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

Andrew Bailey
Governor
Bank of England
Threadneedle Street
London
EC2R 8AH

22 November 2023

Dear Andrew,

REMIT AND RECOMMENDATIONS FOR THE FINANCIAL POLICY COMMITTEE

This letter and the accompanying annex constitute the remit and recommendations for the Financial Policy Committee (FPC) for the coming year. Below I set out my perspective on the current economic context and its relevance for the Committee's priorities for the year ahead.

I am committed to ensuring the UK's economic stability and delivering strong, sustainable, and balanced economic growth. The Government's commitment to financial stability and the Bank of England's operational independence also remains absolute. A strong UK economy has always depended on a strong and stable financial services sector, which underpins the UK's position as a global financial centre. The Committee's main contribution to this goal is therefore protecting and enhancing financial stability in the UK, working in tandem with other organisations including the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

As the Committee has noted, the risk environment remains challenging, against an uncertain global economic backdrop. Recent stresses in the global banking sector highlight the continued importance of maintaining robust macroprudential, regulatory, and supervisory standards, and I welcome the Committee's continued work to respond flexibly to such events to contribute to financial stability. Addressing systemic risks in the system of market-based finance also continues to be vitally important and I am very supportive of the long-standing work programmes being undertaken by the Bank and the Financial Stability Board to address these vulnerabilities. The Committee should continue to attach a high priority to supporting this work and ensure that the Bank continues to coordinate with the relevant regulatory authorities and across jurisdictions to take forward this work in a way that works for UK markets. As global financing conditions remain tight, the close coordination of macroprudential and monetary policy will also continue to be of heightened importance.

The Committee should also seek to support the Government's economic policy to achieve strong, sustainable and balanced growth, and thereby the Committee's secondary objective, where doing so does not directly conflict with the achievement of the Committee's primary objective.

The Government is committed to making the UK more globally competitive, and to the growth of the UK's financial services sector throughout the country, unlocking its full potential as a global powerhouse that delivers for the UK economy. The financial services reform programme that I set out in the Edinburgh Reforms and at Mansion House will future-proof our approach and enable the sector to seize the opportunities of the future whilst retaining our commitment to high international standards. Royal Assent of the Financial Services and Markets Act 2023 in June marked a significant milestone in this journey, providing the framework for us to deliver the Government's vision for an open, competitive, sustainable and technologically advanced sector.

I look forward to working with the Committee in the year ahead.

Best wishes,

Jeremy Hunt

RT HON JEREMY HUNT MP
Chancellor of the Exchequer

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:

- contributing to the achievement by the Bank of the Financial Stability Objective (to protect and enhance the stability of the financial system of the United Kingdom); and
- subject to that, supporting the economic policy of His Majesty's Government, including its objectives for growth and employment.

Section 9C 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 of the Act allows me to specify what the economic policy of the government is to be taken to be. Section 9E 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.
- the responsibility of the Committee in relation to support for the economic policy of His 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 contains the Treasury's recommendations to the Committee and specifies the government's economic policy.

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 parts of the UK and sectors of the 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;
- responsible fiscal policy where debt as a proportion of GDP falls over the medium term, supported by strong and independent institutions, and a credible macroeconomic framework maintaining sustainable public finances, while providing the flexibility to support the economy;

- supply side reforms to promote sustainable growth in all parts of the UK by supporting a dynamic business environment, increasing long-term energy security and delivering Net Zero;
- maintaining a resilient, effectively regulated, and internationally competitive financial system that supports the economy, while protecting consumers and safeguarding taxpayer interests.

B. Matters that the Committee 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 systemic risks to the resilience of the UK financial system. 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, including financial and non-financial (such as cyber and operational) risk, prioritising as appropriate. The purpose of preserving stability is to avoid serious interruptions in the vital functions which the financial system 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).

The Government appreciates the work of the Committee to date to enhance the resilience of non-bank financial institutions. The Committee should continue to place a high priority on building on this to improve regulatory frameworks, including at the Financial Stability Board and across jurisdictions, and using insights gained (e.g., from the System Wide Exploratory Scenario), with a view to protecting and enhancing the resilience of the UK financial system.

The Committee should also continue to regard risks from climate change (including physical risks and risks from the transition to net zero) as relevant to its primary objective.

Finally, the role of the Committee is a crucial complement to, but distinct from, those of the regulators. The Committee should continue to work closely with the Prudential Regulation Committee (PRC) and the FCA to ensure coordination between microprudential and macroprudential policy, so far as it is possible while complying with its objectives. In ensuring it considers all parts of the financial system, the Committee should also seek to work in an open and collaborative fashion with other bodies, such as the Pensions Regulator and the Payment Systems Regulator, to identify and seek to address systemic risks and vulnerabilities.

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 primary and secondary objectives will often be complementary. For example, actions to support a resilient financial system can support growth 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 its primary and secondary objectives, 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 action.

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, as per the recommendations outlined below.

The Act requires the Committee to explain the use of its powers. 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 its assessment of any conflicts between the primary and secondary objectives, 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.

<u>ii. Recommendations regarding support for the government's economic policy towards the financial services industry</u>

The Government is committed to securing a financial sector that is both secure and globally competitive over the long term. This includes taking forward an ambitious agenda to unleash the potential of the UK financial services sector. 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 its primary objective, and it is practical and relevant to do so. This is particularly relevant to the following priorities:

- Growth and Competitiveness. The Government aims to promote international competitiveness by having a financial services regulatory framework that upholds our commitment to stability and high regulatory standards and is tailored to UK markets, creating a landscape that serves the needs of domestic and international market participants. Through this, the government aims to facilitate economic growth by attracting and retaining internationally active financial services firms and activity, encouraging trade and investment into the UK, and unlocking capital to support growth sectors across the economy.

- Competition and innovation. The Government is keen to see 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 and its technologies (including distributed ledger technologies).
- Home ownership. The Government is committed to supporting first-time buyers looking to access the mortgage market.
- Boosting productive finance. The Government is committed to improving capital allocation and investment culture to boost productive finance and the supply of equity finance.

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. There may, however, be occasions when there are short term trade-offs to be made between these objectives. The FPC should continue to have regard to the MPC's actions, and thereby ensure coordination between monetary and macroprudential policy. To enhance that coordination, where appropriate, the Committee 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.

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

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).

iii. Recommendations to the Treasury on legislative changes

The Act allows the FPC to make recommendations to the Treasury on the need for legislative changes. 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 Committee should 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.

v. Recommendations as to engagement with financial sector 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;
- wherever practicable, a robust quantitative assessment of the impact of any proposed policy action is provided, including an estimate of the private costs to businesses.

The length of any public 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 should not prevent the FPC from making a direction or recommendation without, or with a more abbreviated, consultation where it considers it necessary to do so, by reason of urgency, in order to protect and enhance the resilience of the UK financial system.