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BANK OF ENGLAND

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Mr Matthew Cooper

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

Dear Mr Cooper

Thank you for your further email of 4 September in reply to our response of 3 September to your Fol request of 18 August, asking for information about commercial banks' reserves at the Bank in relation to the demand for banknotes. You specifically ask:

'How do the commercial banks get their BoE reserve accounts increased in order to have more banknotes and reserves to leverage to cover depositors demands for notes and credit? Do these banks sell assets to the BoE in exchange for credits to their reserve accounts? Do these banks sell assets to the BoE in exchange for credits to their reserve accounts?'

In order to address your questions I would like to expand on the information we previously supplied about the commercial banks' reserves at the Bank of England and how we supply central bank money to the banking system. But first of all, you comment that it is your understanding that the commercial banks must have reserve accounts for transactions to take place. Strictly speaking there is no requirement for commercial banks that wish to make transactions between each other to hold accounts at the central bank. The system that has developed over time is that banks have chosen to do so, as central bank money is the preferred choice of asset for inter-bank settlement. Typically, commercial banks settle transactions via settlement banks' *settlement* accounts at the Bank of England which can be funded / defunded from the reserves accounts.

Within the Bank's Sterling Monetary Framework the Bank supplies central bank money to the banking system through its open market operations (OMOs). In normal times, reserve scheme members undertake to maintain a level of reserves at the Bank of England within a defined range around a target of their choice. (The policy since March 2009 has been to remunerate all reserves at Bank Rate and the usual system of setting a range has been suspended).

There are different types of OMOs which typically involve reserves scheme members participating in repos with eligible collateral (as you know, a repo is a legal agreement for the sale and subsequent repurchase of a security). Some longer-term OMOs also involve the Bank buying sterling securities outright.

Specifically in relation to Banknotes, there are weekly OMOs that the Bank uses to drain or supply reserves to the market (as necessary), among other things to reflect expected weekly changes in banknotes in circulation. As for '*reserves to leverage to cover depositors demand for...credit*' as previously explained, the reserves that Reserves Scheme members hold at the Bank are not directly related to the loans they then make to their customers. Rather, these reserves balances are used as a liquidity buffer to manage day to day variations in their cash requirements.

For further information about how the various operations work and the types of collateral accepted, you may find the following links helpful:

www.bankofengland.co.uk/markets/money/reserves/index.htm

www.bankofengland.co.uk/markets/balancesheet/index.htm#sterling

www.bankofengland.co.uk/markets/money/stomo/index.htm

Finally, for interest you may wish to look information on the Banknotes section of our website, in particular, the Notes Circulation Scheme (NCS) which explains the process for distributing banknotes throughout the economy. This is available at:

www.bankofengland.co.uk/banknotes/about/distribution_circulation.htm

Yours sincerely

A handwritten signature in black ink that reads "Ben Norman". The signature is written in a cursive, slightly stylized font.

Ben Norman

Deputy Secretary of the Bank