



# MOU on crisis management

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## Memorandum of Understanding on financial crisis management

- 1 This memorandum has been prepared and published in line with the provisions of Section [61] of the Financial Services Act [2012], (the Act) which requires HM Treasury (the 'Treasury') on the one hand, and the Bank of England and its subsidiary, the Prudential Regulation Authority (PRA), on the other, to prepare and maintain a memorandum of understanding on financial crisis management. This memorandum of understanding therefore establishes the framework for coordination of financial crisis management between the Treasury and the Bank of England and its subsidiary, the PRA. Within this memorandum, a reference to the 'Bank' refers to both the Bank of England and the PRA, except where the context otherwise requires or it is explicitly stated otherwise.
- 2 The Bank is responsible for protecting and enhancing the stability of the UK financial system. Through the PRA, the Bank will regulate deposit-takers, insurance companies and certain 'investment firms' to promote the stability of the UK financial system and ensure that when individual institutions fail, they do not pose a threat to the stability of the system as a whole. Stability, while important, is only one element of a successful financial sector and economy; and the possibility of failure of individual firms is a vital element of the competitive discipline imposed by efficient markets.
- 3 When the risk of instability or failure arises, it must be monitored and mitigated so as to minimise the impact on the financial system, and the economy, as a whole. Managing such risks when there is a material likelihood of crystallisation is the process referred to in this memorandum as 'financial crisis management'.

## Responsibilities

- 4 The key principle of financial crisis management is to make clear who is in charge of what, and when. The Bank and the Treasury have clear and separate responsibilities. The Bank has primary operational responsibility for financial crisis management. The Chancellor and the Treasury have sole responsibility for any decision involving public funds. When the Bank has formally notified the Treasury of a material risk to public funds, and either there is a serious threat to financial stability, or public funds are already committed by the Treasury to resolve or reduce such a serious threat and it would be in the public interest to do so, the Chancellor may use powers to direct the Bank.
- 5 The Bank has primary operational responsibility for financial crisis management. Its responsibilities in a financial crisis stem from:
  - the PRA's monitoring and mitigating of risks to the safety and soundness of individual firms – including through the Proactive Intervention Framework (PIF), which makes clear how and when the PRA will escalate its engagement as risks in relation to a firm increase;

- its oversight of payment systems, settlement systems and clearing houses, which are systemically important to the financial system, including its power to close an inter bank payment system.
  - offering, as the central bank, liquidity insurance to the financial system on terms that safeguards the Bank's capital, as described in the Bank's published frameworks;
  - the provision, when authorised by the Treasury, of Emergency Liquidity Assistance (ELA - defined as support operations outside the Bank's published frameworks) to firms that are at risk but are judged to be solvent;
  - the Bank's powers under the Special Resolution Regime (SRR), as set out in Parts 1 to 3 of the Banking Act 2009; and
  - the Bank's obligation, under Section [54(1)] of the [2012] Act, to notify the Treasury of a material risk to public funds arising from a potential crisis.
- 6 The Chancellor and the Treasury have sole responsibility for any decision on whether and how to use public funds, including:
- authorising any proposal by the Bank to provide ELA to one or more individual firms in a support operation that goes beyond the Bank's published frameworks;
  - authorising the use of any stabilisation power which would have implications for public funds, including in respect of a firm to which financial assistance has already been extended by the Treasury; and
  - the exercise of the Temporary Public Ownership stabilisation option in relation to a bank or a bank holding company in accordance with the relevant provisions of the Banking Act 2009.
- 7 The Chancellor and the Treasury are also responsible for:
- keeping Parliament and the public informed of action taken to manage a crisis; and
  - ensuring that actions considered or taken are assessed for compliance with the UK's international obligations.

### **Notification by the Bank of a risk to public funds**

- 8 Operational responsibility for mitigating and managing risks to financial stability rests with the Bank. Where the Bank is able to manage a financial crisis without public funds being put at risk, it will have autonomy in exercising its responsibilities, in line with the relevant statutory provisions. The Bank will keep the Treasury informed of such actions and their outcomes in a manner proportionate to the severity of the situation.
- 9 When the Bank, however, considers there to be a material risk of circumstances arising in which public funds would be at risk, close co-ordination is required to ensure that the Bank and the Treasury are able to fulfil their individual responsibilities effectively. Both the Bank and the Treasury have particular responsibilities to ensure this co-ordination is effective.
- 10 The Bank has a statutory duty under Section [54(1)] of the [2012] Act to notify the Treasury immediately when there is a material risk of circumstances arising in which public funds would be put at risk.

- 11 The [2012] Act establishes that these circumstances are those in which:
  - the Treasury<sup>1</sup> might reasonably be expected to regard it as appropriate to provide financial assistance to or in respect of a financial institution;
  - the Treasury<sup>2</sup>, the Bank or the PRA might reasonably be expected to regard it as appropriate to exercise any of their respective powers under the SRR and the Treasury might reasonably be expected to regard it as appropriate to incur expenditure in connection with the exercise of those powers; or
  - the scheme manager of the Financial Services Compensation Scheme might reasonably be expected to request financial assistance from the Treasury (including via the National Loans Fund) for the purpose of that scheme.
- 12 In addition, where the Bank proposes to make ELA available to one or more financial institutions it will notify the Treasury and seek the Treasury's approval.
- 13 In determining whether a notification of a risk to public funds is needed in respect of an individual firm, the starting point for the assessment will be the published generic risk "stages" identified in the PRA's PIF. However, the PIF stages will not be used as a formulaic test. Notification may be required at earlier or later stages of the PIF, depending on the probability, nature and severity of the risk to public funds. The same will apply to assessment of non firm-specific or systemic risks: the precise notification threshold will depend on a range of factors relating to the nature and probability of the risk to public funds.
- 14 The assessment will not, however, depend on the amount of public funds at risk. The principle that the Chancellor and the Treasury are responsible for any decision involving public funds, regardless of the amount concerned, is absolute.
- 15 Notification will be made in sufficient time for the Treasury to make a fully informed decision about the potential use of public funds. This will include sufficient time to allow the Treasury to commission the Bank to develop alternative mitigation options. If in doubt, the Bank will tend towards notification.
- 16 If the Treasury independently identifies an issue which it believes may result in a threat to financial stability or a risk to public funds, it may ask the Bank to assess whether this issue requires a notification.
- 17 When the Bank notifies the Treasury under Section [54(1)], the Bank will, as soon as possible thereafter and on a timetable agreed with the Treasury, provide:
  - an explanation of the risk to public funds;
  - identification of the options the Bank is considering to mitigate the risks to stability including, where relevant, resolution options under consideration;
  - an assessment of the potential systemic or firm-level impact of each option; and
  - identification of specific risks to public funds arising from any action being considered, including inaction.
- 18 The Bank and the Treasury will agree a suitable frequency for updates, reflecting the severity and immediacy of the risk to public funds given the specific crisis. The Bank will also notify the Treasury when a risk is deemed to have passed.

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<sup>1</sup> Or the Secretary of State of another Government Department

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## Financial crisis management

- 19 As noted above, where the Bank is able to manage risks to financial stability without public funds being put at risk, it will do so on an autonomous basis. Once a risk to public funds has been notified, the Bank will continue to lead the operational response, working closely with the Treasury to develop options to mitigate the risk.
- 20 During a potentially fast-moving crisis, it will become especially important to ensure close and effective coordination so as to maintain coherence in the overall crisis management process. At the heart of institutional coordination during a live crisis will be frequent contact between the Chancellor and the Governor. However, the Chancellor and the Governor may agree to establish ad hoc or standing committees at other levels to support this process.
- 21 The Treasury will provide the Bank with clear information on particular issues of interest or concern to the Treasury which relate to resolving the crisis in the public interest. If requested by the Bank, this will include the Treasury's view on the type and the level of public funding commitments that, consistent with the 2009 Act, it is likely to authorise. This information will be provided in sufficient time to assist the Bank in developing and implementing resolution options. It will not, however, constitute Treasury pre-approval of a specific public fund envelope within which the Bank may operate. Any decision with public funds implications will still require explicit Treasury authorisation. Within this framework, the Bank will be responsible for developing options for managing or resolving the risk to public funds consistent with its statutory responsibilities as the resolution authority. The Bank will provide the Treasury with information needed on the options for managing the situation, including on options commissioned by the Treasury. This will be provided in sufficient time to allow the Treasury to make a fully informed decision about any use of public funds.
- 22 The Bank will take account of the Treasury's need to use public funds in a way which meets standards of regularity and propriety and provides good value for money.
- 23 The Chancellor and Treasury Accounting Officer will take responsibility and ultimate control over all decisions involving the use of public funds. The Treasury will take decisions on the use of public funds in a timely manner, to allow the Bank (and any other agencies or authorities involved) to implement the chosen course of action, within the constraints imposed by legislation (including EU legislation).
- 24 The Treasury's involvement after notification will increase in proportion to the magnitude of the risk to public funds up to the point where, having consulted the Governor, the Chancellor is satisfied that there is a serious threat to financial stability, or that it would be in the public interest to do so, given public funds already committed to resolving the crisis. At this point, the Chancellor will have the ability, if necessary in the public interest, to exercise the power of direction provided for in the Act and set out below.

### The Chancellor's power of direction over the Bank

- 25 The Bank has primary responsibility for financial stability and operational responsibility for managing financial crises. But consistent with the Treasury's overall responsibilities, the Chancellor may, in some circumstances during a financial crisis, use additional powers to direct the Bank. This is provided for in Section [57] of the Act, which allows the Chancellor to direct the Bank to:

- conduct special support operations for the financial system as whole, in operations going beyond the Bank's published frameworks;
  - provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms that are not judged by the Bank to be solvent and viable;
  - provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms on terms other than those proposed by the Bank; and
  - implement a particular SRR stabilisation option.
- 26 Where the Chancellor directs the Bank to conduct a support operation, either to the financial system as a whole or to one or more individual firms, the Bank will act as the Treasury's agent. The Bank will set up a Special Purpose Vehicle (SPV), separate from the Bank's balance sheet, to effect the support operation. The Bank and the Vehicle will be indemnified by the Treasury. Where the Treasury has determined that the operation needs to be carried out covertly, the Bank will execute the operation in a way which best ensures that the existence of the operation does not become public.
- 27 The Treasury will decide whether the Vehicle shall be financed through the issuance of government securities, by a loan from the Bank with share capital provided by the Treasury or via another mechanism. When the Vehicle is financed by a loan from the Bank or would otherwise affect the Bank's balance sheet, the Bank will decide, consistent with its operational independence in monetary policy, whether and how to offset the resulting expansion of central bank reserves.
- 28 The 2009 Act contains a number of provisions covering the Treasury's role in the SRR where public funds are at risk. The Bank may not exercise a stabilisation power without the Treasury's consent, if the exercise would have implications for public funds. In addition, if the Treasury has provided financial assistance to resolve or reduce a serious threat to financial stability, the Bank may only exercise its stabilisation powers where recommended to do so by the Treasury on the grounds that such an exercise is necessary to protect the public interest.
- 29 In general terms, these provisions are sufficient to allow the Treasury to fulfil its role in protecting public funds when use of the SRR is being considered in a crisis. Notwithstanding this, the power of direction in the [2012] Act will cover the SRR to put beyond legal doubt the Chancellor's ability to require the Bank to take specific action when public funds are at risk. This is a backstop power, and it is not anticipated that its use will be considered in the majority of crisis situations.
- 30 As with directions involving liquidity, when the Chancellor directs the Bank to implement a specific option under the SRR, the Treasury will provide the Bank with indemnities covering any risks arising from actions it had taken under direction from the Treasury.
- 31 The power of direction may be exercised if and only if:
- the Bank has notified the Treasury of a material risk of circumstances arising in which public funds will be at risk in accordance with Section [54] of the Act; and
  - the Chancellor, having consulted the Governor, is satisfied that the direction is either a necessary response to a serious threat to financial stability or, where

financial assistance has already been provided in respect of a firm to resolve or reduce such a serious threat, necessary to protect the public interest.

- 32 Upon a direction being given, that direction, along with any response the Bank may wish to make, will be laid immediately before Parliament. The only circumstance in which the direction would not be immediately laid before Parliament will be when such disclosure would reveal the existence of a support operation that the Treasury has decided needs to be covert in order to preserve financial stability. In that case, the Chancellor will notify the Chairs of the Treasury Select Committee and the Public Accounts Committee in confidence immediately. The direction and any Bank response will be laid before Parliament when the Treasury, having consulted the Bank, has decided that the need for confidentiality of the support operation has passed.
- 33 This power of direction is not available in relation to (1) supervisory decisions taken by the PRA or by the rest of the Bank in its regulation of systemic post-trade infrastructure; (2) policy decisions made by the MPC and FPC; or (3) changes to the Bank's published framework for providing liquidity support to the financial system.

### **Other aspects of co-ordination**

#### *Other organisations*

- 34 In some cases, the Financial Conduct Authority, the Financial Services Compensation Scheme or other organisations may need to be involved in the monitoring and assessment of risks, or the planning and implementation of financial sector interventions. The Bank and Treasury will involve these organisations as necessary.

#### *Compliance with international obligations*

- 35 Action to manage a potential financial crisis may give rise to considerations of compliance with the UK's international obligations, particularly those arising from European law. The Government is legally responsible for ensuring that this compliance is achieved. The Bank and the Treasury will therefore coordinate activity to ensure that actions considered or taken are assessed for compliance with those international obligations.
- 36 In particular, use of the special resolution regime or other interventions in respect of failing firms may require the European Commission to be notified of, and approve, the measure on state aid grounds, whether or not public funds are deployed. The Treasury is responsible for developing the UK policy and framework for state aid in financial services. The Bank will develop options for intervention or resolution that are consistent with this framework, and will prepare initial State aid notifications in consultation with the Treasury. The formal State aid notification to the European Commission will be made by the Treasury acting on behalf of the UK Government. The Bank will support the Treasury in securing state aid approval when the issue has arisen from its actions.

#### *Communicating with Parliament and the public*

- 37 Treasury Ministers are responsible for keeping Parliament informed of action taken to manage a financial crisis – including action taken by the Bank without any public funds implications. The Bank will keep the Treasury informed to the degree needed for Ministers to fulfil this function.
- 38 The Bank and the Treasury will also work closely together to ensure that wider communication – including provision to the markets of information relating to

regulatory reporting events, and communication to the general public about the progress of a financial crisis and the steps being taken to manage them – is carried out effectively.

- 39 Within that, the Bank is responsible for communications to the market: about the use of its balance sheet; about measures concerning critical financial infrastructure arising from its oversight under the 2009 and [2012] Acts; through the PRA, about the PRA's regulation and supervision of individual firms; and about any measures taken by the Bank under the SRR, excepting any use of public money by the Treasury in association with those measures.