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

Andrew Bailey
Governor
Bank of England
Threadneedle Street
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14 November 2024

Dear Andrew,

Remit and recommendations for the Financial Policy Committee (FPC)

Maintaining economic and financial stability is the bedrock for delivering the economic growth that is this government's number one priority. A stable, predictable environment is essential for providing the conditions for businesses and consumers to invest with confidence. Alongside sustainable public finances, the success of our economic institutions will be critical to maintaining the secure foundations we need for the UK to thrive in the face of both domestic and global challenges. I am grateful for the FPC's work in preserving financial stability through recent, turbulent years.

The financial stability outlook remains challenging. We are in a higher interest rate environment with heightened geopolitical and global risks, including climate change, which is the greatest long-term global challenge that we face. These risks highlight the importance of maintaining macroprudential and regulatory standards, whilst events of recent years underscore the importance of the Committee's ability to respond to unfolding events.

I support the FPC's work to address systemic vulnerabilities in market-based finance. The Committee should continue to prioritise this work and ensure that the Bank continues to cooperate with relevant authorities and across jurisdictions to increase resilience in a way that is consistent with supporting sustainable economic growth. In the context of increasing global uncertainty, I also support the FPC's continued focus on cyber and operational risks. The Committee should continue to note the evolving threat landscape, including how this might increase these risks, and other potential impacts for financial stability.

The UK's financial services sector is one of the UK's greatest assets. It plays an important direct role in the economy, representing nearly 9% of total UK GVA, whilst also being a key enabler of economic growth, whether it be through providing credit to households or channelling capital into productive investment. But there remains untapped potential, and it is essential we work together to ensure that the financial system is supporting economic growth. That is why I launched the Pensions Investment Review with the aim to unlock billions of pounds of investment and further boost growth. The sector also has a key role to play in driving the Government's clean energy mission. I am therefore pleased to reinstate sustainable finance as one of the government's priorities which the FPC should support as part of its secondary objective.

I expect the FPC to play an active role in supporting the growth and competitiveness of the UK's financial services sector and the wider economy, through its primary objective to maintain financial stability, and also by supporting the government's economic policy under its secondary objective. In the remit and recommendations, I have asked the Committee to assess and identify areas where there is potential to increase the ability of the financial system to contribute to sustainable economic growth without undermining financial stability.

I look forward to working with you and the Committee in the year ahead. I am also copying this letter and the Remit and Recommendations to the chairs of the Treasury Select Committee, the Lords Economic Affairs Committee and the Lords Financial Services Regulatory Committee.

Best wishes,

Rachel Reeves.

RT HON RACHEL REEVES 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)
- 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
- 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
- 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 restore broad-based and resilient growth built on strong and secure foundations. Price and financial stability are essential pre-requisites to achieve this objective.

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

- maintaining a stable macroeconomic environment, key to which is operationally independent monetary policy, responsible for maintaining price stability and supporting the economy;

- supporting investment through the effective management of public finances and overseeing sustainable taxes and borrowing, to deliver long-term growth and accelerate the transition to a climate resilient, nature positive and net zero economy;
- supply-side reform and targeted industrial strategy to remove the barriers to our productive capacity and increase productivity-enhancing investment, increasing access to high-quality jobs across the UK;
- growing the financial sector and increasing its international competitiveness, while enhancing its role in financing growth, safeguarding financial stability and consumer protection, and supporting the transition to a net zero economy.

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. 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 role of the FPC is a crucial complement to, but distinct from, those of the regulators. The Committee should continue to work closely with the PRA 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.

i. <u>Climate change and nature</u>

The climate and nature crisis is the greatest long-term global challenge that we face. The Committee should therefore continue to regard the risks posed by climate change, including physical and transition risks, as relevant to its primary objective. The Committee should consider how these risks could impact financial stability over the near and longer-term, including, where appropriate, through its stress testing frameworks, ensuring that risks stemming from possible and severe global climate scenarios are reflected in its analysis on climate risks and that sufficient time horizons are considered.

Over the next year, the Committee should continue to consider the materiality of nature-related financial risks for its primary objective.

ii. Risks from the non-bank financial sector

Non-bank financial institutions play an increasingly important role in the financial sector and are critical to supporting economic growth through their role in supporting market liquidity, channelling investment, extending credit and providing services such as insurance and pensions. The government appreciates the significant contribution of the Committee to date in enhancing the resilience of the sector. The Committee should continue to prioritise building this resilience, including by working through the Financial Stability Board to improve regulatory frameworks 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 Bank's development of the Contingent NBFI Repo Facility is welcome, and the Committee should continue to consider the role of the Bank's toolkit in addressing risks in the non-bank financial sector.

iii. Geopolitical risks

Given a backdrop of increasing global uncertainty, the Committee should continue to monitor geopolitical risks and how these are accounted for by markets. And recognising that the National Cyber Security Centre describes the threat to critical infrastructure from state-aligned groups as enduring and significant, the Committee should continue to consider risks posed by these actors where activities may increase cyber or operational risk and impact UK financial stability.

iv. Non-financial risks (including cyber and operational risks, and emerging technologies)

The Committee should continue to regard all types of non-financial risks, including cyber and operational risk, as relevant to its financial stability objective. Moreover, the Committee should consider these risks in line with the evolving landscape highlighted above. Identifying and addressing these risks is essential to safeguarding critical financial infrastructure, maintaining public confidence, and ensuring the resilience of the entire financial sector against potential disruptions. Having highlighted the risk created from the outsourcing of key financial sector services to third party suppliers, the Committee should continue to monitor the implementation and outcomes of the critical third parties regime as part of its broader work on operational resilience.

Whilst recognising the significant economic opportunities presented by emerging technologies, including Artificial Intelligence, the Committee should also continue to consider potential financial stability risks associated with their widespread adoption.

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. As part of its work in 2025, the Committee should assess and identify areas where there is potential to increase the ability of the financial system to contribute to sustainable economic growth without undermining financial stability.

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.

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

The Committee should act with a view to supporting the government's overall policy towards the financial services sector, recognising that the growth and competitiveness of the sector is the government's top priority. The government aims to drive the growth of the sector by providing the stability to attract investment, embracing innovation and emerging technologies, including the safe adoption of Artificial Intelligence, and ensuring the competitiveness of the UK as a global financial centre, including through continuing international engagement.

In addition, the Committee should also seek to support the following Government priorities:

- Leading the world in sustainable finance
  The government is committed to leading the world in sustainable finance by making the UK a global hub for green and transition finance activity, and delivering a world-leading sustainable finance regulatory framework. The government will unlock the full potential of the financial services sector to fund the green transition.

- Supporting home ownership
  The government is committed to making home ownership more accessible by fixing the planning system and building 1.5 million more homes, as well as supporting first-time buyers who struggle to save for a large deposit.

- Reinvigorating capital markets
  The government is committed to ensuring the UK's capital markets are competitive, supporting global and UK growth, for example, through the ongoing Pensions Investment Review that aims to unlock billions of pounds of investment.

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
- 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.