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10 June 1982

N J Monck Esq
H M Treasury
Parliament Street
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at phone
Mr. 1/6
MoD *Cost*
Security of payment
Ag 1/11/82
by Antony in Mrs. White
Revised.
Dear Nick.

As it concerns relations between the Bank and its customers,
Tony Coleby has passed your letter of 26 April to me for reply.
I am sorry that I have not done so sooner.

So far as the Ministry of Defence payments are concerned, we have talked, over a period of several months, to the Ministry in Liverpool and the Paymaster General's office in Crawley to see if a means could be found to enable the Ministry to pay its suppliers in ways which would be acceptable to all the parties involved, including the Bank both as banker and in its management of the money market. Proposals were made several months ago which would go a long way towards achieving this objective. However, I understand that, after review at senior level in the Ministry of Defence, in the light of certain comments by the Exchequer and Audit Department, these proposals are not being pursued. We are now reconsidering what action we can take.

So far as overdrafts on the clearing banks' operational accounts are concerned, I made it clear to each bank individually just prior to the abolition of the 1½% requirement that, so long as they did not go into overdraft, they were free to maintain whatever balance they thought fit on their operational accounts. If, in order to avoid overdrawing, they considered it wise to maintain a rather larger balance than they otherwise might, then it was essential for us to know, for money market management purposes, at what target they were aiming. This arrangement has worked satisfactorily and, despite inevitable day to day variations (which is what the larger balances are intended to accommodate), their average balances have run extremely close to target.

Each bank asked what penalty we would impose if they overdrew their account, but I declined to be drawn on this, merely repeating that we expected them to manage their affairs in such a way that they did not overdraw. Nevertheless, I reserved the right to impose a charge if an account went into overdraft but made it clear that we could not lay down rules for events which should not occur. I also pointed out that failure to maintain an account in funds would be indicative that they were not aiming for a sufficiently large cushion to cover unforeseen movements. Conversely, if they could arrange their affairs in such a way that unforeseen movements were kept to a minimum, then they would be able to aim at a smaller cushion.

Inevitably, as experience led us to expect, overdrafts have very occasionally occurred, including those in March to which you refer. Our reactions to the overdrafts have depended entirely on the circumstances of each case and we have no hard and fast rules whatsoever. This is, of course, the approach that we adopt with all customers (including Government Departments) who do not have agreed overdraft or advance facilities but who for one reason or another occasionally overdraw. In the case of the clearing banks, however, it has so far been our practice, in the absence of any special factors to charge interest at rates not less than the highest closing rate for overnight funds in the inter-bank market.

Yours Sincerely

David Samuel



H M Treasury

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A Coleby Esq
Bank of England
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26 April 1982

Dear Tony

You will remember that before you went on holiday we discussed the occasion in March when the clearing banks went collectively and individually into overdraft with you. The immediate cause was the way in which the Ministry of Defence pays its bills but you told me later that you did not wish me to take this up with the Ministry as you were doing so direct. I should be interested incidentally to hear the outcome of that approach.

Irrespective of the cause of this incident I asked if you would let me know what, if any, penalties the clearers had suffered as a result of going into overdraft. This is clearly relevant to the future level of balances with you which the clearers will think it worthwhile to maintain. You will remember that during our discussions of the new arrangements we always attached importance to the requirement that the banks should not go into overdraft. You told me before you went on holiday that you were not sure who in the Bank would write to me about this but you agreed to arrange a reply.

Yours

N. Monck

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