

Studying the functions of the bank of england finance essay

[Finance](#), [Banks](#)



Introduction

The Bank of England also known as the central Bank of England. In 1694 it started as the joint stock company, and in return for a large loan to the government was put in privileged position which enabled it to be a largest private bank. It was then authorized to hold the large gold reserves of the banking system of UK. In 1844 note issuing powers were terminated other than via bank, which become as the monopoly supplier. Before coming as the bank of England Act 1946, it was under the control of the treasury. It is managed by the Court of Directors, headed by the governor, who is appointed by the crown.

Since 1844, the balance sheet of the bank was divided into two halves, namely as:

Issue Department (concerned with the notes issuance).

Banking Department (concerned with other banking).

Functions of Bank of England

Bank of England Act in 1946 defines the constitutional relationship between bank and the government as follows:

The treasury of the bank of England can give the instruction to the bank time by time as, after constitution with the governor of the bank, they think necessary in the public interest.

The Act makes no specific reference to the bank's responsibilities and duties because they were considered to be well established by the customs and practices. Overall, the Bank of England performs the following:

BoE is responsible for the issuance of notes and coins,

BoE acts as banker to the central government,

BoE acts as banker in the banking sector,

BoE manages the Exchange Equalization Account,

BoE is conscientious for the precise timing of interest rate changes,

BoE as well supervises the banking sector.

As per the Governor of the Bank of England, Mr. George in 1996, three major purposes are:

Maintaining the honor and value of currency;

Maintaining the stability of financial system, both internal and external,

Ensuring the effectiveness of the UK's financial services.

Role of Bank of England in oversight of Core UK Payment Systems

Introduction

Basically, Payment system is playing a major role in the development of the economic and financial infrastructure. One of key functions of the UK

payment system is to allow transactions to be completed securely and well in time, makes a good involvement to overall financial development. It is essential to be considering that payment systems can also involve risks for members, and can be a gateway for the transmission of disorder from economy or financial system to another. Therefore central bank has always taking steps to develop and operate the Payment system to control this systemic risk.

The Bank's lapse of payment systems is a major part of its responsibilities for Financial and monetary solidity. The basic function, the Bank's lapse work is to identify risks posed by the defining, developing and operate of payment systems and to take necessary steps to control them.

A payment system is a system that allows its users to transfer " money", it varies from country to country and location to location. In this modern era, in most developed countries, " monetary system" is regarded as cash ie notes and coins issued by the central bank and can be claims against credit institutions in the form of deposits.

Payment system is a safe way to complete a transaction safely and well in time. Companies can use them when they want to buy or sell goods and services and individuals depend on them to receive their wages and for purchases; and Government depends on them to receive taxes and other benefits.

Through a payment system a customer can make payment to the customer of other banks. These interconnections mean that, that a customer who hold

the money with a bank can focus on their balances, cost and quality of the services and others like credit standings with their banks.

The volume of the UK payments system has been considerably increased from the last few years.

As for as the payment system concern for the efficiency and effectiveness of the UK's financial sector both domestically, for the stabilization the UK economy, and internationally, to invest in the UK business and financial markets. Working with financial market participants, the Bank plays a vital role to develop and improve the UK payment system so that the investors can enjoy the benefits. The Bank seeks to support market-led development but take a more active part in catalyzing market initiatives the operational role.

Bank of England oversight Role for payments

That is the major responsibility of the bank to oversight the payment system and as well the stability of the financial system. As the values of payment systems have increased, but at the same time there's an increase in the risk management have become an important issue. The Bank's oversight role relates to its operational role as the provider of the central bank money to some of the payment systems and as final provider of liquidity to the banking system and to the stability of the economy more widely.

The Bank:

The bank of England is entirely responsible for the settlement of CHAPS sterling and CHAPS Euro.

The bank of England is responsible to provide the intra day liquidity of CHAPS Sterling and CHAPS Euro by way of reserves against their securities.

The main function of the bank of England is to oversee the payment system and to ensure that sufficient weight has given to risk reduction and management and to view their development and operation.

However, the BoE taking an interest in promoting payment systems, proper lapse of the competitive upbringing for systems, their members and their users is a subject for the competition authorities.

b) Major Developments in UK Payment System in 2008

In the year 2008 there's many changes in the UK payment system because in this year £200 trillion were passed. The UK Payment system development and performance can be assessed by the systematic payment Core Principles. Through these core principles in 2008 there's main payment system development in UK.

CLC and SWIFT are two international infrastructures in the faster payment services and development.

To assess the performance and flexibility of the payment system Core principles were developed. These differentiate between the systems and the risk related to their operations and as well the basic tools developed by the

bank to avoid these risks. For this purpose bank has developed Oversight Risk Framework.

In the year 2008, most important risks to the systems relate to the settlement risks in the event that a member becomes bankrupt, and as well to the operational risks of failure of a system or its supporting network. Overall, the most significant risks identified by the support relate to the main wholesale payment systems. This reflects the blow of

Out ages of these systems for economic and financial activity in the United Kingdom.

CHAPS

One of the most important Payment System in UK is known as CHAPS that provides real time gross settlement of transfers between members which eliminates credit risk. Since, the CHAPS Euro closed in 2008; it is now consist of CHAPS Sterling. The relationship between the Bank and CHAPS Clearing Company is governed by the Memorandum that's known as Memorandum of Understanding.

In the year 2008, daily value of CHAPS Sterling was around £280 billion, that's make it largest UK Payment system. CHAPS played a vital role in distributing the liquidity and mitigation of risks within CHAPS and its real time gross settlement infrastructure in UK financial system

During 2008, CHAPS volume fell while values remained constant. There are two reasons for the reduction in volume:

Down turn in economic activity may caused fewer CHAPS payments to be made, such as those associated with the housing transaction.

Smaller payments could be migrating to the faster payment services which launched in May 2008.

There were more signs that volume falling more rapidly in the second half of 2008.

In this real time world the largest gross settlement system is the CHAPS sterling which is as well used by the banks to move money around the fiscal system through the following ways:

Payments from one Business to other Business.

Payment made through the Solicitor for the purchase of house to other party or bank

By the individuals who are selling the high value items. Such as car which require guaranteed payments.

CREST

CREST is as well one of the best Payment System that provides a payment settlement service for gold, shares, and money market technique in both sterling. CREST supervised by the Financial Service Authority (FSA), and the BoE responsible for its oversight. It is a totally owned firm of Euro clear SA/NV and is an RTGS system. As stated in 2009 BoE report, the average

daily value of transactions in the sterling element of the system was £478 billion per day in 2008, and its daily volume reached 211, 559.

Three types of payments can be made through CREST:

Real-time gross settlement in central bank money in sterling.

RTGS in central bank money in euro

A mutual net settlement arrangement for transactions in US dollars.

Bacs

As in the change in the technology it changes all the ways of living and work styles, in the same way it changes the payments methods. So, people are choosing automated methods of payment as compare to paper based like cheques and drafts.

In 2008 a record of 4. 8 billion automated payments in UK has been noted. 92 % of automated payments are bulk transactions generated by the small and large business organisations and are:

Direct debits mainly to pay utility bills, life and general insurance premiums and various subscriptions;

Direct credits, used for salary payments, pensions, annuities and child benefit.

The remaining 8% is made up of inter-bank telephone and online banking payments and standing order payments.

Standing Orders

Basically, a standing order is an instruction an account holder give to bank or building society to make payments, usually on a regular basis, to a UK bank or building society account.

Any person or company with a current account at a bank or building society in the UK can set up a standing order.

Your bank or building society will, on the day specified, debit your account and transfer the money to the bank or building society account of the recipient.

The money will be transferred either through

The Bacs system or increasingly from June 2008 through.

The Faster Payments Service.

If it goes via Bacs it will arrive with the recipient within three working days, e. g. for a standing order initiated on a Monday, the earliest it could arrive would be the Wednesday. However, standing orders processed via Faster Payments will be processed on the same day.

Internet and Phone

In the last few years there's a huge increase in the internet and phone banking that rise the automated payment.

The 22.5 million customers are registered with online facilities and more than half use the internet for making payments, and 40% of the other half (12.3 million) use telephone banking to make payments.

Internet and phone banking transactions are processed as Faster Payments or as one-off Credits using the same three-day Bacs system and so follow the three-day timescales developed for bulk payments (Direct Debits and Direct Credits).

Cheques

Cheques are written orders by the account holders instructing their banks to pay the specified amount to the named person. Cheques are not legal tenders but they are legal documents and their use is governed by the Bills of Exchange Act 1982, and the Cheques Act 1957 and 1992.

Bankers' drafts

Bankers' drafts are cheques drawn directly on the account of a bank rather than the account of a customer. They provide added assurance as bankers' drafts are unlikely to be returned unpaid due to lack of funds. However, it is important to note that they do not provide a guarantee against fraudulent use. For example, they may be lost or stolen and then used fraudulently.

Daily Averages in 2008

Volumes, value and payment types (daily average)

Payment Systems

Volumes

Values (£ millions)

Important Payment Types

Substitute

CHAPS

136196

283745

1. Settlement in Financial Market Settlement.

2. CLS pay ins and pay outs.

3. House Purchases

1. CHAPS sterling bypass mode

2. Manual procedure for making small number of Bank Transmission.

Bacs

22266734

15537

1. Salary and Benefit Payments.

2. Bill payment by direct debit.

3. Telephone and internet banking.

1. Perhaps minimum scope for switching to other instruments in the short term e. g. Cheques, Cash.

Faster Payment Services

939866

310

1. Telephone and internet banking.

2. Single immediate payment.

3. Forward dated payments.

4. Standing order payments.

1. Bacs

2. Cash

3. Card Network.

Visa (Credit and Debit Card)

14997260

836

1. Payments for goods and services by consumers and business.

1. Cheques

2. Other Networks

3. Cash

Master Cards(Credit and Debit Cards)

10742466

593

1. Payments for goods and services by consumers and business.

1. Cheques

2. Other Networks

3. Cash

Link

7797260

306

1. Withdrawal of cash using an ATM not operated by customer own bank.

1. Own bank ATM

2. Other cash withdrawal channels

CREST

211559

477512

1. Settlement in respect of cash margin payments.
2. Payments for commodity deliveries.
3. Cash settlement

If disruption does not prevent calculation of settlement obligation, contingency payments, procedure may be invoked.

D). Core Principles

The Bank has adopted some principles, among of these principles few provided a basis for the Bank's non statutory oversight up to now and the few other principles related to the UK Payment system. All these principles were adopted by the bank for consultation during 28th September and 30th October. These principles are:

Principle 1

The Payment System must have well legal basis under the relevant jurisdictions.

The Bank of England notes in 2009 that this is one of the well suited principle for CHAPS as well in 2003 International Monetary Fund observes that's the best principle for CHAPS. In a financial report by International Monetary Fund it is also noted that Bank of England and Wales govern the CHAPS rules, and the Courts of England and Wales also exercise exclusive jurisdiction over any

disputes in connection with these rules. The system designed under the rules of Financial Market Regulation in 1999 that was implemented in the European Union settlement and was finally implemented in the United Kingdom.

Principle 2

The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.

As per the Bank of England report in 2009, CHAPS observes this principle. In 2003 the International Monetary Fund drew a conclusion that CHAPS rule set out high level rights and duties of the members, membership criteria and operational criteria. The report issued by the Bank of England in 2009 self assessment mentions a Memorandum of Understanding that sets out the rights and responsibilities of the Bank of England as operator and settlement agent of CHAPS; CHAPCo, as the member of the system and the payment organization. CHAPS rules contain the detail procedures and operational manuals that cover all the aspects of the payment system.

Principle 3

The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.

In 2009 the Bank of England declares that CHAPS observes this principle. In 2007 report CHAPS declares as RTGS system, settlement process does not involve

credit risk as is the case in deferred settlement system. It adds that domestic payments are both irrecoverable and finally at the point where relevant members settlement account is debited. If a paying bank has insufficient funds available on its settlement account with the Bank of England, CHAPS payments cannot be made, and a liquidity crunch in the system could result in a gridlock. The BoE nevertheless notes that CHAPS members do not experience liquidity management difficulties in meeting CLS pay-in deadlines.

Principle 4

The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day. (Systems should seek to exceed the minima included in this Core Principle.)

In 2009 Bank of England self assessment that CHAPS operates on RTGS basis, minimizing the credit risk and thus observes this principle. In 2003 a report by International Monetary Fund assessment also assessed CHAPS as observing this principle.

Principle 5

A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation. (Systems should seek to exceed the minima included in this Core Principle.)

This principle is not applicable to CHAPS, according to both the IMF 2003 and BoE 2009 reports, since it is a RTGS system.

Principle 6

The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.

According to Bank of England and International Monetary Fund assessment, CHAPS observe this principle because CHAPS security architecture was founded on the range of policies and procedures governing the security demanded by the Bank of England, SWIFT and as well for the CHAPS members. In 2009 it was declared by BoE that CHAPS security controls and measures effective, and the business continuity, recovery procedures extensive. The BoE encourages the CHAPCo and its members to continue the system arrangements, communication among the members and to improve the operational arrangements to tide over a crisis.

Principle 7

The system should provide a means of making payments which is practical for its users and efficient for the economy.

According to both, BoE report in 2009 and IMF report in 2003 assessment, CHAPS observes this principle. As Per the 2003 IMF report, the CHAPS security architecture was founded on a range of policies and procedures manuals governing the levels of security demanded of the system operator (the BoE), (SWIFT) and the CHAPS members. The BoE, in its 2009 report, also finds the CHAPS' security controls and measures effective, and the business continuity and recovery procedures extensive. The report mentions the Tripartite Resilience Benchmarking Project (TRBP) that underscores the high quality of the system.

Principle 8

The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.

In 2003 IMF indicate in a report that CHAPS complies with this principle and as per BoE assessment in payment system report that in the country notes CHAPS only broadly observe this principle. This lower rating was assigned by the BoE primarily because of the fee charged for new membership is £70,000 which BoE deems as inappropriate.

Principle 9

The system's governance arrangements should be effective, accountable and transparent.

In 2009 BoE and in 2003 IMF assessment indicates that CHAPS observe this principle. As per BoE, CHAPCo has clear governance structure with board having ultimate responsibilities for the management of the system. Further in 2007 the payment council introduced new governance arrangement for UK payment system. Under this CHAPCo is contractually bound to follow the directions of council on issue like integrity and innovation.

Principle 10

The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.

In 2003 in IMF report, BoE observe this principle. As noted by the IMF, the BoE published a paper on “ Oversight of Payment Systems” in November 2000, explaining its objectives in regard to the oversight of UK payment systems. BoE had not yet published any follow-up/annual account of its oversight activities. However, in the June 2002 Financial Stability Review (FSR), a useful box was included to give some more detail of BoE oversight.

In 2005 report, the BoE states that payment systems in the UK are not subject to statutory oversight, but notes that in its 2005 report, the BoE states that in order to ensure financial stability, the BoE especially focuses

on the reliable functioning of systemically important payment systems in the country.

Principle 11

The central bank should ensure that the systems it operates comply with the Core Principles.

According to the 2003 FSAP conducted by the IMF, the BoE observes this principle. The IMF adds that the BoE had, together with CHAPCo and CRESTCo, (company operating the UK securities settlement system – CREST and the settlement system for money market instruments, now merged with Euro clear, the European Securities Settlement Agency) developed the RTGS Central System, which it operates and provides to these companies as well as to other settlement systems with net end-of-day settlement.

Principle 12

The central bank should oversee compliance with the Core Principles by systems it does not operate and it should have the ability to carry out this oversight.

According to the 2003 FSAP conducted by the IMF, the BoE observes this principle. As observed by the IMF, the BoE formalized its oversight of UK payment systems with the creation of an Oversight Team in the Market Infrastructure Division with express responsibility for the oversight of payments systems. The BoE also assesses the key UK systems against the core principles.

Principle 13

The central bank, in promoting payment system safety and efficiency through the Core Principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.

According to the 2003 FSAP conducted by the IMF, the BoE observes this principle. The IMF notes that the BoE has close and frequent contact with its European and Group of Ten (G10) counterparts, both through formal mechanisms – in particular G10, European System of Central Banks (ESCB), and EU committees – and ad hoc contacts. The BoE also has close contacts with other U. K. authorities, especially through the Tripartite Standing Committee in which senior representatives of the Chancellor of the Exchequer, the Governor of the BoE and the Chairman of the FSA meet monthly to discuss financial stability; and the U. K. Competition Authorities. The BoE has also signed the Memorandum of Understanding between Payment Systems Overseers and Banking Supervisors in Stage Three of Economic and Monetary Union aimed at promoting cooperation and information sharing between EU payment systems and banking supervisors in relation to large-value interbank transfer systems, in order to ensure the soundness and stability of financial systems and their participating credit institutions. As the BoE website adds, the BoE collaborates with domestic (FSA) and international regulators to “ provide collective oversight of systems such as Euro clear, Society for Worldwide Interbank Financial Telecommunication (SWIFT), LCH.

Responsibilities of the central bank in applying the Core Principles

The central Bank should consider the following:

The central bank should define the clear objectives of the payment system and as well should relate its publicity role with respect to the importance of payment system.

The Central Bank should ensure that the all system operates in accordance with the Core Principles.

The central bank should supervise acquiescence with the Core Principles by the systems it does not operate and it should have the ability to carry out this oversight.

The central Bank should cooperate with the other central banks of the domestic and foreign for the safety and efficiency of the Payment System through the Core Principles.

The Bank of England (BoE) asserts that as the overseer of the payment systems in the United Kingdom (U. K.), it prioritizes its oversight activities in accordance with the risks posed by a system to the overall financial stability. Therefore, it focuses its major attention on the high value payment systems in the country that include CHAPS, BACS, and CREST. A 2009 report of the BoE titled “ Payment Systems Oversight Report 2008,” which is a self-assessment of the UK’s payment systems notes that the main systems operate, to a great degree, in accordance with international standards. The

report also states that CHAPS, which is defined as a system with systemic significance, observes eight of the nine core principles.