Bank of England

Mr Richard Tice MP
House of Commons
London
SW1A 0AA

Andrew Bailey
Governor

20 June 2025

Dear Mr Tice,

Thank you for your recent letter concerning the Bank's policies on reserve accounts and Quantitative Tightening. I agree with you that these are important issues. I welcome your interest and that of the Treasury Select Committee, to which the Bank is formally accountable. In what follows I have addressed these two points in turn but also provided broader context on how they fit together.

1. **Reserve Accounts**

You have questioned the Bank's policy towards paying interest on the reserve accounts held by commercial banks. Our policy in steady state is to meet the demand of the banks to hold reserves at the Bank. These reserves take the form of cash accounts which can be used to meet immediate requirements for liquidity. From the Bank's perspective, they are the foundation of both of our statutory policy objectives, namely monetary and financial stability.

For monetary policy, our implementation of the MPC's chosen level for Bank Rate is anchored by remunerating reserve accounts at that rate. This helps to ensure that the rates at which banks lend to businesses and households – and the rates they pay on customers' savings – move broadly with Bank Rate. Over time, we have been able to demonstrate that this approach reduces interest rate volatility at the short-end of the interest rate curve, and thus improves the efficiency of implementation of monetary policy, with real benefits for the economy as a whole.

For financial stability, reserve accounts provide one form of what are called High Quality Liquid Assets (HQLA). Assets such as gilts and other high-quality debt also qualify as HQLA.

In terms of the scale of reserves required to achieve our two policy objectives, there is a difference. We could operate monetary policy successfully with quite a low level of reserves, as was done before the financial crisis. With this level of reserves, Bank Rate could still anchor the interest rate curve although it would be less robust to shocks. However, the experience of the financial crisis demonstrated that this policy could not ensure financial stability – for which a much larger stock of reserves is needed.

It follows that the overall level of reserves is driven by our financial stability objective rather than the monetary policy objective. However, it also follows that, as the overall regulatory requirement for banks is set in terms of high-quality liquid assets that can be readily converted into cash if needed, there is no requirement specifically on reserves. So, in steady state banks have choices over the amount of reserves they wish to hold. This is what I meant when I referred earlier to the Bank meeting the demand for reserves of the banks.

An important question that follows is therefore what determines that demand for reserves? One determinant will be the price, in other words the rate paid by the Bank as interest on the reserve accounts. This is because the alternative forms of HQLA – like gilts - carry their own remuneration. It is therefore reasonable to think that were the Bank to cut or eliminate the return paid on reserves, the demand for reserves would fall – possibly substantially. Hence, reserves would not be a reliable or large-scale source of income to the public purse in the way that might be thought just by looking at the level of reserves today.

There would be a way to avoid this outcome, namely by mandating the level of reserves that banks must hold. I will make two points on this. First, by mandating reserves, they would in effect be frozen and hence we could not treat them as liquid assets available for banks to use as we do today. Locking up reserves in this way would undermine the liquidity of the banking system, and thus financial stability. Moreover, there would need to be a liquid asset buffer held in addition to the locked in reserves, and this would mean less scope for the banks to lend. Nor would these locked in reserves be able to perform the monetary policy function, because they would not anchor the interest rate curve.

The second point follows from this. It would not be within the remit of the Bank to require such a system, because it would not serve our statutory purposes. Rather, it would be fiscal policy, which is something that must be enacted by the Government and Parliament. Indeed, we have in the past noted that removing remuneration on reserves is akin to a tax on banks. It is only appropriate that such a tax be imposed by the elected Government of the day.

I will now turn to the impact of the current reserve remuneration on both the Bank's income and that of the banks. Moreover, since the Bank is a public body, income above our operational needs is part of the public purse.

In steady state (I will come on to QE and QT), the reserve remuneration arrangements are neutral in terms of the Bank's income. Put simply, and after meeting our costs, we aim to both receive and pay rates around Bank Rate. The Bank is therefore not losing money on these arrangements. Ceasing to remunerate reserves would be an attempt to shift from a situation that is cost neutral to the Bank and the public sector more broadly, to one that is profit making. However, as I set out above, in order to make money we would have to alter the remuneration of reserves in a way that is not consistent with our statutory objectives, and that would likely lead to a natural reduction in the demand for reserves.

As far as the banks are concerned, they have to fund the reserves they place at the Bank (in other words, they are depositing with us the money that customers deposit with them). Depending on arrangements, they will earn an interest rate spread which will contribute to their earnings, but the important point here is that the interest paid on reserves is not free money for the banks, not least as most of it is paid on to customers in the form of interest on their deposits. Any reduction in income received on banks' reserve assets would therefore likely be reflected in either the interest received by depositors on their deposits with banks or in increased interest charged on other bank assets. In this sense, although constructed as a tax on banks, one might consider it a tax on banking services.

In your letter, you suggest that the banks are now earning excess profits, fuelled at least in part by the reserves arrangements. The question of what is excess is a matter of judgement of course, but I will set out what I see as the technical basis for rebutting this point. From a commercial point of view, banks need to earn a rate of return which at least equals their cost of capital. A good measure of whether they achieve this, and are expected to do so in the future, is whether the ratio of their market value to book accounting value is at least unity.

For over a decade after the financial crisis, for most banks in the UK this test was not met. Capital requirements had, necessarily, increased, and their business models were adjusting to that change. In the last two or three years, that situation has changed, and most of our banks are meeting that test, but not excessively so either by historical or some international comparisons. The increase in interest rates has played a part in this, but not the largest part by any means.

I conclude from this that we do today have a stable banking system with adequate capital and liquidity buffers, which can support our economy and the people of this country, and that is what they should do. I would add that in my view the ringfencing regime helps here because it requires for the most part UK deposits to be used to lend into the UK economy.

2. Quantitative Easing / Quantitative Tightening

I will now turn to Quantitative Easing and Quantitative Tightening (QE and QT). I used the term steady state above to describe the regime where we meet the demand for reserves from banks. QE involves a different state of the world, where the central bank buys financial assets, thereby increasing the prices of these assets and reducing their yield. It thus has the effect of flattening the yield curve benefitting those who borrow at long maturities.

At the same time, it increases the money supply and, other things equal, increases the stock of reserves above the level of natural demand described above. QT puts that process into reverse, though it is generally accepted that the asset price and yield effects are smaller.

You have challenged the Bank's approach to QT and whether it represents value for money. There are two main ways to look at value for money here, and it is important to keep them distinct. One – which fits the Bank's statutory objectives – is to look at the economic costs and benefits and how they fit the Bank's two objectives. The other is to look at the cost in terms of cash flow and the public finances, which is outside the Bank's objectives but something that I recognise is important.

The first test is important but challenging. It requires a full set of alternative economic scenarios going back to 2009 when QE started and modelling what would have been the state of the economy in the absence of QE and QT. We have experienced major economic shocks during this period – the aftermath of the financial crisis, Covid, Ukraine. It is easy to forget the severe problems we faced with these shocks. Although the counterfactual is unknowable with any precision, most estimates indicate that QE provided very significant support to the UK economy, protecting both jobs and tax revenues.

Your focus though is on the second test. Here, it is important to consider cash flows, as you indicate, and moreover the impact on the overall public cash position. While QE was being used as an active policy tool, and interest rates remained low, the cash flow was positive, totalling £124bn that was transferred from the Bank to the Exchequer between 2013 and 2022. Once interest rates increased, the cash flow started to reverse, something the Bank had said since the start would happen. Today the net positive cash flow stands at £34bn, but we expect it to go negative over the remaining lifetime of the policies on this basis of calculation.

An important point to bear in mind here is that we ought to expect that the cash flow will over time be the same regardless of whether we sell the assets or hold them to maturity. This is because the price discount on an active sale is simply equal to the present discounted value of the carry cost that would be incurred were the assets held to maturity. The timing of the cashflows, but not their overall size, is affected by whether or not there are active sales. By avoiding disrupting markets, our gradual and predictable approach to QT supports this.

But this is not the end of the story, though it is the end in most of the accounts of the cash flows expected. An important missing element is that successive UK Governments have issued more long-term debt (gilts) than those of other major economies. The average term of outstanding UK Government debt is around 14 years, compared to around 6-7 years in, for instance, the US, Germany and Canada. The Bank's policy throughout QE was to buy equal amounts across the maturity distribution of gilts, to ensure that our operations were neutral for the gilt market. This means that the Bank now owns more long-term gilts, something that helps to explain why we are conducting more active sales (as we have a slower path for natural maturities). A consequence is that, with an upward sloping yield curve, we do have larger discounts (and would otherwise have larger carry costs) on our long-dated gilts. This has led some commentators to suggest that the Bank's QT programme is more expensive than those of other countries.

This misses an important part of the argument. Because it issued much more long-term debt than other countries when interest rates were low and QE had flattened the yield curve, the UK gets a longer lasting benefit in the form of lower debt costs. We estimate that today the average coupon on UK gilts is 2.8%, at a time when Bank Rate is 4.25%. Some of this advantage from QE reverses as Bank Rate goes up. We estimate that at current Bank Rate, the average coupon is 3.3% after taking into account that some of the bonds were bought in the secondary market as part of QE financed by the issuance of reserves. But the key point is that the UK will keep the benefit of lower debt costs for considerably longer than other countries. Yes, QE/QT reduces it from what it would otherwise be, but that is an artificial calculation because QE itself contributed to the improved cost of issuance. Put simply, the cash flow cost of QE/QT is not therefore what it seems, and the outcome in these terms will be better.

I must emphasise again that these cash flows are not a part of our objectives, but I recognise that we must, and do, have regard to value for money.

I hope that this explanation of the issues helps. I will be happy to meet if that would be useful. I am copying this letter to the chair of the Treasury Select Committee.

Yours sincerely,

cc: Dame Meg Hiller, Chair of the Treasury Select Committee