positivemoney

# Bank of England Discussion Paper on the transition to a repo-led operating framework: Positive Money response

January 2025

Positive Money welcomes the opportunity to respond to the Bank of England's discussion paper on transitioning to a repo-led operating framework.

Positive Money is a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

**General Comments**

We are supportive in principle of the Bank of England's transition to a repo-based operating framework, in that it reflects Hyman Minsky's recommendation that financial institutions always be "in the bank" (i.e borrowing from the central bank), as this would enhance the central bank's supervisory capacity, and thus financial stability and monetary control. To this end we are particularly supportive of the Bank's guidance for SMF participants to pre-position sufficient levels of collateral.

As disinterested non-counterparties, our responses to the questions posed by the discussion paper are concerned primarily with the Bank's approach to the role of collateral in a repo-based operating framework, and how the Bank intends to meet its principles for transparency and accountability. We are particularly interested in how climate and environmental risks would be incorporated into any broadened use of collateral, and argue that it is warranted for the Bank to revise its collateral haircut framework, as well as eligibility framework, as part of the transition to a repo-led framework

Question 2: What are the key risks to our framework's effectiveness at achieving our stated policy aims? How should the Bank address these risks during transition?

As explored further in our response to question 13, there is a risk that the framework doesn't achieve the stated principle of transparency and accountability if the Bank does not publish sufficient information regarding usage, including the assets that have been accepted as collateral.

Furthermore, we are concerned that the Bank's current framework for collateral eligibility and haircuts does not sufficiently integrate climate and environmental (C&E) risks and impacts. Failing to sufficiently address these risks may undermine the Bank's primary objectives for price and financial stability, insofar as there is evidence to suggest that the collateral framework as it stands may be providing an implicit bias towards high-carbon and other environmentally damaging sectors – a bias that may be exacerbated in the transition to a repo-based operating framework if this is left unaddressed.

We welcome the Bank's recognition that climate change and nature loss represent material financial risks to our economies and the financial system, and thus are relevant to maintaining financial and price stability. There is now recognition that these risks are endogenous to the financial system, insofar as today's capital allocation locks in economic activities that are fuelling further C&E risks, further increasing transition risks and future physical risks, with such dynamics poorly reflected in dominant approaches to financial risk modelling.

Thorough integration of C&E risks and impacts into collateral frameworks is crucial for the Bank's stated aim of minimising risk to its balance sheet, as well as to ensure that the correct incentives are sent to market actors to reduce the risk of moral hazard and mitigate against systems-wide C&E risk. Quantitative analysis has shown that central bank collateral eligibility criteria and haircuts have signalling effects that materially impact the financing conditions of issuers' of financial assets. These impacts may intensify as a consequence of the transition of the Bank of England's operating framework, given the heightened dependence on collateral for banks' access to reserves in a repo-based operating framework.

We are supportive of the changes the Bank made in 2024 to collateral eligibility criteria based on UK Minimum Energy Efficiency Standards for buy-to-let mortgages, and the adjustment of haircuts based on energy price shock risk for owner-occupied mortgages and flood risk for all residential mortgages. Further steps could be taken by the Bank in this regard, such as assessing and incorporating physical risk exposure beyond flood risk, including risks from coastal erosion and extreme heat. More broadly, adjustments to collateral eligibility and haircuts are limited in their capacity to mitigate the C&E risks that mortgagors are exposed to. Sufficiently protecting the financial system from the potentially systemic financial risks posed by physical and transition C&E risks to properties will require complementary and coordinated government policy, such as through measures to support retrofitting and building adaptation. We would welcome further steps to assess and communicate these risks, including highlighting where mitigating such risks require actions that lie beyond the scope of the Bank.

We believe that there is a strong case, however, for the Bank to adjust its eligibility criteria and haircut treatment of non-financial and financial corporate assets accepted as Level B and C collateral. Doing so would support the mitigation of system-wide C&E risk, which would also support actions the Bank has taken already to mitigate risk in mortgage collateral, by addressing risk drivers. Such adjustments could include applying exclusion criteria to issuers' whose main economic activity is fossil fuel production, and adjusting haircuts based on C&E risk and impact criteria. Abdelli et al. (2024) have proposed a methodology to assess and integrate issuers' associated C&E risk and impacts based on the latest available data, notably, including an assessment of nature-related risks and impacts, as highlighted in the Chancellor's recent remit letters to the MPC, FPC and PRC

Question 13: We are seeking feedback on possible improvements to the Bank's documentation to support firms' operational engagement with the Bank. This includes the Bank's Market Operations Guide, operational process guides, loan pre-positioning guide, and collateral eligibility framework. What information do you currently access and what improvements or additions do you suggest?

As highlighted above, the transition to a demand-driven, repo-led framework has the potential to amplify the impact of collateral eligibility and central bank haircuts on issuers' financing conditions, with potentially significant implications for the climate, environment, and green transition. Given this, and given that the central bank's provision of liquidity acts as an essential public support for financial firms, we believe there is a strong case for increased transparency surrounding the collateral framework. Not only would such transparency be in the public interest, but it would enable civil society and academia to conduct research that would advance understandings of the impact of the collateral framework. The Bank of England could look to follow, for instance, the data provided by the European Central Bank on its collateral operations. Whilst the Bank of England provides broad eligibility criteria and haircuts, as well as a list of (unidentified) accepted assets, the ECB publishes nominal amounts of eligible marketable assets according to asset class, as well as collateral used and outstanding credit.

For more information on this response or any of Positive Money's wider work, please contact Simon Youel at simon.youel@positivemoney.org.uk.