an example of how the Bank is implementing this international principle in the United Kingdom and how its role in terms of its provision of banking services has evolved in response to developments in financial markets.

Risk management

The Bank's customer banking activities are supported by robust risk management processes with a separation of duties between the operations and control functions. The area of the Bank which undertakes customer banking activities is monitored by staff with separate reporting lines who are responsible for developing and overseeing a framework to ensure that risks are effectively managed.

Conclusion

This article has described the Bank of England's role in providing banking services to its three main groups of customers. The services it offers to the Government, overseas central banks and certain other financial institutions largely reflect its position as the central bank of the United Kingdom and are typically provided only where there is a clear financial stability rationale. While the banking services provided by the Bank have changed over time, as external circumstances have changed and judgements are made on what supports the Bank's mission, banking nevertheless remains an integral part of the Bank's role.

(1) An over-the-counter trade is executed bilaterally between two counterparties, rather than through an exchange.

(2) See Committee on Payment and Settlement Systems Technical Committee of the International Organization of Securities Commissions (2012).

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