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AUTHORITY

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Dear CEO

Feedback: operational readiness for a zero or negative Bank Rate

I wrote to you on 12 October 2020[1] to request information about your firm's readiness to deal with a zero or near-zero Bank Rate, a negative Bank Rate, or a tiered system of reserves remuneration, in the event that the Bank of England's Monetary Policy Committee (MPC) employs a zero or negative Bank Rate.

I would like to thank you for your response to that letter and information request. The responses have informed the Prudential Regulation Authority's (PRA) understanding of the operational implications for PRA-authorised firms in the context of our objectives, including promoting safety and soundness. The responses have also been shared with colleagues across the Bank of England (Bank) in order to inform the MPC about the operational timelines for firms to implement a zero or negative Bank Rate.

As I noted in my October letter, and as stated in the February MPC minutes[2], our engagement to date and this subsequent letter should not be interpreted as a signal that the setting of a negative Bank Rate is imminent, or indeed in prospect at any time. Such monetary policy decisions are made by the MPC and will, as always, remain driven by the evolution of the economic outlook and the MPC's commitment to meeting the 2% inflation target.

The responses to my October letter showed that firms are already able to deal with near-zero rates (down to at least two decimal places) and that, in the main, a zero Bank Rate would pose less of an operational challenge than a negative Bank Rate, and would take less time to implement.

Whilst a small number of firms do not need to do any development work to implement a negative Bank Rate, the majority of firms would need to make some changes to systems and processes in order to implement either a strategic or tactical solution. We define strategic solutions as permanent changes, involving material systems upgrades that feed through internal systems for managing the calculation of interest, customer communications, treasury, accounting and risk models. Tactical solutions are typically shorter-term fixes, involving workarounds on the periphery of core systems, along with overrides in downstream systems

[1] https://www.bankofengland.co.uk/prudential-regulation/letter/2020/info-request-operational-readiness-policy-rates
[2] https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2021/february-2021

and customer communications. A summary of that feedback is included as an annex to this letter.

On the basis of firms' responses to this exercise, the PRA understands that the majority of firms would be able to implement tactical solutions to accommodate a negative Bank Rate within six months, without material risks to safety and soundness.

Taking this into account, and consistent with the PRA's primary statutory objective to promote the safety and soundness of individual firms, along with its insurance policyholder protection objective and secondary competition objective, the PRA considers that an implementation period of shorter than six months would attract increased operational risks and could adversely impact some firms' safety and soundness and the PRA's wider statutory objectives.

Having considered the MPC's request, as set out in the February MPC minutes, the PRA will now engage with PRA-authorised firms on their development of tactical solutions, with the aim of having firms put themselves in a position to be able to implement a negative Bank Rate at any point after six months.

Strategic solutions to implement a negative Bank Rate have been reported by many firms as having a significantly longer timeframe than tactical solutions. Since this could involve reprioritising other important projects, we would not expect you to commence work to implement these strategic solutions unless they are already in your plans.

If you have any questions about the contents of this letter, please speak to your usual supervisory contact.

Yours sincerely

S. Woods

Sam Woods

Deputy Governor and CEO, Prudential Regulation Authority

Annex: firms' responses on operational readiness

We asked firms to give us time and cost expectations for the tactical and strategic solutions which would be required in the event that the MPC employs a zero or negative Bank Rate.

We define "strategic solutions" as permanent changes, which would entail material systems upgrades that feed through internal systems that manage the calculation of interest, customer communications, treasury, accounting and risk models.

We view "tactical solutions" as typically shorter-term fixes, involving workarounds on the periphery of the core systems, along with overrides in downstream systems and customer communications.

The responses showed that firms are already able to deal with near-zero rates (down to at least two decimal places) and that, in the main, a zero Bank Rate would pose less of an operational challenge than a negative rate, and would take less time to implement without material risks to firms' safety and soundness.

Whilst a small number of firms do not need to do any development work to implement a zero or negative Bank Rate, the majority of firms would need to make some changes.

<u>Wholesale banking business</u>

Many firms reported being able to accommodate negative rates for their wholesale business, largely due to experience of dealing with negative interest rates in other countries. Many firms use different systems for their wholesale and retail businesses, with the former often being newer and more bespoke than retail systems, making them easier to adapt.

<u>Retail banking business</u>

A lot of firms reported that their legacy retail systems were not built to accommodate a negative Bank Rate, and substantive changes would need to be made to these systems to enable them to accept and process a negative number as a reference rate. There was a wide spread of responses on how long firms would need to be operationally ready for negative rates. For most firms shorter-term tactical solutions would take up to six months to implement. The majority of firms reported that implementing longer-term strategic solutions would take up to twelve to eighteen months.

These tactical solutions referred to workarounds that would be put in place to handle a negative Bank Rate, but do not necessarily result in a negative rate on retail products such as mortgages and current or savings accounts. Several firms reported that the area where this would require most preparatory work would be on tracker mortgages, where customer rates are directly determined by Bank Rate. Implementing a tactical solution for negative Bank Rate would also result in varying levels of workarounds in areas such as customer communications as well as treasury systems and financial reporting tools.

<u>Insurance</u>

Responses from insurance firms generally presented fewer operational challenges than responses from deposit-takers, largely because insurers rarely refer to the Bank Rate in their contracts with policyholders.

A zero rate would present some challenges, but would have less of an impact than a negative rate. Some insurers identified a second-order effect of negative rates relating to transient cash held by SIPP customers which would require tactical solutions to maintain a fair treatment of policyholders.