FEDERAL RESERVE BANK of NEW YORK

Providing Banking Services to Central Banks and Relevance to Monetary Policy Implementation

Central Bank and International Account Services, FRBNY

September 2015

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Overview of Presentation

- Background on Official Sector Service Providers of Banking and Custody Services

- Provision of these services by the Federal Reserve

- How these services can interact with monetary policy implementation

Background on Official Sector Service Providers of Banking and Custody Services

Why do Central Banks Provide These Services?

- Supporting role of their currency as a reserve asset and broad usage as medium for financial transactions
- Accommodating demand by other central banks for a safe and confidential location to store their foreign assets
- Fostering cooperation among central banks
- Reciprocity
- Provision of an infrastructure for cross-border financial stability operations and official payments

Range of Services Provided by Central Banks

- Payment Services
  - Funds receipts/payments
  - FX trades
- Deposit Services
  - Overnight
  - Term
  - Multicurrency
- Investment Services
  - Purchase/Sale of Government Securities
  - Medium Term Investment Vehicles
  - Asset Management
- Custody Services
  - Fixed Income Securities
  - Other Securities
  - Gold Safekeeping
  - Securities Lending
- Banknote services

Current Landscape of Service Providers

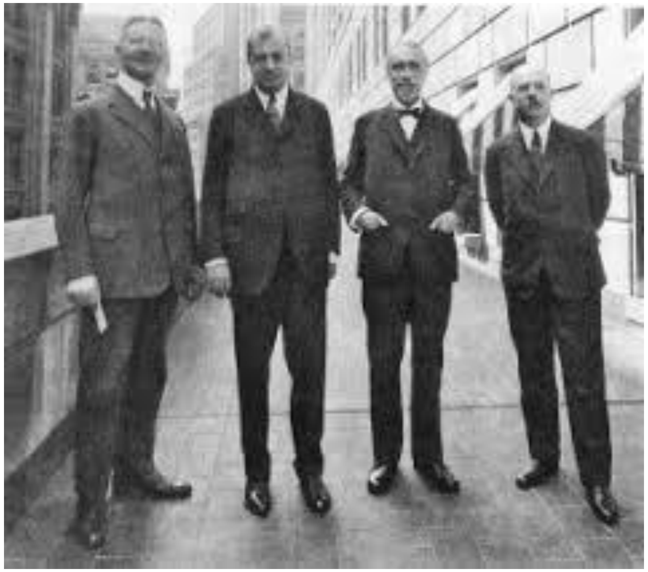
- Traditional Providers of Services
  - Federal Reserve
  - Bank of England
  - Banque de France
  - Bundesbank
  - Bank of Japan
  - BIS – Banking Department
- Others of Note
  - Bank of Canada
  - Reserve Bank of Australia
- Emerging Market Providers
  - People's Bank of China
  - Bank of Korea

- Footprint of Official Deposits
  - About 50% of FX reserves held in deposit form are held at central banks and the BIS
- Footprint of Official Custody
  - About 60% of FX reserves held in sovereign securities custodied at central banks

Provision of these services by the Federal Reserve

Historical Origins of Foreign Central Bank Accounts at FRBNY

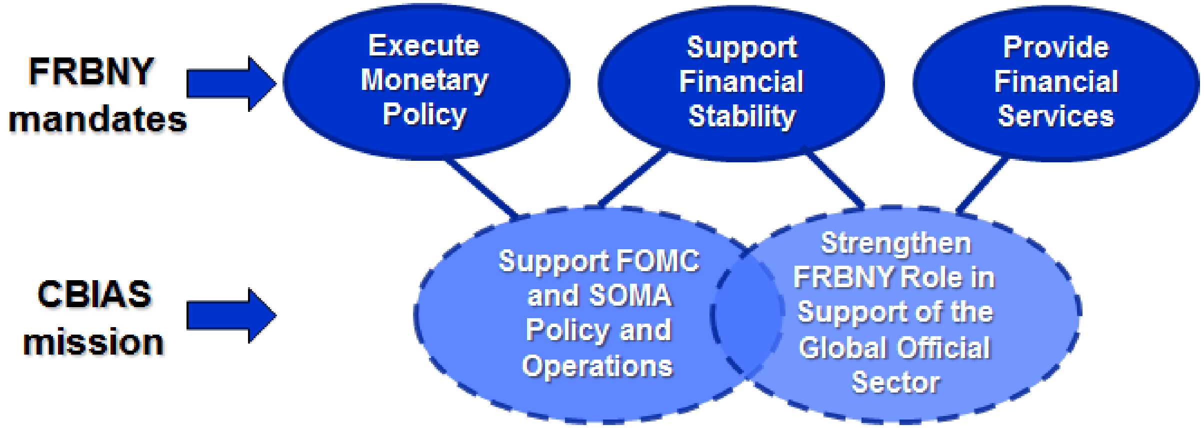
- First accounts established in 1917 (France and England)
- Pursuit of reciprocal correspondent banking relationships with foreign central banks in early-20th century driven by several motives:
  - Desire to more effectively manage credit and FX markets, cross-border gold flows
  - Facilitate global commerce, trade, and emergence of New York as a global financial center
  - Physical safekeeping of European gold during WWI
  - Coordination of debt repayments



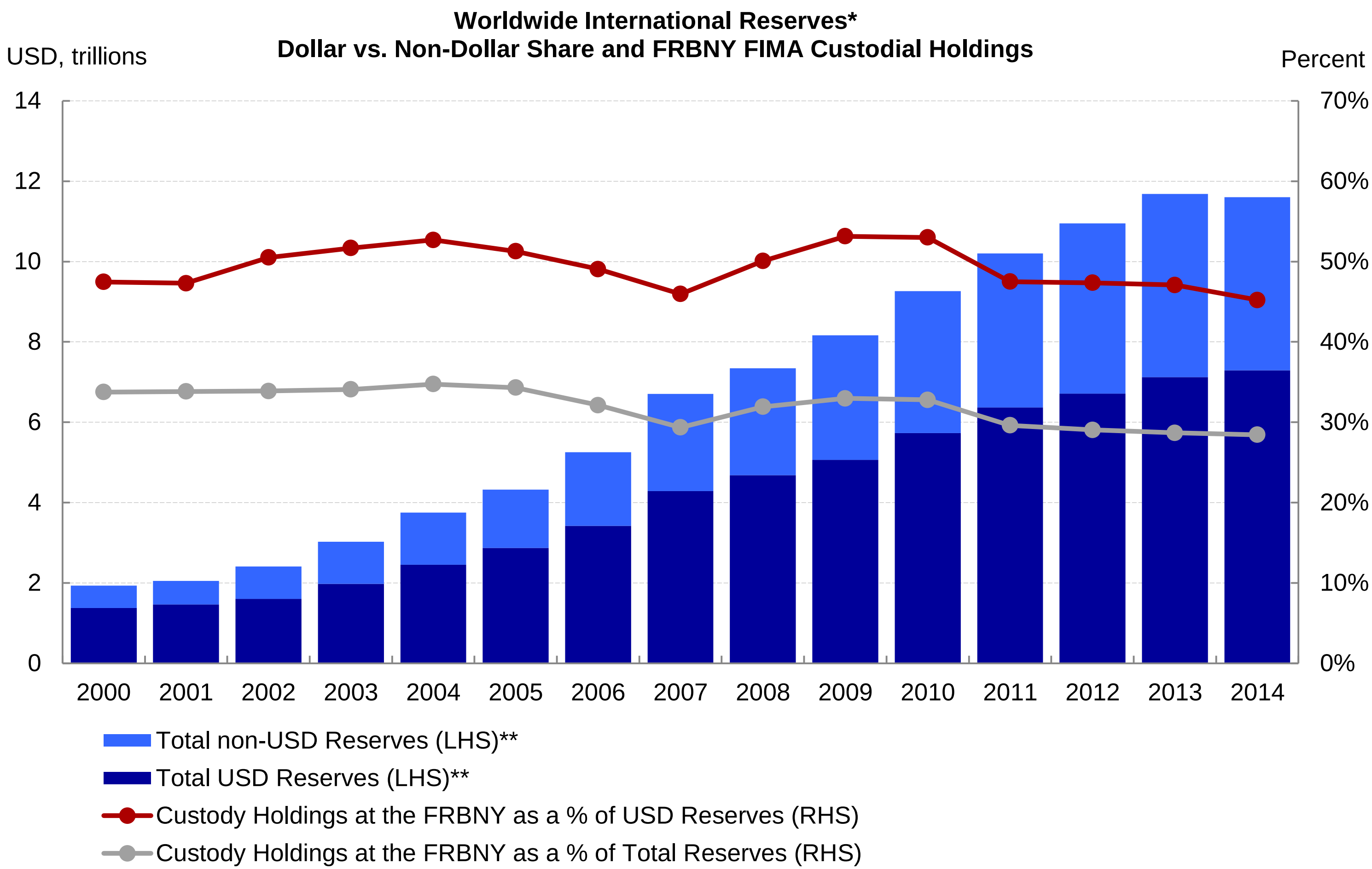
(left to right) Heads of German Reichsbank, FRBNY, Bank of England, and Banque de France (circa 1920)

CBIAS Mission

- The activities conducted by the Central Bank and International Account Services (CBIAS) Function of the Markets Group are derived from executing on two interconnected missions:
  - Supporting the implementation of U.S. monetary policy and financial stability efforts by providing comprehensive clearing and settlement services for the domestic and foreign activities of the System Open Market Account (SOMA)
  - Supporting the role of U.S. dollar as the principal reserve currency and international medium of exchange by providing the global official sector – Foreign and International Monetary Authorities (FIMA) – with secure, confidential access to U.S. markets and payment and securities depositories and networks



Custody Growth Keeps Pace with FX Reserve Accumulation Through Periods of Both Financial Stress and Stability



*Total reserves minus gold. Source: IMF; latest data Q4 2014.
**Composition of unallocated reserves is assumed to be the same proportion as allocated reserves
***FIMA customers only, excluding collateral accounts, FMS accounts, and gold. Includes current face value MBS

Services Offered to FIMA Customers

Deposit Account

- Make and receive payments in US dollars
- Foreign Exchange – purchase and sale

Liquidity Management Services

- Invest customer funds in high-quality, safe and liquid fixed income instruments.

Custody Account

- Securities – Fedwire eligible and corporate securities
- Gold – Earmarking, custody and movement

How these services can interact with monetary policy implementation

Impact of Cash Balances on Bank Reserves

- Cash balances left at central banks are a drain on bank reserves and thus can impact short term interest rates and monetary policy implementation
- For these reasons, central banks have traditionally sought to manage cash balances closely through a variety of methods (e.g., notification requirements, agreed upon targets and/or caps, automatic cash sweeps)
  - However, when excess reserves are very large, short term interest rates are less sensitive to changes in reserves, including foreign official deposits
- Additionally, central banks often try to manage cash balances through rates of remuneration (e.g., tiering with differential rates)
  - The specific choice of rates may also be influenced by a desire to avoid interfering with monetary policy implementation, prevent crowding out of private competition, ensure liquidity buffers for settlement activities, and to facilitate cost recovery
- If a central bank's assets are small relative to demand for cash deposits, there may be tension between those responsible for managing the balance sheet and those providing deposit services to foreign central banks

Impact on Domestic Bond Market Function

- Availability of official banking and custody services to foreign central banks may impact monetary policy implementation through its impact on domestic bond market function
- These services may encourage foreign official investment in local bond markets and deepen bond market liquidity, thereby supporting monetary policy transmission and implementation
- But there also may be concern that outsized positions in benchmark securities by "buy-and-hold" investors (including foreign central banks) may potentially impair market function, especially in securities lending and repo markets

For More Information

- CBIAS Website

  For access or any additional information please email the Account Relations and Services Staff at account.relations@ny.frb.org.