# Reserve ratios and Special Deposits

Bank of England

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Following discussions by the Bank of England with the banking associations and with individual banks on the Bank's paper *Competition and credit control* which was published last May, agreement has been reached on new arrangements for the control of credit which will come into effect from 16th September. In future the banks will observe (day by day) a uniform minimum reserve ratio of $12\frac{1}{2}$ per cent of "eligible liabilities" and will place such Special Deposits with the Bank (on a uniform basis, related to eligible liabilities) as may be called for from time to time. This gives effect to the basic principles of the arrangements outlined in *Competition and credit control*, but in the course of the discussions a number of clarifications and modifications of detail to the original proposals have been agreed. The main features of the scheme are described in the following sections.

**Eligible liabilities** are defined as the sterling deposit liabilities of the banking system as a whole, excluding deposits having an original maturity of over two years, plus any sterling resources obtained by switching foreign currencies into sterling. Inter-bank transactions and sterling certificates of deposit (both held and issued) will be taken into the calculation of individual banks' liabilities on a net basis, irrespective of term. Adjustments will be made in respect of transit items.

**Eligible reserve assets** will comprise balances with the Bank of England (other than Special Deposits), British government and Northern Ireland government Treasury bills, company tax reserve certificates, money at call with the London money market, British government stocks with one year or less to final maturity, local authority bills eligible for rediscount at the Bank of England and (up to a maximum of 2 per cent of eligible liabilities) commercial bills eligible for rediscount at the Bank of England.

Eligible money at call with the London money market will comprise funds placed with members of the London Discount Market Association, with certain other firms carrying on an essentially similar type of business (the discount brokers and the money trading departments of certain banks traditionally undertaking such business) and with certain firms through whom the banks finance the gilt-edged market, namely the money brokers and jobbers. In order to constitute an eligible reserve asset, funds placed with these firms must be at call (or callable, if not explicitly at call) and must be secured (in the case of the jobbers, on gilt-edged securities).

**Special Deposits,** when called, will be a uniform percentage across the banking system, normally of each bank's total eligible liabilities; further consideration will be given to the possibility of different rates of call relating to overseas deposits. Calls and repayments will normally be announced on a Thursday with the announcement of Bank rate. Amounts called will be rounded to the nearest £5,000 and will be adjusted monthly to take account of changes in eligible liabilities as reported to the Bank. Special Deposits will bear interest at a rate equivalent to the Treasury bill rate.

**Interest rates** The London and Scottish clearing banks will abandon their collective agreements on interest rates as part of the new arrangements. In the light of discussions held with the banks, the authorities see no need, at least in present circumstances, to seek to limit the terms offered by the banks for savings deposits to protect the position of the savings banks and building societies.

**Transitional arrangements** The problems of adjustment mentioned in *Competition and credit control* are being met in two ways. Firstly, after allowing for the repayment of existing Special Deposits it was apparent that the reserve asset holdings of the London clearing banks over and above the prescribed minimum level would be quite out of proportion to their present and immediately prospective level of lending. These banks have therefore agreed to subscribe for some £750 million of three new government stocks, maturing respectively two, three and six years hence, to be issued concurrently with the repayment of outstanding Special Deposits. Secondly, individual banks whose holdings of reserve assets have hitherto been well below the prescribed ratio have been given the opportunity of agreeing with the Bank appropriate transitional periods (not extending beyond the end of the year) during which their reserve asset holdings may be built up gradually to the prescribed level.

**Northern Ireland banks** The new arrangements apply in principle to all banks in the United Kingdom. However, in the Bank's discussions with the Northern Ireland Bankers' Association, members of that Association, while accepting in principle the application to them of a reserve asset ratio, have represented that the unmodified application to them of the ratio now agreed with other banks in the United Kingdom would present certain difficulties peculiar to the branch-banking system in Northern Ireland. The difficulties arise, inter alia, from the fact that the system is operated by banking companies who, in varying degrees, also operate the branch-banking system in the Republic of Ireland. In acknowledging these difficulties, the Bank have accepted that further and detailed discussions must take place before a reserve asset ratio can be agreed with banks in Northern Ireland. In addition, the authorities acknowledge that the application of specific credit policy measures to Northern Ireland should, in the future as in the past, take account so far as practicable of such special economic conditions as may prevail there.

**The money market** Agreement has been reached with the London Discount Market Association on the basis of the Bank's proposals published in July. Members of the Association will continue to apply each week for a total amount of Treasury bills sufficient to cover the amount of bills offered at the tender. They will also maintain at least 50 per cent of their funds in defined categories of public sector debt. The Association have informed the Bank that, from the introduction of the new arrangements, they will no longer tender for Treasury bills at an agreed price. The discount brokers outside the Association will continue to participate in the Treasury bill tender and will maintain a similar minimum ratio of public sector debt, as will the money trading departments of certain banks (which will be treated separately from the rest of their business for this purpose). The Bank will continue to confine to the money market access to last resort lending facilities.

The categories of public sector debt to be included in the ratio will be British government and Northern Ireland government Treasury bills, company tax reserve certificates, 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.

**Finance houses** Agreement has been reached with members of the Finance Houses Association (and with certain individual houses outside the Association) on a scheme for instalment credit finance houses which take deposits, parallel to that agreed with the banks.

The Bank understand that some of these houses wish to seek full recognition as banks [in particular, under Section 25 (2) of the Protection of Depositors Act]; all houses obtaining such recognitions will be treated as banks for reserve ratio and Special Deposit purposes. The parallel scheme will apply in principle to all other instalment credit finance houses (whether members of the Finance Houses Association or not), although houses having eligible liabilities of less than £5 million will be exempt so long as they remain below this limit.

In all essentials the scheme for finance houses closely follows that for the banks. Eligible liabilities, as for the banks, will exclude deposits having an original maturity of over two years; however, as the houses remain outside the banking system, amounts borrowed from banks will also be excluded, so that the liability to hold reserve assets and make Special Deposits is not applied twice to the same funds. The required minimum reserve asset ratio will be 10 per cent instead of 12½ per cent, but the definition of eligible reserve assets will be the same. Calls for Special Deposits will normally be at the same rate as calls on the banks, but the Bank will have the right in certain defined circumstances to call Special Deposits from the finance houses at a higher rate. In no circumstances, however, will the total of reserve assets and Special Deposits represent a higher proportion of eligible liabilities for the finance houses than for the banks. Finance houses participating in these arrangements will be allowed a transitional period of twelve months in which holdings of reserve assets may be built up in stages to the required level.

**Banking statistics** On the third Wednesday of each month (and at end-quarters) each bank will complete a new return detailing its eligible liabilities, eligible reserve assets and reserve ratio position. For the time being these returns will be additional to present banking statistical returns. The definitions of the various items making up eligible liabilities and eligible reserve assets have been developed with the assistance of representatives of banking associations at a number of statistical working party meetings. It is intended that a permanent statistical committee should develop from this working party, in order to provide a forum at which longer-term problems concerning the collection of banking statistics may be examined. The new arrangements for monetary control envisage more uniform treatment of all groups of banks, and it will be necessary to achieve greater standardisation and uniformity in various types of returns now made by different categories of banks. At the same time it is hoped that fuller discussions will enable the authorities' needs for statistical information to be co-ordinated more closely with the banks' own requirements.

Bank of England
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