Witness Name: Bank of England
Statement No.: 1
Exhibits: 6
Dated: 12 May 2023

UK COVID-19 INQUIRY

WITNESS STATEMENT OF RUTH SMITH
ON BEHALF OF THE BANK OF ENGLAND

I, Ruth Smith, make this statement on behalf of the Bank of England (***Bank***), for the purposes of the UK Covid-19 Inquiry (***Inquiry***) following a Rule 9 Request addressed to Mr Andrew Bailey dated 6 January 2023.

Introduction

1. I am the interim Secretary of the Bank, a senior official within the organisation with a range of responsibilities in relation to the governance of the Bank [RS/1 - INQ000184656]. I understand that the Inquiry would find it useful to be provided with an overview of the role and remit of the Bank of England. The purpose of this witness statement is to provide that overview. I have included as exhibits an organogram of the Bank [RS/1 - INQ000184656] [RS/2 - INQ000184655] and a copy of the Bank's main constitutional documents [RS/3 - INQ000184660].
2. As a general point, the Bank's mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability. It carries out this mission as an independent central bank, agnostic to the cause of any disturbance which may threaten monetary and/or financial stability. This includes, for example, ensuring that: the Bank can provide a constant supply of banknotes, ensuring continuity of payments systems; banks have sufficient capital buffers to provide lending to households and businesses; the Bank has tools to address market instability and so on. The Bank works with domestic and international stakeholders, firms, payments systems and market participants to

improve resilience, ensure contingency plans are in place and stress test against them.

3. The Covid-19 pandemic was both a national civil emergency and an event which posed a material financial stability risk to the UK economy and markets. The Bank's response to the pandemic engaged a number of its statutory objectives, as demonstrated by the actions taken across its three statutory committees: the Monetary Policy Committee (***MPC***) [RS/4 - INQ000184659], the Financial Policy Committee (***FPC***) [RS/5 - INQ000184658] and the Prudential Regulation Committee (***PRC***) [RS/6 - INQ000184657]. I have not sought to provide a full account of those actions in this witness statement as the Module's ToR indicate expressly that Module 1 of the Inquiry is concerned with preparedness before the onset of the pandemic (with the proposed date range for Module 1 being from 11 June 2009 to 21 January 2020). The Bank of course stands ready to provide an account of its actions in response to the pandemic (in particular from March 2020 onwards) in the context of subsequent Modules of the Inquiry.
4. The framework governing each of the statutory committees (and the range of tools available in the regulatory toolkit) enabled effective regulatory coordination and the taking of the full suite of actions needed, in the time available, in response to the financial stability impact of Covid-19. The fact that the financial stability impact resulted specifically from a global pandemic, rather than any other form of civil emergency, made little difference to the Bank's readiness and ability to respond to the civil emergency, caused by Covid-19, and the Bank does not consider that the pandemic exposed any obvious gaps in the framework in relation to its role and remit.

Constitution and legislative framework governing the Bank of England

5. The Bank was established in 1694 by an Act of Parliament and Royal Charter and is established as a chartered corporation. The Act and Charter confer wide general powers and discretions on the Bank, which in effect mean that the Bank has, at a minimum, all the powers of an individual. This arrangement historically allowed the Bank's responsibilities to evolve over time by agreement of the government of the day, without necessarily requiring primary legislation. In terms of its ownership, the Bank was in private hands until nationalized and having its capital stock transferred to His Majesty's Treasury (***HMT***) in 1946.

6. In more recent years, and particularly since 1998, the Bank's powers – and its relationship with HMT – have increasingly been placed upon a statutory footing. For its most important functions, the Bank now operates within a detailed statutory framework set by Parliament. The broad intent underlying this framework is to ensure that the Bank is free from day- to-day political influence in carrying out its statutory functions. The framework is sophisticated in its design and varies depending on the precise functions being exercised by the Bank. At a high level, the framework operates by Parliament setting statutory objectives for the Bank and then granting the Bank operational independence to pursue those objectives, principally through its three main statutory policy committees: the MPC, the FPC and PRC (described further below).
7. While specific policy responsibilities are reserved to the statutory policy committees, the Court of Directors (***Court***) manages the affairs of the Bank as a corporation. Court's responsibilities include determining the Bank's objectives and strategy and ensuring the effective discharge of the Bank's functions and the most efficient use of its resources. Court delegates to the Governor the day-to-day management of the Bank, including the discharge of statutory functions, while reserving certain key decisions to itself. Court, consulting HMT, is required, at least every three years, to review and if necessary, revise the Bank's strategy in relation to the Financial Stability Objective. This function may be delegated, and Court has delegated this to the FPC.

The MPC: price stability

8. Parliament granted the Bank operational independence for setting UK monetary policy in the Bank of England Act 1998. The MPC was established with the responsibility for formulating monetary policy. The stated rationale was both to de-politicise, as well as de-personalise, the UK monetary policy framework (under which monetary policy had previously been determined by the Chancellor, albeit on the Bank's advice), and to underline a commitment to delivering a low and stable rate of inflation in the UK.
9. The Bank's statutory objectives in setting monetary policy are to maintain price stability and, subject to that, to support the economic policy of the government (including its objectives for growth and employment). The two principal tools open to the MPC are setting interest rates (known as the 'Bank Rate') and using Quantitative Easing to purchase bonds, effectively lowering the interest rates on

savings and loans. (The process of reversing Quantitative Easing, either by stopping reinvestments or selling bonds, is sometimes called Quantitative Tightening. That process, presently underway, has not been used by the MPC as an active tightening tool; rather, the MC has used Bank Rate as its active tightening tool).

10. The monetary policy objectives are supplemented by so-called "remit letters" issued by the Chancellor. The Chancellor's remit letter to the MPC, which must be issued at least once a year, defines price stability (since the regime's inception, an inflation target) and specifies the economic policy of the government. The members of the MPC consist of five senior Bank officials, and four external members appointed by the Chancellor, including a representative from HMT. Whilst the representative from HMT does not vote on MPC decisions, their involvement is to ensure that the MPC is briefed on fiscal policy developments and other aspects of the government's economic policies, and that the Chancellor is duly informed about monetary policy.

11. HMT has retained for itself a "reserve power", after consultation with the Governor of the Bank, to give the Bank directions with respect to monetary policy if satisfied that the directions are required in the public interest and by extreme economic circumstances. A direction would involve the suspension of the monetary policy objectives and would be time-limited to 28 days unless it had the approval of both House of Parliament. This power has never been used to date.

The FPC: financial stability and macro-prudential regulation

12. Following the global financial crisis of 2007-2008, Parliament gave the Bank a financial stability objective for the first time in the Banking Act 2009: to protect and enhance the financial stability of the United Kingdom. Since 2013, the FPC, a committee of the Bank, has been responsible for the financial stability of the UK financial system *as a whole* – otherwise known as macro-prudential regulation. This contrasts with the Prudential Regulation Authority (***PRA***) which has responsibility for the safety and soundness of *individual* institutions – otherwise known as micro-prudential regulation (as discussed further below).

13. The FPC's statutory objectives are to contribute to the achievement of the Bank's financial stability objective (primarily through identifying, monitoring and taking action to remove/reduce systemic risks) and, subject to that, to support the economic policy of the government (including its objectives for growth and

employment). The FPC has the power to direct the PRA and Financial Conduct Authority (***FCA***) to take action across a number of specific policy tools, and to make wider recommendations across a broader range of persons to reduce risks to UK financial stability.

14. Like the MPC, the objectives of the FPC are supplemented by a "remit letter" issued by the Chancellor. The Chancellor's remit letter to the FPC, which much be issued at least once a year, makes recommendations about the FPC's responsibilities for financial stability and also about the Government's economic policy (including its objectives for growth and employment). The FPC consists of six senior Bank officials, five external members, the chief executive of the FCA and a non-voting representative from HMT.
15. The FPC does not have exclusive responsibility within the Bank for achieving the financial stability objective. The Bank has a number of other responsibilities that also support its financial stability objective including: as resolution authority responsible for managing the orderly failure of firms; providing liquidity insurance facilities (including emergency liquidity assistance to solvent but temporarily illiquid financial firms); and as regulator of financial market infrastructure.

The PRC: safety and soundness and micro-prudential regulation

16. In the wake of the 2007-2008 financial crisis, the Financial Services Authority was disbanded and, in its place, two new regulators were established: the PRA (as the lead authority for microprudential regulation) and FCA (as the conduct and markets regulator). Originally established as a legal subsidiary of the Bank, the PRA is now an authority within the Bank itself, and its functions are ultimately exercised through the PRC, a committee of the Bank.
17. The PRA has two primary objectives: a general objective to promote the safety and soundness of regulated firms, and an objective specific to insurance firms for the protection of policyholders. The PRA also has a secondary objective to facilitate effective competition in the market for services provided by PRA-authorised firms. The PRA advances its objectives primarily through rule-making and supervision in relation to PRA-regulated firms.
18. At least once a Parliament, HMT send the PRC a "recommendations" letter which sets out the aspects of the economic policy of the government to which the PRC should have regard when considering how to advance the PRA's objectives. The member of the PRC consists of five senior Bank officials, six external members

appointed by the Chancellor and the chief executive of the FCA. Unlike the MPC and FPC, HMT does not have a representative on the PRC.

Statement of Truth

I believe that the facts stated in this witness statement are true. I understand that proceedings may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief of its truth.

Signed:

Personal Data

Dated: 12 May 2023