Review of the cash ratio deposit scheme: consultation on proposed changes

Our response to HMT's proposals

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Building Societies Association

Executive summary

The BSA recognises the need for an adequately-resourced central bank with funding for those functions that are not already covered by separate levies or income generation. But the current debate about the exact funding mechanism should not obscure the more important principle that these resources should be wisely spent and give value for money. The fact that this funding will come from deposit takers rather than the taxpayer does not make it a “free good”.

Introduction

Since the publication of the minutes of February's meeting of Court of Directors, it has become clear that change is needed. These minutes revealed that the Bank of England would fail to pay a dividend to the Treasury for the first time after its loss-absorbing capital fell below a minimum threshold.

The previous fix in 2018 – the move from a single fixed ratio to a variable ratio indexed to gilt yields – has not produced the income necessary to cover the cost of the BoE's policy functions. As the consultation says: "The scheme parameters set at that review were made on a set of assumptions of gilt yields over the subsequent five years which have not materialised." In other words, mistakes were made for which large deposit takers must pick up the bill - again. Every time the cash ratio deposit scheme review comes around, the call is more money next time. While there is often talk of economies and efficiencies at the BoE, these never seem to materialise. We believe this tendency to over spend should be addressed as urgently as the scheme itself.

Q1**:** *What are your views on the design and operations of the CRD scheme?*

In our opinion, the requirement for banks and building societies place an unremunerated deposit at the Bank is effectively a tax on the banking sector within the wider financial community. We strongly believe that the pool of contributors needs to be urgently reviewed.

All large financial institutions that benefit from the Bank's monetary and financial stability policy should be required to contribute. This aspect of the Bank's work is much more than liquidity. Potential contributors include wholesale and investment banks, mortgage lenders, other retail or wholesale lenders that are not also deposit takers, and insurers. Currently, large deposit takers who, of necessity, have large cash resources are the main contributors[1]. This should not prevent other sectors that benefit from the Bank's important and valuable monetary policy and financial stability work from paying their fair share. They would not be able to operate without stability. Yet still they do not contribute.

Any move to lower the threshold and therefore extend the scheme to smaller deposit takers should be resisted. The amount raised in total by these smaller deposit takers would be inconsequential but the effect on the individual institutions could be significant, particularly in uncertain and challenging times.

We do not disagree with the proposal to move away from an unremunerated contribution model to a levy-based structure, the quantum of the levies payable bearing a clear correlation to the earned investment income from the current scheme. This should result in a much greater degree of transparency and accountability, and would allow firms to reflect the direct cost of contribution to the ratio rather than having to estimate its opportunity cost. But we believe

[1] In June 2021, 83% of the total deposits were made by the largest 20 institutions, of which 8 institutions each contributed more than £200 million in deposits under the scheme. Across all eligible institutions above the threshold, the median deposit was £11 million with a mean of £85 million, (due to concentration of the deposit base in the largest firms). Thus, the main incidence of the scheme is on larger banks and building societies.

seigniorage should be examined more closely (see our response to question 4)

Cash ratio deposits do not contribute towards bank/building society LCR assets. If the deposits were returned, the liquidity position of the bank and building society sector would see broad improvement, a worthwhile result in its own right.

Cost control

We agree the BoE's policy costs should be adequately funded but remain troubled by the continuing sharp rises in these costs. For 2018-2023, the Bank's costs were forecast at £845 million (itself a 40% increase over the £603 million forecast in 2013 for the following five-year period). The £845 million figure was based on the assumption that the Bank's costs will remain at 2018-2019 levels, averaging £169 million a year over the review period. But the actual policy costs for financial years 2018-2020 were £169 million, £171 million and £179 million respectively. Worse, the projected cost for 2021-2022 is £204 million, rising to £208 million in 2022-2023. This means a £931 million projected spend over the 2018-2023 period. In less than ten years the annual forecast costs for the scheme have risen 54%. That is far higher than any rate of inflation.

There appears to be an assumption among regulators that fees go only one way - upwards. If not retrenching, regulators should at least concentrate on making the most of current resources – as the firms that fund them do. Many regulated firms have managed to cut costs by investment in technology; the BoE has invested significantly in IT over recent years, yet its costs appear not to have dropped.

The building society sector has worked hard to cut its costs while still delivering a high quality service - even in the current, challenging climate - to customers. We do not see why the BoE cannot apply the same principles and deliver the same.

Q3: *What are your views on retaining the existing CRD scheme with some modifications*?

As we argue in our response to question 1, we believe if the scheme is retained that the pool of contributors should be broadened to include, for example, wholesale and investment banks, mortgage lenders, other retail or wholesale lenders that are not also deposit takers, and insurers.

Q4: *What are your views on replacing the existing CRD scheme with the direct funding option of a new levy?*

We are concerned that options other than a levy have not been given proper consideration. This is particularly disappointing since the feedback of the 2018 consultation on the CRD scheme[2] stated: "Looking ahead, and in order to inform the next review of the CRD scheme, the Bank intends to do further analysis of alternative funding arrangements."

The 2021 consultation paper itself notes that the most common means of funding [in other countries] has been through retaining the profit from foreign exchange reserves and income from seigniorage (whereby no interest is paid on banknotes and the reserves backing these are invested in interest bearing assets).

This option is, however, quickly ruled out in the consultation paper. The reason given is that the revenues from both have

[2] See "Review of the Cash Ratio Deposit scheme: summary of consultation responses"

always been remitted to the government. The consultation provides no reason why this must remain the case. Even in the current climate, gross income from seigniorage alone[3] would fund the projected costs of the BoE's policy work of £204 million for 2020/2021. Earlier CRD reviews have noted that no central banks fund their activities from general taxation revenues collected by government. One such review added: "All the central banks looked at in the study state monetary policy and financial stability as among their core objectives….". In our response to the 2013 CRD review we remarked that the UK was an outlier – by moving to a levy, it remains so. It would have been helpful to know why the UK must be different.

We have previously argued the case[4] for a levy to replace cash ratio deposits, mainly for the reasons outlined in the consultation paper: it would be simpler and more transparent for CRD payers, and provide a more stable income stream for the BoE. But transparency means a detailed breakdown of what the money is spent on. The consultation paper refers to the 2018 CRD review in which the BoE "committed to enhancing the disclosures in its Annual Report on transparency around the income and use of resources under this scheme, and these have been included in the Financial Review section of the report." The financial review section of the 2020/ 2021 annual report[5] does refer to the scheme but it is hard to discern how the CRD money was actually spent; what there is in the section mainly summarises the scheme.

If an annual levy is introduced, it is imperative that deposit takers have adequate time to digest and respond to the levy rates and any other proposals. Assuming that the BoE is genuinely interested in deposit takers' views, it needs to give them more than four or six weeks to consider its plans.

Q6: *Do you agree with the impacts outlined above and are there others to consider?*

83% of the total deposits were made by the largest 20 institutions, of which eight institutions each contributed more than £200 million in deposits under the scheme. Due to this concentration and the large levels of surplus liquidity already sitting within retail ring fences, has HMT looked at the possibility of additional competitive pressures in the mortgage market?

The levy will be charged to institutions' profit and loss accounts whereas the existing CRD scheme creates foregone interest income. Has HMT calculated the net fiscal impact?

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[3] Bank of England annual report for 2020/ 2021: seigniorage gross income was £209 million.

[4] See our response to the 2018 HMT consultation on cash ratio deposits

[5] See BoE annual report 2021, financial review section

By Andrea Jeffries
Policy Manager
andrea.jeffries@bsa.org.uk
020 7520 5911

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk