Competition and credit control: the discount market

Memorandum issued to the press by the Bank of England on 21st July 1971

In the document entitled *Competition and credit control* published by the Bank of England in May, it was stated that separate proposals would be made to the members of the London Discount Market Association for modifications to official techniques of monetary policy. These proposals have now been made and are being discussed with the Association.

In the document published in May it was stated that it would be part of the changes proposed by the authorities that the London and Scottish clearing banks should abandon their collective agreements on interest rates. The proposed changes also have implications for the agreements between the market and the clearing banks on tendering for and purchase of Treasury bills and on competition for non-bank funds by the market; and for the agreements which at present exist among the members of the market. The future of these agreements is under discussion.

The Bank have told the Association that they wish to maintain their existing mode of operation in the short-term money market. The Bank have therefore asked the market to agree to continue to apply each week for an amount of Treasury bills sufficient to cover the amount of bills offered at the tender; and have said that, if this agreement is forthcoming, they will be prepared to continue to confine to the market their extension of last resort facilities in the form of lending or purchases of eligible paper (apart, of course, from the usual direct purchases of bills from the banks in the day-to-day management of the money market and any facilities accorded by the Bank to money and discount brokers). The Bank have stated that when they extend last resort facilities by lending, they would require the houses to provide part of the collateral, up to a minimum proportion to be agreed, in the form of Treasury bills.

The authorities need to ensure that they have adequate influence over credit extended by the discount market, whether on the basis of funds borrowed from the banking system or of funds borrowed outside the banking system. In framing the proposals put to the market, the Bank have sought to move away from the existing system of quantitative controls and to devise arrangements which would allow members of the market freedom to compete. They have also borne in mind that their proposal that money at call with the market shall qualify without limit as a reserve asset for banks in satisfaction of the minimum requirement enhances the special place of the market in official techniques of monetary control.

In the Bank's view their objectives can be met by obtaining the agreement of members of the market to hold a stated minimum proportion of their funds in public sector debt,[1] conforming closely with the present average

1 British government and Northern Ireland government Treasury bills, local authority bills and bonds and British government, British government-guaranteed and local authority stocks with not more than five years to run to maturity.

practice for the market as a whole – namely 50% – and this has been proposed to them.

The Bank recognise that when their proposals on credit control are accepted and put into effect, members of the market could be approached by banks with requests to engage in very short-term transactions designed to substitute 'window-dressing' arrangements for genuine observance of their minimum reserve ratio obligation. The Bank have therefore asked each house to give a firm undertaking that they would not in any circumstances be prepared wittingly to engage in such transactions; and have said that they would reserve the right to call at any time for full information on the conduct of each house's book.

The Bank will, of course, continue to be concerned that the size of each house's total business bears an appropriate relationship to their capital and reserves.