



## **Memorandum of Understanding between HM Treasury, the Bank of England and the Financial Services Authority**

1. This memorandum of understanding establishes a framework for co-operation between HM Treasury (the 'Treasury'), the Bank of England (the 'Bank') and the Financial Services Authority (the FSA) in the field of financial stability. It sets out the role of each authority, and explains how they work together towards the common objective of financial stability in the UK. The division of responsibilities is based on four guiding principles:

- **clear accountability.** Each authority must be accountable for its actions, so each must have unambiguous and well-defined responsibilities;
- **transparency.** Parliament, the markets and the public must know who is responsible for what;
- **avoidance of duplication.** Each authority must have a clearly defined role, to avoid second guessing, inefficiency and the unnecessary duplication of effort. This will help ensure proper accountability;
- **regular information exchange.** This helps each authority to discharge its responsibilities as efficiently and effectively as possible.

### **The Bank's responsibilities**

2. The Bank contributes to the maintenance of the stability of the financial system as a whole – one of its two core purposes. This involves:

- i. ensuring the stability of the monetary system as part of its monetary policy functions. It acts in the markets to deal with fluctuations in liquidity;
- ii. overseeing financial system infrastructure systemically significant to the UK, in particular payments systems whether based in the UK or abroad. As the bankers' bank, the Bank stands at the heart of the payments system. It falls to the Bank to advise the Chancellor, and answer for its advice, on any major problem arising in these systems. The Bank is also closely involved in developing and improving the infrastructure and strengthening the system to help reduce systemic risk;

iii. maintaining a broad overview of the system as a whole. The Bank is uniquely placed to do this, being responsible for monetary stability and having representation on the FSA Board (through the Deputy Governor (financial stability)). Through its involvement in markets and payments systems it may be the first to spot potential problems. The Bank advises on the implications for UK financial stability of developments in the domestic and international markets and payments systems and assesses the impact on monetary conditions of events in the financial sector;

iv. undertaking, in exceptional circumstances, official financial operations, in accordance with the arrangements in paragraphs 13 and 14 of this Memorandum, in order to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system.

### **The FSA's responsibilities**

3. The FSA's powers and responsibilities are set out in the Financial Services and Markets Act 2000. Within the scope of the Act, it is responsible for:

i. the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and brokers, credit unions and friendly societies;

ii. the supervision of financial markets, securities listings and of clearing and settlement systems;

iii. the conduct of operations in response to problem cases affecting firms, markets and clearing and settlements systems within its responsibilities, where:

a) the nature of the operations has been agreed according to the provisions of paragraphs 13 and 14 of this Memorandum; and

b) the operations do not fall within the ambit of the Bank defined in paragraph 2 above. (Such operations by the FSA may include, but would not be restricted to, the changing of capital or other regulatory requirements and the facilitation of a market solution involving, for example, an introduction of new capital into a troubled firm by one or more third parties.)

iv. regulatory policy in these areas, including that intended to promote the resilience to operational disruption of authorised firms and Recognised Bodies. The FSA advises on the regulatory implications for authorised firms and Recognised Bodies of developments in domestic and international markets and of initiatives, both domestic and international, such as EC directives.

## **The Treasury's responsibilities**

4. The Treasury is responsible for:

- i. the overall institutional structure of financial regulation and the legislation which governs it, including the negotiation of EC directives;
- ii. informing, and accounting to Parliament for the management of serious problems in the financial system and any measures used to resolve them, including any Treasury decision concerning exceptional official operations as set out in paragraphs 13 and 14; and
- iii. accounting for financial sector resilience to operational disruption within government.

5. The Treasury has no operational responsibility for the activities of the FSA and the Bank and shall not be involved in them. But there are a variety of circumstances where the FSA and the Bank will need to alert the Treasury about possible problems: for example, where a serious problem arises, which could cause wider financial or economic disruption; where there is, or could be, a need for a support operation; where diplomatic or foreign relations problems might arise; where a problem might suggest the need for a change in the law; or where a case is likely to lead to questions to Ministers in Parliament. This list is not exhaustive, and there will be other relevant situations. In each case it will be for the FSA and Bank to decide whether the Treasury needs to be alerted.

## **Information gathering**

6. Through the exercise of its statutory responsibilities, the FSA gathers a wide range of information and data on the firms which it authorises and supervises. The Bank similarly collects information and data that it needs to discharge its responsibilities.

7. The FSA and the Bank work together to avoid separate collection of the same data, to minimise the burden on firms. Where both need access to the same information, they reach agreement as to who should collect it, and how it should be transmitted to the other.

## **Information exchange**

8. Free exchange of information is essential if each authority is to meet its responsibilities satisfactorily. Information exchange is to take place on several levels. The Bank's Deputy Governor (financial stability) is a member of the FSA Board, and the FSA Chairman sits on the Court of the Bank. At all levels, there should be close and regular contact between the FSA and the Bank, who maintain a programme of secondments between the two institutions, to strengthen the links and foster a culture of co-operation.

9. The FSA and the Bank maintain information-sharing arrangements, to ensure that all information which is or may be relevant to the discharge of their respective responsibilities will be shared fully and freely. Each seeks to provide the other with relevant information as requested. The authority receiving this information ensures that it is used only for discharging its responsibilities, and that it is not transmitted to third parties except where permitted by law.

### **Standing Committee**

10. The Standing Committee on Financial Stability is chaired by the Treasury and comprises representatives of the Treasury, the Bank and the FSA. It is the principal forum for agreeing policy and, where appropriate, coordinating or agreeing action between the three authorities. It is also an important channel for exchanging information on threats to UK financial stability.

11. Standing Committee meets on a monthly basis at deputies (official) level to discuss individual cases of significance and other developments relevant to financial stability. Meetings can be called at other times by any of the participating authorities if it considers there to be an issue which needs to be addressed urgently. Each authority is to have nominated representatives who can be contacted, and meet, at short notice.

12. A sub-group of Standing Committee co-ordinates the authorities' joint work on financial sector resilience to operational disruption and maintains and tests tripartite arrangements for effective crisis management in an operational disruption.

13. In exceptional circumstances, for instance where a support operation is being considered, the Standing Committee meets at principals level, comprising the Chancellor of the Exchequer, the Governor of the Bank and the Chairman of the FSA (or senior alternates). The Bank and the FSA are each to assess, from the perspective of their distinct responsibilities and expertise, the seriousness of the crisis and its potential implications for the stability of the financial system as a whole. They will each provide their separate assessments to the Treasury, together with their views on the options available to the Chancellor. Standing Committee may then discuss the appropriate use of measures and ensure effective co-ordination of the response, while respecting the formal responsibilities of the three authorities (subject to paragraph 14).

### **Financial Crisis Management**

14. In exceptional circumstances, there may be a need for an operation which goes beyond the Bank's published framework for operations in the money market. Such a support operation is expected to happen very rarely and would normally only be undertaken in the case of a genuine threat to the stability of the financial system to avoid a serious disturbance in the UK economy. If the Bank or the FSA identified a situation where such a support operation might become necessary, they would immediately inform the other authorities and invoke the co-ordination framework outlined in paragraph 16 below. Ultimate responsibility

for authorisation of support operations in exceptional circumstances rests with the Chancellor. Thereafter they would keep the Treasury informed about the developing situation, as far as circumstances allowed.

15. In any such exceptional circumstances, the authorities' main aim would be to reduce the risk of a serious problem causing wider financial or economic disruption. In acting to do this, they would seek to minimise both moral hazard in the private sector and financial risk to the taxpayer arising from any support operation.

16. The authorities maintain a framework for co-ordination in the management of a financial crisis. This includes arrangements that determine which authority would take the lead on particular problems arising and for ensuring orderly communication with market participants and overseas authorities. Each authority would:

- assess the situation and co-ordinate their response within the framework agreed with the other authorities. The form of the response would depend on the nature of the event and would be determined at the time; and
- where possible and desirable to facilitate a solution to a problem, and hence reduce risks to wider financial stability, encourage negotiations between third parties whose agreement might be beneficial for the reduction or resolution of the issue, in its area of responsibility.

### **Operational Crisis Management**

17. The authorities also maintain a framework for co-ordination in the management of an operational crisis. In a major operational disruption, the respective roles of the authorities' are as follows:

i. The Treasury is to ensure that ministers are kept up-to-date on developments so as to be able to take key decisions without delay; and to ensure coherence between measures taken in the financial sector and the operation of public sector continuity arrangements. The Treasury would have specific responsibility for:

- liaising with other UK government departments and authorities, including law enforcement agencies; and
- maintaining contact and liaising with the UK Debt Management Office, particularly on the state of the gilts market.

ii. The Bank is to seek to ensure the orderly functioning of the UK's financial markets, including the maintenance of adequate liquidity. The Bank would have specific responsibility for:

- maintaining, through its market operations and as banker to the banking system, operational contacts with market participants so as to monitor and,

as necessary, facilitate the functioning of UK markets; this may include the provision of liquidity assistance or other support operations agreed within the tripartite framework; and

- monitoring and, as necessary, facilitating the functioning of payment systems, alongside its operational role of providing settlement facilities for the Real Time Gross Settlement system.

iii. The FSA is to monitor the health of institutions that fall within its regulatory remit and ensure, as far as is appropriate in the circumstances, continuing compliance with regulatory standards. The FSA would have specific responsibility for:

- monitoring authorised firms and Recognised Bodies within the framework of the FSA's four statutory objectives where liaison would usually be via normal supervisory contacts; and
- working with authorised firms and Recognised Bodies to resolve any problems that may prevent them from operating normally, or from acting on either their own or their customers' behalf, in accordance with usual regulatory requirements.

### **Consultation on policy changes**

18. Each authority will inform the other about any major policy changes. It will consult the other in advance on any policy changes which are likely to have a bearing on the responsibilities of the other.

### **Membership of committees**

19. The FSA and the Bank cooperate fully in their relations with international regulatory groups and committees. They are both represented on the Basle Supervisors' Committee, the European Central Bank's Banking Supervisors' Sub-Committee and on other international committees. Where only one authority is represented, it will ensure that the other can contribute information and views in advance of any meeting; and will report fully to the other after the meeting. This promotes co-operation and minimises duplication.

20. The FSA and the Bank will keep the Treasury informed of developments in the international regulatory community which are relevant to its responsibilities.

21. The Bank chairs the following domestic market committees:

- Money Market Liaison Group
- Foreign Exchange Joint Standing Committee
- Securities Lending and Repo Committee

22. The FSA and the Bank will each use best endeavours to facilitate contacts by the other with overseas central banks and/or regulators, where necessary to discharge their respective responsibilities.

### **Provision of services**

23. In some cases it is more efficient for a service to be provided by the FSA to the Bank, or vice versa, rather than for both authorities to meet their own needs separately. Where necessary, service agreements between the two authorities are maintained, setting out the nature of the service to be provided, together with agreed standards and other details.

### **Litigation**

24. The Bank retains responsibility for any liability attributable to its acts or omissions in the discharge or purported discharge of its banking supervisory functions prior to the transfer of those functions to the FSA and shall have the sole conduct of any proceedings relating thereto. The two authorities will co-operate fully where either faces litigation.

### **Records**

25. The FSA is responsible for the custody of all supervisory records. It ensures that, within the framework of the relevant legislation, the Bank has free and open access to these records.

Rt. Hon Gordon Brown MP  
Chancellor of the Exchequer

Mervyn King  
Governor of the Bank of England

Sir Callum McCarthy  
Chairman, Financial Services Authority