

Monetary control—provisions

This paper, which was issued by the Bank on 5 August, sets out the new arrangements for monetary control which took effect on 20 August. It includes a list of recognised banks whose acceptances are eligible for discount at the Bank.

Introduction

1 On 24 November 1980, the Bank published a Background Note describing a number of improvements to be made to the existing framework of monetary control.⁽¹⁾ On 12 March this year, in a paper entitled *Monetary control: next steps*,⁽²⁾ more detailed proposals on a number of the subjects covered in the Background Note were sent to all recognised banks and licensed deposit-takers (LDTs). The present paper sets out the provisions resulting from discussions since then with the various associations, as well as with a number of individual institutions.

The cash ratio

2 A substantial part of the Bank's resources and income in recent years has been provided by the average of 1½% of eligible liabilities (ELs) maintained by the London clearing banks in non-interest-bearing accounts at the Bank. This sum has also served as a fulcrum for money market management. The Bank's paper in March proposed that this latter purpose should in future be served by the volume of operational funds which the London clearing banks would retain voluntarily at the Bank for clearing purposes, while the Bank's resources and income should additionally be secured primarily by a uniform requirement on all banks and LDTs to hold non-operational, non-interest-bearing deposits with the Bank. The provisions set out in this section have accordingly been designed to provide, in aggregate, broadly the same amount of non-interest-bearing funds initially as did the previous arrangements with the London clearing banks alone.

3 This non-operational requirement will be ½% of an institution's ELs and will apply to institutions covered in paragraph 16(i)–(iii) below having ELs which average £10 million or more in the latest period over which the requirement is calculated. The level of an institution's non-operational balance will be set twice a year in relation to its average ELs in the previous six months.⁽³⁾

4 For institutions not on the present statistical list of banks and whose business mainly comprises the provision of fixed-rate finance for periods in excess of one year, the

Bank accepts that the introduction of the ½% cash ratio may present a special transitional problem. The Bank will be prepared to consider individual representations from such institutions for some temporary alleviation of the requirement. In addition, in recognition of the special conditions in Northern Ireland, the Bank has reduced to ¼% the cash ratio to be observed by institutions for which Northern Ireland is the principal place of business in the United Kingdom. This concession will apply in respect only of the ELs of their Northern Ireland offices and will run for two years, when it will be reviewed.

5 ELs are to be redefined to reflect the changes set out in this paper. In future, offsets will be allowed in the calculation of ELs in respect of:

- (i) funds (other than cash ratio deposits or special deposits placed with the Bank) lent by one institution in the newly defined monetary sector⁽⁴⁾ to any other;
- (ii) money at call placed with money brokers and gilt-edged jobbers in the Stock Exchange, and secured on gilt-edged stocks, Treasury bills, local authority bills and eligible bank bills.

6 ELs will be calculated in uniform fashion for all reporting institutions⁽⁵⁾ except:

- (i) members of the London Discount Market Association (LDMA), whose ELs will be calculated as the total of sterling deposits other than from institutions within the monetary sector and from money brokers and gilt-edged jobbers in the Stock Exchange;
- (ii) certain banks with money-trading departments, who will be allowed to omit from their ELs secured money at call placed by other banks with these departments, up to a limit set by the Bank.⁽⁶⁾

7 It would be contrary to the objective of these agreed arrangements for any institution to reduce its ELs deliberately or artificially on reporting dates. The Bank accordingly reserves the right to make a spot check on the

(1) This Note was reproduced in the December 1980 *Bulletin*, page 428.

(2) This paper was reproduced in the March 1981 *Bulletin*, page 38.

(3) A deposit calculated in, say, May would relate to the monthly average of ELs from November to April inclusive.

(4) See paragraph 16 below.

(5) The present arrangements for those finance houses which have observed a 10% reserve asset ratio since 1971 will lapse accordingly.

(6) The banks concerned are: Algemene Bank Nederland, Banque Belge, Charterhouse Japhet, Leopold Joseph and Samuel Montagu. Hitherto, funds placed on this basis, up to a limit set by the Bank, have counted as reserve assets.

level of an institution's ELs on days when it would not normally report.

Special deposits

8 The special deposits scheme remains in place and will apply to all institutions with ELs of £10 million or more at the latest make-up day for which figures are available.⁽¹⁾ As hitherto, calls will be set as a percentage of ELs. The scheme for differential special deposits⁽²⁾ has lapsed.

Eligibility

9 As set out in its March paper the Bank has judged applications, by recognised banks wishing their acceptances to become eligible for discount at the Bank, according to the following criteria:

- (i) whether the applicant has and maintains a broadly based and substantial acceptance business in the United Kingdom;
- (ii) whether its acceptances command the finest rates in the market for ineligible bills;
- (iii) whether, in the case of foreign-owned banks, British banks enjoy reciprocal opportunities in the foreign owners' domestic market.

A first list of eligible banks is attached.

10 A bank may apply for eligibility at any time. An eligible bank which wishes to renounce its eligibility is free to do so on giving notice to the Bank.

Undertakings by eligible banks

11 From 20 August 1981, each eligible bank undertakes to maintain secured money with members of the LDMA and/or secured call money with money brokers and gilt-edged jobbers⁽³⁾—all at market rates appropriate to the nature of the lending—such that:

- (i) the total funds so held normally average 6% of that bank's ELs (as defined in paragraph 5);
- (ii) the amount held in the form of secured money with members of the LDMA does not normally fall below 4% of ELs (as defined in paragraph 5) on any day.

12 In relation to the above undertaking, each eligible bank will:

- (i) aim to meet the daily average ratio over either six or twelve-month periods (having first notified the Bank of its choice of period), the ratio on any particular day in a banking month being calculated as a proportion of ELs at the last but one make-up day;⁽⁴⁾
- (ii) provide monthly returns of its daily figures, which the Bank will use to assess the bank's performance relative to its long-term commitment.

A bank will go below the minimum only in exceptional circumstances and will be ready to explain such action to the Bank when the relevant monthly return is made.

13 The Bank will be prepared to review these undertakings, in consultation with eligible banks and the LDMA, when sufficient experience of the operation of the arrangements has been gained, covering at least a year. The Bank will also be prepared to discuss particular difficulties, as they arise, with any party to the arrangements.

Prudential considerations

14 The Bank has received the assurances required in its paper of 12 March *The liquidity of banks*,⁽⁵⁾ and mentioned in the Chancellor's Budget speech, that those institutions in the United Kingdom to whom the reserve asset ratio has applied will discuss with the Bank, in advance, changes in their policies for the management of their liquidity and its composition. The Bank is resuming discussions with the banks on the measurement of liquidity as the basis for continuing supervision.

Statistical changes

15 The present banking sector, as defined for the purposes of calculating the monetary aggregates, contains those institutions included in the statistical list of banks and the list of discount market institutions. These lists were drawn up prior to the Banking Act and are no longer appropriate to current circumstances. They exclude a number of recognised banks, many LDTs, and also the trustee savings banks⁽⁶⁾ (who will become subject to cash ratio and special deposit requirements when they are authorised under the Banking Act).

16 A new monetary sector will therefore be defined, to include:

- (i) all recognised banks and LDTs;
- (ii) National Girobank;
- (iii) those banks in the Channel Islands and the Isle of Man which opt to join the cash ratio scheme described earlier in this paper;
- (iv) the trustee savings banks (TSBs);
- (v) the Banking Department of the Bank.

17 Although the population of the monetary sector will be considerably larger than that of the 'statistical list', the statistical effect will be comparatively modest since the present business of many of the new contributors is relatively small. In total, the initial once-for-all adjustment to the stock of the main monetary aggregate, sterling M₃, will probably be of the order of £8 billion (13%), of which the TSBs account for around £6 billion (9½%).

(1) Hitherto only banks on the statistical list and finance houses observing a reserve asset ratio have been subject to special deposits.

(2) Details can be found in the March 1973 *Bulletin*, page 52.

(3) The Bank's concern with the adequate availability of funds for the efficient functioning of the gilt-edged market was noted in *Monetary control: next steps*. There are six recognised money brokers—James Capel & Co., Cazenove & Co., Hoare & Co., Govett (Moneybroking) Ltd, Laurie, Milbank & Co., Rowe & Pitman Money Broking and Sheppards & Chase. Secured call money with these firms has hitherto counted as a reserve asset. The amount of such money which these firms can take will continue to be limited by the Bank.

(4) For example, the relevant ELs figure for each day in banking September will be those as at make-up day in banking July.

(5) This paper was reproduced in the March 1981 *Bulletin*, page 40.

(6) The Central Trustee Savings Bank is a recognised bank.

18 Institutions in the monetary sector having either eligible liabilities totalling £10 million or more, or a balance sheet of £100 million or more, will be asked to supply the full range of statistics (comprising both the monthly and other returns); other institutions will be asked to report only at end-calendar quarters.⁽¹⁾

The timetable for change and the transitional arrangements

19 The essential features of the new arrangements can be brought rapidly into effect. This section sets out the sequence of developments.

20 On 20 August 1981:

- (i) the reserve asset ratio will be abolished;
- (ii) the acceptances of all banks in the first list (attached) of eligible banks will become eligible for discount at the Bank;
- (iii) all the banks covered in (ii) above will begin to observe the undertakings set out in paragraph 11 above;
- (iv) the agreement with the London clearing banks, whereby they keep an average of 1½% of their ELs at the Bank, will lapse;
- (v) the Bank will receive the first deposits under the cash ratio requirement.

21 On this date, the first cash deposits will be placed by institutions on the present statistical list of banks and by members of the LDMA; the statistics necessary to include other institutions are not yet available. These initial deposits will relate to the average of institutions' ELs on the monthly make-up days in the period January–June 1981

inclusive, ELs being defined on a transitional basis, i.e. calculated for 'statistical banks' as at present except that offsets will be allowed in respect of all lending to the discount market and all secured money at call placed with money brokers and gilt-edged jobbers and money-trading banks.⁽²⁾ These initial deposits will remain unchanged until sufficient figures using the new definition of ELs are available (see paragraph 22 below). Thereafter, these deposits will be adjusted every six months. The undertakings by eligible banks as set out in paragraph 11 will take effect on 20 August 1981, based on the transitional definition of ELs and in respect of their level as at 15 July.

22 As soon as possible thereafter (probably in respect of the make-up day in banking November), currently reporting institutions will be asked to produce figures for one reporting date both on the basis used hitherto and on the basis of the enlarged list of institutions comprising the new monetary sector. At the same time, those seventy or so institutions which are not currently on the statistical list of banks and which are above the cut-off points for full statistical reporting will join the full reporting network. They will be asked to place cash deposits with the Bank when two months' figures have been obtained, if their ELs are £10 million or more on average.

23 Monetary aggregates will be calculated on both bases for this one reporting date; thereafter statistics will only be collected on the basis of the new monetary sector.

24 The remaining institutions not currently reporting and below the cut-off points set out in paragraph 18 will be brought into the reporting network only when the current review of banking statistics has been completed (which is unlikely to be before the second half of 1982).

(1) The TSBs will continue, for the time being, to make returns on the existing consolidated basis.

(2) The Bank can calculate these offsets for listed banks from statistics already provided. The ELs of members of the LDMA will be calculated as set out in paragraph 6 above, except that no allowance will be possible in this transitional period for deposits by money brokers and gilt-edged jobbers in the Stock Exchange.

Recognised banks whose bills are eligible for discount at the Bank

List issued on 5 August 1981

Algemene Bank Nederland N.V.
Allied Irish Investment Bank Ltd
American Express International Banking Corporation
Amsterdam-Rotterdam Bank N.V.
A P Bank Ltd
Arbuthnot Latham & Co. Ltd
Australia & New Zealand Banking Group Ltd
Bank für Gemeinwirtschaft A.G.
Bank of America N.T. & S.A.
Bank of Montreal
Bank of New South Wales
The Bank of New York
Bank of New Zealand
The Bank of Nova Scotia
Bank of Scotland
The Bank of Tokyo, Ltd
Bankers Trust Company
Banque Belge Ltd
Banque de L'Indochine et de Suez S.A.
Banque de Paris et des Pays-Bas S.A.
Banque Nationale de Paris p.l.c.
Barclays Bank Ltd
Barclays Bank International Ltd
Barclays Merchant Bank Ltd
Baring Brothers & Co. Ltd
The British Bank of the Middle East
The British Linen Bank Ltd
Brown, Shipley & Co. Ltd
Canadian Imperial Bank of Commerce
Charterhouse Japhet Ltd
The Chase Manhattan Bank, N.A.
Chemical Bank
Citibank N.A.
Clydesdale Bank Ltd
The Commercial Bank of Australia Ltd
The Commercial Banking Company of Sydney, Ltd
Commerzbank A.G.
Commonwealth Trading Bank of Australia
Continental Illinois National Bank and Trust Company
of Chicago
Co-operative Bank Ltd
County Bank Ltd
Coutts & Co.
Crédit Industriel et Commercial
Crédit Lyonnais
Crédit Suisse
The Dai-Ichi Kangyo Bank, Ltd
Deutsche Bank A.G.
First Interstate Bank of California
The First National Bank of Boston
The First National Bank of Chicago
Robert Fleming & Co. Ltd
The Fuji Bank, Ltd
Antony Gibbs & Sons, Ltd
Grindlay Brandts Ltd
Grindlays Bank Ltd
Guinness Mahon & Co. Ltd
Hambros Bank Ltd
Hill Samuel & Co. Ltd
The Hongkong and Shanghai Banking Corporation
International Westminster Bank Ltd
Irving Trust Company
Kleinwort, Benson Ltd
Lazard Brothers & Co., Ltd
Lloyds Bank Ltd
Lloyds Bank International Ltd
Manufacturers Hanover Trust Company
Marine Midland Bank N.A.
Mellon Bank, N.A.
Mercantile Bank Ltd
Midland Bank Ltd
Midland and International Banks Ltd
The Mitsubishi Bank Ltd
The Mitsui Bank Ltd
Samuel Montagu & Co. Ltd
Morgan Grenfell & Co. Ltd
Morgan Guaranty Trust Company of New York
The National Bank of Australasia Ltd
The National Bank of New Zealand Ltd
National Westminster Bank Ltd
Northern Bank Ltd
Rea Brothers Ltd
N. M. Rothschild & Sons Ltd
The Royal Bank of Canada
The Royal Bank of Scotland Ltd
The Sanwa Bank, Ltd
J. Henry Schroder Wagg & Co. Ltd
Security Pacific National Bank
Singer & Friedlander Ltd
Société Générale pour favoriser le développement
du commerce et de l'industrie en France
Standard Chartered Bank Ltd
The Sumitomo Bank, Ltd
Swiss Bank Corporation
The Toronto-Dominion Bank
Ulster Bank Ltd
S. G. Warburg & Co. Ltd
Williams & Glyn's Bank Ltd