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

17 November 2022

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

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 FPC's priorities for the year ahead.

I am committed to ensuring the UK's economic stability and delivering 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 FPC's main contribution to this goal is therefore protecting and enhancing financial stability in the UK, working in tandem with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

As the Committee has noted, the global economic outlook has deteriorated significantly, while geopolitical risks remain heightened. I welcome the action taken by the Bank, under the guidance of the Committee, to address recent disruption in financial markets. Volatility in financial markets – both globally and domestically – continues to highlight the importance of improving the resilience of market-based finance, and I am very supportive of the long-standing work programmes being undertaken by the Bank and the Financial Stability Board to address the vulnerabilities identified by the Committee. 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 this forward. As global financing conditions continue to tighten, the close coordination of macroprudential and monetary policy will also continue to be of heightened importance in the coming months.

The Committee should also seek to act to support 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 government is committed to making Britain more globally competitive. There are too many barriers for enterprise, and we need a new approach to break them down. That means reforming the supply side of our economy.

The government is determined to unleash the potential of the UK financial services sector and, through the Financial Services and Markets Bill, will repeal retained EU law and establish a comprehensive domestic model of regulation. The Bill unlocks the opportunities to tailor financial services regulation to UK markets in order to bolster the competitiveness of the UK as a global financial centre and to deliver better outcomes for businesses and consumers. I expect the Committee to make use of these opportunities when exercising its functions with a view to supporting the government's economic policy towards the financial services industry, consistent with its secondary objective.

It is more important than ever that the UK financial system serves the people of this country, creating jobs, supporting businesses, unleashing investment and powering economic growth. The FPC has, and will continue to have, a central role in helping to achieve that outcome.

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

Best wishes,

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:

a) 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

b) 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 investment, skilled employment, infrastructure, and enterprise to create a more pro-growth environment in all parts of the UK, 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 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).

In order for the FPC to carry out its responsibilities, it is essential that the appropriate risk oversight and mitigation systems are in place for non-bank financial institutions. Given the inherent international nature of the risks posed by non-banks, the Committee should place a high priority on building on the ongoing work at the Financial Stability Board and across jurisdictions, to contribute to the development of robust regulatory frameworks for non-banks. Furthermore, while it might not be reasonable to expect market participants to insure against all market outcomes, it is important that lessons are learned from the recent dysfunction in the gilt market and the vulnerabilities associated with leveraged funds that this exposed. The Committee should seek to support this work such that appropriate levels of resilience in the UK financial system are ensured.

The Committee should also continue to regard risks from climate change as relevant to its primary objective. Climate change may pose risks to the stability of the UK financial system, including physical risks, and transition risks, resulting from a transition towards a net zero economy that is sudden, disorderly or more generally fails to appropriately balance environmental and economic factors.

Finally, the role of the Committee is a crucial complement to, but distinct from, those of the regulators. The Committee should also 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 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 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 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. 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. 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.

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

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 the Committee's primary objective – covering, in particular:

- **Openness and Competitiveness.** The government aims to promote an open and internationally competitive UK financial services sector by facilitating, subject to alignment with relevant international standards, the competitiveness of the UK economy (including in particular the financial services sector). This includes attracting and retaining internationally active financial services firms and activity, and encouraging trade and investment into the UK.
- **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).
- **Climate change and energy security**. The government aims to align private sector financial flows with environmentally sustainable and resilient growth, in a manner that is consistent with the important role that the financial system will play in supporting the UK's energy security - including through investment in transitional hydrocarbons like gas - as part of the UK's pathway to net zero.
- **Home ownership**. The government is committed to supporting first-time buyers looking to access the mortgage market.

The Committee should regularly review how it is able to proactively support the areas highlighted above in a manner that is consistent with its objectives. In its assessment of the costs and benefits of its policy actions, the Committee should, wherever practical and relevant, take these considerations into account.

<u>iii. Recommendations regarding facilitating finance for productive investment</u>

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. This includes, but is not limited to, venture and growth equity to support the UK's scale up companies, and finance to support the UK's energy security and the pathway to net zero. 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 for the purposes of compliance with section 9C (4) of the Act.

In line with the recommendation above, the Committee should continue to build upon its work examining 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 parts of the UK. The Committee should, where possible and appropriate, act with a view to supporting the supply of long-term capital and the successful delivery of the Long-Term Asset Fund structure.

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 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.

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.