

**EXECUTIVE
BOARD
MEETING**

SM/22/25
Correction 1

February 2, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **United Kingdom—Financial System Stability Assessment**

Board Action: The attached corrections to SM/22/25 (2/2/22) have been provided by the staff:

Mischaracterization of the Views of the Authorities

Page 25

Evident Ambiguity

Pages 10, 23, 24, 44, 67, 68, 69 (para. 82, lines 7-9)

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Pages 14, 24, 36, 40, 43, 50, 57, 59, 60, 64, 65, 67, 68

Typographical Errors

Pages 12, 42, 61, 69 (para. 82, line 3)

Questions:

Mr. Das, MCM (ext. 36330)

While the three challenges intersect and interact, contagion risks across the sovereign-nonfinancial-financial channel remain muted for the present. However, given the nature of the U.K. financial system, financial stability remains sensitive to exogenous factors and cross-border channels.

The FSAP has identified the following risk factors that would benefit from continuing vigilance:

- *Pandemic obfuscated financial risks.* Under FSAP stress scenarios, corporate and household vulnerabilities could materialize. (Section III-B). Banks' capital ratios could decline by up to 4.9 percentage points under the most severe scenario (Section III-C), and the solvency ratios of a few insurers could fall below the 100-percent threshold (Section III-D). These potential losses are prima facie absorbable in the near term with their current capitalization levels.
- *Surge in house prices.* Imbalances in the housing market are not apparent yet, but prices have continued to rise. Under some FSAP stress scenarios, mortgage arrears could rise sharply and peak at 2.8 percent in 2022, higher than the GFC levels (Sections III-B and III-I).
- *Deepening interconnectedness.* NBFIs are now sizeable credit providers to the real economy, including in riskier market niches less served by banks. They are already interconnected among themselves and with banks, including cross-border firms and asset managers (Sections III-E and III-G). Active use of financial technology is deepening these linkages, and data gaps preclude identification and a more definitive assessment of such risks.
- *Liquidity in core markets.* The risk to core financial markets remains primarily via liquidity mismatches in the internationally active NBFIs. It is desirable to actively consider strengthening backstops and allowing access to some central bank facilities to well- appropriately regulated, large, and systemically interconnected NBFIs (Section III-H).
- *Regulatory predictability.* Market fragmentation risks remain amplified in the areas of derivatives clearing, and international banks and insurers' choices of post-Brexit operating models. Both could impact systemic liquidity pools and heighten volatility. Uncertainties surrounding the long-term access of EU clearing members to the U.K. CCPs remain a source of market unease, albeit not viewed as a financial stability risk in the short term for the United Kingdom. (Section III-F).

On the institutional side, the Financial Policy Committee (FPC) is a world-class macroprudential authority. The FPC runs robust interagency processes to monitor financial stability conditions (Section IV-A). The quality of interagency coordination on prudential and related financial policies is thorough. There is seamless data-sharing within and between the BOE/PRA and the FCA. The United Kingdom also has a transparent approach to macro- and micro prudential, and conduct regulation.

Table 1. United Kingdom: Key Recommendations

Recommendations		Paras	Time¹
A. Further Bolster Management of Systemic Risks			
1	<i>Strengthen backstops</i> to the functioning of core markets in times of stress by considering <i>allowing</i> appropriately regulated and systemically interconnected NBFIs access to repo and/or Gilt purchase operations; <i>clearly communicating</i> the objectives, instruments, eligible participants, and the exit criteria. (BOE)	¶34–36	MT
2	<i>Enhance and further strengthen</i> the existing stress testing framework by consolidating the internal toolkit and run independent full-fledged top-down exercises covering all systemically relevant components of the financial system. (BOE/PRA, <u>with</u> FCA)	¶17	MT
3	<i>Seek additional statutory</i> powers to review and examine the resilience of all critical services (including, but not limited to, cloud services) that third parties provide to regulated firms. (BOE/PRA, FCA, <u>and</u> HMT)	¶54	MT
B. Continue Strengthening Regulation and Supervision			
4	Further develop “on the ground” reviews of systemically important financial firms’ exposures and risk management practices for early identification and remediation of supervisory issues, including AML/CFT risks, and to also support macroprudential surveillance. (BOE/PRA <u>and</u> FCA)	¶53, ¶59 and ¶71	NT
5	<i>Enhance</i> cyber risk technical risk reviews on technology risk management expectations for all financial firms, and by conducting additional cybersecurity control verification activities to <u>complement</u> CBEST security testing. (BOE/PRA, <u>and</u> FCA)	¶68 and ¶69	NT
6	<i>Enhance</i> entity transparency through improved verification of beneficial ownership information on the PSC Register and augment, as needed, ongoing support to Crown Dependencies and British Overseas Territories in operationalizing similar registers. (HMT, BEIS/Companies House, <u>and</u> FCDO)	¶71	NT
C. Minimize Potential Risks of Ongoing Transitions and Future Crises			
7	<i>Continue to encourage</i> the conversion of remaining legacy LIBOR exposures of U.K. regulated firms and support foreign efforts to migrate from non-Sterling LIBOR, mindful of the needs of emerging markets users. (FCA, HMT, <u>and</u> BOE)	¶62–64	NT
8	<i>Continue preparing</i> for diverse failure scenarios; eliminate rules that may constrain the bank resolution regime; and accelerate and expand the work on recovery and resolution planning for insurers and CCPs. (HMT, BOE/PRA, FCA, <u>and</u> FSCS)	¶72–75	MT
D. Secure Institutional Safeguards for Financial Stability and Integrity			
9	<i>Preserve</i> the primacy of the FPC’s financial stability objective and <i>strengthen</i> its focus on global financial standards and cross-border surveillance. (HMT, BOE, PRA, <u>and</u> FCA)	¶91–93	I
10	<i>Preserve</i> the primacy of PRA and FCA’s objectives of safety and soundness and market integrity, in principle and in practice, over any secondary objectives and ad hoc policy priorities. (HMT and FPC)	¶82	I
11	Review and estimate the expected workload in core and new financial stability and supervisory risk areas and determine how to align BOE/PRA and FCA capacity and resources accordingly. (HMT, BOE/PRA, <u>and</u> FCA)	¶83	NT
12	<i>Ensure</i> that the final accountability and transparency mechanisms adopted under the ongoing FRF review seek to safeguard regulatory independence and pose no constraints for operational and oversight effectiveness. (HMT, PRA, FCA <u>with</u> other agencies)	¶80–81	NT

¹ I = Immediate (within one year); NT = Near Term (within 1 to 3 years); MT=Medium Term (within 3 to 5 years).

FINANCIAL STABILITY CONTEXT

A. Pandemic Shock and Macroeconomic Conditions

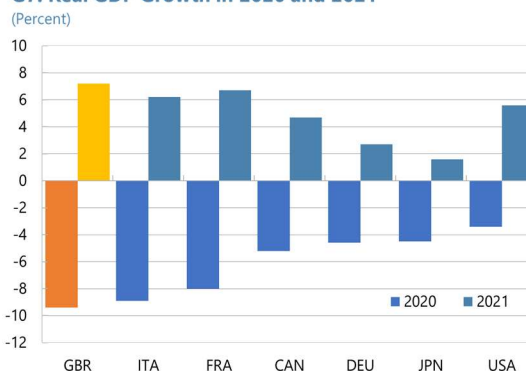
1. The United Kingdom is recovering from an unprecedented pandemic-related contraction.

With comprehensive policy support, vaccinations, and removal of mobility restrictions, the economy is recovering fast and expected to grow by about 7¼ percent in 2021, returning to its pre-pandemic level by end-2021 (Table 2). Inflation has been rising markedly recently, spurred by supply bottlenecks and a recovery in demand, and could peak at about 7 percent in early 2022.

2. The authorities swiftly launched a multipronged response to support financial stability.

Direct and indirect budget support measures helped safeguard households' and corporates' balance sheets. Exceptional prudential measures were adopted to ensure continued lending to households and corporates via banks and securities markets and to prevent amplification of the crisis by mitigating procyclicality of regulations. The BOE, in concert with other central banks, deployed a range of tools to restore market liquidity. The FCA set new reporting thresholds limits on the shorting of securities, most affected by the pandemic, giving asset managers flexibility to alleviate operational burdens.

G7: Real GDP Growth in 2020 and 2021



Sources: IMF 2022 January WEO.

3. With swift and strong policy support, financial conditions progressively reversed the initial sudden tightening following the outbreak (Figure 1). Supported by central bank asset purchases and liquidity measures, asset prices recovered, the yield curve flattened, and credit spreads fell from the peaks seen during the March 2020 “dash-for-cash.” The credit-to-GDP gap declined to about zero for the first time in a decade. Bank lending rates remained low, and corporate credit growth was strong—partly on the back of publicly guaranteed loans. Residential real estate prices rose sharply since mid-2020, although the share of new mortgages issued at high loan-to-value (LTV) ratios remains low relative to the pre-pandemic period (Section III-H).

4. A materialization of risks could reverberate through sovereign-financial-corporate linkages, particularly with increased contingent liabilities to the sovereign (Figure 2). Banks and insurance companies started the pandemic well capitalized and with sufficient liquidity buffers (Table 3). The limited impact of the pandemic so far on the aggregate balance sheets of nonfinancial corporates (NFCs), thanks to the extraordinary support measures, may bely the real strength of the corporate sector and pockets of household vulnerabilities. Materialization of macrofinancial risks could weaken the NFC sector and transmit via the financial sector (largely banks) to the sovereign, notably via state guaranteed loan schemes. Conversely, higher Gilt yields due to fiscal concerns would result in higher funding costs economy-wide and slow down the recovery.² Both scenarios would exacerbate risks to financial stability

² The public Debt Sustainability Analysis (DSA) in the Staff Report for the 2021 Article IV Consultation highlights that higher government financing needs would call for higher demands on NBFIs' and banks' gilt holdings, with implications for crowding out private credits, raising interest rates, and tightening sovereign-financial links.

ISSUES IN SYSTEMIC RISK AND RESILIENCE

A. Brexit and Financial Stability

6. The Brexit transition period ended without a materialization of risks for financial stability.

The United Kingdom closely monitored risks, engaged with the industry, and provided necessary regulatory certainty in a timely manner (see Table 5 for measures taken by the U.K. and EU authorities). The United Kingdom has replicated most of the equivalence determinations in respect of overseas jurisdictions made by the European Commission pre-Brexit. In November 2020, the United Kingdom also granted a package of equivalence decisions in respect of the EEA states. As of November 2021, 32 jurisdictions plus the EEA benefit from equivalence decisions under the United Kingdom's framework.⁴

Table 5. United Kingdom: High-Priority Exit Risks and Other Selected Exit Risks

	Risk Description	United Kingdom Actions	EU Actions
Legal Framework	The absence of a functioning legal and regulatory framework for financial services.	An "onshoring" process to convert the operative EU law into domestic law, with only minor adjustments.	Not relevant to the EU.
Cooperation	A breakdown of cross-border cooperation in supervision and resolution.	An extensive network of Memoranda of Understanding (MOUs) agreed with EU authorities. Ongoing authority level cooperation in a range of forums.	See U.K. actions.
Banking Services	Inability of U.K. and EEA banks to access U.K. and EEA markets.	A temporary permission regime for the continuity of the provision of EU firms' services, while they seek permanent authorization in the United Kingdom.	No EU level action. Some member states have introduced temporary regimes. As a result, major U.K.-based banks transferred their EU clients to subsidiaries in the EU to continue to service them.
Insurance	Inability of U.K. and EEA insurance companies to service cross-border insurance contracts.	Legislation to allow EEA companies to service policies held by U.K. households	Some member states introduced run-off regimes. EIOPA guidance issued to facilitate servicing of existing contracts
Uncleared Derivatives	Inability to perform certain lifecycle events.	Legislation to ensure EEA banks can perform life-cycle events on contracts with U.K. firms. U.K. firms repapered clients. ISDA advice.	Temporary exemptions to facilitate novation contracts with EEA counterparties without triggering clearing and bilateral margin obligations.
CCPs	U.K. CCPs unable to provide clearing services to EEA clearing members and vice-versa.	Temporary recognition regime allows EEA CCPs to provide services to U.K. clearing members, while they apply for permanent recognition.	Equivalence and recognition for U.K. CCPs until June 2022. The EU recently provided public reassurance that it will extend the CCPs' temporary equivalence (details still unknown). ESMA has refrained from recommending the derecognition of U.K. CCPs and advised measures to mitigate financial stability risks.

⁴ Note that the EEA Agreement extends the EU single market for financial services to EEA countries (Iceland, Liechtenstein, and Norway). However, as EU institutions are the relevant authorities shaping together with the United Kingdom, the development of cross-border financial services between the United Kingdom and the EU/EEA, this FSSA refers to the EU.

Table 5. United Kingdom: High-Priority Exit Risks and Other Selected Exit Risks (concluded)

	Risk Description	United Kingdom Actions	EU Actions
Asset Management	Inability to market/operate cross-border and to delegate portfolio management to the United Kingdom (vice-versa).	A temporary permission regime for the marketing of EEA UCITS and Alternative Investment Funds (AIFs), and cooperation agreements between the FCA, ESMA , and EEA National Competent Authorities enable portfolio management delegation and access to the U.K. National Private Placement Regime.	Cooperation agreement between National Competent Authorities and FCA. Some member states adopted temporary regimes for the marketing of U.K. UCITS and AIFs. U.K. AIFs may access National Private Placement Regimes. Recent Commission proposal to continues to allowing delegation portfolio management under somewhat stricter reporting rules.
Personal Data	Transfer of personal data disrupted.	Legislation to allow United Kingdom to EEA transfers and firms put contractual clauses in place to allow transfers from the EU to United Kingdom. U.K. FCA signed IOSCO-ESMA Administrative Arrangement.	Following the TCA's "bridging mechanism," the Commission adopted adequacy decisions for United Kingdom privacy legislation until 2025.
Central Securities Depositories (CSDs)	CSD cross-border services may have been disrupted.	Transitional regime allows Temporary Recognition Regime to allow CSDs outside the U.K. to continue providing services in the United Kingdom.	U.K. CSD completed its migration of Irish securities to Euroclear Bank in March 2021, after a temporary equivalence decision.

Sources: HMT, BOE, and IMF staff.

7. At the time of the FSAP the impact of the exit from the EU on the U.K. financial system is not creating financial instability, but the risk of market fragmentation, and uncertainty remain. In anticipation of the loss of EU passports, some U.K. firms set up EU establishments or restructured existing ones to access EU clients. Relocation of assets and jobs is below initial estimates. Some market fragmentation has already occurred. For instance, following EU and U.K. rules requiring trading of certain shares and derivatives on domestic venues or equivalent third-country venues, EU share trading in the United Kingdom largely migrated to the EU, and some OTC derivatives trading (notably EUR interest rate swaps) shifted to EU and U.S. venues). Temporary U.K. relief mitigated the impact of fragmentation on U.K. firms. The industry sees Brexit's current impact as leading to increased costs (e.g., reallocation of internal capital and cost of new authorizations). It expects further optimization of their EU footprints informed *inter alia* by future U.K. and EU regulatory developments and supervisory expectations.

8. The United Kingdom's structured regulatory cooperation with the EU is of mutual and global interest, and the institutional framework continues to evolve. Each party maintains its regulatory autonomy, including equivalence decisions to grant unilateral cross-border market access and mitigate regulatory overlaps and duplications. The United Kingdom issued a package of equivalence decisions for the EU. A Memorandum of Understanding (MOU) providing a cooperation framework was agreed at the technical level but is not signed yet.

9. The long-term ability of U.K. CCPs to operate in the EU remains an open issue. Currently three U.K. CCPs, two of which are globally systemic, serve EU clearing members based on a Commission equivalence decision and ESMA recognition decisions expiring on June 30, 2022. The Commission recently signaled that it would avoid cliff-edge risks by March 2022 through an extension of its equivalence decision; also, a recent ESMA review of the “substantial systemic importance” of two U.K. CCPs refrained from a recommendation to derecognize while adopting mitigating measures for risks relating to these CCPs serving EU market participants. Yet, while the EC intends a 3-year extension to June 2025, there is no clarity yet on the details of the extension of equivalence and mitigation measures. However, the status of U.K. CCPs in the long run remains uncertain, mainly in relation to some EUR products. In any event, no financial stability risks appear evident over the short term, and the United Kingdom is expected to remain a primary clearing center for derivatives given that non-EU clearing members—accounting for over 70 percent of activity—will stay in the United Kingdom at least until 2025. ~~the U.K. authorities see no financial stability risks and expect the United Kingdom to remain a primary clearing center for derivatives given that non-EU clearing members—accounting for over 70 percent of activity—are likely to stay in the United Kingdom.~~ That said, a broader concern is that increased costs to clear derivatives in case of market fragmentation—due to loss of multi-currency netting benefits, higher margin requirements, and concentrations in fragmented local markets—may create pressures globally to relax the clearing mandate, a key post-GFC reform that is important for financial stability.

10. Cooperation on the prudential supervision and resolution of banks works well. While U.K.-EU cooperation on supervision and resolution matters is no longer a *mutual* obligation legally, the U.K. authorities’ cross-border cooperation mandate with the EU remains strong, supported by obligations in U.K. primary legislation, and parties have agreed an extensive network of cooperation arrangements. However, the effectiveness of crisis management arrangements will be tested in times of stress.

B. Macrofinancial Linkages

11. Despite having endured the crisis well, economic agents continue to face interlinked risks ranging from the effects of a prolonged pandemic to rising global inflation and post-Brexit uncertainties. Thus, to assess the resilience of the U.K. financial system, the FSAP considered a baseline scenario aligned to the October 2021 WEO, and two adverse (tail) scenarios covering a five-year span (2021–25) upon which stress tests were built for corporates, households, banks, and insurers (Appendices I, II and Figure 4). The results from the corporates and household stress-tests fed into those for banks and insurers to account for second-round effects.

- The first adverse scenario entails a **recession with lasting economic scars** from a protracted pandemic.
- The second scenario considers a surge in global inflation and consequent tightening of global financial conditions.

12. Recent developments suggest that both macrofinancial risk scenarios considered in the FSAP remain very present. Omicron is impacting global growth and derailing some aspects of the budding recovery. Global trade could be further undermined as the pandemic continues to dislocate international supply chains. Supply-demand mismatches combined with a rise in energy and commodity prices could generate further inflationary pressures and lead to a tightening of global financial

17. After having consolidated its approach to “bottom-up” stress testing, the BOE could invest in strengthening its “top-down” stress testing capacity. The BOE has been running its program of annual cyclical scenarios (ACS) and biennial exploratory scenarios (BES) since 2016. The framework is well-consolidated, and it has produced interesting results through the years. The exercises are run in bottom-up modality, with the BOE employing some internal tools to validate the banks’ own results. Its internal toolkit is wide, but it does not cover the whole spectrum of portfolios and P&L components that would be needed to run a full-fledged top-down stress test. The BOE could invest in completing and consolidating its in-home analytics to be able to independently run stress tests at a higher frequency, when needed, and progressively cover all systemically relevant components and their mutual interactions

18. The results of LCR-based stress tests show that the U.K. banking system is overall liquid and resilient to sizable withdrawals of funding and haircuts to liquid assets. Liquidity Coverage Ratios (LCRs) are currently well above the regulatory minimum of 100 percent for all banks surveyed. The FSAP team conducted a stressed LCR simulation, based on the combination of “haircut” and “outflows” scenarios. It showed that banks generally maintain high “total currencies” liquidity ratios under all scenarios. The analysis by single currency revealed potential FX liquidity shortfalls but would require more granular information to quantify them accurately. The addition of further details to the PRA own reporting scheme on liquidity (PRA 110) would help provide a better sense of the potential liquidity gaps in foreign currency.

D. Insurance Sector Solvency and Liquidity

19. During the pandemic, insurers' balance sheets proved stable, with solvency ratios declining only temporarily when markets became more volatile in February/March 2020 (Figure 12). Earnings of life insurers declined due to lower sales amid lockdown restrictions. General insurers were moderately affected, mainly through business interruption claims.

20. A top-down stress test of 146 larger U.K. insurers showed vulnerabilities from lower interest rates and equity price declines, particularly for life insurers. The analysis applied two severe scenarios to insurers’ balance sheets at end-2020, covering about 70 percent of the market. The instantaneous top-down modeling does not recognize hedging instruments and management actions—companies would normally have different options to de-risk their balance sheet and improve solvency positions.

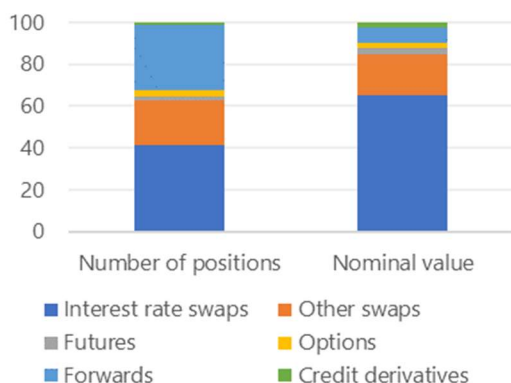
21. In the “scarring” scenario, which involves a downward interest rate shift, life insurers are considerably more affected than general insurers (Figure 12). Solvency ratios of two firms would drop below the 100 percent threshold with an aggregated capital shortfall of almost £9 billion, highlighting the need for recovery plans. Among general insurers, the balance sheet impact is much smaller. The increase in corporate bond spreads contributes most to the reduction in available capital.

Figure 14. United Kingdom: Insurance Liquidity Risk Analysis

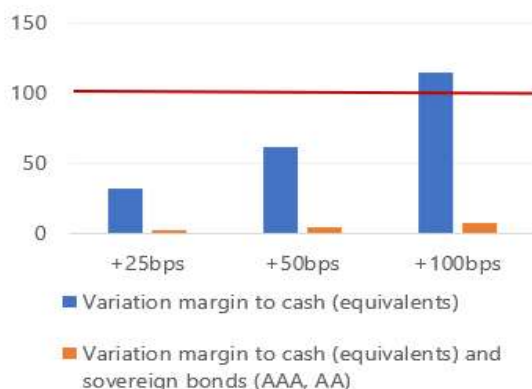
Derivative exposures of life insurers comprise mainly interest rate swaps.

Variation margins caused by a 100-basis-point interest rate increase would exceed cash buffers, but highly rated sovereigns' bonds serve as an additional liquidity buffer.

Derivative Holdings of Life Insurers
(breakdown in percent)



Interest Rate Swaps: Variation Margins
(in percent of liquid assets)



Sources: IMF staff calculations based on PRA supervisory reporting data.

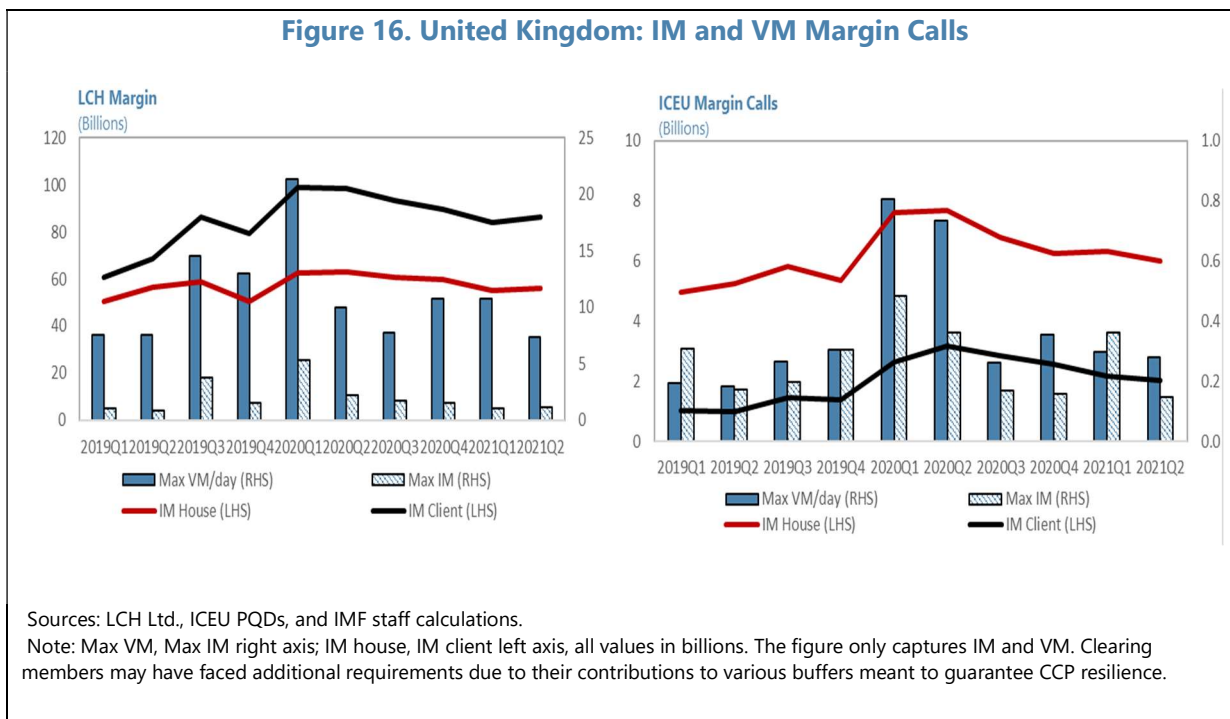
F. Central Counterparties

27. U.K.-based CCPs are among the largest in the world. LCH Ltd., ICE Clear Europe Ltd., and LME Clear Ltd. are CCPs domiciled in London with clearing members in 23 jurisdictions. The aggregate initial margin (IM) they collect is close to [around 3330](#) percent of total IM collected by CCPs worldwide. U.K. regulators have significant experience supervising them and participate actively in international regulatory bodies.

28. U.K.-based CCPs proved resilient during March 2020, but spikes in margins exposed differing abilities by clearing members and clients to cope with higher liquidity needs. Increased volatility saw the IM and variation margin (VM) surge, resulting in margin calls for which clearing members' and clients' preparedness was mixed (Figure 16). Nevertheless, the ability to deal with higher margin calls varied among clearing members and clients.

29. The BOE's proposed supervisory CCP stress testing framework could be augmented. This could be done by increasing transparency under stress conditions, and reporting stressed margin demands on clearing members and especially clients. Lack of information on potential liquidity needs could be at the heart of members' and clients' different abilities to plan. CCPs provide limited information regarding potential IM increases in advance of a stress, particularly towards clients. Increasing transparency on liquidity demands, for example by providing estimates of increases in IM under stressed conditions, would help balance the need for resilience of CCPs and the potential effects on clearing members, clients, and markets.

Figure 16. United Kingdom: IM and VM Margin Calls



G. Asset Managers

30. The U.K. asset management industry is the second largest in the world. Its assets under management of £11 trillion consist of savings, pensions, and investments of millions of clients across the world. The industry supports 114,000 people, including 42,200 directly employed, and contributes about 1 percent to the United Kingdom’s GDP. The U.K. government announced a review in early 2021 to make the United Kingdom more attractive to set up, manage, and administer funds.¹⁰ The United Kingdom is also leading the transition to green the financial system as part of its net-zero commitment.

31. The global nature and complex structures complicate monitoring by the U.K. supervisors alone. Many funds used by U.K. investors and/or investing in U.K. assets are domiciled outside the United Kingdom. U.K. regulators rely partly on fund surveys and on commercial databases for simulations to assess the market impact of the actions of non-U.K. domiciled funds that may be relevant to U.K. markets. In relation to U.K. domiciled funds, the U.K. authorities can and do collect information through both regular regulatory reporting requirements and ad hoc data requests. The U.K. authorities have several MOUs on cooperation in place and are exploring data sharing agreements with regulators in funds’ domiciles. A complete assessment of market liquidity will require collecting more information on Sterling holdings. An international consensus on regulation and U.K.’s engaging in data sharing agreements with regulators of funds operating in the United Kingdom will need to continue to better monitor and address liquidity vulnerabilities.

¹⁰ <https://www.gov.uk/government/publications/review-of-the-uk-funds-regime-a-call-for-input>.

32. Assessing liquidity risks posed by asset managers ought to be based on fund specific risks—redemptions, increased margins, funding risks, and de-levering:

- Money Market Funds (MMFs)—especially non-government MMFs—faced large withdrawals in March 2020. Decoupling regulatory thresholds from fees and gates during stress periods while permitting them at critically low liquidity buffer levels would help MMFs to use cash buffers instead of liquidating assets. Access to BOE liquidity support could also help encourage MMFs to use buffers.
- Available data for [sterling](#) MMFs and open-ended funds (OEFs) used to calculate liquidation demands under the March 2020-size shock indicate that risks are limited (Figure 17 and 18, Tables 6 and 7). Using the data in AIF Managers Directive (AIFMD), Figure 19 shows that aggregate expected losses for AIFs, expressed as a percentage of assets under management, in a March 2020-sized shock are limited. Nevertheless, large variations may exist for individual funds. Hedge funds are leveraged, although the overall exposure is small. OEFs may have significant liquidity mismatch. Liquidity demands would be best assessed under a scenario of simultaneously increasing redemptions, declining leverage, and rising IMs and funding costs, e.g., using historical information or by considering specific stress scenarios.

33. The authorities should continue to push for a more consistent use of liquidity management tools, calibrated to the liquidity of underlying assets. In response to the findings of inconsistent application of swing pricing—which could exacerbate systemic risks—[during March 2020; in July 2021](#), the BOE and FCA proposed a framework that includes enhanced swing pricing, which would aim to reduce the potential financial stability risks associated with first-mover advantage. The new framework would also introduce a more consistent liquidity classification of funds' assets. The FPC should ensure for the open-ended fund sector that both sensible swing pricing and redemption notice periods are calibrated to the liquidity of underlying assets. This is in line with its 2019 principles on liquidity mismatch.

H. Systemic Liquidity and Core Markets

34. The pandemic shock roiled core U.K. markets, and the BOE, with other central banks, effectively responded to restore liquidity. Gilt market liquidity was pressured, reflecting a significant imbalance of supply and demand for Gilts that market makers could not effectively balance, while the FX and cross-currency swaps markets reflected a global desire for U.S. dollars. While global drivers such as deleveraging among NBFIs and liquidity demands from official sectors investors pressured U.K. markets, a particularly important issue in the United Kingdom was liquidity mismatches among liability driven NBFIs who were poorly prepared for the shock. The BOE (with peer central banks) quickly augmented its regular repo operations and front-loaded bond purchases to support market liquidity (Figure 20). Non-financial firms' liquidity was backstopped via the Covid Corporate Financing Facility (CCFF) and Term Funding Scheme with SME incentives (TFSME; Figure 20).

35. The BOE’s toolkit would be reinforced by including some key classes of appropriately regulated NBFIs. While ultimately effective, the BOE’s toolkit was not ideally positioned to meet NBFi liquidity needs as most cannot directly access BOE liquidity. The BOE’s main option is to use asset purchases to provide liquidity to the entire market, which, while effective, results in a significant long-term expansion of the BOE’s balance sheet, even if liquidity stresses are transitory and concentrated. Incorporating NBFIs into the BOE’s operational framework would improve the BOE’s options in future stress situations if the first best approach of mitigating the impact of NBFi stress on markets—beefing up regulation and supervision—falls short. Allowing appropriately regulated and systemically interconnected NBFIs—which could include firms such as MMFs, insurance companies, asset managers, and pension funds—access to at least some of the BOE’s facilities would widen the range of options available to counteract future market-wide stresses. Not all NBFIs would be eligible for access to BOE liquidity as the focus should be on those that are large and have the most significant holdings of sterling securities in core markets and the greatest degree of interconnectedness with the wider financial system. Support should be focused on instruments traded in the United Kingdom’s most interconnected markets (Gilts and Gilt repos especially). Strengthening the BOE’s liquidity support toolkit could be valuable if the BOE’s move to tighten policy (via interest rate increases and Quantitative Tightening) increases risks of bumps in the level and distribution of liquidity around the financial system. Any backstop will need to balance the risks posed to the BOE’s balance sheet against limitations on the scope of the facility.

36. The design of facilities accessible to NBFIs should reflect their diverse nature and adequately address moral hazard risks. Both asset purchase operations and lending facilities are needed as some NBFIs are unable to use repo facilities.¹¹ Backstops should only be provided to NBFIs that are adequately supervised and subject to more prescriptive liquidity requirements to manage risks that BOE backstops give rise to increased NBFi liquidity mismatches. This will involve close coordination with the PRA and FCA as NBFi supervision is shared among agencies. Backstops should be priced to encourage a stronger link between ex-post support and ex-ante risk taking, encourage users to use market funding but not discourage use in stressed conditions to avoid asset fire sales. Clearly defined exit criteria should be developed and communicated ex ante to better align market expectations of support with the BOE’s short-term backstop role. Since foreign NBFIs play an important role in core Sterling markets, they could be factored into the BOE’s operational framework, supported either by arrangements with foreign supervisors or through direct information sharing requirements to ensure that any foreign counterparts provided access to BOE liquidity meet standards equivalent to U.K. based counterparties.

¹¹ Other central banks have used both lending facilities (for example, the Primary Dealer Credit Facility in the United States) and asset purchase facilities (the U.S. Secondary Market Corporate Credit facility) to good effect.

I. Real Estate Markets

37. The continued surge in house prices warrants closer monitoring (Figure 21). House prices have posted the strongest gains since November 2004 and the house price-to-earnings ratio, at 5.6, surpassed historical highs from 2007. The house price increase is more pronounced outside London. The share of new mortgage lending at high-LTI ratios also continues to rise. Booming transactions reflect support measures (Stamp Duty Land Tax (SDLT), Mortgage Guarantee Scheme (MGS)) and other factors—larger household savings, demand for additional space, lower construction activity, and advantageous financing conditions. Nonetheless, the share of new mortgages issued at high-LTV ratios remains low relative to the pre-pandemic period. In December 2021, the FPC judged that the LTI flow limit—which restricts the number of mortgages that lenders can extend at LTI ratios of 4.5 or higher to 15 percent of their new mortgage lending—plays a strong role in guarding against unsustainable household indebtedness through the housing market cycle. In the first half of 2022, the FPC will therefore consult on withdrawing its affordability test, noting that the FCA’s [Mortgage Conduct of Business Framework affordability testing framework](#) still plays an important role.¹² This would not constitute a significant change in the macroprudential stance through the housing cycle, as the FCA’s [Mortgage Conduct of Business Framework affordability framework](#) still requires that [in many cases](#) mortgage providers stress interest rates over a minimum five-year horizon. Any removal of the FPC’s affordability test, at this juncture, will require careful consideration, as housing prices have been rising markedly and inflation risks loom.

38. The Commercial Real Estate (CRE) market continues to cool down. The CRE market slowed sharply following Brexit. The BOE recognized a potential fall in CRE prices as a domestic financial stability vulnerability in December 2019. The slowdown in the CRE market has accelerated during the pandemic. The BOE considered the risk of a potential third decline in CRE prices in its 2021 stress test. The FPC concluded that the banking sector is resilient to the overall stress scenario, including the sharp decline in CRE prices. Against this background, the FSAP sees the potential systemic impact of CRE risks as contained.

J. Climate-Related Vulnerabilities

39. Climate-related balance sheet risks for financial institutions were assessed through a separate scenario-based analysis for transition risk, and sensitivity analyses for physical risks. This covered the eight largest banks, eight largest life insurers, seven large general insurers, and a sample of investment and pensions funds.

- **Transition risk.** The transition risk of financial institutions is measured as the potential materialization of credit and market losses in a “climate Minsky moment,” through the impact on their exposures to corporate counterparts (Figure 23). The source of shock is a policy change, i.e., a switch in the economic agents’ expectation from a low and relatively flat carbon price path to a high and steep one, in the United Kingdom and globally.

¹² The analysis substantiating this decision by the FPC was based on the FCA maintaining its affordability stress testing rules, which call for a stress on interest rates based on expected interest rate paths for the next five years or 100bps, whichever is higher.

46. The FPC runs interagency processes to monitor financial stability conditions on a regular basis. The FPC's annual interagency Risks Beyond Banking (RBB) exercise assesses risks of roughly 40 nonbank activities. Since the last FSAP, the FPC has conducted several thematic deep-dives and continues to conduct its [regularannual](#) in-depth reviews of its rules for the housing market, including on the rules' calibration. The FPC also reviews the appropriateness of the regulatory perimeter in its RBB exercise.¹³ However, consideration of insurance matters, cross-border NBFIs, interconnectedness and contagion occur relatively less frequently at the FPC. The next natural step is to expand the scope of systemic risk surveillance by the FPC on a continuing basis.

47. FPC's primary objective in setting the Countercyclical Capital Buffer (CCyB) is to ensure that the U.K. banking system can withstand stress without restricting essential services. The FPC record from November 2015 states that the CCyB should be 1 percent after a period of recovery, but before risks are elevated. The judgment to set the CCyB's neutral or standard risk rate in the region of 1 percent was based in part on an analysis in Brook et al. (2015)¹⁴ and later confirmed by the conclusion of the 2016 stress test. The FPC announced an increase in the CCyB to 0.5 percent in March 2016, in line with this policy. Three months later, before the increase had taken effect, it lowered the CCyB to 0 percent to prevent risks from materializing following the U.K. referendum to leave the EU.

48. The FPC announced in December 2019 that the new neutral, standard risk rate of the CCyB would be two percent, to take effect 12 months hence. The main objective of the increase in the standard risk environment CCyB was to improve the responsiveness of capital requirements to economic conditions, so that banks would be better able to absorb losses and maintain lending through the cycle. The FPC also expected to lower the economic cost of the buffer build-up by moving early before risks were elevated. It expected banks' overall loss-absorbing capacity to stay broadly unchanged, as the PRA reduced Pillar II capital requirements accordingly.¹⁵ However, the combination of a higher CCyB and lower Pillar II requirement raised the overall quality of capital by replacing Pillar II capital with the Tier 1 capital that the CCyB requires. Once the pandemic hit, however, the FPC lowered the CCyB to 0 percent. In December 2021, the FPC raised the CCyB to 1 percent, effective December 2022, as it judged that domestic risks to U.K. financial stability had returned to around their pre-COVID levels. This is in line with the FPC policy of raising the CCyB in measured steps to the 2 percent standard risk environment levels.

¹³ To date, it has not found it necessary to recommend expansions to the 'regulatory' perimeter, although it said in the December 2019 FSR that it was considering its first recommendation, to regulate new payment services. Parliament and HMT ultimately determine which activities and entities are subject to regulation.

¹⁴ Financial Policy Committee. "The Financial Policy Committee's approach to setting the countercyclical capital buffer." London: Bank of England (2016).

¹⁵ BOE/PRA Policy Statement PS15/20, [Pillar 2A: Reconciling capital requirements and macroprudential buffers](#), Bank of England, July 2020.

B. Microprudential Framework

52. The United Kingdom operates a sound and transparent regulatory and supervisory framework for banks and insurers. The PRA uses an array of tools and techniques to implement its risk-based approach. It has taken steps to address key concerns raised during the 2016 FSAP and ~~plans to~~ increased the intensity of supervision on non-systemic smaller banks. The regulatory framework for insurance supervision is sophisticated and the United Kingdom are leaders in supervisory techniques. Regulators have also implemented reforms to enhance firms' operational resilience. The joint ~~2016~~ PRA-FCA Senior Manager and Certification Regime (SMCR) ~~rolled out from 2016~~ designed to increase individual accountability of ~~impose personal accountability on~~ senior managers is producing positive results, but the PRA has not yet used the full range of powers provided for by the framework.

53. However, a stronger 'on-the-ground' focus on individual banks, insurers and other systemically important financial firms and their activities is highly desirable—a point also made in earlier FSAPs. The current supervisory approach is a blend of a cross-firm supervision and firm-level oversight. The PRA has significant engagement with the largest and most significant firms, meeting senior management and key function holders very regularly. The PRA should use the full range of existing tools on a more frequent basis while conducting in-depth investigations and providing timely and substantive feedback to firms. This would provide better assurance that risks arising from the most complex activities and those that could materialize later in the context of COVID-19 are adequately measured and mitigated by firms. The potential that firms' risk management becomes hubristic should not be underestimated in the current environment. In banking supervision, the Section 166 Skilled Persons Review authority should also be used in a more proactive supplemental manner while the PRA increasingly develops more competencies internally. Indeed, the S-166 Review should not be a long-term solution to inadequate resourcing within the professional staff involved in banking and insurance supervision.

54. Cloud outsourcing heightens the need for more direct supervisory attention and understanding of the underlying structures and practices. The PRA and FCA lack express statutory authority to directly review and examine any critical services from cloud and other third-party providers to regulated entities. Firms' increasing use of the cloud to perform core services raises operational (and potentially systemic) risks given the relatively small number of providers involved. The authorities should seek legislation granting direct supervisory access to third-party providers.

55. The PRA and FCA are proactively addressing the financial risks associated with climate change into their regulatory programs. The PRA set a deadline of end-2021 for firms to have fully embedded supervisory expectations for the management of climate-related financial risks. In June 2021, it launched a Climate Biennial Exploratory Scenario exercise to explore the resilience of major U.K. banks, insurers, and the financial system to these risks. The Climate Change Adaptation Reports published by the U.K. financial regulators conclude that financial institutions have made tangible progress against supervisory expectations on climate. However, more remains to be done, especially with respect to firms' risk management and scenario analysis capabilities. Banks' climate disclosures

remain incomplete despite tangible progress, but further initiatives have been launched.¹⁸ As they advance their proposals, it will be very important for the U.K. authorities to specify regulatory standards and guidance with sufficiently detailed requirements and expectations, building on existing work and in accordance with international standards that are currently being developed.

Banking-Specific Issues

56. International banking activities are a major regulatory and supervisory responsibility of the United Kingdom. International banks, including G-SIBs undertaking corporate and investment banking (CIB) activities, can operate in the United Kingdom as either subsidiaries or branches. The United Kingdom's entity-neutral approach is largely unique among jurisdictions hosting large financial centers. This has implications for supervision as it presents certain limitations and may raise practical challenges in the case of branches. The U.K. authorities have recognized their global responsibility to maintain top-notch prudential standards and that openness must be accompanied by financial and operational resilience. It will be important, however, for the PRA to further enhance cooperation with [relevant](#) third-country home authorities to maximize information sharing and supervisory collaboration and review regularly whether the approach to supervising international banking firms delivers the expected supervisory outcome and preserves financial stability.

57. The post-Brexit challenge will include streamlining the prudential framework while continuing to meet internationally agreed standards. The process of preserving the EU legislation has been completed, but at the end of the Brexit transition period, the United Kingdom is left with a relatively complex regulatory structure that integrates core aspects of the EU regulatory framework into a multilayered mix of primary legislation, on shored regulations and other statutory instruments, as well as technical standards, and PRA and FCA rules and guidance. The post-Brexit challenge will include streamlining the prudential framework and introducing appropriate levels of proportionality without weakening internationally agreed requirements and creating opportunities for regulatory arbitrage. The PRA intends to introduce proportionality measures into the prudential framework for banks that are neither systemically important nor internationally active. The diversity of deposit-taking institutions that comprise the U.K. banking sector is conducive to a proportional approach to regulation, but non-internationally active banks must remain subjected to rigorous prudential standards, broadly consistent with the Basel framework.

¹⁸ Building on previous initiatives, the U.K. government published in October 2021 its Roadmap to Sustainable Investing, setting out details on new Sustainability Disclosure Requirements (SDR) and on the U.K. Green Taxonomy. An indicative path towards "integrated economy-wide disclosure" under the SDR framework has been proposed.

Insurance Issues

58. The United Kingdom has a highly developed framework for insurance supervision, implemented by highly sophisticated regulators. This is borne out in a very good assessment outcome of the FSAP 'Detailed Assessment of the IAIS Insurance Core Principles (ICPs)'; where 17 ICPs were found to be observed, six largely observed, and only one partly observed. The Solvency II framework inherited from the United Kingdom's former membership of the EU is a rigorous prudential framework, and the conduct requirements are similarly robust and both regulators are advanced practitioners of supervision. Post-Brexit, the United Kingdom should take care not to reduce these high standards while tailoring the adopted European requirements to the domestic and international aspects of its insurance market.

59. The Society of Lloyds and the broader London Market for specialist insurance is important for the United Kingdom, and for many insurance markets in advanced economies and emerging markets. While the Society plays a useful economic and market role, the PRA should consider setting up a platform for supervisory cooperation for Lloyds to allow interactions with supervisors where Lloyds operates both regulated operations and operates in markets without physical operations. This will allow for better understanding of the role played by Lloyds in insurance markets around the world and can build on existing systemic risk analysis performed in relation to Lloyds. It would also foster understanding among other cross border supervisors of the supervisory activity performed by the PRA with respect to Lloyds.

60. The institutional framework is strong and the independence of the PRA and FCA should continue to be preserved. The risks can clearly be seen in the Solvency II review with HMT running the consultation process with the PRA in a central but essentially supportive role. One way forward to address this issue would be to ensure that requests for advice from the PRA are made transparently by HMT and that the PRA can provide that advice in an independent and transparent way. Any variation in final policy compared to PRA advice would then be clear.

61. The mission encourages HMT and the BOE/PRA to proceed with the development of a resolution regime for insurers, as such regime does not yet exist in the United Kingdom. Practically, insurers can be resolved through market transfers of portfolios of insurance liabilities, sale of companies, or winding-up of companies. There is a vibrant market for portfolios of insurance liabilities in the United Kingdom with some significant companies specializing in the market. The risk of a failure of a large insurer not being easily resolvable through market mechanisms or run-off is currently not addressed, although work to address this issue is in train. Currently, the United Kingdom is assessed as partly observed for ICP 12 (exit from the market).

66. The acceleration of technological changes suggests a need to review policy coordination and develop more innovative and effective ways for the oversight of the digital finance markets. The ongoing structural transformation could increase competition in both domestic and cross border financial services and compound the existing sources of financial stability risks. Combined with a rapid entry of BigTech into financial services, the sector could face a considerable transformation. Building on the innovative Digital Regulation Cooperation Forum launched in 2020, formal mechanisms could be considered to ensure that the views from regulators are taken into consideration in deliberations on competition policy interventions as the needs for coordination across public policy interests in competition and stability continue to grow.

67. The United Kingdom has a proactive approach towards developing a policy framework and tracking risks posed by crypto asset innovation. The United Kingdom has issued regulations for crypto assets to ensure consumer protection, and regulations for stable coins are being developed following international guidance. As host of the most prominent global financial center, the authorities' commitment to innovation and robust regulatory standards will require a continued and special focus in containing emerging and possibly systemic financial stability risks arising from crypto's high-paced growth and increasing links to the financial system. Innovation will continue to challenge the status quo. While a steady state is presently hard to envision, policy and regulatory frameworks will need to remain nimble, and resources allocated appropriately and timely, allowing the oversight agencies to react quickly and prevent any rapid buildup of risks to financial stability.

C. Cybersecurity Threats

68. Safeguards against growing cyber threats are a top concern for U.K. authorities. Growing reliance on critical third parties to provide vital services is increasing risks, especially in the absence of greater direct regulatory oversight. In June 2017, the FPC set out a strategy to withstand and recover from cyber incidents. The authorities oversee cyber resilience by regulating and supervising the sector (macroprudential) and single firms (microprudential). The CBEST program, aimed at assessing the effectiveness of cyber defenses with simulated attacks, is the cornerstone of the testing strategy. The regulatory framework builds on good international practices and cross-sectoral cybersecurity standards.

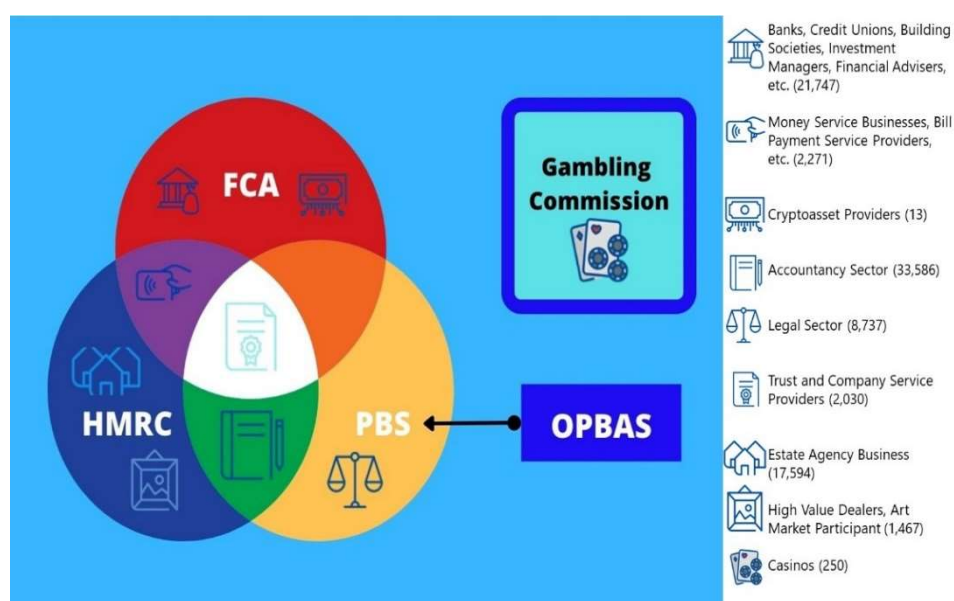
69. The cyber risk management framework must continue to be built to contain three financial stability concerns: (i) complexity of operational risks; (ii) unregulated third-party services; and (iii) span of entities covered. The United Kingdom must complement existing supervisory practices with onsite activities to verify the operational effectiveness of cybersecurity controls and to capture cyber incident underreporting. Statutory powers will allow a direct assessment of the resilience of any critical services provided by certain systemically important third parties (including cloud outsourcing). The FPC along with FCA and BOE/PRA/FPC should consider specific resilience standards for these providers and their inclusion in resilience testing.

D. Combating Financial Crimes and Safeguarding Financial Integrity

70. The United Kingdom continues to combat financial crimes across a wide range of activities (Figure 26). Its AML/CFT regime is one of the most effective worldwide (Figure 27). The FCA is strengthening proactive and reactive supervisory activities using modular/thematic approaches and data analysis. The People with Significant Control (PSC) Register allows public access to beneficial ownership information of legal entities and requires entities with AML/CFT obligations to report discrepancies. The authorities can share financial intelligence with foreign peers, and the Global Anti-Corruption Sanctions Regulations require-allow the freezing of U.K. assets of designated persons involved in foreign corruption.

71. Several additional measures could boost the authorities' AML/CFT objectives.²⁰ To enhance the FCA's risk-based supervision, technology tools (e.g., machine learning) should be leveraged. Properly supervised "skilled persons" could supplement FCA's AML/CFT oversight functions for low-risk entities. Having OPBAS conduct direct AML/CFT supervision for low-capacity or high-risk PBS can maximize efficiencies and harmonize approaches. The proposed legislation to improve verification of information in the PSC register and for a beneficial ownership register for foreign entities owning U.K. properties should also advance, in addition to augmenting support to CDs and BOTs for adopting effective beneficial ownership registers. Unexplained wealth orders should continue to be utilized to confiscate illicit assets and generate financial intelligence for cross-border investigations.

Figure 26. United Kingdom: Supervisory Population of Entities with AML/CFT Obligations
(as of end-December 2020)



Source: U.K. authorities and IMF staff calculations.

²⁰ 2019–22 Economic Crime Plan.

74. The special resolution regime (SRR) for banks appears robust but assigns HMT a critical role in firm-specific resolution decisions. The SRR includes modified insolvency regimes for banks, building societies, and investment firms. The BOE plays a crucial role in the court-based insolvency proceedings. Under certain conditions, HMT can also play a critical role in elements of firm-specific decisions although this remains untested, including in cross-border cases. Moreover, certain parts of the United Kingdom resolution regime that were introduced or maintained to comply with EU rules may constrain resolution funding. The authorities should eliminate these constraints from their rulebook, and review and explain to moderate HMT's involvement in firm-specific resolution decisions to focus on cases where public funds are at risk.

75. The authorities are considering enhancing the resolution regimes for CCPs and insurers. With modifications for CCP characteristics, the SRR applies to the three recognized U.K. CCPs, aiming to achieve the same objectives as the banks' SRR, under similar conditions and with similar powers. However, this regime predates pertinent international guidance issued since 2012; nor was the EU CCP RRP regime on shored prior to Brexit given it had not been yet implemented in the EU at that stage. HMT is considering statutory changes for an expanded CCP resolution regime with more powers for BOE. HMT, alongside the BOE, is also considering an SRR for insurers, and the PRA, together with the BOE, is developing an RRP approach for insurers. These legislative and policy efforts should be accelerated and complemented with a RAF-like regime.

B. Internationally Active Mixed Financial Groups

76. Internationally active financial groups are actively seeking arbitrage advantage through several demand-side and technology-based shifts. These entities seek to divert risk to areas where data, reporting, and oversight seem looser and avoid stronger regulation through regulatory arbitrage across jurisdictions. These entities (hybrid structures, finance companies, family offices, and other non-traditional forms) are also often CIB banks' counterparties (some of them are supervised in the United Kingdom).²¹

77. Recent cases that have garnered public attention involved excessive leverage in unregulated or lightly regulated entities, as well as limited disclosure requirements. While different, these cases illustrate the challenges of identifying vulnerabilities in dynamic cross-border NBFIs activities. While the global supervisors later described the incidents as 'nonsystemic', the events point to neglected risks in cross-border activities that could have become systemic under different circumstances. The incidents have revealed that several banks and CIB branches did not have appropriate governance and risk management arrangements and were unable to monitor and mitigate risks arising from these activities. Moreover, supervisors did not systematically monitor these types of positions on a real-time basis and were not aware of the common exposures across banks globally. ElementsGaps in domestic regulatory regimes, such as the U.K.'s approach to

²¹ As part of its international finance activities, private capital markets are also becoming a major force out of the United Kingdom for corporate and SME financing. This is routed mainly through "alternative asset managers", who offer private equity, venture capital and private credit funding options. Data on this practice is scant, and this trend needs to be fully explored with international cooperation.

“appointed representatives,” also helped keep the risks off supervisors’ radar.²² Furthermore, these entities are not subject to detailed [regulatory mandatory](#) public disclosure requirements. Such or similar businesses, enhanced by ongoing technology transformation could amplify channels for arbitrage and bypassing of financial stability oversight.

78. The United Kingdom and peer foreign authorities should address data gaps and improve cross-border supervisory cooperation. The United Kingdom is already considering measures to address the data gaps, but any such effective reform will require international cooperation given the cross-border nature of these activities. The BOE could also expand its biannual survey of prime brokers to include in a more granular manner cross-border, cross-market, and cross-product exposures. The United Kingdom should consider whether its oversight over internationally active NBFIs operating in the United Kingdom should be expanded to include additional monitoring criteria. That would include the need to take a closer look at the unregulated entities of mixed cross-border groups to evaluate their impact on the regulated entities and any potential systemic implications. It also should review whether the existing supervisory cooperation arrangements provide sufficient information-sharing for effective monitoring of systemic risks. The authorities should also consider fundamental changes in the appointed representative regime.

C. Agency Independence and Resources

79. The U.K. financial regulators have separate mandates, with a clear focus on financial stability, safety and soundness, and market integrity. They also have, [respectively](#), secondary objectives to facilitate effective competition and to support the economic policy of the government. Unlike the former Financial Services Authority, the PRA and the FCA do not have an express competitiveness mandate. However, this approach is being questioned increasingly. “Competitiveness” has been listed in Remit Letters issued by the Chancellor since 2015 as an aspect of government economic policy to which the FPC and PRA should have regard. The Financial Services Act of 2021 introduced additional considerations that the PRA must have regard to when making rules implementing Basel III standards, including the international competitiveness of the U.K. financial sector.

80. Moreover, HMT’s Financial Services Future Regulatory Review (FRF review) has sought comments on redesigning the regulatory framework for financial services regulators.²³ Under the proposal, regulators would be empowered to set out the regulatory and supervisory requirements that apply to firms while being subject to enhanced accountability and other arrangements. The proposal also introduces a statutory secondary objective for the FCA and PRA to “facilitate the long-term growth and international competitiveness of the U.K. economy.”

²² Under U.K. laws, an appointed representative can carry out specific regulated activities without direct government oversight if a regulated firm, known as the appointed representative’s “principal,” has agreed to take responsibility for them.

²³ After a first consultation in October 2020, HMT has published for consultation in November 2021 a second package of detailed proposed measures.

81. Certain measures could constrain U.K. regulators' ability to discharge their new rulemaking responsibilities. Taken in totality, measures simplifying the rulebook, delegating rulemaking, and expanding the regulatory remit to new activities are beneficial. The process of repealing relevant retained EU law and replacing it with regulators' new rules will maintain continuity of regulatory requirements. Other proposals will need to be designed carefully, to ensure the FCA and PRA maintain their focus on their primary prudential objectives and can retain their operational independence.

82. Going forward, preserving the primacy of the U.K. regulators' general objectives in principle and practice will be paramount. Delegating responsibility to the regulators for setting requirements that are often technical and complex is beneficial, but ~~t~~The United Kingdom must avoid a proliferation of wider financial services policy priorities that could divert focus from financial stability. Enhanced accountability and transparency mechanisms should also operate in a way that preserves the independence of regulators and should not reduce operational and regulatory effectiveness. Concerning resolution, strengthening the operational autonomy of the BOE where public funds are not at risk and the FSCS regarding funding, and ensuring that the BOE undertakes the resolvability assessments of the banks with a high degree of autonomy will be critical. Maintaining robust and high-quality regulatory standards that naturally encourage investment and growth is the best way to preserve the United Kingdom's role as a major financial center.

83. Always maintaining adequate skills and resources for systemic risk oversight, and supervision of systemically important financial firms and financial markets is crucial. The current level of resources is fully deployed given the range and nature of the tasks outlined in the FSAP report. Going forward, new post-Brexit prudential rulemaking responsibilities, an increased number of firms to be supervised after Brexit, the need for more intrusive supervisory practices, new climate change responsibilities, rapid technological change, the need to deliver on major U.K. financial sector projects, and participating in international standard setting body activities will require the BOE/PRA and FCA to carefully evaluate and maintain the level of resources required to deliver on their objectives for regulated firms. The authorities should also continue to pursue staffing resources for resolution and crisis management that are commensurate in quantity and quality with increasing demands due to market developments and policy ambitions. Leveraging technologies (big data and machine learning) and exploring further data and platform synergies between the BOE/PRA and the FCA can support timely identification of risks, maximize oversight efficiencies, and move the financial stability framework to the next level. Finally, and related to agency independence and resources, the FSAP welcomes the progress made by the United Kingdom in taking forward the recommendations of the 2016 FSAP and urges the authorities to assign resources to complete the implementation of those FSAP recommendations where action has been initiated but work is underway (Appendix IV).