Financial Policy Summary and Record of the Financial Policy Committee Meetings on 9 and 19 March 2020

Publication date: 24 March 2020

This is the record of the Financial Policy Committee meetings held on 9 and 19 March 2020.

It is also available on the Internet: https://www.bankofengland.co.uk/financial-policy-summaryand-record/2020/march-2020

The Financial Policy Committee (FPC) was established under the Bank of England Act 1998, through amendments made in the Financial Services Act 2012. The legislation establishing the FPC came into force on 1 April 2013. The objectives of the Committee are to exercise its functions with a view to contributing to the achievement by the Bank of England of its Financial Stability Objective and, subject to that, supporting the economic policy of Her Majesty's Government, including its objectives for growth and employment. The responsibility of the Committee, with regard to the Financial Stability Objective, relates primarily to the identification of, monitoring of, and taking of action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system. The FPC is a committee of the Bank of England.

The FPC's next Policy meeting will be on 24 June 2020 and the Record of that meeting will be published on 2 July 2020.

Financial Policy Summary

The backdrop to the Committee's March meetings has been dominated by the outbreak and spread of Covid-19 (Coronavirus). The nature and global impact of this shock, and the speed with which it has spread, is unprecedented in recent history.

The Financial Policy Committee (FPC) recognises that the front line of combating the challenges of Covid-19 comprises the extraordinary efforts of NHS health professionals, carers, and volunteers across the country, as well as the exceptional support provided by the Foreign and Commonwealth Office to UK citizens abroad.

Consistent with its remit, at its March meetings, the FPC has taken action to respond to the financial stability risks associated with the economic disruption resulting from Covid-19. These actions, taken in concert with actions taken by the Bank, the Monetary Policy Committee (MPC) and the Prudential Regulation Committee (PRC), have sought to reduce pressure on banks to restrict the provision of financial services, including the supply of credit and support for market functioning, and ensure that the financial system can be a source of strength for the real economy during this challenging period. Given the pace at which the situation is evolving, the FPC will continue to monitor closely the credit conditions faced by UK households and businesses and the operation of the UK financial system, and stands ready to take any further actions deemed appropriate to support UK financial stability.

Having built up the resilience of the UK financial system over recent years, the FPC judges that major UK banks are well able to withstand severe market and economic disruption. Major UK banks have Tier 1 capital levels of around 17.5% of risk-weighted assets — more than three times higher than before the global financial crisis. They hold £1 trillion of high-quality liquid assets, enabling them to meet their maturing obligations for many months. The FPC further judges that household vulnerability is considerably lower than before the financial crisis.

The UK countercyclical capital buffer (CCyB) creates an additional cushion for banks to absorb potential losses and continue lending. The FPC can release this buffer in a stress, meaning that banks can keep lending to households and businesses. This means that banks absorb rather than amplify shocks, and banks can be part of the solution to any stress, rather than contributing to the problem.

At its Policy meeting on 9 March, the FPC reduced the UK CCyB rate to 0% of banks' exposures to UK borrowers with immediate effect. The rate had been 1% and had been due to reach 2% by December 2020. This action supports further the ability of banks to supply the credit needed to bridge a potentially challenging period, and reinforces the FPC's expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks can be drawn down as necessary.

The FPC welcomed the PRC's supervisory guidance that banks should not increase dividends or other distributions in response to these policy actions. The FPC expects that the additional capital headroom will be used to support the real economy.

The release of the CCyB amounts to £23 billion of capital, which can support up to £190 billion of bank lending to businesses. That is equivalent to 13 times banks' net lending to businesses in 2019.

The FPC has also made clear that it expects to maintain the 0% rate for at least 12 months. Due to the usual 12-month implementation lag, any subsequent increase would not be expected to take effect until March 2022 at the earliest. In addition, the pace of return to a standard-times rate of in the region of 2% will take into account how far banks' capital has been depleted through this period and thus the task to rebuild capital.

Together with the Bank's new Term Funding Scheme (TFSME), announced by the MPC on 11 March, which will increase the availability of funding for banks and thus lending, especially to small and medium-sized enterprises, these actions mean that banks should not face obstacles to supplying credit to the UK economy.

At its Policy meeting on 19 March, the FPC reviewed developments and actions since its meeting on 9 March. The FPC welcomes the announcement by HM Treasury and the Bank of England of a Covid Corporate Financing Facility (CCFF) to provide additional help to firms to bridge through Covid-19 related disruption to their cash flows.

By providing an alternative source of financing for companies that make a material contribution to the UK economy, and that had an investment-grade rating (or equivalent) prior to being affected by Covid-19, the CCFF will help to retain the capacity of the banking system to lend to a much broader range of companies, including small and medium-sized enterprises. That capacity was boosted by the reduction in the UK countercyclical capital buffer and the launch of the TFSME.

Businesses and households should be able to turn to the banking system to meet their need for credit to bridge through this period of economic disruption. The FPC, together with the PRC, will monitor closely the response of banks to these measures as well as the credit conditions faced by UK businesses and households more generally.

Stress testing

At its Policy meeting on 19 March the FPC, together with the PRC, agreed to cancel its 2020 annual stress test of major UK banks and building societies. The decision to cancel the 2020 stress test will help lenders focus on meeting the needs of UK households and businesses via the continuing provision of credit.

The FPC, together with the PRC, also agreed to pause the 2019 biennial exploratory scenario on liquidity until further notice. It had been due to publish the results of this exercise in mid-2020.

The FPC supports the Financial Conduct Authority's (FCA's) decision to postpone its survey into open-ended funds, which was planned in the context of the joint Bank/FCA open-ended funds review. The survey has been delayed until further notice.

Record of the Financial Policy Committee meeting held on 9 and 19 March 2020

Record of 9 March

1. The Committee met on 9 March. Immediate developments were dominated by the spread of Covid-19 (coronavirus) and the consequent market and real economy developments.

2. In the run-up to this meeting, the FPC had, jointly with the Monetary Policy Committee (MPC) and the Prudential Regulation Committee (PRC), been briefed by Bank staff on recent developments, including: monetary and financial conditions, current global and domestic economic conditions. In preparation, Bank staff had been briefed extensively by health experts who had been advising the Government.

3. The FPC recognised that the front line of combatting the challenges of Covid-19 comprised the extraordinary efforts of NHS health professionals, carers, and volunteers across the country, as well as the exceptional support by the Foreign and Commonwealth Office to UK citizens abroad.

4. The initial outbreak of Covid-19 in China had been associated with substantial disruption to activity as the authorities looked to contain the spread of the virus. The Purchasing Manager Indices (PMI) in China had fallen to their lowest ever levels in February and were consistent with a significant fall in GDP. By the 9 March meeting there were already signs of global supply chains being affected, with business surveys in the United States and the euro area pointing to lengthening supplier delivery times. As the virus spread to other countries, the impact on global activity was likely to become more severe, including in the United Kingdom. This marked deterioration in the global outlook was against the backdrop of already weak global growth and areas of material financial vulnerabilities in some countries.

5. These developments had been reflected in major equity indices which had fallen sharply since 19 February. By 9 March the S&P 500 equity index was down by 12%, the Eurostoxx by 22%, the FTSE All Share by 19% and the MSCI emerging market equities index by 8%. The VIX – a measure of volatility – had reached levels seen during the global financial crisis - Both investment grade and high-yield corporate bond spreads had widened materially over this period. Primary issuance had been affected severely. There had been a marked decline in market liquidity and functioning, especially in fixed income markets. Global equity and corporate bond funds had seen substantial net outflows in the immediate period leading up to the FPC's meeting on 9 March.

6. By 9 March UK bank funding costs had increased markedly across the board from 19 February. Wholesale unsecured funding spreads had increased. UK Bank CDS spreads and option adjusted spreads on UK banks' additional Tier 1 issuance had also risen to over 60bps and 400bps respectively. Major UK banks' equity prices had fallen markedly: those of domestically focussed banks had fallen by over 20% while those of internationally focussed banks had fallen by over 10%.

7. Although the magnitude of the economic shock from Covid-19 and measures to control the spread of the virus spread were highly uncertain, activity was likely to weaken materially in the United Kingdom over the coming months. Disruptions to supply chains and weaker activity could challenge cash flows and increase demand for credit from households and working capital from companies.

8. There was therefore a clear case for policies which would help the economy bridge through a period of disruption.

9. The FPC noted that given the prevailing uncertainty around the outlook, it would be very challenging for financial institutions, firms, banks and auditors to make judgements about the outlook for the economy at this time. In the event firms believe they can make any such judgements, they should ensure they reflect the temporary nature of the shock, and fully take into account the economic support measures announced by fiscal and monetary authorities globally.

Banking sector resilience

10. The FPC considered that the economic disruption associated with Covid-19 should have less impact on the core banking system than recent stress tests run by the Bank have shown the system can withstand.

11. Those stress tests demonstrated that banks would be able to continue to lend to households and businesses even while absorbing the effects of substantial, prolonged economic downturns in both the UK and global economies, that were more severe than the global financial crisis, as well as falls in asset prices much larger than experienced in recent weeks. The moves in the FTSE, S&P 500 and Eurostoxx were all less than half the falls in the scenario in the Bank's Annual Cyclical Scenario (ACS), however measures of volatility had reached levels higher than in the ACS.

12. The disruption from Covid-19 would likely be more severe than the stress test in the first phase but the FPC expected that it would ultimately be less protracted and lead to less output loss overall over the course of two years than the ACS which contained a very prolonged fall in output.

13. Major UK banks are well able to withstand severe market and economic disruption. Major UK banks have maintained Tier 1 capital levels of around 17.5% of risk-weighted assets - more than three times higher than before the global financial crisis. And they hold £1 trillion of high-quality liquid assets, enabling them to meet their maturing obligations for many months.

14. **Given the resilience of the core banking system, businesses and households should be able to turn to it to meet their need for credit to bridge through a period of economic disruption.**

The FPC noted that UK households and corporates had considerable undrawn facilities at around £140bn and £260bn respectively and that there could be an increase in demand for credit. The FPC judged that if banks continued to provide financial services to the real economy this would help households and businesses bridge through the disruption, limiting corporate distress and unemployment, thereby helping to minimise the longer-term impact of any downturn resulting from Covid-19.

UK Countercyclical Capital Buffer rate

15. Having built up the resilience of the UK financial system over recent years the FPC considered how the financial system should be a source of strength to the real economy. The FPC considered actions to reduce any pressure on firms' ability to support the provision of financial services, including the supply of credit.

16. The Committee considered that although the situation was developing rapidly, there was enough information to warrant a timely response.

17. A review of the Basel 'buffer guide' – a simple metric based on the gap between the ratio of credit to GDP and its long term trend which the FPC was required by legislation to consider when setting the CCyB rate – did not change this view.

18. The FPC had previously stated, for example in the December 2019 Financial Stability Report, that it stood ready to move the CCyB in either direction as economic conditions and the overall risk environment evolved.

19. The FPC considered that ensuring firms and households could bridge the downturn would ultimately increase the resilience of the banking sector and it was therefore in the banking sector's collective interest.

20. At its policy meeting on 9 March, the FPC agreed to reduce the UK CCyB rate to 0% with immediate effect. The rate had been 1% and had been due to reach 2% by December 2020.

21. The cut in the CCyB reinforced the FPC's expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks could be drawn on, as necessary to support the economy.

22. The FPC welcomed the PRC's supervisory guidance that banks should not increase dividends or other distributions in response to these policy actions. The FPC expected that this additional capital headroom would be used to support the real economy.

23. The FPC noted that this cut would increase further the ability of banks to supply the credit needed to bridge a potentially challenging period. Cutting the CCyB rate to 0% rather than continuing with the increase to 2% would release £23bn of capital. This could support up to £190bn of business lending capacity, or thirteen times banks' net lending to the business sector in 2019.

24. The FPC welcomed the Term Funding Scheme with additional incentives for SMEs (TFSME), whereby additional funding would be available for banks that increase lending, especially to small and medium sized enterprises.

25. **Together with the new term funding scheme, this action meant that banks should not face obstacles to supplying credit to the UK economy. The FPC would monitor closely the response of banks to these measures as well as the credit conditions faced by UK businesses and households more generally.**

Future CCyB setting

26. At its December meeting the FPC had raised the level of the UK CCyB rate that it expected to set in a standard risk environment from in the region of 1% to in the region of 2%.

27. Reflecting the additional resilience associated with higher macroprudential buffers, the Prudential Regulation Authority (PRA) had begun consulting on proposals to reduce minimum capital requirements in a way that leaves overall loss-absorbing capacity (capital plus bail-inable debt) in the banking system broadly unchanged. **The FPC welcomed this ongoing consultation on reducing minimum requirements.**

28. **Having now cut the CCyB rate to 0% the FPC expected to maintain the 0% rate for at least 12 months**. **Due to the usual 12 month implementation lag, any subsequent increase would not be expected to take effect until March 2022 at the earliest.** The FPC noted the

importance of being clear with banks that although it expected the economic downturn to be short-lived, the cut in the CCyB would not be immediately reversed; thereby providing assurance that this capital was usable. A return to a standard times UK CCyB rate in the region of 2% would only be expected to occur when the risk environment returned to standard. Additionally, the pace of any return to a standard times rate in the region of 2% would take into account how far banks' capital had been depleted through this period and their ability to rebuild capital whilst continuing to support the UK economy and lend to households and businesses.

29. The FPC considered that it was important to continue to monitor closely the credit conditions faced by UK households and businesses, in particular for any unwarranted tightening. The FPC pointed to the monitoring of credit conditions, which had been put in place as contingency for the withdrawal from the EU, and the network of Bank of England Agents who have extensive contacts with local businesses.

30. As the outlook evolved, the FPC stood ready to take any further actions deemed appropriate to support UK financial stability.

Record of the 19 March Meeting

Stress testing and supervisory action

31. The FPC, together with the PRC, agreed to cancel the 2020 annual cyclical scenario (ACS) stress test of major UK banks. This was intended to free up resources in the Bank and at banks, when those same resources could be better used monitoring, forecasting and reacting to the impacts of the virus. The decision was also consistent with the FPC and PRC expectation that all elements of banks' capital and liquidity buffers should be drawn down as necessary to support the economy through this shock.

32. The FPC was of the view that cancelling the 2020 ACS would have modest costs but these were easily outweighed by the benefits.

33. The FPC would need to form a view about the resilience of the banking system throughout 2020 to provide reassurance and inform further policy action. While in principle the ACS could provide this, the FPC judged that it would be better to use banks' own in-house stress testing plus the Bank's desk-based analysis, given the rapid pace of developments.

34. Importantly however, the FPC noted that the results of the 2019 ACS had shown that the UK banking system would be resilient to deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis.

35. The FPC, together with the PRC, agreed to pause the 2019 biennial exploratory scenario (BES) on liquidity until further notice. The results of this exercise were due to be published in mid2020. Similar to the annual cyclical scenario, pausing the 2019 BES would free up resources in the Bank and at banks when those same resources could be better used monitoring, forecasting and reacting to the impacts of the virus.

36. The FPC noted that the discussion paper on the 2021 biennial exploratory scenario on the financial risks from climate change had asked for responses by 18 March 2020. The FPC supported the Bank in its intention to take stock of those responses as well as the evolving situation, with a view to announcing the way forward for this exercise in the summer.

37. The FPC also welcomed work undertaken by the Bank and the PRA to identify a number of other prudential supervisory and policy measures, targeted at alleviating operational burdens faced by firms and financial market infrastructure providers in the current environment. These measures were due to be announced as part of a package of measures, including the above stress testing actions, on Friday 20 March.

Covid Corporate Financing Facility

38. The FPC welcomed the announcement by HM Treasury and the Bank of England of a Covid Corporate Financing Facility to provide additional help to firms to bridge through Covid-19-related disruption to their cash flows. The FPC noted that this scheme would help to retain the capacity of the banking system to lend to a very broad range of companies, including small and medium sized enterprises, and considered that this scheme complemented the measures announced previously including the FPC’s cut in the UK CCyB rate to 0% and the Bank of England’s Term Funding Scheme for SMEs.

Open-ended funds

39. The FPC had previously discussed the risks to UK financial stability associated with liquidity mismatch in open-ended funds. The mismatch between redemption terms and the liquidity of some funds’ assets meant there was an advantage to investors who redeemed ahead of others, which could create run dynamics and lead to forced sales of assets at prices well below their fundamental value, particularly in a stress. That had the potential to become a systemic risk.

40. The Bank and the FCA were undertaking a joint review to assess how redemption terms might be better aligned with the liquidity of funds' assets. At its December meeting, the FPC had established three principles for achieving greater consistency between the liquidity of a fund's assets and its redemption terms. These related to the classification of the liquidity of different assets, notice periods and pricing.

41. The FPC received an update on the progress of the review, building on the principles established by the Committee at its December meeting. Further work was being undertaken to consider how those principles could be implemented in practice. FPC members emphasised that the design of different options should consider their impact on the supply of finance to the real economy through the cycle.

42. The FPC received details of a planned survey covering c.300 funds in the context of the joint Bank/FCA open-ended funds review. The FPC supported the FCA's decision to postpone this survey to reduce the operational burden on firms at this time.

The FPC would review progress later in 2020.

Decisions taken by written procedure

43. Following briefings on the subject prior to the disruption caused by Covid-19 the FPC took additional decisions by written procedure on 23 March.

The UK-EU relationship

44. Prior to the disruption caused by Covid-19, the Committee had been reviewing developments since its meeting in November. The UK had left the EU with a withdrawal agreement on 31 January 2020, entering an 11-month transition period. The UK and EU would negotiate their future relationship during the transition period, including the future terms on which trade would take place.

Disruption to cross-border financial services at the end of the transition period

45. The FPC reviewed and approved a checklist of actions that would mitigate risks to financial stability that could arise from disruption to households and companies if no further arrangements were put in place for cross-border trade in financial services for the end of the transition period on 31 December 2020. This checklist would be published alongside the Record of the Committee's March meetings.

46. The FPC judged that, reflecting extensive preparations by authorities and the private sector, should the transition period end without the UK and EU agreeing specific arrangements for financial services, most risks to UK financial stability that could arise from disruption to cross-border financial services had been mitigated.

Future Regulatory Framework

47. The Committee noted that HM Treasury had launched its Financial Services Future Regulatory Framework Review ('the Review') in June 2019. The next phase of this of this Review would look at the overall coherence and effectiveness of the UK's regulatory framework following the UK's withdrawal from the EU. The Committee would evaluate developments in this Review against the benchmark of its commitment to the implementation of robust prudential standards in the UK.

48. Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the FPC would remain committed to the implementation of robust prudential standards in the UK. This would require maintaining a level of resilience that is at least as great as that currently planned, which itself exceeds that required by international baseline standards, as well as maintaining UK authorities' ability to manage UK financial stability risks.

FPC remit letter March 2020

49. On 11 March, the FPC had received from the Chancellor a letter setting out the economic policy of Her Majesty's Government and Treasury's recommendations under Sections 9D-9E of the Bank of England Act 1998. The FPC would respond in due course.

Open-ended funds

50. In July 2019, the FPC discussed the potential UK financial stability risks from open-ended funds. As part of that discussion, the Financial Conduct Authority (FCA) briefed the FPC that, in the event of a disorderly Brexit, some open-ended commercial real estate (CRE) funds could be suspended, as they were after the referendum.

51. At that stage, the Committee agreed that disclosure of this briefing could act to raise the probability of the risks of suspension being triggered in the event of Brexit. The Committee therefore agreed that it was against the public interest to publish its discussion of this briefing in the Record of its meeting and decided to defer publication, under Section 9U of the Bank of England Act 1998. It agreed to review this text after Brexit had occurred.

52. At its March meetings,[1] the Committee agreed that it remained against the public interest to publish this discussion. This was on the grounds that there remained a risk that disclosure could act to raise the probability of suspension being triggered, as cliff-edge risks remained and current volatility and market sentiment were already contributing to fund suspensions. The FPC decided to continue to defer publication, under Section 9U of the Bank of England Act 1998. It would review again after the end of the Transition Period.[2]

[1] The decision set out in paragraph 52 was taken by written procedure on 23 March, following briefing and deliberations during the quarter.
[2] The text in this and the two preceding paragraphs was omitted from the version of the Record that was initially published on 24 March 2020. The Committee agreed at its 11 March 2021 meeting to publish this text, for the reasons set out in the Record of that meeting.

At the 9 March meeting the following members of the Committee were present:

Mark Carney, Governor
Jon Cunliffe, Deputy Governor responsible for financial stability
Ben Broadbent, Deputy Governor responsible for monetary policy
Dave Ramsden, Deputy Governor responsible for markets and banking
Sam Woods, Deputy Governor responsible for prudential regulation
Colette Bowe
Alex Brazier
Anil Kashyap
Donald Kohn
Elisabeth Stheeman
Martin Taylor
Andrew Bailey, Chief Executive of the Financial Conduct Authority
Charles Roxburgh attended as the Treasury member in a non-voting capacity.

As permitted under the Bank of England Act 1998, Bradley Fried was present at the 9 March meeting as observer in his role as a member of Court.

At the 19 March meeting the following members of the Committee were present:

Andrew Bailey, Governor
Jon Cunliffe, Deputy Governor responsible for financial stability
Ben Broadbent, Deputy Governor responsible for monetary policy
Dave Ramsden, Deputy Governor responsible for markets and banking
Sam Woods, Deputy Governor responsible for prudential regulation
Colette Bowe
Alex Brazier
Anil Kashyap
Donald Kohn
Elisabeth Stheeman
Martin Taylor
Christopher Woolard, interim Chief Executive of the Financial Conduct Authority
Charles Roxburgh attended as the Treasury member in a non-voting capacity.

As permitted under the Bank of England Act 1998, Diana Noble was present at the 19 March meeting as observer in her role as a member of Court.

ANNEX: PREVIOUS FPC POLICY DECISIONS

Outstanding FPC Recommendations and Directions

The FPC has no Recommendations or Directions that have not already been implemented.

Other FPC policy decisions which remain in place

The table below sets out previous FPC decisions, which remain in force, on the setting of its policy tools. The calibration of these tools is kept under review.

Topic	Calibration
Countercyclical capital buffer rate	The FPC agreed at its meeting on 9 March 2020 to set the UK CCyB rate at 0%. This would take effect immediately. This rate is reviewed on a quarterly basis. The UK has reciprocated a number of foreign CCyB decisions — for more details see the Bank of England website.[1] Under PRA rules, foreign CCyB rates applying from 2016 onwards will be automatically reciprocated up to 2.5%. Cuts to foreign CCyB rates have been reciprocated automatically.
Mortgage loan to income ratios	In June 2014, the FPC made the following Recommendation (14/Q2/2): The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) should ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at loan to income ratios at or greater than 4.5. This Recommendation applies to all lenders which extend residential mortgage lending in excess of £100 million per annum. The Recommendation should be implemented as soon as is practicable. The PRA and the FCA have published their approaches to implementing this Recommendation: the PRA has issued a policy statement, including rules,[2] and the FCA has issued general guidance.[3]
Mortgage affordability	At its meeting in June 2017, the FPC replaced its June 2014 mortgage affordability Recommendation to reference mortgage contract reversion rates: When assessing affordability, mortgage lenders should apply an interest rate stress test that assesses whether borrowers could still afford their mortgages if, at any point over the first five years of the loan, their mortgage rate were to be 3 percentage points higher than the reversion rate specified in the mortgage contract at the time of origination (or, if the mortgage contract does not specify a reversion rate, 3 percentage points higher than the product rate at origination). This Recommendation is intended to be read together with the FCA requirements around considering the effect of future interest rate rises as set out in MCOB 11.6.18(2). This Recommendation applies to all lenders which extend residential mortgage lending in excess of £100 million per annum. At its meeting in September 2017, the FPC confirmed that the affordability Recommendation did not apply to any remortgaging where there is no increase in the amount of borrowing, whether done by the same or a different lender.

[1] https://www.bankofengland.co.uk/financial-stability
[2] http://www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps914.pdf
[3] https://www.fca.org.uk/publications/finalised-guidance/fg17-2-fpc-recommendation-loan-income-ratiosmortgage-lending