HM Treasury

Review of the cash ratio deposit scheme:

Policy statement

June 2022

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Chapter 1

HM Treasury's approach to replacing the Cash Ratio Deposit (CRD) scheme with a new levy

Background

1.1 The Cash Ratio Deposit (CRD) scheme funds the Bank of England's (the Bank) monetary policy and financial stability functions. Under the scheme, banks and building societies with eligible liabilities currently greater than £600 million are required to place a proportion of their deposit base with the Bank on a non-interest bearing basis. The Bank invests these funds in interest bearing assets (mainly gilts) and the income generated is used to meet the costs of its monetary policy and financial stability functions.

1.2 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 Economic Secretary to the Treasury laid a written ministerial statement on 20 July 2021 announcing the start of this review.

1.3 HM Treasury ran a 6-week public consultation between 24 September 2021 and 5 November 2021.[1] It consulted on the way banks and building societies contribute to funding the Bank of England's monetary policy and financial stability functions, and proposals for an alternative funding arrangement.

1.4 The consultation document set out the government's proposals to replace the CRD scheme with a levy to raise the funds to meet the costs of the Bank of England's policy functions. Overall, respondents supported the proposal of a new levy. The consultation respondents raised many of the same themes in their responses: the cohort of payers, the implementation and operation of the proposed levy and alternatives to the levy. A summary of consultation responses was published on 24 February 2022.[2]

1.5 This policy statement details HM Treasury's policy for replacing the current CRD scheme with the Bank of England levy, a new levy for funding the Bank's policy functions.

Objective of the Bank of England levy

1.6 The CRD scheme has resulted in cash ratio deposit sizes significantly higher than originally forecast and a lack of predictability for CRD payers as it changes in line with gilt yields, which have been lower than anticipated since

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[1] Review of the cash ratio deposit scheme: Consultation on proposed changes (publishing.service.gov.uk)

[2] Review of the Cash Ratio Deposit Scheme: Summary of consultation responses (publishing.service.gov.uk)

the 2018 review. This has resulted in the CRD scheme not being able to generate its target income from the investment of deposits and therefore failing to fully fund the Bank's policy functions. The shortfall to date has been funded from the Bank's capital and reserves.

1.7 Replacing the CRD scheme with a levy-based arrangement will deliver a more reliable and stable funding scheme for the Bank's policy functions. That will mean the Bank will no longer need to fund the income shortfall through its own capital or reserves. A levy-based arrangement will ensure that the income received by the Bank is in line with its forecast expenditure for its policy related activities. This will not only provide increased certainty to the Bank over its funding, but also increased certainty to payers over the size of their annual contribution, which they will be notified of annually.

The Bank of England levy

1.8 In line with the intention of the existing CRD scheme, the levy will cover the costs of the Bank's monetary policy and financial stability functions. The Bank's expenditure on these functions currently includes Monetary Analysis and the Monetary Policy Committee (MPC), Markets and Banking, Research and statistics, Financial Stability Strategy and Risk, Resolution, International policy, the elements of Financial Market Infrastructure (FMI) supervision not funded by the FMI levy and elements of Prudential Regulatory Authority (PRA) activity not funded by the PRA levy. Expenditure not intended to be covered by the levy will be the Bank's (i) remunerated activities - including its banking services, services to HM Treasury (such as the management of the note issue and the Exchange Equalisation Account) and lending operations for the Bank's own account, (ii) operations acting as the PRA which are funded by the PRA levy, and (iii) supervision of FMIs which are funded by the FMI levy.

1.9 The CRD scheme will be replaced with a new levy of the same cohort that currently pay into the CRD scheme. In line with the CRD scheme, eligible institutions will broadly be UK deposit-taking institutions (banks and building societies) authorised under the Financial Services and Markets Act 2000. The policy rationale for maintaining this cohort as payers of the levy is that they are all eligible to act as participants in the Bank's Sterling Monetary Framework, which gives them access to a range of facilities including reserves accounts and various borrowing facilities. They are also the primary beneficiaries of the Bank's role as resolution authority.

1.10 The Bank will determine the total policy levy annually to match budgeted expenditure on policy functions. The Bank's policy costs to be recovered through the levy will be approved by the Bank's Court of Directors as part of the annual budget setting processes. The levy, in line with current arrangements for the CRD scheme, will also be discussed as part of the established arrangements for regular discussions between the Bank and HM Treasury covering the Bank's financial position.

1.11 Each year, the Bank will be required to notify industry of the aggregate costs that it has set for that year. Through this annual notification process, the Bank will explain any changes to costs or operation of the levy.

1.12 It is intended that secondary legislation made after the provisions come into force will allocate the Bank's policy costs to payers in proportion to their eligible liability base, setting out the formula and ratio for how this will be applied. This will be a continuation of how the CRD scheme operates. The policy rationale for this is the link between the size of a financial institution's liabilities and its potential impact on the Bank's financial stability functions. The secondary legislation will be amendable by HM Treasury. The making of such secondary legislation will require that HM Treasury consult with the Bank and others that HM Treasury consider likely to be affected by the regulations.

1.13 Each year the Bank will notify eligible institutions of the amount of the levy that they are liable to pay and the time and method by which the levy must be paid. If the Bank determines that the levy may be paid in instalments, then this notification will set out the times by which each instalment must be paid. The Bank will continue to have the power to require eligible institutions to provide information to support the operation of the levy.

1.14 In the event of an eligible institution's failure to pay the levy, the outstanding amount will be recoverable as a debt due to the Bank. The interest payable on the debt will be 4% over the benchmark, which will be defined as the official Bank rate. This is a continuation of what is currently done in the CRD scheme. HM Treasury will have the power to change the rate of interest through secondary legislation.

1.15 When the new levy scheme is introduced, the Bank will publish a standalone framework document outlining the Bank's approach to levying policy costs. The Bank will consult on this framework document before it is finalised (and whenever it is amended by the Bank in future). This framework document will outline:

- the costs that will be recovered through the levy, including the true-up mechanism to align to actual costs incurred,
- the mechanism to determine average eligible liabilities on which the levy will be calculated, and
- the circumstances under which the Bank may deem it necessary to modify the eligible liabilities data.

1.16 Through the Bank's consultation on the framework document, levy payers and the public will have an opportunity to engage and make their views known on the detail of the levy.

1.17 Each year the Bank will publish the costs and reconciliation of the levy in the Bank's Annual Report and Accounts. The annual notification will include details of budgeted costs for the forthcoming year and details of deviations from budget.

1.18 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 at least five years of legislation being introduced and publish a report in respect of that review. As part of HM Treasury's five-yearly review of the levy scheme, consideration of the Bank's approach to levying policy costs, including its approach to setting the annual aggregate costs will be included.

Next steps

1.19 The government intends to legislate when Parliamentary time allows. Following the Royal Assent of primary legislation, HM Treasury will take forward steps for secondary legislation.

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