HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

11 March 2020

Mark Carney
Governor of the Bank of England
Bank of England
Threadneedle Street
London
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Dear Mark,

REMIT AND RECOMMENDATIONS FOR THE FINANCIAL POLICY COMMITTEE

The Bank of England Act 1998 (the Act), requires me, at least once a year, to specify what the economic policy of the government is and to make recommendations to the Financial Policy Committee (FPC) about matters that the Committee should regard as relevant to the Committee's understanding of the Bank's Financial Stability Objective and the Committee's responsibility in relation to the achievement of that objective. The Act also empowers me to make written recommendations to the Committee about its responsibilities in relation to support for the government's economic policy, as well as matters to which the Committee should have regard in exercising its functions.

This letter and the accompanying annex constitute the remit and recommendations for the FPC for the coming year. This covering letter sets out my perspective on the current economic context and the FPC's priorities for the year ahead.

The government's economic policy

In accordance with the Act, I confirm that the government's economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential pre-requisites to achieve this objective in all regions and sectors of the UK economy. The specification of the government's economic strategy to achieve this objective can be found in section A of the annex to this letter.

The government is also committed to UK financial services being effectively regulated; securing the right balance between a financial sector that is globally competitive and secure over the long term. The Treasury will come forward with a Financial Services White Paper in the Spring. This will set out an ambitious vision of the future of the UK's financial services sector which benefits the whole of the UK.

The FPC's main contribution to these goals is protecting and enhancing financial stability in the UK, working in tandem with the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). The government believes that a strong and stable financial system supports economic growth, facilitates the provision of finance to support the expansion of the economy's productive capacity and underpins the UK's position as an important global financial centre.

When acting with a view to protecting and enhancing the resilience of the UK financial system, the Committee should also have regard to the impact of its policies on the government's economic objectives, the government's strategy for achieving these objectives, and the recommendations I set out in this remit. The Committee should use its regular communications, including the Financial Stability Report (FSR), to explain how its actions are contributing to the achievement of its secondary objective and how it is managing any potential conflicts between its objectives, including in relation to the recommendations I make in this remit. I consider these communications important with regards to both the accountability of the Committee and the transparency of its decision making.

As I emphasise in my recommendations to the Committee, there may be circumstances in which the Committee can act with a view to supporting the government's economic objectives, and thereby the Committee's secondary objective, where doing so does not conflict with the achievement of the Committee's primary objective. The Committee should, therefore, routinely assess whether these conditions are met. Where they are, the Committee should seek to act to support the government's economic objectives in a way that is consistent with the recommendations set out in this remit. In particular, I am today recommending that as part of its ongoing work on productive finance, the Committee should examine how financial regulation and changes to the structure of the financial system may have affected the balance between financial stability and the supply of productive finance, in all regions and nations of the UK. This work will assist the government's levelling up agenda. I look forward to hearing how you plan to incorporate these assessments into the Committee's work.

Future relationship with the European Union

The UK ceased to be a member of the European Union (EU) on 31 January 2020. Under the terms of the Withdrawal Agreement, there will now be a transition period. As set out in legislation, it is government policy that the transition period will end on 31 December 2020.

Europe is and will continue to be a hugely important friend, partner and market for the UK's financial services. Equally, the UK will remain a significant market and source of critical financial services for Europe.

As the UK's negotiating mandate sets out, we are seeking a Free Trade Agreement with the EU that provides a predictable, transparent, and business-friendly environment for firms to undertake cross-border financial services business, and which promotes financial stability, market integrity, and investor and consumer protection. This sits alongside the commitment by the UK and the EU in the Political Declaration to conclude equivalence assessments by June 2020 via equivalence regimes. It is important that the government and regulators continue to work closely together, in order that the government can ensure a smooth transition, secure the continuity of provision of credit and finance to households and businesses, and maintain the UK's position as a world-leading financial centre operating to the highest international standards.

In the context of both the FPC's primary and secondary objectives, and the recommendations I have made to the Committee in this remit, the Committee should take into account the UK's exit from the EU.

I welcome the FPC's commitment to the implementation of robust prudential standards in the UK, irrespective of the particular form of the UK's future relationship with the EU. The FPC has noted that this will require maintaining a level of resilience that is at least as great as currently planned, which itself exceeds that required by international baseline standards, as well as maintaining UK authorities' ability to manage UK financial stability risks. In the context of its primary objective, the Committee should make use of opportunities arising from the UK's exit from the EU to help implement this commitment.

The expertise of the regulators, and particularly the FPC's role within the UK regulatory framework, will also be critical for supporting the government's economic policy with regards to its overall post-EU exit strategy for financial services. The Committee should therefore make use of opportunities arising from the UK's exit from the EU when exercising its functions with a view to supporting the government's economic policy towards the financial services industry, including in relation to competition, innovation, and competitiveness, where doing so does not conflict with the achievement of the Committee's primary objective.

Non-bank financial sector

The Committee has focussed much of its efforts since the financial crisis on rebuilding the resilience of the UK banking sector. Reforms have enhanced the resilience of the core financial system and the Bank's 2019 stress test demonstrated that the UK banking system would be resilient to deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis. The Committee has also broadened its focus to include systemic risks to, or stemming from, other sectors such as financial market infrastructure, investment funds and insurance, as communicated twice annually in its Financial Stability Report. This is welcome.

However, as noted by the Committee, and as demonstrated by the ongoing Bank and FCA review into open-ended funds, non-bank financial intermediation (NBFI) has become a more important supplier of finance since the global financial crisis. While the growth of this sector has diversified the supply of finance to the economy, it also entails potential risks. Given the importance of being able to effectively monitor, assess and take action to mitigate risks to the stability of the whole (or significant part) of the UK financial system, I have recommended that the Committee publishes a more detailed assessment of the oversight and mitigation of systemic risks from this sector by end 2020. I would, however, be grateful to receive the preliminary findings of this work by July, either in response to this remit letter or in the July FSR.

Climate change

The UK was the first major economy to pass laws that require the UK to bring all greenhouse gas emissions to net zero by 2050. The shift to a world where we are at net zero will mean systemic changes across all parts of our economy. This includes delivering a financial system which supports and enables a net zero economy by mobilising private finance towards green and resilient growth, and is resilient to the physical and transition risks that climate change presents.

Climate change poses risks to the UK financial system, and so the FPC has a role in protecting and enhancing the resilience of the financial sector to climate risk. I welcome the Committee's consideration of risks from climate change, including its decision to test the UK financial system's resilience to physical and transition risks of climate change and the publication of the Bank's discussion paper on that stress test in December 2019. I recommend that the Committee should continue to regard risks from climate change as relevant to its primary objective.

The government's Green Finance Strategy sets out the government's objectives for green finance – to align private sector flows with clear, environmentally sustainable and resilient growth, supported by government action; and to strengthen the competitiveness of the UK financial sector – and its approach to achieving them. Finance will also be a key focus of COP26, which will be hosted by the UK in Glasgow in November 2020. In the context of its secondary objective, the FPC also has a role to play in seeking to support the government's Green Finance Strategy, which aims to ensure that the financial system is able to act to facilitate finance to support the delivery of the UK's carbon targets and clean growth.

<u>Coordination with the Monetary Policy Committee</u>

Finally, I confirm that the FPC and the Monetary Policy Committee (MPC) should continue to have regard to each other's actions, to enhance coordination between monetary and macroprudential policy. This coordination has enhanced the strength and resilience of the UK's macroeconomic framework.

I am grateful to you and all the members of the Committee for your continuing good work and dedication. I look forward to working with the FPC over the coming years.

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REMIT AND RECOMMENDATIONS FOR THE FINANCIAL POLICY COMMITTEE

The Bank of England Act 1998 ("the Act") sets out the objectives of the Financial Policy Committee (FPC). The Committee is to exercise its functions with a view to:

a) contributing to the achievement by the Bank of the Financial Stability Objective; and
b) subject to that, supporting the economic policy of Her Majesty's Government, including its objectives for growth and employment.

The Bank's Financial Stability Objective, under the Act, is to protect and enhance the stability of the financial system of the United Kingdom.

The responsibility of the Committee in relation to the achievement by the Bank of its Financial Stability Objective relates primarily to the identification of, monitoring of, and taking of action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system.

Section 9C(4) of the Act makes clear that it does not require or authorise the Committee to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term.

Section 9D(1) of the Act allows me to specify what the economic policy of Her Majesty's Government is taken to be.

Section 9E(1) of the Act also allows me to make recommendations to the Committee about:

- matters that the Committee should regard as relevant to its understanding of the Bank's Financial Stability Objective; or
- the responsibility of the Committee in relation to the achievement of that objective.

Section 9D(2) and 9E(2) of the Act require that I specify the economic policy of the government and make recommendations to the Committee at least once in every calendar year.

In addition, section 9E of the Act empowers me to make recommendations to the Committee about:

- the responsibility of the Committee in relation to support for the economic policy of Her Majesty's Government, including its objectives for growth and employment; and
- matters to which the Committee should have regard in exercising its functions.

This document discharges the Treasury's duties under both section 9D and section 9E of the Act.

A. The government's economic policy

The government's economic policy objective is to achieve strong, sustainable and balanced growth. Price and financial stability are essential pre-requisites to achieve this objective in all regions and sectors of the UK economy.

To achieve this objective, the government's economic strategy consists of:

- operationally independent monetary policy, responsible for maintaining price stability and supporting the economy;
- a credible fiscal policy, maintaining sustainable public finances, while providing the flexibility to support the economy;
- levelling up opportunity in all regions of the UK with structural reform, including through an ambitious programme of investment in skills, infrastructure and innovation in order to sustain high employment, raise productivity and improve living standards; and
- maintain a resilient, effectively regulated and competitive financial system that supports the real economy through the provision of productive finance and critical financial services, while protecting consumers and safeguarding taxpayer interests.

B. Matters that the FPC should regard as relevant to the Bank's Financial Stability Objective, and the responsibility of the Committee in relation to the achievement of that objective

The FPC is charged with contributing to the Bank's Financial Stability Objective primarily by identifying, monitoring and addressing risks to the resilience of the UK financial system as a whole. It should ensure that it considers all parts of the UK financial system, prioritising as appropriate. It should also ensure that it considers all types of risks to the stability of the UK financial system as a whole or a significant part of that system, including financial and non-financial (such as cyber and operational) risk, prioritising as appropriate. The purpose of preserving stability is to contribute to avoiding serious interruptions in the vital functions which the financial system as a whole performs in our economy: notably, the provision of payment and settlement services, intermediating between savers and borrowers, and insuring against risk (for individuals, businesses and financial market participants).

i. Recommendations as to risks from the non-bank financial sector

In order for the FPC to carry out its responsibilities, primarily to identify, monitor, assess, and take action to mitigate risks to the stability of the whole (or significant part) of the UK financial system, both now and in the future, and including non-banks, it is essential that the appropriate risk oversight and mitigation systems are in place. The Committee should therefore prepare an assessment detailing the adequacy of: i) the risk oversight system for non-banks, including how well systemic risks are identified and monitored via existing data; and ii) the risk mitigation system for non-banks, including the availability and effectiveness of tools and the UK's framework for dealing with systemic risks. The assessment should also set out a list of possible indicators that the FPC could publish regularly to monitor and assess risks from the non-bank financial sector going forward. This report should apply to all non-bank financial institutions and be published by December 2020, with preliminary findings to be published by July.

ii. Recommendations as to risks from climate change

In line with the Committee's responsibility to monitor systemic risks – and to act to reduce those risks with a view to protecting and enhancing the resilience of the UK financial system – the Committee should continue to regard risks from climate change as relevant to its primary objective. Climate change poses risks to the stability of the UK financial system, including physical risks, which arise from the increased frequency and severity of climate and weather-related events, and transition risks, resulting from a sudden or disorderly transition towards a low carbon economy.

iii. Recommendations as to the Committee's interaction with the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) in exercising its functions

The role of the Committee is a crucial complement to, but distinct from, those of the firm regulators. The Act provides the Committee with the power to give directions and also recommendations, including on a 'comply or explain' basis, to both the PRA and the FCA. The Act makes clear that the Committee will not be responsible for making decisions in respect of individual regulated firms. In the exercise of its functions, the Committee should use its recommendation powers to steer both the PRA and FCA's general policies towards types of firms or risks, including, for example, in the case of the PRA's strategic approach to large systemically important firms. The Committee should also continue to work closely with the Prudential Regulation Committee (PRC) to ensure coordination between microprudential and macroprudential policy, so far as it is possible while complying with its objectives.

C. The responsibility of the FPC in relation to support for the government's economic policy

i. Recommendations as to the interaction between the FPC's objectives

The FPC's objectives can interact in different ways and over different time horizons. It is therefore important that the Committee gives consideration to this during its deliberations, decision making and communications:

- The FPC's primary and secondary objectives will often be complementary. For example, actions to support a strong and stable financial system can support growth and the expansion of the economy's productive capacity over the medium and long term. Likewise there may be scenarios in which the FPC can act to support the secondary objective where such action complements the primary objective.
- There may be circumstances in which the Committee faces potential conflicts between the primary objective of contributing to the achievement of the Bank's financial stability objective and the secondary objective of supporting the government's economic policy, including in the short term. Any conflicts, and assessment of those conflicts, should be managed and communicated transparently, and consistently with the Committee's assessment of the costs and benefits of its actions, in the light of the Act's provisions. When considering how to manage conflicts, the Committee is neither required nor authorised by the Act to exercise its functions in a way that would in its opinion have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term.
- In other circumstances, the Committee can exercise its functions to support one of its objectives largely independently of any effect on the other. The Committee should

therefore routinely assess whether it can take actions to support the government's economic objectives in a way that will not conflict with the Committee's primary objective. When the Committee judges these conditions to be met it should seek to act to support the government's economic objectives in a way that is consistent with the recommendations set out in this remit, including through the use of its policy tools.

The Act requires the Committee to explain the use of its powers, and also to prepare explanations of how decisions to exercise the following powers are compatible with the Committee's objectives and other general duties:

- its direction making powers;
- its powers to make recommendations within the Bank relating to the exercise of the Bank's functions in relation to payment systems, settlement systems and clearing houses;
- its powers to make recommendations to the Treasury; and
- its powers to make recommendations to the PRA and FCA.

In discharging this requirement, the Committee should set out publicly how its actions are assessed to contribute to its objectives, including its judgement as to the balance of risks to those objectives, how those risks are judged to have evolved and how they are expected to evolve. Further, when publicly setting out conflicts between the primary and secondary objectives, and its assessment of those conflicts, the Committee should highlight where, in its opinion, its decisions may result in significant conflicts between its objectives, including in the short term, and consider these in light of each of the recommendations made to it in this remit.

ii. Recommendations regarding facilitating finance for productive investment

The government places a high priority on expanding the supply of finance through the cycle to support long-term investment to increase the productive capacity of the economy, across all regions and nations of the UK. This includes, but is not limited to, areas such as infrastructure, SME finance, venture and growth capital, and finance for decarbonisation to help achieve net zero by 2050.

The FPC should act with a view to facilitating the supply of finance for productive investment provided by the UK's financial system, where doing so does not conflict with the achievement of the Committee's primary objective. When explaining how its actions are consistent with its objectives, the FPC should consider the impact of its policy actions on the ability of the financial sector to provide finance for productive investment.

The Committee should also consider the impact on finance for productive investment when making any judgements as to whether its actions would have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term for the purposes of compliance with section 9C (4) of the Act.

In line with the recommendation above, and as part of its ongoing work on productive finance, the Committee should examine how financial regulation and changes to the structure of the financial system may have affected the balance between financial stability and the supply of productive finance, in all regions and nations of the UK. This work will assist the government's levelling up agenda.

iii. Recommendations regarding support for the government's economic policy towards the financial services industry

The government is committed to UK financial services being effectively regulated; securing the right balance between a financial sector that is globally competitive and secure over the long term. Protecting and enhancing UK financial stability, the Committee's primary objective, is an essential prerequisite for achieving that ambition. The Committee should act with a view to supporting the government's overall strategy for financial services, where doing so does not conflict with the achievement of the Committee's primary objective – covering, in particular:

- Competition and innovation. The government is keen to see more competition and innovation in all sectors of the UK financial services industry, particularly in the retail banking sector and through the promotion and support of FinTech. This includes minimising barriers to entry and ensuring a diversity of business models within the industry.
- Competitiveness. The government wishes to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as the leading international financial centre. In its assessment of the costs and benefits of its policy actions, the Committee should, wherever practical and relevant, take these considerations into account.
- Climate change. The government aims to align private sector financial flows with clean, environmentally sustainable and resilient growth, and to strengthen the competitiveness of the UK financial sector by ensuring it can capture the opportunities arising from the greening of finance and to help foster the transition to net zero.

D. Matters to which the Committee should have regard in exercising its functions

i. Recommendations as to the interactions between monetary policy and macroprudential policy

In general, the objectives of price stability and financial stability will be complementary over the longer term. As with both the Monetary Policy Committee's (MPC) and the FPC's primary and secondary objectives, there may, however, be occasions when there are short-term trade-offs to be made between these objectives.

In order to foster coordination of monetary and macroprudential policy, there is overlap between the membership of the MPC and the FPC. The Bank has implemented a programme of regular joint meetings of the MPC and FPC to further improve interaction between the two Committees. To enhance that coordination, where appropriate, the FPC should note in the records of its meetings, its policy statements and its Financial Stability Reports (FSR) how it has had regard to the policy settings and forecasts of the MPC. In the same way, the government has also asked the MPC to reflect in any statements on its decisions, the minutes of its meetings and its Monetary Policy Reports how it has had regard to the policy actions of the FPC.

ii. Recommendation that the FPC have regard to risks to public funds

The government has implemented reforms to strengthen the resilience of the UK financial system, minimise risks to taxpayer funds and reduce the perceived implicit taxpayer guarantee. The Financial Services Act 2012 places obligations on the Bank, in pursuing its Financial Stability Objective, to notify the Treasury where there is a material risk of public funds being required and to notify the Treasury of any subsequent changes to such a risk.

The FPC should, in exercising its responsibilities and functions under the Act, have regard to whether there is a material risk of public funds being required, such that the Bank's obligation to notify the Treasury would be triggered. The Committee should seek where possible to minimise such risks whilst recognising that it will be for the Chancellor and the Treasury to determine whether any use of public funds would be in the public interest. Where it identifies such a risk, the Committee should take it into account in its assessment of the costs and benefits of its actions, and should reflect its assessment in its publications and wider communications (subject to deferred publication on public interest considerations).

Similarly, where the Bank makes a public funds notification that, in its judgment, is relevant to the exercise by the Committee of its responsibilities and functions under the Act, the Bank should alert the Committee to that notification.

The Chancellor and the Treasury have sole responsibility for any decisions on whether and how to use public funds in support of financial stability. The Treasury will need to satisfy itself that any use of public funds would offer good value for public money and to this end may, as appropriate, request further information from the Bank.

iii. Recommendations to the Treasury on legislative changes

The Act allows the FPC to make a number of written recommendations to the Treasury on the need for legislative changes; these include changes to the scope of activities regulated under the Financial Services and Markets Act 2000, to the scope of activities prudentially regulated by the PRA and the purposes for which the FCA may make product intervention rules. The Committee may also recommend that the Treasury gives it additional or revised powers of direction. In order to aid the Treasury's assessment of the case for making these legislative changes, the Committee should provide, along with its written recommendations, evidence that:

- there are potential risks which the Committee, the PRA or the FCA need to address in those areas that cannot be effectively mitigated within the current regulatory powers;
- the Committee's proposals would address effectively those risks; and
- changes to the potential actions by the Committee, the PRA or the FCA, and any resulting action by those bodies in those areas would not create material unintended consequences or costs in excess of the benefits.

iv. Recommendations regarding enhancing the accountability of the FPC

The FPC's performance and procedures are reviewed by the Court of the Bank of England on an ongoing basis. The Bank is accountable to Parliament through its publication of the twice annual

FSR and evidence given to the Treasury Committee. Finally, through the publication of the record of its meetings, the FSR, policy statements for its direction-making powers, the explanations of its decisions and its wider communications, the FPC is accountable to the public at large. The Committee should use these communications to explain how its actions have contributed to the achievement of both the Bank of England's Financial Stability Objective and have supported the economic policy of the government.

The Committee should also attach high priority, in so far as consistent with its statutory objectives and functions, to reducing uncertainty and boosting confidence in the UK financial system through its communications. This includes continuing to develop the set of published indicators that it uses to monitor and assess risks to financial stability. It should provide clear, focussed and consistent messages about the planned regulatory response to identified financial stability risks and ensure that its policy actions are as predictable as possible.

Recognising the requirement imposed by paragraph 11 (4) of Schedule 2A of the Act to achieve consensus wherever possible, communication by individual members regarding FPC decisions needs to be coordinated and consistent where this is the case. The record of the FPC's policy meeting should continue to set out the deliberations considered in reaching the consensus. Where consensus cannot be reached and a vote is taken, as required by the Act, the balance of arguments should be reflected in the record of the meeting. In such circumstances, members should be free to explain their differences and will be publicly accountable accordingly.

<u>v. Recommendations as to engagement with financial sector participants and other external experts</u>

The FPC already operates to high standards of transparency and accountability, including frequent appearances before Parliament and an active programme of public speeches. An important element of this accountability is the FPC's dialogue with financial market participants and other external experts. The FPC should endeavour to fulfil its statutory responsibilities in an open and collaborative fashion, seeking the views of industry participants, academics, other regulators and the public, as appropriate, to supplement the Committee's own expertise.

When seeking the views of external experts, the FPC should ensure that:

- any supporting documentation is sufficiently detailed so as to provide a comprehensive description of the FPC's views or proposed actions;
- respondents are given adequate time to consider the proposals and produce any response that they wish to provide; and
- wherever practicable, as set out in statute, a robust quantitative assessment of the impact of any proposed policy action is included in the documentation provided, including an estimate of the private costs to businesses.

In cases where the FPC consults publicly, the length of any consultation should be proportionate to the complexity and impact of the proposals, and the FPC's consultation periods should match best practice in the public sector.

These recommendations as to engagement with financial sector participants and other external experts should not prevent the FPC from making a direction or recommendation without, or with a more abbreviated, consultation where in line with its statutory duties, it considers it necessary to do so by reason of urgency, in order to protect and enhance the resilience of the UK financial system.

When deciding whether and how it would be appropriate to engage with external experts, the FPC should consider whether the publication of a contemplated future policy action may lead to actions aimed at avoiding future requirements, regulatory arbitrage, or financial sector participants taking other actions which could lead to risks to financial stability.