

**FOR
INFORMATION**

SM/22/69
Correction 2

April 7, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **United Kingdom—Publication of Financial Sector Assessment Program
Documentation—Technical Note on Vulnerabilities in NBFIs, Market-Based
Finance, and Systemic Liquidity**

Board Action:

The attached correction to SM/22/69 (3/25/22) has been provided by the staff:

Typographical Errors

Page 51 (subsequent paragraphs renumbered)

Questions:

Mr. Das, MCM (ext. 36330)

76. The capacity to provide liquidity reflects regulatory constraints and funding and credit risk management considerations. Firms can only provide funding if their own funding is secure. Hence market liquidity is important in allowing firms capacity to support customers as is the availability of central bank liquidity backstops. Firms can only lend to or trade with customers if the credit risks are adequately managed. Collateral availability of clients, and the capacity to trade using cleared instruments greatly reduces risks of client trading and increases firms' capacity to provide liquidity. Capital, liquidity, and leverage constraints are important determinants of firms' capacity to provide liquidity. Most of these are regulatory constraints laid down by the United Kingdom and/or foreign regulators. Firms can't breach these requirements out of concern of supervisory action but, at least as importantly, because of what being seen to be in breach of regulatory requirements might mean for their position in the market and their ability to raise funding (as well as the value of the firms' equity). Hence, there is a strong overlap in firms' willingness and capacity to provide liquidity. Regulators generally impose high level regulatory constraints that don't specifically apply at the business line level of firms. The firm's risk management framework translates aggregate regulatory requirements into specific business-line limits – generally in the form of balance sheet limits. The flexibility and buffers built into firms' risk management frameworks are important drivers of the capacity of firms to provide liquidity when customer demand unexpectedly rises. If capital can't quickly flow to a business unit experiencing a spike in customer demand, then rationing occurs. The probability of constraints becoming binding can be reduced if firms can clear and net customer trades as more volume can be dealt within a given leverage/capital envelope.

B. Supporting Liquidity Among Core Intermediaries

77.—The experience of the Covid-19 shock shows that the BOE's SMF caters well to the needs of banks and core intermediaries. Covid-19 was an unprecedented global shock that, while not financial-sector centric as in the GFC, still severely disturbed balance sheets of a broad range of financial and non-financial firms. Such large shocks will naturally test central bank operational frameworks and require some level of discretionary intervention. The SMF held up well to the "dash for cash" episode and the design of the SMF itself wasn't a constraint on banks and large investment firms. U.K. money markets were well backstopped by the regular scalable repo operations the BOE routinely provides and there seems little evidence of stigma around the Banks operations as the key ILTR and CTRF operations were well supported by a full range of core intermediaries.

78.—A key challenge for the BOE is how to improve the leverage of its facilities on the wider markets. The BOE (and central banks generally) need to find ways to relax the constraints banks and core intermediaries face when channeling funding from the BOE to the wider market in periods of stress. As summarized in figure 17, these constraints reflect factors that drive the willingness of intermediaries to take risk and extend funding in times of stress as well as factors around their capacity to provide financing to customers. The BOE has contributed to developing thinking and policy responses in the area through its participation in FSB and BIS working groups.⁴⁴

⁴⁴ The BOE has contributed to the FSB's work program as discussed in the FSB work program for 2021 – see <https://www.fsb.org/wp-content/uploads/P200121.pdf>