City of London Chair of Policy
Calls with Washington DC policymakers. 4-5 May 2020

Summary:

- **Emergency COVID measures from the Government, Federal Reserve, Regulators and states have been effective in maintaining stability.**
- **We are just at the beginning. The crisis will take years to play out. Thinking on recapitalisation has just begun.**
- **Beneath the political turmoil, senior officials are working very strongly internationally. Daily regulator calls ensured sharing of approaches and prevented fragmentation. This close collaboration will continue through the easing of lockdown.**
- **The crisis has strengthened the case for UK-US regulatory dialogue to focus on thematic areas including operational resilience, innovation and ESG.**
- **Resumption of UK-US trade talks generated a buzz. Data flows and digital trade is an area where an FTA could add value by building on 'gold standard' USMCA.**

Detail:

COVID-19: The response

1. The first wave of the COVID crisis has passed. US policymakers are coming up for air. All reflect on a remarkable fiscal response and underpinning logistical effort, made even more impressive given the divisions in American society. Three and a half major pieces of legislation (the 'half' referring to re-provisioning existing programmes) have pumped $2.5 trillion into the economy. To date, support measures account for 16-17% of GDP with an additional $2 trillion expected by year end. The Fed receives a lot of credit: "there's nothing they won't buy", and "so many interventions they're running out of acronyms".

2. These efforts have averted a liquidity crisis. Derivatives markets served as a shock absorber rather than an amplifier of risk, especially in April. Clearing houses continue to function well. An emerging issue is the need to develop a better 'feel' for the financial stability role played by the non-bank sector.

3. Individual states have considerable authority to adapt their responses. Federal government sets the direction leaving state governors to apply local expertise: "North Dakota is very different to New York". Expect significant state-by-state differences in exiting lockdown and an element of economic competition between states. Many will turn to innovative models for attracting business back. The recent state banking delegation visit to London, coordinated by the Confederation of State Bank Supervisors, generated considerable interest in the FCA's sandbox model.

COVID-19: The recovery. A 'Nike Swoosh' rather than a 'V'

4. At best, this is the end of the beginning. Institutions are taking on debt right up the stack, from households to multinationals. US unemployment sits at over 30 million and rising. Policymakers

openly recognise that insolvencies are coming. The US is beginning to make painful choices on which sectors to save (many in US Treasury's International Affairs division are redeployed to support the aviation industry). Market forces will claim weakest firms and industries fastest with policymakers focused on minimising knock-on effects. The recovery will look more like a 'Nike Swoosh' than a 'V' with all recognising that it will be "a long slog back".

5. Unlike in 2008, the finance sector is seen as central to the recovery. Bank lending to SMEs comes in for specific praise. The Fed has implemented programmes providing medium-term financial support to non-financial firms. This is a break from the post '08 playbook and essentially a 'work around' as the Fed is not authorised to use QE for corporates.

6. Looking forward, the US response recognises that debt to equity transfer will be key element in recapitalising the post-COVID economy. Our conversations touched on various potential mechanisms and precedent: The Resolution Trust Corporation in the 80s, for example. There was interest in UK thinking in this area.

   Some specific areas of immediate concern:

   Banking:

7. This is a real economy shock transmitting to the banking system. American banks entered this crisis in a much stronger position with post-GFC reforms having reduced systemic risk significantly. Community banks, "the backbone of America", carry substantial mortgage exposure, however, and are less diversified than larger players. Prior to the crisis, 51 such institutions were on the FDIC's danger list. Given its parallel role as a supervisor, the FDIC sees itself as well placed compared to simple resolution authorities. There is concern for the immediate future of European banks, undercapitalised in American eyes: "the ECB is the only game in town".

   Mortgage markets:

8. The Fed, FDIC, US Treasury and state regulators are monitoring mortgage markets closely. To date, 20% of American mortgage holders have requested forbearance of some form. 14% missed rent payments in April with the true impacts expected to materialise over the coming months. When considering the pile-up of risks associated with non-payment, one state regulator reflected, "it feels like 2008".

   Rating agencies:

9. Credit rating agencies are back in the limelight. March saw the fastest pace of downgrades on record (dating back to 2002). Looking forward, we might expect deeper analysis into rating agencies' affect on corporate insolvencies and efforts to recalibrate methodologies.

   International arena:

10. The IMF is shifting focus from developing countries, where debt service suspensions coordinated with US Treasury have had a stabilising impact, to middle income economies. Some countries presumed to be secure are sending warning signs. Monitoring will aim to identify signs of financial crises emerging from the health crisis.

COVID: International cooperation:

11. Despite a disjointed political economy, the crisis has seen a significant uptick in international cooperation at an official level. Regulators talk of continual G20, IOSCO, Basel and FSB coordination meetings, the latter focused on the sharing of approaches (over 1000 measures

worldwide). This is seen as a universal positive across our discussions: “the machinery works”. Active UK-EU regulatory cooperation throughout the crisis is welcomed with some relief.

12. All underline the intention for these efforts to continue. As a result, our interlocutors expect to see a minimum of market fragmentation as we move out of this crisis. Despite additional responsibilities, US Treasury’s International teams remain focused on the day job with significant engagement ongoing with global partners – bilateral, G20, G7, World Bank, IMF etc.

UK-US regulatory cooperation:

13. As always, we were reminded of the strong relationships between US and UK regulators. Recent administrative UK-US agreements on the transfer of data and close collaboration on cross-border resolution are pertinent examples. There is momentum here and recognition that the US-UK Financial Regulatory Working Group could provide the mechanism for enhancing the bilateral regulatory relationship post-Brexit. US officials are keen for substantive business engagement on the issues to address. COVID strengthens the case for greater UK-US alignment in several areas:

ESG:

14. Senior officials recognise the opportunity to reorganise the economy during the COVID recovery. US scepticism of the EU taxonomy and COP26 could provide momentum behind a focus on ESG as central to the process. The IIF makes the case for greater international alignment in sustainable finance (here).

Cyber security and operational resilience:

15. COVID-19 has seen a documented rise in cybercrime. Increased UK-US information sharing, and public-private sector cooperation will be of immediate value with potential to underpin the longer-term efforts.

FinTech:

16. Innovation will be “one of the routes out of this crisis”. The UK and US, already leaders in FinTech and regulatory fora, have an opportunity to take this cooperation forward. The Financial Innovation Partnership provides a ready platform. As mentioned, individual states are developing thinking in parallel and several ‘sandbox bills’ are on hold. The US looks towards the UK on support for Fintech development. One state regulator told us the UK environment was “on par, if not better, than Silicon Valley”.

Data transfer:

17. US Treasury is placing emphasis on data connectivity in financial services. The US and Singapore recently committed to promoting “adoption and implementation of policies and rules in our bilateral and multilateral economic relationships” in the fields of data transfer (here). US Treasury would welcome business engagement on this agenda. There is recognition that UK-US FTA negotiations could make a positive contribution in this space.

Bilateral relationship: UK-US FTA:

18. Our calls coincided with the official launch of UK-US FTA negotiations. Conversations focused on the potential for an FTA to advance data transfer and digital elements of the trading relationship. In these fields, USMCA is seen as the ‘gold standard’. The Software and Information Industry Association (SIIA) senses appetite among US policymakers to explore ways for the UK and US to build on this agreement, pointing to USMCA itself having ‘grown’ from TPP. Concrete ideas from

the FPS sector would be welcome and a concerted effort to bring US regulators on board will be crucial.

19. USMCA's Chapter 17 covers financial services. Chapter 17.7 relates to 'New Financial Services' and includes commitments that should one party offer a new financial service within its territory, it must allow the other parties to offer the same. With both the UK and US at the forefront of developing new financial services, this is an area where deeper dialogue may be of value. An FTA should encourage regulatory cooperation which focuses on developing common understandings, for example on how such commitments interact with the Prudential Carveout. USMCA's Digital Trade Chapter 19 says that the Parties "shall endeavor" to cooperate on a range of issues important for digital trade. A UK-US FTA might delineate these areas further.

20. There is a belief that US-EU data flows will continue even as the European Cloud Initiative takes shape and the EU begins to include trade agreement provisions permitting the halting of data flows in certain circumstances. The concern relates to the precedent such an approach sets for less likeminded partners: China and India. Inclusion of more overt anti-data localisation measures in a UK-US agreement could apply pressure on the EU to tone back its own restrictions. There are issues at every level from industry to policymakers with the UK's upcoming digital tax. This risks becoming a roadblock to achieving a US-UK FTA.

21. We were reminded that USMCA remains a relatively new agreement and encouraged to consider how best to capture learnings to date. SIIA pointed to USMCA's tripartite financial services committee as a potential source of intelligence. There may be value in establishing a parallel stakeholder dialogue here.

Brexit:

22. We faced questions on the likelihood of transition being extended in the context of COVID-19, and the possibility of doing business against rolling temporary permissions regime extensions in systemic areas like clearing post 1 January 2021. US partners are looking forward to certainty having learned to be patient. All agree that various actors have addressed the stability risks and that the FPS sector is well-prepared for any eventuality.

List of meetings:

- Federal Reserve Board. Vice Chair Randal Quarles
- Commodity Futures Trading Commission. Chairman Heath Tarbert
- Federal Deposit Insurance Corporation. Chairman Jelena McWilliams
- Securities and Exchange Commission. Senior Counsel Alan Cohen. Director International Raquel Fox
- US Treasury. Undersecretary for International Affairs Brent McIntosh
- International Monetary Fund. First Deputy Managing Director Geoffrey Okamoto
- Institute of International Finance. President and CEO Tim Adams
- Software and Information Industry Association. VP Carl Schonander
- Conference of State Banking Supervisors. John Ryan CEO. Bret Afdahl Chair. Selected members
- Center for Strategic and International Studies. Senior VP Matthew Goodman and wider team