



HM Treasury

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

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September 2021



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# Executive summary

Under the Cash Ratio Deposit (CRD) scheme, deposit-taking financial institutions (i.e., banks and building societies) place non-interest bearing deposits at the Bank of England (“the Bank”). The Bank invests these deposits in financial instruments, and the income earned on these investments is used to fund the costs of the Bank’s monetary policy and financial stability operations.

As part of the last review of the CRD scheme (which took place in 2018), the government made a commitment to conduct a further formal review within five years. The 2018 review resulted in a move from a single fixed ratio to a variable ratio indexed to gilt yields. 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.

Leaving the existing parameters unchanged would mean that the CRD balances would remain elevated and volatile, resulting in an ongoing lack of predictability for CRD payers. The income generated by the scheme would also continue to fall short of the costs of the Bank’s policy functions. This would inhibit the Bank from discharging its functions in pursuit of its statutory objectives in respect of monetary policy and financial stability.

The current government review therefore focuses on the operation and suitability of the CRD scheme, taking into account the interests of the wider financial sector, the Bank’s customers and the taxpayer, as well as the need to ensure that the Bank’s policy costs are fully funded over the next CRD period. This consultation document sets out these assessments and analysis and the amendments the government is considering to make to the CRD scheme.

The review of the past performance of the CRD scheme found that the Bank’s income has fallen below required levels since 2018. This was primarily due to lower than expected gilt yields, which have persistently fallen below the downside scenario set out in the 2018 review. Additionally, the Bank’s responsibilities have increased in this period, resulting in increased policy costs.

While discrepancies between projections and actual outcomes have always existed under the CRD scheme, this has become more significant in recent years. The CRD deficit has resulted in the Bank being underfunded, with the Bank’s capital and reserves funding the shortfall. If the CRD scheme were retained, the CRD portfolio would need to increase substantially in order to generate the target income over the 2023-2028 period. The scheme would also become increasingly sensitive to prevailing yields. The proposals set out in this consultation document are intended to ensure the Bank’s policy costs are fully funded, whilst also delivering a simpler, more transparent funding scheme for CRD payers.

Looking ahead, the Bank is now adopting a multi-year budget planning and prioritisation process. The Bank has not forecast its policy costs over the 2023-2028 review period. However, under an alternative funding arrangement, such as the proposed new levy, the Bank would consult with industry annually on the basis of actual policy costs, as it does for the PRA charge. The Bank would also continue to disclose the income and use of resources under this scheme as it currently does in its Annual Report.

## Proposals for consultation

- To replace the CRD scheme with an alternative, direct means of raising the funds to meet the costs of the Bank's policy functions, a new levy;
- the new levy would replace the placing of deposits with a levy of the same cohort that currently pay into the CRD scheme using the same arrangement for apportioning costs to those that pay;
- the government will continue to monitor the effectiveness of the funding model used to meet the Bank's policy costs and will conduct a further formal review within five years and publish a report in respect of that review.

## Consultation and how to respond

The purpose of publishing this consultation document is to enable any interested parties to make representations on the following issues:

- the proposals of the review set out for consultation;
- any other matters raised in this consultation document.

This consultation will be published on the Treasury website. Following receipt of responses, we will inform the interested parties of the outcome, or contact them with further questions that have been raised as a result of this consultation, and consider next steps.

Responses are invited by 5 November 2021 and should be sent to [CRD.Review@HMTreasury.gov.uk](mailto:CRD.Review@HMTreasury.gov.uk). This six-week consultation period reflects the narrow target group for consultation (financial institutions materially affected by the CRD scheme and the above government proposals), the relatively short span of time since the previous review, and the regularity of consultation on the CRD scheme since 2003.

# Chapter 1

## Introduction

- 1.1 Under the CRD scheme, deposit-taking institutions place non-interest bearing deposits at the Bank. The Bank invests these deposits in gilts, and the income earned is used to fund the costs of its monetary policy and financial stability operations.
- 1.2 The CRD scheme was placed on a statutory footing by the Bank of England Act 1998 (“the Act”), with effect from 1 June 1998. The scheme was reviewed in 2003, 2008, 2013 and 2018. As part of the 2018 review, the government made a commitment to conduct a further formal review within five years’ time at the latest. This consultation document sets out the work of the review so far.

### The Review

- 1.3 The review of the CRD scheme was announced by the Economic Secretary to the Treasury in a written statement to the House of Commons on 20 July 2021.<sup>1</sup>
- 1.4 The review is being led by a joint Treasury-Bank steering group, whose lead members are:
  - Tom Josephs, Director, Fiscal, HM Treasury
  - Azin Roussos, Deputy Director, Debt and Reserves Management, HM Treasury
  - Nathanaël Benjamin, acting Executive Director, Finance and Performance, Bank of England
  - Andrew Hauser, Executive Director, Markets, Bank of England

### Background

- 1.5 Financial institutions potentially liable to make deposits at the Bank are defined as “eligible institutions” under the Act. As set out when the CRD scheme was placed on a statutory footing in 1998, deposit-taking institutions benefit from the Bank’s provision of liquidity, since their balance sheets are characterised by assets (loans) with long-term maturity, and liabilities (deposits) many of which can be called in at short notice. CRD payers are all eligible to act as participants in the Bank’s Sterling Monetary

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<sup>1</sup> <https://questions-statements.parliament.uk/written-statements/detail/2021-07-20/hcws211>



Framework, which gives them access to a range of facilities including reserves accounts and various borrowing facilities.<sup>2</sup>

- 1.6 Eligible institutions within the CRD scheme are, broadly, UK deposit-taking institutions (banks and building societies) authorised under the Financial Services and Markets Act 2000.
- 1.7 The size of an eligible institution's cash ratio deposit is calculated by applying two factors:
  - the size of its eligible liabilities<sup>3</sup> above a minimum threshold;
  - a cash ratio, applied above this threshold.<sup>4</sup>
- 1.8 As part of the 2018 review, an indexation-based approach was introduced to adjust the cash ratio every six months, using a formula that takes into account past gilt yields (see below).

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<sup>2</sup> [SMF operating procedures \(bankofengland.co.uk\)](https://www.bankofengland.co.uk/smf/operating-procedures)

<sup>3</sup> Paragraph 2 of Schedule 2 to the Act provides that the liability base of an eligible institution at any time is the aggregate of those sterling and foreign currency liabilities of the institution which are eligible liabilities.

<sup>4</sup> Eligible institutions with eligible liabilities below this threshold are not required to place any cash on deposit at the Bank under the current scheme.

# Chapter 2

## Operation of the CRD scheme

2.1 This chapter considers how the CRD scheme has operated to date and provides an overview of the assumptions on costs, yields and eligible liability growth used in 2018 to establish the current parameters of the scheme.

### Performance of the CRD scheme 2018-2023

2.2 As part of the current review, the government looked at the past and projected performance of the scheme in the 2018-23 period. The volatility and the lack of predictability in the current scheme was noted, which results in significant uncertainty for CRD payers and the Bank. The total cash deposits are projected to rise in size from £7.6 billion following implementation of the 2018 review changes, to approximately £14 billion by 2023.

2.3 The Bank is also exposed to volatility since the income generated from the investment of CRD is directly linked to market yields. The projected shortfall of funding for the Bank's policy functions over the 2018-23 period is expected to reach £261 million.<sup>1</sup> The main reason for the shortfall has been lower than anticipated gilt yields, which have resulted in below target income from the investment of deposits. The cost of the Bank's activities funded by the scheme have also increased over the period, beyond the income target set in 2018. These drivers are explained below.

2.4 The shortfall in CRD income has resulted in a deficit in the scheme. The shortfall has been funded from the Bank's capital and reserves, reducing the Bank's retained profits. In 2020/21, the Bank did not transfer a dividend to HM Treasury for the first time in available records, as its loss-absorbing capital level was below the target set in agreement with HM Treasury in 2018.<sup>2</sup>

### Yields and the operation of the indexation-based approach

2.5 Prior to 2018, the CRD scheme operated by forecasting gilt yields at the start of each five-year period and applying a fixed ratio that would apply throughout the period. The 2018 review identified that the surpluses and deficits on the CRD scheme over previous periods had largely arisen as a result of this approach, and the expected yield over the five-year period deviating from the forecast set at the beginning of the period.

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<sup>1</sup> These projections are based on the relevant financial years for the Bank of England, which do not align exactly with when the changes of the 2018 review took effect.

<sup>2</sup> [Financial relationship between the Treasury and the Bank of England - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/684242/Financial_relationship_between_the_Treasury_and_the_Bank_of_England_-_GOV.UK_(www.gov.uk).pdf)

- 2.6 The 2018 review introduced an indexation-based approach. The approach sought to make the scheme responsive to changes in gilt yields, to the extent that those gilt yields affected the return on the Bank's portfolio, resulting in a smoother income profile.
- 2.7 The indexation-based approach uses the following formula for determining the ratio, recalculated every six-months:

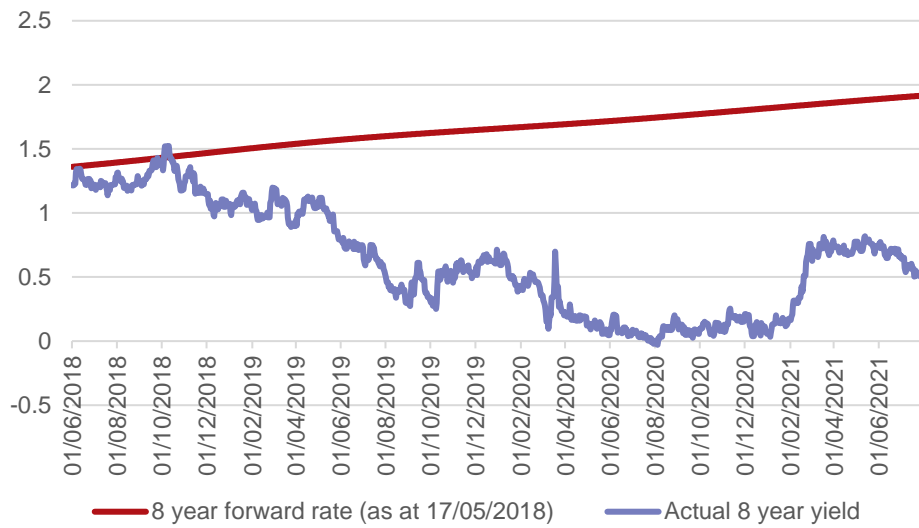
$$CRD\ ratio = \frac{Target\ income}{Aggregate\ eligible\ liabilities * Portfolio\ yield}$$

- 2.8 The "portfolio yield" seeks to reflect the actual yield on the Bank's investments and consists of three components weighted as per below. It is based on an eight-year gilt, chosen to reflect the average duration of the Bank's portfolio. The portfolio generally holds purchases to maturity.

$$\begin{aligned}
 & \textit{Portfolio yield} \\
 & = 0.55 \textit{ (average of 8yr gilt yields over prior 13 years)} \\
 & + 0.42 \textit{ (average of 8yr gilt yields over May 2018 to Nov 2018)} \\
 & + 0.03 \textit{ (average of 8yr gilt yields over prior six months)}
 \end{aligned}$$

- 2.9 The portfolio yield formula accurately reflected the actual yield on the Bank's portfolio at the point of introduction in 2018. However, while it has adjusted over time in response to changing market conditions, it has diverged from the actual yield on the Bank's portfolio. At the time of the most recent recalculation in June 2021, the calculated portfolio yield was 1.54%, while the actual yield on the portfolio was 1.3%. As a result, the growth in the CRD ratio and the size of the portfolio has not been sufficient to offset the lower income resulting from reduced yields.
- 2.10 The main cause of this divergence is that gilt yields during the period have persistently fallen below the downside scenario set out in the 2018 review (chart 1 below shows how actual yields compared to the implied gilt forward curve at the time of the previous review in February 2018). The 8-year gilt yield was 0.52% as of 30 July 2021, and for periods during 2020 it fell below 0.1%. In order to maintain simplicity and predictability, the indexation approach introduced in 2018 was not designed to ensure stable income across all possible yield scenarios.

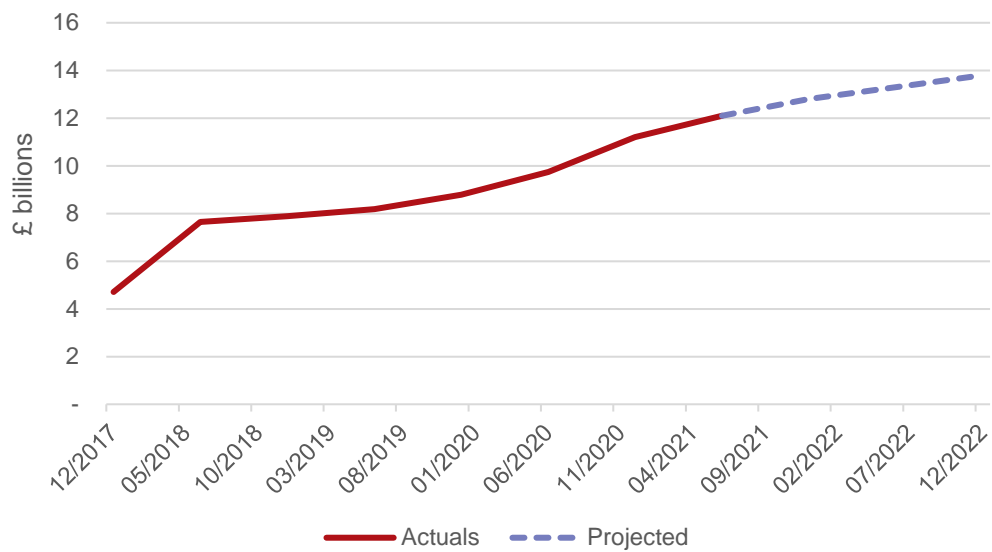
Chart 1: Actual vs historical implied gilt yields



Source: Bank of England, 2021

- 2.11 The scheme was calibrated in 2018 to deliver a fixed income target of £169 million per annum. In the financial year 2020-21, the CRD scheme generated £130 million of income, and over the five-year period as a whole it is projected to deliver £670 million based on market expectations of gilt yields – a shortfall of £261 million.
- 2.12 The indexation-based approach introduced in 2018 has caused the cash ratio to respond to low gilt yields by increasing over time, as intended, causing the total size of the portfolio to rise. The chart below shows the total size of required deposits since 2017. It illustrates the immediate increase resulting from the 2018 review, and the continued rise in balances driven by the index-based approach. The dotted section shows projected future requirements to the end of the present five-year period, based on current market-expectations for yields and linear growth in eligible liabilities. By the end of this period, CRDs are set to grow to over three times their level prior to the 2018 review, and almost double their level in 2018.

Chart 2: Total cash ratio deposits



Source: Bank of England, 2021

## Questions for interested parties

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

Q2: What has been the impact of the scheme's performance for your firm (e.g., administration of the scheme; the mechanism determining balances; rising balances)?

# Chapter 3

## Policy costs

### Bank costs

- 3.1 The Bank operates a financial framework that includes different funding mechanisms:
- The CRD scheme funds the costs of the Bank’s monetary policy and financial stability operations;
  - the remunerated activities of the Bank (banking services, services to government and lending operations) are financed from earnings generated by those functions;
  - operating in its capacity as the Prudential Regulatory Authority (PRA), the Bank charges the firms it regulates to recover all costs for the performance of the PRA’s functions. A separate charge recovers the costs of supervising Financial Market Infrastructure firms;
  - seigniorage (income from assets held to back notes that the Bank has issued) funds the Bank’s note production and operations.
- 3.2 At the 2018 review, the annual costs of the Bank’s policy functions to be funded by the CRD scheme were set at a nominal level of £169 million per annum, totalling £845 million over the period. Actual policy costs for financial years 2018-2020 were £169 million, £171 million and £179 million respectively, and the projected cost for 2021-2022 is £204 million. Allowing for an inflationary increase for 2022-23 to £208 million, this would total £931 million over the five-year period, compared to a 2018 target budget of £845 million. The £86 million cost difference accounts for one third of the CRD scheme’s £261 million total income shortfall.
- 3.3 As background, between 2016 and 2020, the headline cost budget of the Bank as a whole remained broadly flat. However, during that same period the Bank absorbed in excess of £100 million of additional cost due to significant new demands on it arising from external factors, such as: EU withdrawal; ring-fencing; regulation of Central Counterparties (CCPs); and increased operational expenses and depreciation.
- 3.4 Given these pressures, in line with the rest of the public sector, for the 2020/21 budget year the Bank moved to a “flat-real” budget to accommodate inflationary increases. However, as the year 2020/21 progressed, the Bank faced increased pressures arising from the Covid pandemic, and whilst all areas of the Bank had already deprioritised

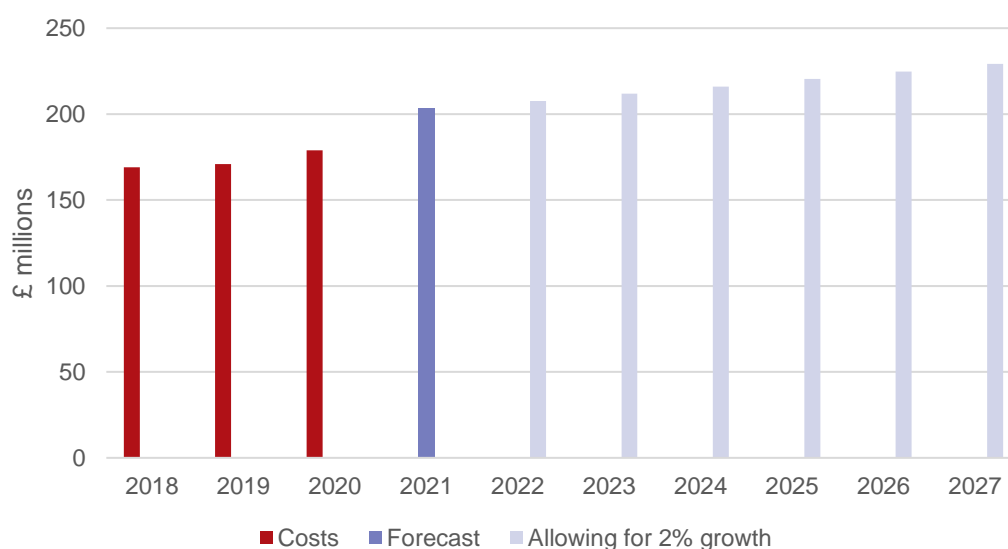
considerable amounts of work in order to accommodate the factors above, they then had to do so again to respond to the pandemic.

- 3.5 Within this broader context, the increase in policy costs, relative to initial forecasts, is attributable to: a) the Bank having been given additional regulatory, supervisory and financial stability responsibilities; b) the Bank investing in areas to support the UK in positioning itself for technological advances in financial services; and c) increased pension costs due to the low yield environment. Further detail of these increased costs is set out in the Bank of England’s Annual Report and Accounts.

## Bank future costs

- 3.6 Looking ahead, the Bank is now adopting a multi-year budget planning and prioritisation process. The Bank has not forecast its policy costs over a 2023-2028 review period. For the purpose of providing a basis for calculation, an illustrative scenario of future costs rising at 2% a year from the 2021 forecast has been used, resulting in an average of £220 million a year over the period. Under an alternative funding arrangement, such as an annual levy, the Bank would consult with industry annually on the basis of actual policy costs, as it does for the PRA levy, rather than the Treasury assuming an income level requirement at the beginning of every five-year period using estimates, as for the current CRD scheme.

Chart 3: Bank of England annual costs attributable to CRD



Source: Bank of England, 2021

## Value for money and cost benchmarking

- 3.7 As set out in its 2021 Annual Report,<sup>1</sup> the Bank remains committed to providing value for money in the effective performance of its functions, and in that context continues to aim to re-prioritise and seek efficiency savings.

<sup>1</sup> <https://www.bankofengland.co.uk/annual-report/2021>

- 3.8 The Bank's annual budget is approved by the Bank's Court of Directors (Court), which has a majority of non-executive members. Its statutory aim is to effectively discharge the Bank's functions and, subject to that, to ensure the most efficient use of the Bank's resources.<sup>2</sup> As set out in its 2021 Annual Report, as part of its work to control costs and provide value for money, the Bank has continued to focus on benchmarking Central Services functions on performance and costs, and now systematically measures and reports progress across benchmarked metrics to Court on a quarterly basis. This progress has been monitored and reviewed by the Audit and Risk Committee of Court.
- 3.9 Under the Memorandum of Understanding on the financial relationship between HM Treasury and the Bank of England,<sup>3</sup> the Bank provides the Treasury with an overview of its draft budget and an opportunity to comment prior to presentation of the final budget at Court. The Governor writes to the Chief Secretary to the Treasury following Court's review of the Bank's budget for the coming year, setting out the consequences of that review. The Bank also provides the Treasury with a quarterly update on the Bank's performance against the budget, alongside meetings of the Bank's Finance team with Treasury counterparts.
- 3.10 Following the 2018 review of CRD the Bank 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 Bank is accountable to Parliament and is subject to periodic examinations by the National Audit Office (NAO). These examinations may cover the economy, efficiency and effectiveness with which the Bank has used its resources in discharging its functions.<sup>4</sup> The NAO must report to the House of Commons on any examination conducted.

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<sup>2</sup> Bank of England Act 1998, Section 2(3) and 2(4): <https://www.legislation.gov.uk/ukpga/1998/11/section/2>

<sup>3</sup> <https://www.gov.uk/government/publications/financial-relationship-between-the-treasury-and-the-bank-of-england>

<sup>4</sup> NAO examinations are not concerned with the merits of the Bank's policy objectives, including the policies of the Financial Policy Committee, Monetary Policy Committee or Prudential Regulation Committee.



# Chapter 4

## Retention of the CRD scheme

- 4.1 This chapter sets out potential changes that could be made to the CRD scheme if it were to be retained in its current format after the current five-year period, to allow it to meet its objectives with greater certainty. The chapter identifies the main challenges in making the CRD scheme sustainable, in particular arising from low gilt yields. The government considers the challenges facing retention of the CRD scheme to be significant and has therefore set out proposals for replacing the scheme in chapter 5.

### Potential changes to the CRD scheme

- 4.2 As noted in chapter 3, the CRD scheme in its current format has resulted in significant volatility in the size of the CRD deposit and a lack of predictability for CRD payers. The scheme has also failed to generate the stable income required to fund the Bank's policy functions. Retention of the CRD scheme for a further five-year period would therefore require recalibration of the formula for the CRD ratio with the aim of reducing income volatility, but as set out below this would be likely to further increase uncertainty for CRD payers over the size of their contribution.
- 4.3 The target income in the formula would need to be updated from that set for 2018-2023, to reflect the Bank's higher costs resulting from its additional responsibilities. The review has not sought to make a detailed projection of future policy costs for the five-year period beyond 2023, given the timing of the review ahead of the end of the period and the main proposals set out in chapter 5. For the illustrative purpose of assessing the options reviewed, it has been assumed that the Bank's policy costs will remain flat in real terms beyond those expected for 2021/22. This would imply a target income of £220 million a year averaged over the period.
- 4.4 The CRD portfolio would need to increase substantially in order to generate this target income. This is primarily due to gilt yields, where market expectations are that these will remain low across the period, as well as an increase in the Bank's responsibilities, resulting in increased policy costs. If the CRD scheme were recalibrated at the end of the current period in June 2023 in order to fully cover the Bank's policy costs, the total balance would need to grow from the current £12.1 billion to £19.8 billion, taking account of expected maturities and investments to that point. This figure is sensitive to prevailing yields at the point of the increase. A deviation of 25bps below the market expected yield at that point would increase the balance required by around £2 billion.

- 4.5 The required CRD portfolio would be expected to continue to grow past 2023, as previous investments made during higher yield periods progressively mature. Under current market yield expectations, the portfolio would need to grow to £21 billion by 2028. If yields were 25bps below expectations between now and 2028, this would increase to over £25 billion.
- 4.6 The underperformance of the portfolio yield formula set in 2018 demonstrates the challenge involved in stabilising the income from the CRD scheme in a low yield environment. Retaining the general approach and updating the weightings and time periods in the formula would face similar challenges if yields again deviate too far from market expectations, and could again result in income under- or over-shooting the target.
- 4.7 Recalibration of the CRD scheme would therefore require balancing between design choices that leave the Bank exposed to under-recovery of costs in low yield conditions, or that make the cash ratio more volatile, imposing additional uncertainty and cost on CRD payers. In conditions where yields fall to or below zero, it is not possible to design a CRD scheme that is reliant on investing deposits such that it delivers stable income.
- 4.8 This review is not proposing a specific formula for recalibrating the CRD scheme, reflecting these challenges and the proposal to replace the CRD scheme set out in the following chapter. However, if the decision is made to retain the CRD scheme in the current format in light of consultation responses, additional proposals will be put forward that seek to achieve an appropriate balance between ensuring the scheme provides stable income and avoiding excessive uncertainty and volatility for payers.
- 4.9 The government is considering whether adjustments to the eligible liabilities threshold or eligible institutions definition within the CRD scheme could make it more sustainable:
- A reduction in the threshold value band above which deposits are required to be placed with the Bank under the scheme would increase the burden on smaller institutions that are currently not required to place deposits. If the minimum threshold were increased, it would have the effect of concentrating the financial burden still further on a smaller number of institutions.
  - An expansion to the definition of eligible institutions would reduce the burden on eligible deposit takers. But the Treasury is mindful of the historic link between the CRD scheme and firms' access to liquidity support from the Bank. A requirement on non-deposit-takers to place CRD deposits may also be more onerous given the different nature of liquidity management for such firms.
- 4.10 Therefore, adjustments to the eligible liabilities threshold or definition of eligible institutions would change the distribution of costs of the CRD scheme but would not address the challenges relating to its performance and unpredictability.

## Questions for interested parties

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

# Chapter 5

## Alternative funding arrangements

- 5.1 As in previous years, included in this review is consideration of alternative funding arrangements to the CRD scheme and the arrangements used to fund unremunerated functions of central banks in other countries. The most common means of funding 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).
- 5.2 In the UK, the revenues from both of these have always been remitted to the government. The UK's foreign exchange reserves are an asset of the government, and as such the income belongs to the Treasury. The net proceeds of seigniorage income have been paid to the government, as set out in section 6(1) of the Currency and Bank Notes Act 1928.
- 5.3 The CRD scheme funds the Bank's monetary policy and financial stability functions, and CRD payers are all eligible to participate in the Bank's Sterling Monetary Framework. Respondents in previous years' consultations indicated that they considered direct funding through a fee or levy a more suitable means of funding the Bank's policy functions.

### A new levy

- 5.4 A new levy is a suitable alternative to consider at this time. Such a model was suggested in some responses to previous consultations on the CRD, and the 2018 review acknowledged that such a model could be appropriate. However, it was not pursued at the time as such a proposal was not possible within the scope of the existing legislation and within that CRD review period.<sup>1</sup>
- 5.5 Following further analysis, and recognising the increased challenges to the CRD scheme set out in chapter 4, this review considers that a levy-based arrangement would deliver a simpler, more transparent funding scheme for CRD payers. It would represent a more straightforward approach, whilst releasing for payers potential income opportunities currently locked in unremunerated deposits. It would also offer a more reliable way of providing stable funding for the Bank's policy functions.

### Operation of a levy-based scheme

- 5.6 The Bank of England already operates cost recovery schemes for costs relating to the operation of the Prudential Regulation Authority (PRA), and to

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<sup>1</sup> 2018 consultation, p22

the supervision of financial market infrastructure firms (FMIs). For 2021/22, PRA fees will total £287.7m<sup>2</sup> and FMI fees will total £10.6 million,<sup>3</sup> compared to the costs attributable to CRD which are projected to be £204 million this year.

- 5.7 As the PRA and FMI fees have distinct legislative bases and purposes, the new levy would be implemented as a separate scheme. However, a levy to fund policy costs would take account of the approach and principles of the existing PRA, FMI, and CRD schemes, and would look to align where possible to minimise the administrative burden on firms covered by multiple schemes.
- 5.8 Under a levy-based arrangement, the Bank would determine the total policy levy annually to match expected expenditure on policy functions. As noted in chapter 3, the Bank's policy costs to be recovered through the levy would be approved by Court as part of annual budget setting processes and discussed with HM Treasury.<sup>4</sup>
- 5.9 The Bank would then allocate the expenditure total to eligible firms according to a defined metric, for example using the long-established allocation process currently used in the CRD scheme. Firms would then be required to make a payment according to this determination. As happens with other cost recovery schemes, a mechanism would exist for adjusting subsequent years' levies to take account of under or overspends, following the finalisation of accounts.
- 5.10 As currently happens in the PRA scheme, the Bank would consult annually on the proposed levy. The Bank would then issue a statement reflecting the results of the consultation and finalising the fees for the year.
- 5.11 In line with the existing CRD scheme, levy payers would only be required to cover the operational costs of the Bank of England's policy functions. Financial gains or losses from policy operations – for example in relation to profits or losses from trading activities or counterparty losses – would not be covered by the scheme. The Bank already identifies the operational cost of policy functions in its Annual Report and would continue to calculate and attribute costs using its current approach.

## Eligible firms for the new levy

- 5.12 Considered as part of the review is whether there should be changes to the eligible institutions or the method used for apportioning costs between them, alongside replacement of the CRD scheme with a levy-based scheme. Currently, eligible institutions are a set of deposit takers, as explained in chapter 1. In June 2021, there were 159 eligible institutions, although some of these represented multiple legal entities within larger financial groups.
- 5.13 Deposit-taking institutions are the primary beneficiaries of the Bank's Sterling Monetary Framework, which gives them access to a range of facilities including reserves accounts and various borrowing facilities. The review of

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<sup>2</sup> [PS15/21 | CP8/21 - Regulated fees and levies: Rates proposals 2021/22 | Bank of England](#)

<sup>3</sup> [Fees regime for financial market infrastructure supervision 2021/22 Consultation Paper - June 2021 | Bank of England](#)

<sup>4</sup> Under the terms of the Memorandum of Understanding on the financial relationship between HM Treasury and the Bank of England

the CRD scheme in 2013 considered the impact of changes to the Bank's structure made by the Financial Services Act 2012, including the establishment of the Financial Policy Committee to monitor and respond to systemic risks.<sup>5</sup> Although the benefits of the Bank's policy work go beyond just deposit-taking institutions, such institutions are also primary beneficiaries of many areas where the Bank's role has expanded, including as the macro-prudential authority and resolution authority. The conclusion of the 2013 review was that it remained appropriate for deposit-takers to fund the additional policy costs associated with these changes.

- 5.14 This review is considering subsequent changes to the Bank's responsibilities, including an increased focus on FinTech and financial market infrastructure.<sup>6</sup> It considers that the definition of eligible institutions under the CRD scheme would remain appropriate if this were replaced with a levy-based scheme.
- 5.15 The allocation of required deposits between eligible firms under the CRD scheme is by reference to their eligible liabilities above a threshold.<sup>7</sup> As set out when the CRD scheme was placed on a statutory footing in 1998, this means that each institution's contribution is proportional to their potential exposure to liquidity risk from maturity transformation, which is the rationale underlying the CRD scheme. As this rationale remains in place, the current definition of eligible liabilities remains appropriate as a basis for determining the allocation of a levy between eligible institutions.
- 5.16 Under the operation of the PRA and FMI fee regimes, the Bank has responsibility for defining and making any changes to the allocation of a levy, subject to consultation. One option would be to mirror this approach in any levy to replace the CRD. Various factors, including the extent of delegation and the content of the legislative provisions, would come into consideration under all options.
- 5.17 How the new levy is introduced has implications for both CRD payers and the Bank. For example, it could be introduced immediately at the point of implementation, with the Bank returning firms' existing cash ratio deposits, or it could be phased in over time and operate alongside the existing CRD scheme. If the new levy is adopted, the method of introduction would need to take into account operational, legislative and risk-based considerations in addition to the impact on payers.

## Questions for interested parties

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

Q5: What are your views on how the new levy could be introduced?

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<sup>5</sup> [Review of the cash ratio deposit scheme: consultation on proposed changes \(publishing.service.gov.uk\)](#)

<sup>6</sup> The Bank's role as supervisor of financial market infrastructure is no longer covered by the CRD, given the introduction of supervisory fees in 2018: [Fees regime for financial market infrastructure supervision 2018/19 \(bankofengland.co.uk\)](#)

<sup>7</sup> As defined in [The Cash Ratio Deposits \(Eligible Liabilities\) Order 1998](#)

## Chapter 6

# The impact on the financial sector of a new levy

- 6.1 This chapter examines the incidence of the existing CRD scheme and assesses the impact of the changes being proposed in this document. The government considers there are two broad benefits to the financial sector from the proposal to replace CRD with a levy-based scheme:
- It will change the way the burden falls on payers, since they will pay directly and will no longer have to deposit large sums in an unremunerated account. This should offer a simpler and more efficient way of generating a given target income. This also allows the cost to payers to be assessed directly rather than inferred, as with CRD.
  - A levy will provide increased certainty to payers over the size of their annual contribution, which currently changes in line with gilt yields under the current scheme. This will also provide increased certainty to the Bank over its funding, which is a fundamental reason for the consultation's proposals.
- 6.2 It should be noted that, regardless of the mechanism used to generate the income, payers will face an increased burden than assumed in the 2018 calibration of the CRD scheme, as the costs of the Bank's policy functions are now higher than forecast at the time – as explained in chapter 3.

### Incidence of the current scheme

- 6.3 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. Table 1 shows the proportions of deposits made by UK-owned and foreign-owned institutions. UK-owned institutions contribute 80% of the deposits made. Owing to commercial sensitivity, only aggregated information relating to deposits has been included.

Table 1: Breakdown of current CRD payers as at June 2021

Group	Deposits (£m)	Deposits as % of total
<b>UK</b>		
Major British Banking Groups	7,599	62.7
Other UK banks and building societies	2,147	17.7
<b>Non-UK</b>		
Subsidiaries of foreign institutions in the UK	761	6.3
Branches of foreign institutions in the UK	1,607	13.3
<b>Total</b>	<b>12,114</b>	<b>100</b>

Source: Bank of England, 2021

## Impact of changing CRD to a levy-based scheme

### Direct cost of a levy vs indirect cost of the CRD scheme

- 6.4 The main cost of the CRD scheme to payers is the foregone income, an opportunity cost on the deposits they are required to hold in non-remunerated accounts. This will vary by firm and over time depending on their business mix, the market environment, and whether they are constrained by regulatory requirements, such as risk-weighted capital requirements.
- 6.5 Replacing CRD with a levy-based scheme would result in a direct cost that is straightforward to assess. Comparing the two approaches therefore requires an assessment of this direct cost with the opportunity cost of a CRD ratio that would generate the same income.
- 6.6 The CRD ratio that is required to generate a given income is driven by the yield on the Bank's investment in UK gilts. Low market yields will drive up the required CRD ratio to generate a given target income, but will also lower the opportunity cost for firms, given investment opportunities will also tend to be lower.
- 6.7 The Bank invests in gilts with a maturity between 3 and 22 years and aims to match the issuance profile of the UK Debt Management Office in this range. This results in average maturity of around 8 years. At present, the yield on the portfolio is above the market yield for 8-year gilts due to purchases made in the past, but over time the portfolio and market yield should be expected to converge.
- 6.8 Over time, a levy would be less costly for a payer than the CRD scheme if they are to be able to earn a higher risk-adjusted return than that available



from investing in 8-year gilts. As payers could choose to invest in 8-year gilts, generate the same income as the Bank would have been able to, and use this to pay a levy, they should as a minimum be no worse off from such a change.

6.9 Many payers will also have access to a wider set of choices, allowing them to earn higher rates of return on the assets that would otherwise have been deposited as CRDs. Deposit-takers as a group could be expected to be able, over time, to earn returns in excess of those available on gilts, implying that a levy regime should be more efficient for payers.

6.10 The regulatory treatment of CRDs supports this approach to considering opportunity costs and alternative investment opportunities for most firms:

- CRDs already count towards calculations of the leverage ratio as set out in the PRA Rulebook, to those firms to which it applies. So, alternative investment of these funds would not increase the ratio for firms;
- CRDs are excluded from calculations of high-quality liquid assets, so alternative investments into qualifying assets could contribute positively towards regulatory measures of liquidity adequacy;
- CRDs do not contribute to calculations of risk-weighted assets, so alternative investments could increase a firm's risk weighted capital requirements, requiring adjustments to be made to calculations of returns for firms that are constrained by this measure.

6.11 The review has not sought to calculate the projected opportunity cost of maintaining CRDs in order to compare this directly with a levy, given the dependency on the future economic environment and the different positions of payers. The government invites feedback from payers on how they would assess the relative costs.

#### **Increased budget certainty for eligible firms**

6.12 A levy-based scheme could also offer wider benefits for payers than opportunity cost savings. A levy would remain relatively stable over time, in contrast to the CRD scheme which has already seen significant increases in the ratio and could become more volatile if further changes were made to stabilise income under low yield conditions. In comparison to a levy, CRD payers face additional costs from the uncertainty of the CRD balance they are required to maintain, and from administering the treasury operations required to generate the CRD balance.

6.13 The operating costs of the Bank's policy functions that would determine a levy would continue to be challenged and controlled by the mechanisms set out in chapter 3. In addition, moving to a levy scheme would involve annual consultation with payers (in line with the PRA and FMI fees), providing payers with more frequent and direct means to represent views on the levy than currently exists under the CRD scheme.

## Impact of addressing the existing income shortfall

- 6.14 For illustrative purposes, the current CRD scheme would be projected to generate £162 million in 2023-24 (the first year after the end of the current five-year period), if maintained in its current form with the current income target. The income target for that year, assuming flat real growth in costs, would be £212 million. Any recalibration of the CRD scheme or replacement by a levy scheme would seek to address this £50 million shortfall, increasing the burden on payers.
- 6.15 This review has not projected the cost of the Bank's policy functions for a further five-year period, given the proposal to replace CRD with an annually calibrated levy (chart 3 provides a simple illustration of what the costs could look like). This is in line with the PRA and FMI fees already administered by the Bank, which are consulted on annually on the basis of expected costs.
- 6.16 In the wider context of the total tax burden on banks and building societies, in 2019-2020 £2.5 billion was raised from the government bank levy and £2 billion from the bank corporation tax surcharge. Corporation tax receipts from the banking sector over the same period totalled £5 billion.<sup>1</sup> By comparison the CRD scheme is looking to recover policy costs of the Bank that currently stand at £204 million per annum.

## Questions for interested parties

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

Q7: Do you consider payers will be able to make a return greater than the return available through the Bank's investments in a portfolio of gilts and if so why?

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<sup>1</sup> <https://www.gov.uk/government/statistics/payee-and-corporate-tax-receipts-from-the-banking-sector-2020>

# Chapter 7

## Consultation and how to respond

7.1 The purpose of publishing this consultation document is to enable any interested parties to make representations on the following issues:

- the proposals set out for consultation;
- any other matters raised in this consultation document.

Following receipt of responses, we will inform the interested parties of the outcome, or contact them with further questions that have been raised as a result of this consultation, and consider next steps.

7.2 Responses to the consultation are invited by 5 November 2021 and should be sent to:

Azin Roussos  
Deputy Director, Debt and Reserves Management Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ  
Email: [CRD.Review@HMTreasury.gov.uk](mailto:CRD.Review@HMTreasury.gov.uk)

7.3 Responses may be made public unless confidentiality is specifically requested.

# Annex A

## Consultation stage impact assessment

- A.1 Following the passage of the Small Business Enterprise and Employment Act 2015, changes to the CRD scheme fall within the scope of the government's business impact target.
- A.2 This impact assessment aims to set out the economic impact on businesses of the changes proposed in this consultation document: moving from the current CRD scheme to a levy. The government will seek further evidence through the consultation to provide a fuller picture of costs and benefits in a final stage impact assessment, which will be subject to validation by the Regulatory Policy Committee.

### Policy objectives

- A.3 Price stability and financial stability are key pre-requisites for the government's economic objective of creating strong, sustainable and balanced growth. This is set out in remits for the respective policy committees of the Bank.
- A.4 The Cash Ratio Deposit scheme is intended to finance the Bank's monetary policy and financial stability activities. The intended effect of amending or replacing the scheme is to reduce the volatility in contributions and provide increased budgetary certainty for CRD payers. This will also ensure that the income received by the Bank is in line with its forecast expenditure for these policy related activities.

### Proposed amendments

- A.5 Over time it has become apparent that the income from the scheme can be volatile relative to the cost of the Bank's operations. The proposed amendments seek to address this through replacing the existing CRD scheme with a levy of the current payers into the scheme.
- 7.4 Under a levy-based arrangement:
- the Bank would determine the total policy levy annually to match expected expenditure on policy functions;
  - the Bank would consult annually on the proposed levy and would issue a statement reflecting the results of the consultation and finalising the fees for the year;
  - the Bank would allocate the expenditure total to eligible firms according to a defined metric, for example using the long-established allocation process currently used in the CRD scheme;

- firms would be required to make a payment according to this determination; and
- a mechanism would exist for adjusting subsequent years' levies to take account of under or overspends, following the finalisation of accounts, as happens with other cost recovery schemes.

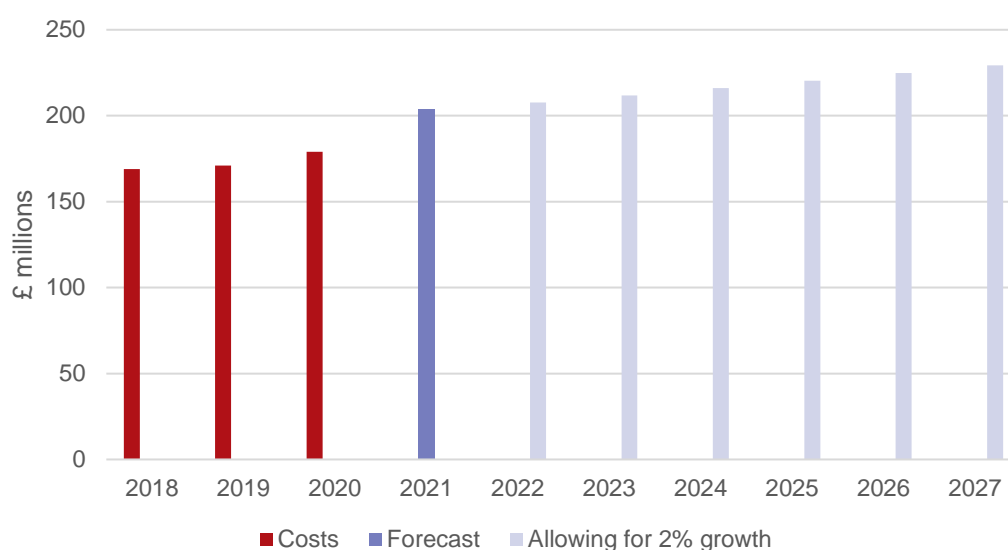
A.6 For the purposes of this initial impact assessment the definition of eligible institutions under CRD is assumed to remain unchanged, and no assumptions are made over how the proposed levy is introduced.

## Costs to the main affected group

### Direct costs

- A.7 The direct cost of the proposal is the levy payment that eligible firms are required to make to the Bank to pay for the Bank's policy costs. The size of the firm's direct contribution under the levy would be the same as the firm's indirect contribution under the existing CRD scheme. However, the levy contribution would likely appear as recurring direct cost that would affect firms' profit and loss accounts as an administrative expense.
- A.8 It is not possible to meaningfully forecast Bank policy cost over the CRD period 2023-28. The Bank will calibrate the proposed levy annually, as it does with the PRA and FMI fees, and the Bank is now in the process of adopting a multi-year budget framework after several years of flat nominal costs.
- A.9 For the purpose of providing a basis for calculation, chart A1 shows what would happen to the policy costs to be funded by the proposed levy using an illustrative scenario of future costs rising at 2% a year from the 2021 forecast. This results in an average of £220 million for CRD related costs over the five-year period. This is an illustrative projection to provide an indication of the potential size of the annual levy over time. This is not a forecast of the Bank's policy costs over this period, which will need to account for evolving responsibilities and investment requirements.

Chart A1: Bank of England annual costs attributable to CRD



Source: Bank of England, 2021

## Indirect costs

- A.10 Switching to a levy would not be expected to result in regulatory costs to firms. Under existing regulatory treatment:
- CRDs already count towards calculations of the leverage ratio, as set out in the PRA Rulebook, to those firms to which it applies, so alternative investment of these funds would not increase the ratio for firms; and
  - CRDs are excluded from calculations of high-quality liquid assets, so alternative investments into qualifying assets could contribute positively towards regulatory measures of liquidity adequacy.
- A.11 However, CRDs do not contribute towards the calculation of risk-weighted assets. Alternative investments could therefore increase a firm's risk weighted capital requirements, requiring adjustments to be made to calculations of returns for firms that are constrained by this measure. This depends on the individual capital position of firms, and what they choose to do with their CRD balances. The overall impact would be expected to be minimal given the size of CRD balances relative to total assets.
- A.12 The administrative cost to firms of moving from the status quo to the proposed levy system is expected to be minimal. The operational costs to the Bank arising from administering the proposed levy are also expected to be negligible.
- A.13 As outlined in chapter 6, in June 2021 83% of the total deposit was made by the largest 20 institutions, of which 8 institutions each contributed more than £200 million in deposits under the scheme. Under the proposed levy approach, the allocation of costs to be applied to each institution will continue to be a proportion of the eligible liability base of that institution.

Therefore, there is no departure from the proportionality inherent in the current indexed ratio scheme.

## Benefits

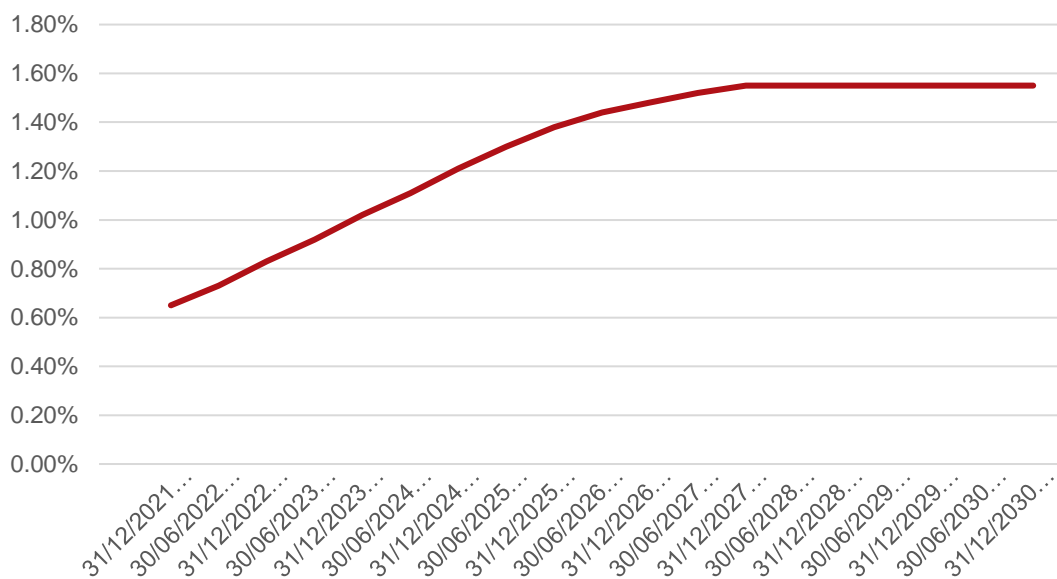
### Increased certainty for firms over contribution

**A.14** The principal benefits to firms from switching to a levy are reduced volatility in contributions, and increased budget certainty. Under the existing CRD scheme, firms' required balance will change in response to gilt yields, with greater balances required as gilt yields fall. As shown in chart A2, gilt yields are forecast to remain low across the upcoming CRD period. Under a levy, firms' contributions will not be influenced by gilt yields and will be solely determined by the Bank's policy costs. This will provide greater certainty over the size of payment that firms will be required to make.

### Opportunity cost from CRD investments

**A.15** Under the existing CRD scheme the primary cost to firms is the foregone interest income (the opportunity cost) from the unremunerated reserves. A benefit to CRD payers from the levy would therefore exist if the direct cost of a levy were less than the opportunity cost on their CRD deposit.

**Chart A2: Market implied forward curve for 8-year gilts as of 30 June 2021**



Source: Bank of England, 2021

### Investment choice

**A.16** Whilst the total contribution from firms remains unchanged under the proposed levy, changing from an indirect to a direct funding method would be expected to benefit CRD payers from an investment choice perspective.

- **Under the existing CRD scheme costs are met indirectly:** firms ultimately provide the same payment but do so by first depositing an agreed amount of unremunerated funds at the Bank, which in turn invests these deposits in gilts. The interest earned from these investments corresponds to the firm's determined contribution.
- **Under the proposed levy the policy costs are met directly:** firms would make a direct payment in line with their determined contribution. Firms have the choice over how to invest and generate the income required to make the levy payment.

**A.17** This implies that a levy should be preferable to CRD payers: they would have the option of continuing to invest in gilts (as currently happens with their CRD deposit) or invest in a broader range of assets in order to earn the required income to make the levy payment. As payers could choose to invest in 8-year gilts, generate the same income as the Bank would have been able to, and use this to pay a levy, they should as a minimum be no worse off from such a change.

### Transparency over costs

**A.18** The proposed levy would be a transparent and easily identifiable cost for firms. In contrast the cost to firms under the existing CRD scheme is the opportunity cost from foregone interest income which needs to be imputed. Firms would also have more frequent opportunities for representing views on the levy through the annual consultation process with the Bank than currently exists under the CRD scheme.

### Benefits to the Bank

**A.19** The existing CRD scheme is not currently generating the target income, resulting in a large deficit in the scheme. If unchanged, the scheme's generation of income would continue not to meet the costs of the Bank's policy functions. This would inhibit the Bank from discharging its functions in pursuit of its statutory objectives in respect of monetary policy and financial stability. The shortfall to date has been funded from the Bank's capital and reserves, reducing the Bank's retained profits. In 2020/21, the Bank did not transfer a dividend to HM Treasury for the first time in available records, as its loss-absorbing capital level was below the target set in agreement with HM Treasury in 2018.

**A.20** The proposed levy would therefore represent a more stable income source and would ensure that the income received by the Bank is in line with its forecast expenditure for these policy related activities. This would also mean that the Bank would not have to fund the income shortfall through its own capital and reserves.

### Equalities impacts

**A.21** The measure concerns changes to the Cash Ratio Deposit scheme, which is paid only by banks and building societies. No impact is expected for individuals.



## Monitoring and evaluation

- A.22 Under the proposed levy the Bank would consult with eligible institutions annually on its policy function cost base to ensure that its costs are fair and transparent and that the scheme is operating as intended. The government will continue to monitor the effectiveness of the funding model used to meet the Bank's policy costs and will conduct a further formal review within five years and publish a report in respect of that review.

## Declaration

- A.23 John Glen MP, Economic Secretary to the Treasury, has read this impact assessment and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.

# Annex B

## Consultation privacy notice

- B.1** This notice sets out how HM Treasury will use your personal data for the purposes of the consultation on proposed changes to the Cash Ratio Deposit scheme and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

### Your data (Data Subject Categories)

- B.2** The personal information relates to you as representatives of organisations or companies.

### The data we collect (Data Categories)

- B.3** Information may include the correspondent's name, email address, address of place of work, job title, and employer, as well as their opinions. It is possible that correspondents will volunteer additional identifying information about themselves or third parties.

### Legal basis of processing

- B.4** The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective government policies.

### Special categories data

- B.5** Any of the categories of special category data may be processed if such data is volunteered by the respondent.

### Legal basis for processing special category data

- B.6** Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.
- B.7** This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

### Purpose

- B.8** The personal information is processed for the purpose of obtaining the opinions of representatives of organisations and companies, about

departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

## Who we share your responses with

- B.9 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).
- B.10 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.
- B.11 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.
- B.12 Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.
- B.13 Responses to this consultation will be shared with the Bank of England to assist HM Treasury in developing the policies to which it relates. Where information about respondents is not published, it may be shared with officials within the Bank of England and public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at:  
<https://www.gov.uk/government/organisations>
- B.14 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

## How long we will hold your data (Retention)

- B.15 Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.
- B.16 Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

## Your Rights

- B.17 You have the right to request information about how your personal data are processed and to request a copy of that personal data.
- B.18 You have the right to request that any inaccuracies in your personal data are rectified without delay.

- B.19 You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- B.20 You have the right, in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted.
- B.21 You have the right to object to the processing of your personal data where it is processed for direct marketing purposes.
- B.22 You have the right to data portability, which allows your data to be copied or transferred from one IT environment to another.

## How to submit a Data Subject Access Request (DSAR)

- B.23 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit  
G11 Orange  
1 Horse Guards Road  
London  
SW1A 2HQ

[dsar@hmtreasury.gov.uk](mailto:dsar@hmtreasury.gov.uk)

## Complaints

- B.24 If you have any concerns about the use of your personal data, please contact us via this mailbox: [privacy@hmtreasury.gov.uk](mailto:privacy@hmtreasury.gov.uk).
- B.25 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office  
Wycliffe House  
Water Lane  
Wilmslow  
Cheshire  
SK9 5AF

0303 123 1113

[casework@ico.org.uk](mailto:casework@ico.org.uk)

- B.26 Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.