Speech by the Governor of the Bank of England

Given to the Trustee Savings Banks Association on 5 June 1974

. . . I should like first to say how pleased I am to have this opportunity of addressing your association. There is a long tradition of co-operation between the Bank of England and the trustee savings banks, and it is a matter of satisfaction to me that, following in the footsteps of my predecessor, Lord O'Brien, who spoke on this same occasion six years ago, I have the privilege this evening of proposing the toast of the Trustee Savings Banks Association.

Lord O'Brien drew attention to the crucial importance of the central role of the trustee savings banks, the promotion of the largest possible amount of savings. That was in 1968, the year after a devaluation and a time when savings were both difficult to secure and urgently needed. All this is as true today as it was then, and indeed even more so. I congratulate you therefore on the stalwart work you have done, and continue to do. Your deposits now amount to over £3,400 million. This is 50% more than six years ago and accounts for one third of the total of national savings outstanding. It also puts you at the top of the national savings league table, with more money invested in you even than in savings certificates.

I put this emphasis on savings deposits because you were born by thrift out of poverty and savings have been the mainstream of your business. But I am, of course, aware that you provide a range of other banking services, including current accounts transferable by cheque; a unit trust which has been operating successfully for more than six years and to which I was able in a former capacity to lend a helping hand; and many other services which in the present company there is no need for me to detail. But your movement has never been content to rest on past achievements. It has always been keen – as the word movement itself suggests – to progress towards new ways of serving its customers. The obvious next step forward would have been the extension of credit in one form or another; and it was, among other reasons, because this seemed to represent a major break with the past and an advance towards the provision of comprehensive banking services that the Government in 1971 set up the Committee to Review National Savings, the Page Committee. That committee, as we all know, came up with some fairly radical ideas on the future structure and status of the trustee savings bank movement: in some ways, perhaps more radical than many of you then had in mind. Obviously these proposals needed thorough consideration both by the Government and by your association before decisions to put them into effect could be reached. That consideration has been a major preoccupation for you during the past year and now, almost a year since the Page Report first saw the light of day, you await a decision on how and to what extent the recommendations in the report are to be implemented.

I am sure that most of you appreciate the reasons for the delay in taking this decision. It was bad luck that the discussions last year between your association and the Treasury did not reach the necessary stage of agreement before the general election. As a result of the election new ministers have had to familiarise themselves with the questions currently being asked of the Government, and that necessarily takes time.

Apart from the change in Government, however, the problems which implementation of the Page proposals present are formidable, and I think it is fair to say that the Page Report, admirable though it is in general in relation to your movement, was not able fully to explore them. It is a fine thing to have the vision of creating a third force in banking, but before action is taken it is necessary to know clearly what that third force is going to do and, in particular, how much its creation is going to cost. The main point perhaps has been that if the trustee savings banks are to move, as Page recommended, into the private sector, and to compete for business with the commercial banks and other financial institutions more actively than in the past, it would no longer be appropriate or fair to their competitors for the Government to stand behind their ordinary department liabilities. As a reassurance to their depositors, therefore, the trustee savings banks would have to replace this support with visible and freely available reserves of their own. These would have to be earned by you yourselves over a transitional period, or alternatively, contributed directly by the Government. In my view, the amounts required would have to be substantial and, in this respect, I differ from the Page Report. The report took the building societies as the most relevant analogue, and suggested that the trustee savings banks' reserves need only be some 2½%–3½% of total liabilities. As it was intended that the third force trustee savings banks should be operating as banks, however, and that they should be actively in competition with the present commercial banks in the personal sector, I would strongly recommend you to think in terms of building up a proportion of reserves appropriate to banks, and substantially greater than those at present statutorily required of building societies. The importance of adequate capitalisation of deposit-taking institutions in times of fluctuating asset values scarcely needs emphasis, and I am sure you will agree that the trustee savings banks should be adequately provided in this respect before they cut free completely from the public sector.

The implications of this argument cannot, as I am sure you agree, simply be put aside. If the reserves are to be accumulated by the banks themselves, an adequate period of transition will have to be allowed and, still more crucially, the Government will want to be assured that the banks will be sufficiently profitable to generate the necessary funds. If the Government were alternatively to find or help to find the funds needed to build up your reserves there would have to be a substantial addition to public borrowing, which at the best of times would have to be judged carefully, and particularly so just now, when the Chancellor has been making strenuous efforts to reduce the Government's borrowing requirement.

The third force concept also has a relevance to the future sources of government finance. The trustee savings banks are at the moment of course a very reliable and welcome source of finance for the Government, as their assets are very largely invested in public debt. If you are to compete more actively within and against the rest of the banking system, however, you will no doubt want to have considerably greater freedom in the disposition of your assets and this could mean that you would wish to place less funds than before in public sector debt. This is scarcely a conclusive argument but, as the Bank of England are largely instrumental in raising the finance needed by the Government, you will not be surprised to hear me say that I view this aspect with a certain caution. Its acceptability must clearly be dependent on the scale and speed with which the liberated trustee savings banks could exercise their newfound freedom.

I have spent a few moments emphasising some of the major problems involved in the implementation of the Page proposals. I do not need in this audience to spend time in reciting the advantages to be gained. I should like to assure you that I know very well how eager you now are (after the intensive work which has been done over the last months) to be allowed to move forward to provide a fully up-to-date personal savings and banking service, especially to the smaller customers for whose requirements you have always had a special care. I know, too, the frustration you would feel if the opportunity to move in this direction were now denied you.

The trustee savings banks, like all other financial institutions, have to change with the times if they are to continue to flourish, and although I cannot predict the shape of the whole package, this surely means that parts of the Page proposals will be given effect. Meanwhile, there are a number of areas in which action depends on the will of yourselves rather than of the Government, and in which it is obviously prudent for you to be taking steps to help yourselves. I was delighted therefore to hear from your Chairman the other day – and I cite this simply as an example – of the strides which have already been made towards agreeing on amalgamations and mergers amongst your membership. The wedding between Inverness and Aberdeen has already been celebrated in the north-east of Scotland, and I am told that the banns have been read for the third time between Glasgow and Paisley, and between Belfast and Enniskillen. Scotland and Northern Ireland having set this example – and who can be more fiercely (not to say sometimes stubbornly) independent than these two – I understand that plans for an amicable and mutually agreed series of mergers in England are also well advanced. Knowing how strong is the pride felt in the local character and roots of the present trustee savings banks, I think the progress you have made is remarkable, and will in my view stand you in good stead whatever decisions are eventually taken on Page.

Your Chairman has also told me of your plans and progress in adapting your managerial and staff training arrangements to the new environment. I am sure that these are wise moves, as also in particular is your consideration of how best to organise a central co-ordinating authority. In this respect, one initiative which you have already taken should provide a valuable core of expertise round which to build. I refer to the establishment of the Central Trustee Savings Bank. I think this is a useful advance which will serve your movement well. In its early days, the central bank has provided member banks in the association with a convenient vehicle for placing an appropriate proportion of liquid funds in the money markets, and thereby increasing the yield to the movement on this part of its assets. This question of return on assets has, I am well aware, become one of vital importance to institutions competing for small savings at a time of high interest rates, and the problems this has posed for one of your main competitors – the building societies – has been the subject of much public discussion and concern over the past year. I would not expect my present audience to shed too many tears over the societies' recent inability to attract an adequate inflow of funds, nor shall I bore you with the many ways of remedying this situation which have been examined. I cannot forbear to mention, however, that the Bank have been able to make a practical contribution to this problem first by means of a short-term advance to allow the Government's loan facilities to the societies to get off the ground immediately, but secondly and much more significantly from the point of view of all the small savings institutions, by allowing a modest fall in short-term interest rates to take place. So far as the societies are concerned, the benefits are already showing up in an improved inflow of deposits, and I hope that the trustee savings banks too will recently have begun to feel a modest easing of the competitive pressures experienced in the last twelve months.

A reduction in rates became possible in April when the period of severe seasonal pressure on the money markets and the banking system associated with the peak of transfers of revenue to the Government came to an end. The reduction was assisted and maintained by means of repayments of special deposits, especially at times when temporary fluctuations in the Government's transactions seemed likely to leave the markets short of funds, and to renew the upward pressures on interest rates. The flexible use of special deposits in this way was what the Bank of England had in mind in their inception, and it was gratifying to be able to use the mechanism appropriately, and without the misunderstanding with which such changes have sometimes been greeted in the past, when they have been taken to signal a major change in the direction of monetary policy.

The reduction in interest rates could not have been permitted with such equanimity, however, without the assurance which the recently-introduced arrangements for supplementary special deposits have provided to the monetary authorities that an expansion in the money supply would not be the inevitable outcome. I am conscious that this 'corset' – as many newspaper commentators now like to call it – can be, and initially was, as uncomfortable to banks as the hourglass whalebone creations of Edwardian times appear to have been for the ladies of those days; and that to have to wear it too tightly laced for any great length of time could be harmful to the general health of the banking system and particularly the competitive scope for individual banks. But the advantages at present of these new arrangements are in my judgment overriding. They have encouraged banks to reconsider a practice to which a number were becoming prone of taking on substantial lending commitments without giving sufficient thought to the continued availability of an appropriate volume of resources. And they have provided a supporting weapon to deploy besides that of interest rates for influencing the monetary aggregates.

Some argued that the guidelines set for supplementary special deposits would be too restrictive in relation to the essential demands likely to be made on the resources of the banking system during the period of three-day working and subsequent recovery. While short-time working was in force, we in the Bank initiated regular reports and discussions with important industrialists, with our Agents (who are in constant touch with industry in their own particular areas) and with a number of banks so that developments could be closely monitored and monetary policy adapted as appropriate. In the event, most sectors of industry found themselves able to survive the emergency without serious cash difficulties although, as usual in such circumstances, trade credit tightened appreciably. By far the biggest problem proved to be a shortage of materials and components, rather than finance.

When full-time working was resumed and recovery began to get fully under way, it was felt that the cost of restocking at current high prices might lead to a sudden upsurge in demand for credit and thus put the banks under severe pressure. So far these fears have not been realised. The banks have had room to lend to industry on a substantial scale and firms have been able to draw on, or at least cease to add to, their liquid assets built up on such a substantial scale in the recent past.

I think we can claim that the new arrangements have made a satisfactory debut. But the scope they offer for further reductions in interest rates should not be exaggerated. External considerations set limits to what is possible and we need to keep closely in mind the relationship between interest rates in this country and those overseas. . . .