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BoE sets up facility to buffer banks in event of chaotic Brexit

Weekly euro auctions are part of plan to ensure financial system functions smoothly



The BoE maintains the UK's financial system is strong enough to withstand the worst consequences of Britain leaving Europe without a deal © Reuters

Delphine Strauss and Phil Stafford in London and Claire Jones in Frankfurt 43 MINUTES AGO

The UK should expect “significant market volatility” in the event of a no-deal Brexit, even though the financial system is equipped to survive a worst-case scenario, the Bank of England warned on Tuesday, announcing the launch of weekly auctions of euro to ensure banks do not run out of cash.

The BoE and European Central Bank have activated a special currency arrangement, put in place after the global financial crisis, to ensure money markets do not seize up if Brexit leads to heightened turmoil. It complements existing dollar facilities and a move to weekly sterling auctions announced last week.

The new swap line is “a further prudent precaution” to ensure financial markets can function smoothly in the months spanning the UK’s departure from the EU, the Financial Policy Committee said in the published minutes of its meeting last week.

Feedback

The BoE maintains UK banks are strong enough to withstand the worst effects of a disruptive Brexit, with banks holding large buffers of capital that would allow them to survive for many months even if they were locked out from funding markets.

However, the central bank has issued a stark warning of the market turbulence that would be likely, if the UK [leaves the EU next month without a deal](#). The FPC noted that markets were already pricing in the risk of sharp moves in sterling, equities, gilts, corporate debt and in banks' funding costs.

"Financial stability does not guarantee market stability or economic stability," Mark Carney, the BoE governor, told the Lords economic affairs committee on Tuesday.

He said government action to mitigate the impact of a no-deal Brexit — including measures to limit disruption at borders — had reduced the potential impact, but "we would still expect there to be a material economic shock".

The FPC said it had taken action to address the main risks of disruption for UK insurers, asset managers and clearing houses, which sit between deals to ensure that a default on either side does not ripple through the market.

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But Mr Carney said there was still a risk of disruption to wholesale markets, since most European banks, asset managers and insurers trading with London-

based institutions were not yet ready to switch to an EU-based entity. "There will have to be a judgment by Europe of whether to enforce the rules," he said.

The FPC called attention to other risks that would largely affect the EU, but which could spill back into the UK. Among them: the treatment of a notional £20tn of derivatives contracts negotiated privately between banks, which mature after March.

Authorities in Brussels and the ECB have seen some of the UK regulators' claims about derivatives markets and insurance contracts as dubious and exaggerated.

Europe's main concern had been over the risk of being locked out of clearing euro-denominated derivatives, a market that is overwhelmingly centred on London. EU authorities have [issued temporary](#) year-long licences to ensure no immediate disruption to the clearing of derivatives after Brexit.

The BoE also warned that demand for UK assets would be likely to fall in a no-deal Brexit, because EU investors would be obliged to treat them as third-country assets, which are subject to tougher prudential regulation. EU investors hold less than 10 per cent of gilts and less than 15 per cent of UK bank debt, the BoE said.

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