

# Changes to the Bank of England

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The Bank of England is currently experiencing its most important institutional and functional changes in a generation. Failings in pre-crisis arrangements have prompted the Government to introduce wholesale changes to the UK regulatory landscape which come into force in April 2013. This regulatory reform has resulted in the Bank gaining significant new responsibilities, including for: microprudential regulation of insurers, deposit-takers and major investment firms, through the creation of the Prudential Regulation Authority; macroprudential regulation of the financial system as a whole, through the creation of the Financial Policy Committee; and supervision of some critical post-trade financial market infrastructure providers. This article summarises the main changes to the Bank arising from these reforms, including those already put in place in anticipation of the reforms, as well as the new governance arrangements that are being introduced, as part of the Bank's accountability to Parliament and the public.

In April 2013, a new regulatory framework will come into force under the Financial Services Act 2012.<sup>(2)</sup> This article summarises the key elements of the new framework as they affect the Bank of England. The first section gives an overview of the main changes, including the creation of the Prudential Regulation Authority (PRA) and the Financial Policy Committee (FPC), and new responsibilities in relation to some post-trade financial market infrastructures (**Figure 1**). The second section looks at the new policymaking and regulatory powers of the Bank in more detail, focusing on the roles and objectives of the FPC and the PRA, and highlighting the work already done by the interim FPC and to establish the PRA. The third section focuses on the Bank's new responsibilities in relation to the oversight of financial market infrastructure providers. The fourth section looks at interactions between the different authorities. Finally, the fifth section describes a number of important changes to the governance of the Bank and its accountability to reflect its increased responsibilities.

## Overview of responsibilities

The Financial Services Act 2012 ('the Act') introduces important changes to the regulatory framework of financial services in the United Kingdom, many of which affect the Bank of England. The Financial Services Authority (FSA), which was previously responsible for regulation of financial firms from both a 'prudential' and 'conduct' perspective, will cease to exist.

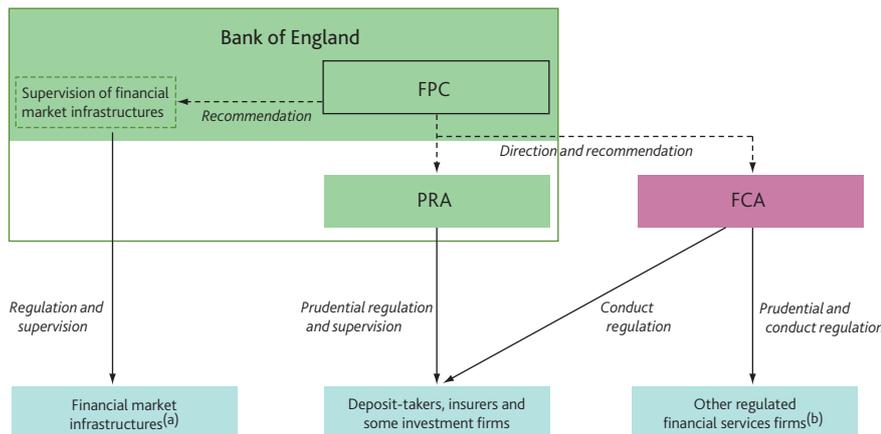
- The Prudential Regulation Authority will be part of the Bank and will be responsible for the **microprudential regulation** of deposit-takers, insurers and major investment firms. This includes setting standards and supervising financial institutions at the level of the individual firm so as to promote their safety and soundness, seeking to minimise the adverse effects that they can have on the stability of the UK financial system; and contributing to ensuring that insurance policyholders are appropriately protected.
- The Financial Conduct Authority (FCA), a separate institution from the Bank, will be responsible for ensuring that relevant markets function well. In doing so, it will aim to advance the protection of consumers, the integrity of the UK financial system and promote effective competition. It will be responsible for the **conduct regulation** of all financial services firms. This includes acting to prevent market abuse and ensuring that financial firms treat customers fairly. The FCA will also be responsible for the microprudential regulation of those financial services firms not supervised by the PRA, for example, asset managers, hedge funds, many broker-dealers and independent financial advisers.

The Bank of England will retain its responsibility for financial stability, having a statutory objective to protect and enhance

<sup>(1)</sup> The authors would like to thank Mounir Kenaissi and Sarah Parkinson for their help in producing this article.

<sup>(2)</sup> The Act is available at [www.legislation.gov.uk/ukpga/2012/21/contents/enacted](http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted).

Figure 1 Stylised diagram of the new regulatory framework



(a) Excludes regulation of trading platforms, which is the responsibility of the FCA.  
 (b) Includes asset managers, hedge funds, exchanges, insurance brokers and financial advisers.

the stability of the financial system of the United Kingdom. In support of this objective, the Financial Policy Committee, which has existed in non-statutory form since 2011, will be formally established under statute within the Bank. It is charged with identifying, monitoring and taking action to remove or reduce systemic risks to the financial system as a whole, rather than at the level of the individual firm — **macroprudential supervision and regulation**.

Further, in support of its financial stability objective, the Bank will be responsible for the regulation of some post-trade **financial market infrastructures**, including the supervision of central counterparties and securities settlement systems, to help ensure that these important institutions are resilient. This responsibility will sit alongside the Bank’s existing responsibilities for overseeing recognised payment systems.

Changes are also being made to the arrangements to deal with failing institutions. In particular, the Act extends modified versions of the ‘special resolution regime’ created for banks in 2009 to investment firms and recognised clearing houses, including their parent undertakings, as well as to the parent undertakings of banks.<sup>(1)</sup> When brought into force (expected in Summer 2013), this will provide the Bank and HM Treasury with powers to deal with failing firms of these types in order to protect the stability of the financial system and public funds. These powers are due to be supplemented in some very important respects by the EU’s Recovery and Resolution Directive (RRD) in due course.

Finally, some changes are being made to the governance of **financial crisis management** arrangements. In particular, an explicit duty will be placed on the Governor to notify the Chancellor of the Exchequer if there is a material risk to public funds. The Chancellor will also have a new power of direction over the Bank in relation to the provision of financial assistance to a firm or to the use of stabilisation powers, where necessary to resolve or reduce a serious threat to financial stability.

Responsibilities in relation to financial crisis management are set out in a new Memorandum of Understanding between the Bank and HM Treasury.<sup>(2)</sup>

## Statutory decision-making bodies

From April 2013, the Bank will have two new statutory decision-making bodies: the PRA Board, responsible for microprudential supervision and regulation; and the FPC, responsible for macroprudential supervision and regulation (Figure 2). These are in addition to the Monetary Policy Committee (MPC) and its existing responsibilities for monetary policy, and the Bank’s responsibilities for liquidity provision and resolution.

Figure 2 Major statutory decision-making responsibilities of the Bank of England



(1) For further detail on the Special Resolution Regime see [www.bankofengland.co.uk/financialstability/Pages/role/risk\\_reduction/srr/default.aspx](http://www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/default.aspx).  
 (2) [www.hm-treasury.gov.uk/d/fin\\_fs\\_bill\\_mou\\_financial\\_crisis\\_management\\_jan2012.pdf](http://www.hm-treasury.gov.uk/d/fin_fs_bill_mou_financial_crisis_management_jan2012.pdf).

The Bank's statutory responsibilities in relation to monetary stability — that is, to maintain price stability and, subject to that, to support the Government's economic policies, including its objectives for growth and employment — remain unchanged under the Act.<sup>(1)</sup> This section therefore focuses on the Bank's new responsibilities in relation to the PRA and FPC.

### Prudential Regulation Authority

The PRA will be a subsidiary of the Bank and will be the United Kingdom's microprudential regulator for deposit-takers, major investment firms and insurers. The PRA's new role will be grounded in two statutory objectives:

- To promote the **safety and soundness** of all the firms it supervises. This will be achieved primarily by minimising the harm that firms can cause to the stability of the UK financial system, in particular the harm resulting from disruption to the continuity of provision of financial services.
- And, specifically for insurers, to contribute to the securing of an **appropriate degree of protection for those who are, or may become, policyholders**.

In addition to its statutory objectives, the PRA must 'have regard' to a series of regulatory principles set out in the Act, including efficient use of its resources; transparency; proportionality; the desirability of sustainable growth in the economy of the United Kingdom; and the need to minimise any adverse effect on competition arising from the discharge of its functions.

A key feature of the statutory regime is that to be authorised, firms must meet, and continue to meet, a set of Threshold Conditions. These require a firm to go about its business in a prudent manner, for example by maintaining adequate financial resources, taking into account its resolvability, and to have suitable management. Given that the Threshold Conditions promote the safety and soundness of firms and policyholder protection, they will be crucial in helping the PRA to meet its objectives.

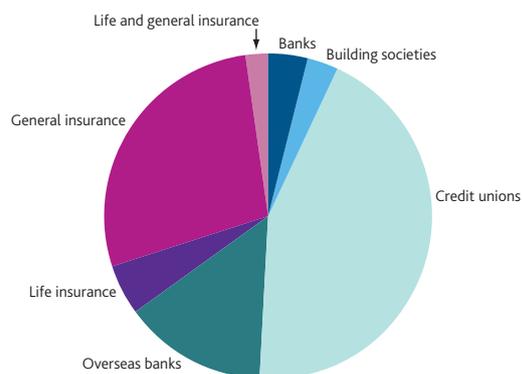
Importantly, a key principle underlying the PRA's approach to supervision, set out in statute, will be that it will not seek to operate a 'zero-failure' regime. Rather, the PRA, working with the Bank's Special Resolution Unit, will seek to ensure that financial firms which fail do so in a way that avoids significant disruption to the supply of critical financial services. This will depend in part on the efficacy of any statutory resolution regime in place. The forthcoming RRD is expected to broaden the range of resolution tools available to the authorities, and improve the effectiveness of some tools.

### Scope

In total, the PRA will supervise around 1,400 financial groups (Chart 1). Approximately 900 of these groups will be

deposit-takers, including banks, building societies and credit unions, a small number of which will contain investment firms that have the potential to present significant risks to the stability of the financial system (and, as such, will have been 'designated' for supervision by the PRA). Some 500 firms will be insurers including general insurers, life insurance companies, firms involved in the largely wholesale London Market, and mutual insurers including friendly societies. The PRA will supervise both UK-headquartered and international financial firms, including 'passport' firms from within the European Economic Area, branches from other countries and UK-owned subsidiaries of international firms, some of which are systemically relevant in their own right. The PRA's legal powers and responsibilities will vary depending on the location of a firm's parent and the legal form of a firm's UK operations.

**Chart 1** Distribution of PRA-supervised financial groups by type<sup>(a)</sup>



Source: Financial Services Authority.

(a) As of 1 March 2013. Numbers of supervised firms change regularly.

The FCA will be the prudential supervisor for approximately 23,000 other firms that were previously regulated by the FSA. This will include investment firms not designated by the PRA, asset managers, hedge funds, exchanges, insurance brokers and financial advisers. In addition, the FCA will be the conduct supervisor.

### Governance and accountability

The PRA, as part of the Bank, will be accountable to the Bank's Court of Directors for administrative matters, including its budget and remuneration policy, value for money and performance against objectives and its strategy. But the PRA will also have its own independent Board, which will be responsible for the most significant supervisory decisions about individual financial firms and PRA policy, including all rule-making. Membership of the PRA Board comprises the Governor of the Bank of England (who also chairs); the Chief Executive Officer of the PRA (who will also be the

(1) These have been detailed in earlier *Bulletin* articles including Lambert, R (2005), 'Inside the MPC', *Bank of England Quarterly Bulletin*, Spring, pages 56–65.

Deputy Governor for Prudential Regulation); the Deputy Governor for Financial Stability; the Chief Executive Officer of the FCA; and at least three independent non-executive members.<sup>(1)</sup> The non-executive members are appointed by Court with the approval of HM Treasury. The appointment of the PRA non-executive directors was announced on 6 March 2013, and the first Board meeting was held on 7 March 2013.

Like the Bank's other statutory decision-making bodies, the PRA Board will be accountable to Parliament. This accountability will be delivered to a large extent by PRA Board members appearing regularly before the Treasury Select Committee. Additionally, the PRA will be required under the Act to conduct a statutory investigation when (i) it appears to either the PRA Board or HM Treasury that a regulatory failure by the PRA has occurred; or (ii) HM Treasury considers it to be in the public interest for there to be an investigation related to a PRA-regulated activity. The PRA must report to HM Treasury on the findings of its investigations and, subject to restrictions set out in the Act, such reports must be published. The PRA will also be subject to performance reviews by the Oversight Committee of Court. The role of the Oversight Committee is discussed in the final section of this article.

Separately from issues of regulatory failure, HM Treasury will be able to order independent inquiries into the PRA's economy, efficiency and effectiveness. The PRA will be subject to regular audit by the National Audit Office, including value-for-money audits.

The PRA will have a number of mechanisms in place to support transparency to regulated financial firms and the wider public. These mechanisms include arrangements to consult interested parties, including on rules; publication of the PRA's strategy on an annual basis; the PRA's Annual Report; and a complaints scheme, including the establishment of an independent Complaints Commissioner, which is being set up jointly with the FCA.<sup>(2)</sup>

With specific regard to the financial services sector, the PRA will have a general duty to consult the firms it regulates, as well as representatives of those firms, about its general policies and practices and their consistency with its statutory duties. As well as requiring the PRA to publish proposed rules in draft, the Act also requires a PRA Practitioner Panel to be set up. The PRA will not be accountable to regulated firms or their representatives for delivery of its public policy objectives, however. It will be accountable to the public and to Parliament.

## Approach

The PRA will advance its objectives by two means. First, through **regulation** — that is, by setting standards or policies that it expects firms to meet. And second, through **supervision** — that is, by assessing the risks that firms pose to

the PRA's objectives in the context of these policies and taking actions, where necessary, to reduce them.

The PRA's approach to regulation and supervision and how it will go about implementing this approach have been developed by the FSA's Prudential Business Unit and the Bank over the past couple of years. The approach, which has been set out in two 'approach' documents and was summarised in a 2012 Q4 *Bulletin* article,<sup>(3)</sup> will build on significant changes to prudential supervision already introduced by the FSA since the crisis. It will, within the statutory framework, have three defining characteristics:

- **A judgement-based approach.** The PRA will use judgement in determining whether financial firms are safe and sound, whether insurers provide appropriate protection for policyholders, and whether firms meet, and are likely to continue to meet, the Threshold Conditions. Judgements will be based on evidence and analysis, and will not be constrained by a narrow interpretation of either domestic or EU rules.
- **A forward-looking approach.** The PRA will assess firms not just against current risks, but also against those that could plausibly arise in the future. Understanding the external economic environment will be crucial in this regard. Where the PRA judges it necessary to intervene, it will generally aim to do so at an early stage.
- **A focused approach.** The PRA will focus on those issues and firms that pose the greatest risk to the stability of the UK financial system and to policyholders. The frequency and intensity of supervision applied to a particular firm will therefore increase in line with the risk it poses to the PRA's objectives.

Although the PRA will be required by statute to promote the safety and soundness of all firms it supervises, it will prioritise its resources and focus towards those firms with the greatest potential to affect its objectives adversely. The scale of a firm's 'potential impact' on the financial system will depend on its size, complexity and interconnectedness with the rest of the system. Additionally for insurers, it will reflect the size (including number of policyholders) and type of business undertaken. The PRA will also vary the resources and focus it applies to financial firms based on their proximity to failure and resolvability, given the possible adverse effects of disorderly firm failure on its objectives.

(1) The Chief Executive Officer of the FCA will not take part in decision-making about individual firms.

(2) [www.bankofengland.co.uk/financialstability/Documents/consultationoncomplaints.pdf](http://www.bankofengland.co.uk/financialstability/Documents/consultationoncomplaints.pdf).

(3) See [www.bankofengland.co.uk/publications/Documents/other/pr/bankingappr1210.pdf](http://www.bankofengland.co.uk/publications/Documents/other/pr/bankingappr1210.pdf), [www.bankofengland.co.uk/publications/Documents/other/pr/insuranceappr1210.pdf](http://www.bankofengland.co.uk/publications/Documents/other/pr/insuranceappr1210.pdf) and [www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb120405.pdf](http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb120405.pdf).

The PRA will set and communicate the policies that support its general approach. Reflecting the international nature of banking and insurance, this will involve the PRA, alongside other areas of the Bank, playing a full and active role in the development and implementation of EU and international prudential standards.

### Financial Policy Committee

The primary statutory objective of the FPC is to exercise its functions with a view to helping the Bank achieve its financial stability objective. The responsibility of the FPC in achieving that 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'.<sup>(1)</sup> The FPC's task will not be to achieve resilience at any cost, however. It should not act in such a way as to likely 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'. The legislation provides that, subject to achieving its primary objective, the FPC must also support the Government's economic policy, including its objectives for growth and employment. This secondary objective is the same as the MPC's (Figure 2). To support meeting these objectives, the FPC will have powers to make recommendations and to use macroprudential tools.

In February 2011, Court created an **interim FPC** to shadow, as far as possible, the future statutory FPC's macroprudential role. Although lacking the legal powers of the statutory FPC, the interim FPC has contributed to maintaining financial stability by monitoring and publicising risks to stability of the financial system and making recommendations in order to reduce and mitigate them.

Against a backdrop of large and persistent risks from the euro area and weak credit growth in the United Kingdom, the interim FPC's recommendations have focused on moving the UK banking system towards a more transparently resilient position. The interim FPC has also strengthened the interaction between the Bank and the FSA, enhancing close co-ordination between micro and macroprudential policies. Finally, the interim FPC has provided leadership in developing the framework for macroprudential policy in the United Kingdom by carrying out preparatory work and analysis to support the creation of the statutory FPC. This has included making recommendations to HM Treasury on the set of statutory macroprudential instruments that the permanent FPC should have at its disposal.

### Instruments of macroprudential policy

The statutory FPC will have two main types of power. The first power will be to make **recommendations**. It can make recommendations to anybody, including, for example, the rest of the Bank, the Financial Reporting Council and representative bodies.

The FPC will have a special power to make recommendations on a comply-or-explain basis to the PRA and the FCA. That is, to comply with the recommendation as soon as practicable or explain in writing and in public to the FPC why they have not done so.

The FPC will also be able to **direct** the PRA or the FCA to adjust specific macroprudential tools or instruments. The FPC will only be able to give directions in respect of macroprudential tools that HM Treasury has designated to it in secondary legislation, including through the implementation of the EU's Capital Requirements Directive (CRD4).

The Government is proposing to make the FPC responsible for the setting of two macroprudential tools:

- The **countercyclical capital buffer** can be used to require banks, building societies and large investment firms to hold additional loss-absorbing capital against all exposures. That increases the capacity of the system to absorb losses and acts to mitigate systemic risks. It is a simple, aggregate tool, readily applicable in a time-varying manner.
- **Sectoral capital requirements** require an additional capital requirement against specific exposures that the FPC judges to pose a risk to the stability of the system as a whole.

In addition, the Government intends to provide the FPC with direction power over a time-varying leverage ratio tool, but no earlier than 2018 and subject to a review in 2017 to assess progress on international standards.<sup>(2)</sup>

Mitigating systemic risks related to the fault lines or other vulnerabilities in the financial system will be a key responsibility of the FPC. The FPC will be able to make recommendations to HM Treasury on the 'regulatory perimeter' — that is, the boundary between regulated and non-regulated activities within the UK financial system. In particular, the FPC may provide recommendations on: which activities should be regulated, and which should not; whether institutions carrying out regulated activities should be designated for prudential regulation by the PRA, rather than the FCA, and *vice versa*; where the FCA might be able to set product intervention rules; and the types of unregulated institutions from which the PRA may collect information.<sup>(3)</sup>

The FPC will co-operate closely with overseas counterparts, including at the European Systemic Risk Board and through other global fora (such as the Financial Stability Board, the

(1) See section 9(c) of the Act.

(2) The design of the leverage ratio tool will depend on the provisions of the relevant European legislation and will be set out in secondary legislation to be introduced as necessary by the Government at the time.

(3) See Box 4, Bank of England *Financial Stability Report*, November 2012 for further detail on the FPC's approach to the regulatory perimeter.

Committee on the Global Financial System and the Basel Committee on Banking Supervision) to ensure that macroprudential policy decisions are implemented effectively and that cross-border leakages are dealt with appropriately. The FPC will have due regard to the impact of its decisions on jurisdictions both inside and outside the European Economic Area and, where relevant, will adhere to EU legislation outlining co-ordination arrangements once finalised.

The FPC will monitor a wide and time-varying set of measures, depending on the emerging risks, including both market and supervisory intelligence, and 'stress tests' of financial sector resilience.<sup>(1)</sup>

### Governance and accountability

The FPC will have ten voting members: the Governor (who will chair the FPC); the Deputy Governors for financial stability, monetary policy and prudential regulation; the Executive Director of the Bank of England for Financial Stability; the Chief Executive Officer (CEO) of the FCA; and four external members. In addition, a representative of HM Treasury will be a non-voting member of the FPC and the Executive Director of the Bank of England for Markets will routinely attend FPC meetings.

If consensus cannot be reached then a decision is taken by a vote of all those voting members present at the meeting. In the event of a tied vote, the Chair of the FPC has a second, casting vote. The nature of the vote on any decision, whether unanimous or otherwise, will be reflected in a formal Record of the meeting.

The FPC is required by statute to meet at least four times a year. Meetings will be held to a pre-announced quarterly schedule. The Record of the FPC's deliberations must be published within six weeks of a meeting. The FPC is also required to publish a *Financial Stability Report* twice a year. This will cover the Committee's assessment of the outlook for the stability and resilience of the financial sector at the time of preparation of the *Report*. It will also review progress against previous recommendations and directions, as well as report any new policy actions it has taken to reduce and mitigate risks to stability. The FPC's public policy decisions will be announced via the *Financial Stability Report* or in an official statement to the market shortly after a meeting.

## Oversight of financial market infrastructures

A further change in the Act is to grant the Bank responsibility for the supervision of central counterparties and securities settlement systems in the United Kingdom, to sit alongside the Bank's existing responsibilities for overseeing recognised payment systems.

The Act brings responsibility for supervision of these post-trade financial market infrastructure providers (FMIs) to the Bank in light of their particular importance to financial stability. The Bank and other authorities internationally, including the G20, have encouraged market participants to make greater use of FMIs given the benefits they can provide to market stability and wider financial stability through improved counterparty credit and operational risk management. But this has, in turn, increased the scale and importance of FMIs, in particular central counterparties, for the functioning of the global financial system.

The Bank's supervision of FMIs will seek to ensure that management of these institutions gives proper regard to protecting the financial system as a whole and that sufficient priority is given to the continuity of key services, without systemic disruption and without recourse to public funds. The FPC, in light of its responsibilities for reducing risks to the UK financial system, will be able to make recommendations to the Bank regarding the supervision of payment systems, clearing houses and settlement systems.

The Bank's approach to supervision of FMIs will be grounded in the international CPSS-IOSCO 'Principles for financial market infrastructures'.<sup>(2)</sup> These establish principles for the management of risks faced by FMIs including credit, liquidity, operational and legal risks as well as governance, default management and transparency.<sup>(3)</sup> And UK central counterparties will need to satisfy the technical standards that support the European Market Infrastructure Regulation. The Bank's supervisory approach will go beyond those minimum standards where necessary.<sup>(4)</sup> The Bank will focus its interventions on material threats to stability but will expect systems to address regulatory requirements across the board. The Bank will have powers of enforcement but will, where possible, seek to supervise with the support of FMIs and their participants.

Importantly, the Act also provides for enhanced recovery and resolution powers in relation to central counterparties. The Act establishes a resolution regime, as part of which the Bank will become the resolution authority for central counterparties. The current European draft legislation for resolution regimes does not extend to FMIs. However, the European Commission issued a consultation on a possible framework for the recovery and resolution of non-bank financial institutions in late 2012.

In terms of accountability, the Bank is required to report annually on performance of its oversight functions. A

(1) See Bank of England (2013), 'The Financial Policy Committee's powers to supplement capital requirements', January.

(2) Committee on Payment and Settlement Systems-International Organization of Securities Commissions.

(3) [www.bis.org/publ/cpss101.htm](http://www.bis.org/publ/cpss101.htm).

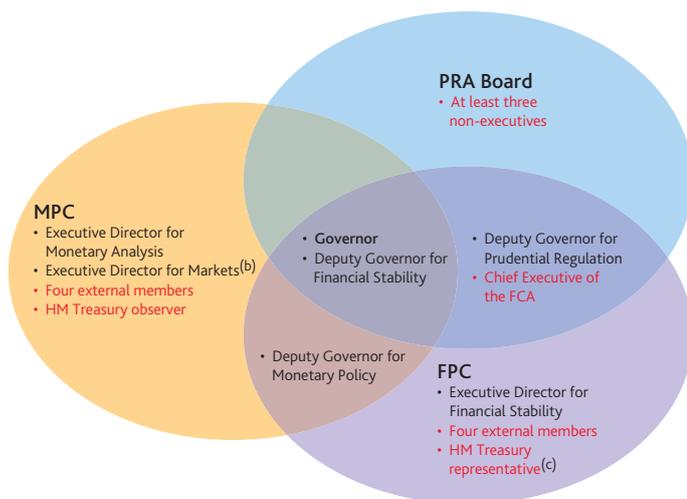
(4) [www.bankofengland.co.uk/publications/Documents/news/2012/nr161.pdf](http://www.bankofengland.co.uk/publications/Documents/news/2012/nr161.pdf).

complaints scheme, with an independent Complaints Commissioner, will be established in relation to these functions. HM Treasury also has power to direct the Bank in relation to its supervision of central counterparties or payment systems if necessary for compliance with EU or international requirements and to request investigations into regulatory failures.

## Interaction between the authorities

The new system will not work if the Bank functions in silos. The framework therefore encourages co-operation and co-ordination across the different policy bodies. As highlighted in **Figure 3**, for example, there is overlap between the memberships of the FPC, the PRA Board and the MPC, including the Governor and the Deputy Governor for Financial Stability both being members of all three policymaking bodies. This will support the flow of information across the different bodies and an understanding of their approaches and likely reactions to events.

**Figure 3** Membership of Bank of England statutory decision-making bodies<sup>(a)</sup>



(a) Members shown in red are not part of the Bank's Executive Team.

(b) The Executive Director for Markets will also routinely attend FPC meetings.

(c) Non-voting member of the FPC.

## PRA

Co-ordination between the PRA and the FCA will be assisted by the membership of their CEOs on each other's board. Further, the PRA and the FCA will have a statutory duty to co-ordinate with each other in the exercise of their public functions, including policymaking and supervision. And the PRA will have the power to require the FCA to refrain from certain actions where it sees a potential threat to financial stability, including where that arises from the potential failure of a firm.<sup>(1)</sup> A Memorandum of Understanding (MoU) between the FCA and the PRA describes how the two regulators will fulfil this duty to co-ordinate.<sup>(2)</sup> A further MoU provides for co-operation between the Bank (including the PRA) and the FCA on market infrastructure issues,

including in relation to the supervision of members of FMI's by the PRA and the FCA.<sup>(3)</sup>

## FCA

As well as being the United Kingdom's conduct regulator, the FCA will carry out microprudential regulation for many financial firms, including non-designated investment firms, asset managers, exchanges, trading platforms and hedge funds. As such, it will play a role in supporting the stability of the UK financial system. Co-ordination between the FPC and the FCA will be assisted by the CEO of the FCA being a voting member of the FPC. And the FPC will have the power to make recommendations on a comply-or-explain basis to the FCA.

## Bank and HM Treasury — crisis management

*Ex-ante* measures to underpin financial stability may not always be successful. The authorities therefore need clear arrangements in place for crisis management. Responsibilities between HM Treasury and the Bank (including the PRA) in relation to financial crisis management are set out in an MoU, which has a particular focus on monitoring and managing potential risks to public funds. Under the Act, the Chancellor has a power of direction over the Bank in relation to the provision of financial assistance to a firm or to the use of stabilisation powers, where necessary to resolve or reduce a serious threat to financial stability. Under the MoU, the Chancellor can direct the Bank to:

- conduct special support operations for the financial system as a whole, in operations going beyond the Bank's published frameworks;
- provide 'Emergency Liquidity Assistance' in support operations going beyond the Bank's published frameworks to one or more firms that are not judged by the Bank to be solvent and viable; and
- implement a particular stabilisation option under the Special Resolution Regime.

HM Treasury will provide the Bank, and any special purpose vehicle set up by the Bank to carry out support operations, with indemnities covering any risks arising from actions taken under direction from HM Treasury. The power of direction is not available in relation to supervisory decisions taken by the PRA and certain other decisions and functions of the Bank.

(1) In the special case of with-profits insurance policies, the Act gives the FCA the responsibility for determining whether the declaration of discretionary payments to policyholders is fair, and the PRA the power to veto any such proposed declaration if it is incompatible with the safety and soundness of the insurer. An MoU sets out the responsibilities of the FCA and the PRA in relation to with-profits insurance, see [www.bankofengland.co.uk/publications/Documents/other/pradraftwithprofitsmou.pdf](http://www.bankofengland.co.uk/publications/Documents/other/pradraftwithprofitsmou.pdf).

(2) [www.bankofengland.co.uk/financialstability/Documents/overseeing\\_fs/fca\\_pra\\_draft\\_mou.pdf](http://www.bankofengland.co.uk/financialstability/Documents/overseeing_fs/fca_pra_draft_mou.pdf).

(3) [www.bankofengland.co.uk/publications/Documents/other/pradraftmou.pdf](http://www.bankofengland.co.uk/publications/Documents/other/pradraftmou.pdf).

## MPC

Information flows between the MPC, the PRA and the FPC will be important in supporting the objectives of all three bodies, including the MPC. Both credit conditions and broader financial stability help to shape macroeconomic conditions and are therefore important to monetary stability, while prudential supervisors may have special insights to developments in credit conditions. Further, actions taken by the FPC may have a bearing on macroeconomic conditions. In addition to overlapping membership between the FPC, the MPC and the PRA Board, there will be information exchange between the bodies, including MPC members being able to attend briefings for FPC meetings and *vice versa*.

## Governance of the Bank

With the granting of significant new powers to the Bank, effective governance will be crucial for ensuring that the Bank can carry out its responsibilities. This section sets out the main governance arrangements of the Bank from April 2013, including the roles of Court and the newly created Oversight Committee.

### Court

The Court of Directors is responsible for managing the affairs of the Bank of England other than the formulation of monetary policy. The members of Court are appointed by the Crown and consist of the Governor of the Bank of England, the Deputy Governor for Financial Stability, the Deputy Governor for Monetary Policy, the Deputy Governor for Prudential Regulation and not more than nine Non-executive Directors. One of the Non-executive Directors is designated by the Chancellor of the Exchequer to chair Court.

Court's overall responsibilities include determining the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of its resources. There is a new requirement for the Bank to publish a record of each meeting of Court. The record will set out decisions taken by Court and, in relation to each decision, a summary of Court's deliberations.

Court delegates the day-to-day management of the Bank to the Governor, who, in turn, delegates to other members of the executive. Court reserves key decisions to itself in relation to the following areas: the Bank's strategy and objectives; risk management policies; senior appointments within the Bank; changes in remuneration and pension arrangements; and the establishment of sub-committees of Court.<sup>(1)</sup>

### Oversight Committee

A new body, created by statute, in the governance of the Bank is the Oversight Committee, a sub-committee of Court consisting of the non-executive Court members. It replaces the Non-executive Directors Committee (NedCo).

The Oversight Committee has a statutory responsibility for keeping under review the performance of the Bank in relation to its objectives and strategy. This responsibility covers both monetary policy objectives and financial policy objectives, including the responsibilities of the MPC and the FPC.

In addition to scrutinising the processes and information used by the Bank and its committees to reach and implement their policy decisions, the Oversight Committee will have the power to commission reviews, including by external experts, of the Bank's performance in relation to its objectives. The Oversight Committee will be required to publish such reviews unless that would not be in the public interest. The Oversight Committee will also be required to monitor the Bank's response to a review and, where recommendations of a review are accepted by the Bank, monitor their implementation. This will give the Oversight Committee an explicit role in ensuring that reviews translate into real action, and that the Bank takes on board the lessons learnt. Members of the Oversight Committee will be able to attend MPC and FPC meetings in order to observe their discussions.

The statutory responsibilities of the Oversight Committee do not extend to the PRA. Court has decided however that, as a subsidiary of the Bank, the PRA should also be subject to review by the Oversight Committee.

The Oversight Committee will be chaired by the chair of Court. The Bank's *Annual Report* will include a report by the Oversight Committee on the matters for which it is responsible.

### Other changes

One other important governance change is to the appointment arrangements of the Governor of the Bank. Under the amendment to the Act, a Governor of the Bank of England is to be appointed for a single term of eight years, rather than a maximum of two five-year terms, as was the case previously.<sup>(2)</sup> Deputy Governors will be appointed for no more than two terms of five years.

## Conclusion

From April 2013, the Bank of England will be given significant new powers and responsibilities by Parliament in relation to the regulation of individual financial institutions, financial market infrastructure providers and the oversight of the financial system as a whole, to go alongside its existing responsibilities, including for monetary policy.

(1) For a full list of responsibilities reserved by Court see [www.bankofengland.co.uk/publications/Documents/annualreport/2012/2012report.pdf](http://www.bankofengland.co.uk/publications/Documents/annualreport/2012/2012report.pdf). Note that, under the Act, the Financial Stability Committee, currently a statutory sub-committee of Court, will be ended and its statutory functions, mainly in relation to firm resolution and payment system oversight, will revert to Court.

(2) Mark Carney, who will become Governor on 1 July 2013, has been appointed for a single term of five years.

As part of the Bank, the PRA will promote the safety and soundness of deposit-takers, insurers and designated investment firms, focusing primarily on the adverse effects that they can have on the stability of the financial system; and contribute to ensuring that insurance policyholders are appropriately protected. Meanwhile, the FPC, which has been operating in interim form since 2011, will be formally charged with contributing to the achievement of the Bank's financial stability objective by identifying, monitoring and taking action to remove or reduce risks to the resilience of the

financial system as a whole. The Bank will also become responsible for regulation of certain post-trade financial market infrastructure providers, as well as having new powers in relation to the arrangements to deal with failing financial institutions.

Given these new powers, revised governance arrangements are being put in place to ensure that the Bank carries out its responsibilities effectively and transparently. The Bank is accountable to Parliament and the public.