

**EXPLANATORY MEMORANDUM TO**  
**THE CASH RATIO DEPOSITS (VALUE BANDS AND RATIOS) ORDER 2008**  
**2008 No. [DRAFT]**

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

**2. Description**

2.1 This Order specifies the value bands and the ratios applicable to them for the purposes of calculating the amount to be deposited with the Bank of England by certain banks and building societies.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

**4. Legislative Background**

4.1 Under Schedule 2 to the Bank of England Act 1998, eligible institutions (broadly, deposit taking institutions such as banks and building societies) may be required to place non-interest bearing deposits (known as cash ratio deposits) with the Bank of England. Under paragraph 4 of that Schedule, this depositable amount is to be calculated by multiplying so much of an institution's average liability base as falls into each of the different value bands by the ratio applicable to that band, and adding up those amounts.

4.2 The value bands and ratios specified by this Order replace those specified by the Cash Ratio Deposits (Value Bands and Ratios) Order 2004.

**5. Extent**

5.1 This instrument applies to all of the United Kingdom.

**6. European Convention on Human Rights**

6.1 The Chief Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Cash Ratio Deposits (Value Bands and Ratios) Order 2008 are compatible with the Convention rights.

**7. Policy background**

7.1 The cash ratio deposits scheme is the means by which the Bank of England funds its work on monetary policy and financial stability functions. The scheme was placed on a statutory basis by the Bank of England Act 1998. Under the Act, certain deposit-taking institutions (such as banks and building societies) are required to place a specified percentage (or "ratio") of the amount of their eligible liabilities (broadly

equivalent to sterling deposits) above a certain threshold at the Bank of England on a non-interest bearing basis. The Bank of England then invests these funds in interest bearing assets and the income generated is used to meet the costs of their policy functions. The rationale behind the scheme is that the financial services sector benefits the most from the Bank of England's monetary policy and financial stability activities and so should therefore bear the burden of the payments.

7.2 Following a review of the cash ratio deposits scheme in 2003, the threshold for eligible liabilities above which the cash ratio scheme applied was set at £500 million, and the ratio at which deposits had to be placed with the Bank of England was set at 0.15% of an institution's eligible liabilities above this threshold. Under the Bank of England Act 1998, the Treasury may, by statutory instrument (subject to affirmative resolution), specify the threshold and the ratio. These changes were enacted in the Cash Ratio Deposits (Value Bands and Ratios) Order 2004. At the same time the Treasury committed to review the scheme again in no more than 5 years.

7.3 The Treasury completed a review of the cash ratio deposits scheme in 2007, assessing how it had met its primary aim of meeting the Bank of England's financial needs since 2003. In doing so it consulted closely with the Bank of England. It was noted that:

- the scheme had generated greater income than forecast in 2003 (£613 million compared to £575 million), due to faster than expected growth in eligible liabilities;
- the Bank's expenditure had been lower than forecast in 2003 (£531 million compared to £575 million), due to steps taken by the Bank to focus on core activities and increase efficiency.

7.4 The review concluded that the most appropriate way to realign the expected income generated by the scheme with the expected expenditure of the Bank of England on its policy functions was to keep the minimum threshold constant at £500 million, but to reduce the ratio that institutions should be required to contribute above that level from 0.15% to 0.11%. This would result in a one-off repayment to the eligible institutions (of which there are around 150) of cash ratio deposits currently held at the Bank of England of approximately £700 million.

7.5 The Treasury conducted an informal consultation of all eligible institutions on the cash ratio deposits scheme (to which it had 68 responses) and a 12-week public consultation on the scheme and the review (to which it received 4 responses – all being either financial services institutions or their representative bodies). The findings of the review are outlined in detail in the public consultation document "Review of the cash ratio deposit scheme: consultation on proposed changes – August 2007" and associated consultation response (both available on the Treasury website). All respondents to the public consultations supported the proposal to reduce the ratio from 0.15% to 0.11%. However, all respondents also advocated either changes that could be made to other parameters of the scheme or the replacement of the scheme with alternative arrangements. The Government concluded, after considering the responses, that the cash ratio deposits scheme continues to be a suitable method of funding the Bank of England's monetary policy and financial stability operations. However, it will keep the parameters of the scheme under active review for the following period and conduct another full review after a further five year period at the latest.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

## **9. Contact**

9.1 Roopal Khoda at HM Treasury Tel: 020 7270 5832 or e-mail: [roopal.khoda@hm-treasury.x.gsi.gov.uk](mailto:roopal.khoda@hm-treasury.x.gsi.gov.uk).

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title: Impact Assessment of Changes to the Bank of England's Cash Ratio Deposit Scheme</b>	
<b>Stage:</b> Implementation	<b>Version:</b> 2.0	<b>Date:</b> 25 March 2008
<b>Related Publications:</b> Review of the cash ratio deposit scheme: consultation on proposed changes (August 2007).		

Available to view or download at: <http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Roopal Khoda

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### What is the problem under consideration? Why is government intervention necessary?

The Government committed to review the Cash Ratio Deposit (CRD) scheme by 2008 at the latest. The CRD scheme is the means by which the Bank of England (the Bank) funds its work on monetary policy and financial stability. The review found that the scheme has been raising greater income than required to finance the Bank of England's monetary policy and financial stability activities. It is therefore necessary to reduce the contribution that financial institutions must make to reduce unnecessary burden on the financial sector. Under the Bank of England Act 1998 this must be done through secondary legislation.

### What are the policy objectives and the intended effects?

The Cash Ratio Deposit scheme is intended to finance the Bank of England's monetary policy and financial stability activities. The intended effects of this change to the parameters of the scheme are to ensure that the income received by the Bank of England is in line with its forecast expenditure.

### What policy options have been considered? Please justify any preferred option.

The review concluded that the Cash Ratio Deposit scheme remained an effective way of financing the Bank, but that some changes to its parameters were required to match income with expenditure. It also concluded that the scheme provides the Bank of England with a degree of financial independence from Government that would be removed were it to be replaced by some form of general taxation. Options considered for changing the parameters of the scheme included amending the definition of 'eligible liabilities' for the scheme, altering the threshold above which eligible financial institutions are required to contribute, and altering the amount they are required to contribute. Under the 1998 Bank of England Act, all of these must be effected through secondary legislation. The preferred option is to amend the amount of contribution, as this keeps the base of the scheme broad while not introducing a new regulatory burden on smaller institutions.

### When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

No later than 2013.

### **Ministerial Sign-off** For implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:

.....Date:

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description: Secondary legislation to adjust the ratio of eligible liabilities that eligible institutions must hold with the Bank of England above the threshold level of the CRD</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' The only cost incurred will be as a result of systems updates required to administer the new parameters of the scheme. This is likely to be very small but is difficult to estimate.	
	<b>One-off (Transition) Yrs</b>		
	<b>£ Negligible</b>		
	<b>Average Annual Cost (excluding one-off)</b>		
	<b>£ 0</b>	<b>Total Cost (PV)</b>	<b>£ Negligible</b>
Other <b>key non-monetised costs</b> by 'main affected groups'			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' A reduction in the amount that eligible institutions (broadly, circa 150 of the largest banks and building societies) are required to hold at the Bank of England on a non-interest bearing basis of approximately £700 million, making these funds available for investment. Using the Bank of England base rate (5.25%) as the assumed return that the banks and building societies will receive this will generate circa £36.75 million interest per annum. The 10-year present value (10 years being the "typical" time horizon advised in the Impact Assessment guidance), with an assumed discount rate of 3.5% is £316.33 million.	
	<b>One-off Yrs</b>		
	<b>£ 0</b>		
	<b>Average Annual Benefit (excluding one-off)</b>		
	<b>£ 36.75 million</b> 10	<b>Total Benefit (PV)</b>	<b>£ 316.33 million</b>
Other <b>key non-monetised benefits</b> by 'main affected groups'			

**Key Assumptions/Sensitivities/Risks** The calculated return of £700 million to eligible banks and building societies (institutions with £500 million or more in eligible liabilities) is based on an assumed growth in eligible liabilities of 4.5% between 1<sup>st</sup> June 2007 and 2nd June 2008 when the revised scheme will be implemented. The key monetised benefits are also based on an assumed return on investment to eligible institutions equal to the current Bank of England base rate.

Price Base Year 2007	Time Period Years 10 yrs	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 316.33 million</b>
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	2nd June 2008
Which organisation(s) will enforce the policy?	Bank of England
What is the total annual cost of enforcement for these	£ Negligible
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	N/A
What is the value of the proposed offsetting measure per year?	£ N/A
What is the value of changes in greenhouse gas emissions?	£ N/A
Will the proposal have a significant impact on competition?	No

Annual cost (£-£) per organisation (excluding one-off)	Micro 0	Small 0	Medium 0	Large 0
Are any of these organisations exempt?	Yes	Yes	No	No

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase	£ 0	Decrease	£ 0
<b>Net</b>		<b>£ 0</b>	

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

## Evidence Base (for summary sheets)

The Bank of England Act 1998 put the cash ratio deposit scheme (by which the Bank of England's monetary policy and financial stability activities are financed) on a statutory footing. Under the Act, eligible institutions (deposit-taking institutions such as banks and building societies) with "eligible liabilities" (broadly equivalent to sterling deposits) are required to place a certain percentage of the amount above a threshold at the Bank of England on a non-interest bearing basis. A review of the scheme in 2003 set the threshold at £500 million and the ratio at 0.15%, committing the Treasury to review the scheme again in no later than 5 years. Under the Act, secondary legislation is necessary to establish the threshold and the ratio. The rationale behind the scheme is that the financial services sector benefits the most from the Bank of England's monetary policy and financial stability activities and so should therefore bear the burden of the payments.

The 2007 review of the cash ratio deposit scheme assessed how the scheme had met its primary aim of meeting the Bank's financial needs over the period. Its findings are outlined in detail in the consultation document "Review of the cash ratio deposit scheme: consultation on proposed changes – August 2007" and associated consultation response available on the Treasury website. Broadly speaking, the review noted that:

- the scheme had generated greater income than forecast in 2003 (£613m compared to £575m), due to faster than expected growth in eligible liabilities;
- the Bank's expenditure had been lower than forecast in 2003 (£531m compared to 375m), due to steps taken by the Bank to focus on core activities and increase efficiency.

The 2007 review looked at possible mechanisms for realigning income and expenditure, in order to ensure that the opportunity cost to financial institutions from holding CRDs at the Bank of England were kept to a minimum. It looked into the possibility of changing the threshold at which institutions are required to contribute and at changing the ratio.

The review considered the case for altering the threshold at which institutions were required to place CRDs at the Bank of England. It concluded that:

- keeping the ratio constant and increasing the threshold would require such a significant increase in the threshold to align income and expenditure that the burden of the scheme would fall on a very small number of institutions. This would not be justifiable given that the rationale behind the scheme is that the banking sector as a whole benefits from the Bank's monetary policy and financial stability activities;
- reducing the threshold would result in only a marginal increase in the income generated by the scheme (even if it were abolished), but would impose a regulatory burden on a considerable number of smaller institutions. It would therefore not be justifiable.

The review therefore concluded that the threshold should be kept constant at £500 million, and that the ratio that institutions should be required to contribute above that level should be reduced from 0.15% to 0.11%. This will result in a one-off repayment

to the banking industry of CRDs currently held at the Bank of England of approximately £700 million. As the existing infrastructure and payment systems will remain unchanged, there will be no change in the annual costs of administering the scheme either from the Bank of England or the banking sector's perspective.

It has been concluded that the implementation of this policy proposal would not have a negative impact on race, disability or gender equality.

More detailed analysis underpinning this change to the CRD scheme can be found in the consultation document and associated Treasury response.



## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes/No	Yes/No
Sustainable Development	Yes/No	Yes/No
Carbon Assessment	Yes/No	Yes/No
Other Environment	Yes/No	Yes/No
Health Impact Assessment	Yes/No	Yes/No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes/No	Yes/No
Rural Proofing	Yes/No	Yes/No