



**BANK OF ENGLAND**

**Mark Carney**  
Governor

The Rt Hon George Osborne  
Chancellor of the Exchequer  
HM Treasury  
Horse Guards Road  
London  
SW1A 2HQ

28 November 2013

*Dear Chancellor,*

The Funding for Lending Scheme (FLS) was launched jointly by the Bank and HM Treasury in July 2012, when credit conditions across the economy were worsening. Interest rates on lending to both businesses and households were elevated, reflecting rising bank funding costs. In April this year the scheme was modified and extended into 2014.

Since its launch the FLS has contributed to a substantial fall in bank funding costs. This has fed through to significant improvements in household credit conditions. Credit conditions for smaller businesses have also improved, but to a lesser extent, and lending to businesses overall remains muted. Meanwhile a recovery has taken hold in the UK although it is still at an early stage.

These positive changes in general economic conditions have been accompanied by a strengthening of the housing market. Although the growth in household loan volumes remains modest, activity is picking up and house price inflation appears to be gaining momentum.

In light of these developments, you and I have agreed that we should refocus the FLS so that it continues to support lending to the business sector, without adding further broad support to household lending at a time when that is no longer necessary. Accordingly Bank and HM Treasury officials have been working together to finalise plans for two changes to the terms of the FLS extension. These changes have no implications for HM Government's Help to Buy scheme, which is designed to address the specific issue that access to mortgages for borrowers without large deposits remains difficult, rather than to provide broad support to household lending.

The first change we are proposing to make to the FLS extension is that household lending in 2014 will no longer generate any additional borrowing allowances. Instead additional allowances will now only reflect lending to businesses in 2014. The initial borrowing allowances in the FLS extension already earned by household and business lending in 2013 will be unaffected.

The second change is that the fee for all drawings from the FLS extension will be set at 25 basis points, which is the lowest point of the previous fee scale. As we announced in April, lending to smaller businesses in 2014 will be encouraged by allowing banks to draw £5 in the scheme for every £1 of net lending to SMEs. Taken together, these features provide certainty over the availability of cheap funding to support small business lending in 2014.

I am conscious that one of the benefits of the FLS has been as a visible backstop to banks' funding costs, should there be renewed pressure on them from unexpected events. However, thanks to the

improvements the Bank recently announced to its liquidity facilities, I am confident that the additional backstop provided by the FLS is no longer required. Banks can rely on having sufficient access to liquidity in the Bank's facilities, without stigma, including during future periods of stress.

I have consulted both the Financial Policy Committee (FPC) and the Monetary Policy Committee (MPC) about these amendments to the FLS. In today's *Financial Stability Report* the FPC welcomed the changes in the context of its overall assessment of the risks to financial stability, including those arising from the housing market. The MPC has judged that there will be no material impact on the stance of monetary policy, and noted that these changes do not affect the MPC's policy guidance.

A Market Notice will be issued today setting out in further detail the changes to the FLS, and how the FLS will operate during 2014. The FLS will continue to be overseen by the joint Bank/HMT Oversight Board.

The re-focusing of the FLS towards business lending builds on its success to date and supports the achievement of the Bank's financial stability objective. I would be grateful if you would confirm that you are content with the proposed changes, and that the scheme remains within the remit of the Bank.

Yours,  
