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Mr Matthew Cooper
Via email: request-45353-29803ff8@whatdotheyknow.com

Dear Mr Cooper

Thank you for your email of 18 August requesting information under the Freedom of Information Act 2000 ('FoI Act'). You ask:

'... if the Bank of England holds any assets sold to them by private commercial banks and if they do could you tell me what makes up most of these assets.

...whether each time a commercial bank makes a loan to a customer, that banks reserves with the Bank of England go up?.... how does the commercial bank obtain all the banknotes needed to provide the customers with the facility of being able to withdraw their deposits that were created through the loans?'

In answer to your first question, the Bank does hold assets sold to it by private commercial banks, both through so-called sale-and-repurchase ('repo') and through outright purchases of securities that are undertaken as part of its money market operations. These appear on the Bank's balance sheet. Information about the components of the balance sheet is available at: www.bankofengland.co.uk/markets/balancesheet/index.htm and details about what collateral is accepted as part of the Bank's operations (for example, gilts) is available at www.bankofengland.co.uk/markets/money/eligiblecollateral.htm

Regarding your other two questions, it is important to understand first that there is no direct connection between the banknotes in circulation and reserves held by banks. Banknotes are a form of money. But so too is money held on bank accounts. When a customer takes out a loan from a bank and (as a result) receives a deposit on his or her account, that customer may, as you suggest, withdraw the money from the bank in the form of banknotes. But that customer might also pay out the money by other means, for example by way of electronic payment methods (such as debit cards).

You also ask about the relationship between banks' loans to customers and their reserves with the Bank of England. I wonder if there is some confusion here between banks' capital requirements and their central bank reserves? When a bank receives a deposit it is able to create a loan from (a fraction of) this deposit which the new borrower can spend. As that money gets spent, its recipient can then deposit these funds, and the so-called "fractional reserve banking" process can start again, based on the second deposit. (And so on.) The original deposit remains on the bank's books for the full amount. In simple terms, to ensure that this lending activity does not get out of hand, the banks are regulated by the Financial Services Authority (FSA), who requires them to hold capital. Broadly speaking, the amount of capital held will depend on the riskiness of the lending which a bank undertakes. Clearly, the more loans that are made, the more capital that needs to be held. The level of capital requirements by banks are currently subject to international reform through the Basle Committee.

Banks' reserves with the Bank of England are separate from these capital requirements. Commercial banks hold reserves at the Bank of England as part of the Reserve Scheme from which they can meet their day-to-day liquidity needs. Participating members can hold reserves which are remunerated at Bank Rate. Further information about the scheme is available on our website at www.bankofengland.co.uk/markets/money/reserves/index.htm

Yours sincerely

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