

Competition and credit control: further developments

There have been a number of developments in the arrangements for credit control since the last article on this subject – "Reserve ratios: further definitions", which was published in the December 1971 *Bulletin*, pages 482–9. These concern the position of banks in Northern Ireland; the possible application of Special Deposits at different rates to overseas, as compared with domestic, deposits; and some relatively minor technical changes in the definition of those forms of call money which may be counted as a reserve asset.

Banks in Northern Ireland

In *Reserve ratios and Special Deposits* issued as a supplement to the September 1971 *Bulletin*, it was stated that the new arrangements for credit control applied in principle to all banks in the United Kingdom but that, following representations from the members of the Northern Ireland Bankers' Association, the Bank accepted that more detailed discussions had to take place before a reserve asset ratio could be agreed for them. In particular, it was recognised that special problems arose from the fact that the branch banking system in Northern Ireland is operated by banks which, in varying degrees, also operate the branch banking system in the Republic of Ireland. The necessary discussions were concluded last summer, and the members of the Northern Ireland Bankers' Association (the "Northern Ireland banks") agreed, subject to certain modifications to the system, to move gradually, from the end of June 1972, towards a 12½% minimum reserve ratio, observing it in full from the end of December 1972.

The agreed modifications are:

- (1) in calculating its eligible liabilities, a member bank may exclude its net liability (if any) to its offices in the Republic of Ireland;
- (2) as an additional transitional arrangement, applicable for two years from the end of June 1972, a member bank may include among its reserve assets its holdings of certain liabilities of the central bank or government of the Republic of Ireland which have traditionally been regarded as liquid assets by the Northern Ireland banks. Any holdings so included must be in excess of those required by the Dublin authorities to satisfy ratios or quotas calculated in relation to deposits originating in the Republic, and should form only a modest proportion of the 12½% ratio; and
- (3) consideration will be given, if occasion arises, to the inclusion in reserve assets of special lending, *e.g.* under government guarantee, arising from the emergency in Northern Ireland or from the needs of reconstruction, if otherwise adherence to the 12½% ratio would severely impair the banks' ability to advance funds for such essential purposes.

Subsequently, the banks in Northern Ireland outside the Northern Ireland Bankers' Association, to whom modifications (1) and (2) above do not apply, also agreed to observe the 12½% ratio, subject to the transitional arrangements.

The Bank have recognised that the application of specific credit policy measures to Northern Ireland should, in the future as in the past, take account as far as practicable of such special economic conditions as may prevail there. Banks in Northern Ireland were exempted from the calls for Special Deposits made on 9th November and 21st December 1972. Certain Northern Ireland banks, however, make Special Deposits in respect of the eligible liabilities of offices which they maintain in Great Britain.

Figures for banks in Northern Ireland are now included (from mid-January) in Table 9 of the statistical annex. Those for members of the Northern Ireland Bankers' Association are shown separately and those for the others are included within the appropriate groups.

Differential Special Deposits

The Bank's consultative document *Competition and credit control* published in May 1971,¹ suggested that "The amount of Special Deposits to be placed with the Bank of England might be calculated by reference to all or only some of the banks' liabilities . . . In particular, a call could be related to domestic or to overseas deposits, or the rate of call might be different for domestic and overseas deposits".

There were two main reasons why the authorities wished to explore the possibilities mentioned in the discussion document of distinguishing between domestic and overseas deposits in calls for Special Deposits. It was thought that there might be occasions when domestic monetary policy considerations made it necessary for the authorities to try to limit the extent to which overseas sterling funds attracted by banks could contribute to an expansion of domestic credit. It was also felt that the authorities might sometimes wish to ensure that a general call for Special Deposits had no effect on banks' overseas deposits. In each case, the desire for some form of differentiation between domestic and overseas deposits in making such calls was seen largely in the context of domestic monetary policy, though it also seemed possible that it might supplement existing influences on flows of funds into and out of the United Kingdom.

In the event, when the new arrangements for control of credit were introduced in September 1971,² they provided only for general calls for Special Deposits. After discussions with the banks during that summer, it appeared that calls calculated in relation to overseas deposits at a rate significantly higher than was usually applied to general calls could cause difficulties, particularly for banks whose business was largely overseas. These banks considered that such differentiation would seriously upset the fine margins on which much of their overseas business was based, and might permanently impair their ability to conduct such business. In the light of these representations, the Bank agreed to leave the scheme open for further discussion.

¹ See June 1971 *Bulletin*, page 189.

² See *Reserve ratios and Special Deposits* issued as a supplement to the September 1971 *Bulletin*.

New proposals designed to take account of these arguments were circulated to the banks in the spring of 1972. There were still considerable problems of definition and complexities of application in the proposed scheme, particularly as regards sterling certificates of deposit, and the Bank expressed themselves ready to discuss any alternatives which were compatible with the objectives of the proposals. Comments received in the course of these discussions were subsequently reflected in a revised memorandum which was sent to the banking associations, the Finance Houses Association, and individual banks and finance houses during the autumn of 1972. All banks and finance houses affected by the proposals have given an assurance that they will abide by the arrangements set out in the memorandum, the text of which is reproduced as an appendix at the end of this note, and the scheme is accordingly ready for use if necessary.

The scheme agreed between the authorities and the banks and finance houses provides for a uniform rate of call for Special Deposits to be applied to any increase from a specified starting date in each bank's eligible overseas liabilities (mainly its overseas sterling deposits – see below). The starting date will generally be the mid-monthly make-up day after a call has been announced, but the Bank have reserved the right to specify the previous make-up day. Calls may be made at the same time as, or separately from, a uniform rate of call applied to the total of each bank's eligible liabilities. The scheme also allows the authorities to exempt from a general call each bank's overseas deposits outstanding or to make the call at a lower rate than on the remainder of their eligible liabilities. For the purpose of differential calls, overseas deposits consist of overseas customers' sterling deposits with an original maturity of two years or less, any net liability in sterling of U.K. banks to their overseas offices, and any net liability in other currencies. Those banks whose overseas deposits are subject to substantial daily fluctuations may choose to average them over a period in calculating the amount of a differential call, rather than use the specified base date.

One of the main problems of definition which emerged during the discussions with the banks concerned the treatment of sterling certificates of deposit. The calculation of each bank's eligible liabilities includes any net liability it may have on account of sterling certificates issued less certificates held. It is, however, impossible for a reporting bank to identify how much of any net liability in sterling certificates (which are bearer documents) is due to foreign holders and how much to domestic holders. It was decided therefore that reporting banks should arbitrarily assume that none would be in overseas hands (transit items are to be dealt with in the same way); the Bank may of course ban the issue or sale of sterling certificates of deposit to overseas holders by using exchange control powers. Where a differential call is made, sterling certificates of deposit will thus be classified as being held by U.K. residents, and will therefore be subject to the rate imposed under a general call.

The differential scheme extends to all banks and finance houses within the reserve ratio scheme; banks in Northern

Ireland, however, would be exempted from a differential call for Special Deposits in circumstances which warranted their exemption (as at present) from a general call. At the same time, parallel arrangements for differential calls are necessary for the institutions which maintain public sector lending ratios (the discount houses, the discount brokers, and the money trading departments of certain banks) in order to remove the possibility that they might provide a by-pass along which overseas funds could reach banks. It has therefore been agreed that any differential call for Special Deposits will be applied to these institutions, at the same rate as for the banking system, on any increase in overseas sterling funds borrowed after the base date, together with any increase in their net liabilities in other currencies.

Reserve assets

In addition to the inclusion of certain assets for Northern Ireland banks mentioned above, the following changes have taken place:

- (1) From the start of the reserve assets scheme, all secured lending at call to certain money brokers has counted as a reserve asset.¹ The number of such brokers was increased on 14th July 1972, when the Bank announced that three more firms of stockbrokers (James Capel & Co.; Hoare & Co., Govett; and Rowe & Pitman) had been recognised as money brokers for this purpose.
- (2) From 17th January 1973, money lent at call to jobbers on the London stock exchange has been eligible as a reserve asset if secured against the following stocks:
 - (a) British government stocks or stocks of nationalised industries guaranteed by H.M. Government;
 - (b) stocks issued by corporations, counties and public boards in Great Britain and Northern Ireland;
 - (c) stocks issued by corporations in, and provinces and governments of, Commonwealth countries; and
 - (d) Republic of Ireland government stocks and South African government and corporation stocks.

As a matter of market convenience, this broadens the range of stocks which may be offered by jobbers as security for call money. It was previously limited to the British government stocks and guaranteed stocks specified in (a) above.

¹ Cazenove & Co., Laurie, Milbank & Co., and Sheppards & Chase. See the December 1971 *Bulletin*, page 485.

Appendix

Special Deposits on overseas deposits

1 The document *Competition and credit control* issued by the Bank in May 1971 envisaged that it might sometimes be desirable, for the purposes of domestic monetary policy, to distinguish between domestic and overseas deposits in making calls for Special Deposits. In particular it was proposed, in paragraph 11, that calls for Special Deposits "... could be related to domestic or overseas deposits, or the rate of call might be different for domestic and overseas deposits." This memorandum sets out the method of implementing these proposals.

Calls for Special Deposits

- 2 Calls for Special Deposits will be made on the following basis:
- (a) A uniform rate of call applied to the total of each bank's eligible liabilities, as provided for in existing arrangements.
 - (b) Additionally to, or separately from, (a) above, a uniform rate of call applied to the increase, if any, in each bank's liabilities to overseas residents from a specified starting date (excluding any increase in certificates of deposit issued).
 - (c) As in (a) above, but exempting from the call, or applying a lower rate of call to, each bank's outstanding liabilities to overseas residents (excluding certificates of deposit).

Definition of overseas deposits

3 For the purposes of 2 (b) and (c) above, each bank's liabilities to overseas residents will be established by reference to *Form RR*¹ and account will be taken of the increase in, or outstanding amount of, the following items:

- (a) Sterling deposits of overseas residents, with an original maturity of two years or less (excluding deposits from overseas offices) [item 3 on *Form RR*].
- (b) Net liability, if any, to overseas offices in sterling [item 4].
- (c) Net liability, if any, in currencies other than U.K. sterling [item 16].

4 As it is impossible to identify the liabilities to which transit items relate, no adjustment will be made for such items in calculating Special Deposits on overseas deposits. For this purpose all transit items will be allocated to domestic deposits.

Base date for calls differentiating against overseas deposits

5 The base date for a call made in accordance with 2 (b) above will generally be the mid-monthly make-up day following the announcement of the call. The Bank reserve the right, however, to specify the previous make-up day if, in their opinion, the circumstances warrant it.

Averaging of overseas deposits

6 Exceptionally, and for the purpose of calculating a call as in 2 (b) above, banks may elect to have their overseas deposits averaged over the eight Wednesdays up to and including the base date and each succeeding mid-monthly make-up day instead of being taken at their actual level on make-up days. Any bank opting for this alternative would be required to submit weekly returns to the Bank from the date of announcement of the call and to provide such earlier information as was necessary.

Other technical arrangements

7 The technical arrangements made for general Special Deposit calls will apply equally to differential Special Deposit calls.

¹ The form on which eligible liabilities and reserve assets are reported.