Financial Policy Summary and Record of the Financial Policy Committee Meeting on 30 September 2020

Publication date: 8 October 2020

This is the record of the Financial Policy Committee meeting held on 30 September 2020.

It is also available on the Internet: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/october-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 30 November 2020 and the record of that meeting will be published on 10 December 2020.

Financial Policy Summary

The Financial Policy Committee (FPC) aims to ensure the UK financial system is prepared for, and resilient to, the wide range of risks it could face — so that the system can serve UK households and businesses in bad times as well as good.

UK households and businesses have needed support from the financial system to weather the economic disruption associated with Covid-19. Reflecting the resilience that has been built up since the global financial crisis, and the extraordinary policy responses of the Government and of the Bank of England, the financial system has so far been able to provide that support.

There is a range of near-term risks facing the UK financial system. Further economic disruption and market volatility could result from: the evolution of the Covid-19 pandemic and measures taken to protect public health; the transition to new trading arrangements between the European Union and the United Kingdom; and various geopolitical risks. Against that backdrop, the FPC conducted its review of UK financial stability including the outlook for the continued provision of support by the financial system to households and businesses.

The outlook for financial stability

Banks

The UK banking system remains resilient to a very wide range of possible economic outcomes. It has the capacity to continue to support households and businesses. This reflects the build-up since the global financial crisis of substantial buffers of capital. In August, the FPC judged that, even if the recent economic disruption were to be followed by events with an economic impact worse than that seen since March, and unemployment were to rise to around 15%, the cumulative losses incurred by the major UK banks and building societies ("banks") since the beginning of the pandemic would deplete only around 60% of their buffers of capital.

Buffers of capital exist to be drawn down in stress; this enables banks to continue to support the economy while weathering losses. The FPC expects all elements of capital buffers to be used as necessary. In support of this, the FPC reduced the UK countercyclical capital buffer rate to 0% in March 2020.

Cutting support to the economy to avoid the use of capital buffers would be costly for the wider economy and consequently for the banks themselves. The FPC supports the Bank in its work to continue to monitor the use of capital buffers and assess the extent to which temporary changes to the capital framework may be necessary. The Basel Committee on Banking Supervision has committed to monitoring risks and vulnerabilities to the global banking system from Covid-19 and pursuing additional measures if needed.

Provision of financial services at the end of the transition period with the EU

Most risks to UK financial stability that could arise from disruption to the provision of cross-border financial services at the end of the transition period have been mitigated. The mitigation of these risks reflects extensive preparations made by authorities and the private sector over a number of years.

The EU has adopted a decision to provide equivalence to the future UK legal and supervisory framework for Central Counterparties (CCPs) until June 2022, and UK CCPs have been recognised by the European Securities and Markets Authority. This will allow EU financial firms to continue to use UK CCPs after the end of the transition period, mitigating the financial stability risk in markets for cleared derivatives.

Financial stability is not the same as market stability or the avoidance of any disruption to users of financial services. Some market volatility and disruption to financial services, particularly to EU-based clients, could arise.

Financial institutions are continuing to make preparations and engage with clients and customers to minimise any disruption and it is important that they continue to do so.

Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the FPC remains committed to the implementation of robust prudential standards in the UK. This will 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.

Global efforts to address issues in non-bank financial intermediation

Large-scale central bank policy intervention stabilised markets in March after an abrupt and disruptive 'dash for cash' in the non-bank financial system resulted in forced sales of assets and put pressure on the functioning of a range of important markets. Markets have since functioned well, although further episodes of market disruption are possible in the event of very sharp changes in economic prospects due to the crisis.

Given this, it is crucial that the causes of the disruptive 'dash for cash' are fully analysed and that, where necessary, remedial action is taken to ensure the resilience of the financial system. Recognising the global nature of markets, work to assess and ensure the resilience of non-bank financial intermediation is being internationally co-ordinated.

The FPC sees a need to examine and address the:

- **mismatch between the liquidity of assets held in open-ended funds – including money market funds - and the redemption terms offered by those funds.** This mismatch can exacerbate stress in the financial system.

- **demands of non-bank financial intermediaries for liquidity in stress.** These arose in the March stress from forced unwinding of leveraged positions and from increases in derivative margin calls.

The FPC welcomes the Financial Stability Board's (FSB) holistic review of resilience in the non-bank financial intermediation sector in light of the Covid-19 shock, due to be delivered to the G20 summit in November. The Bank and FCA are actively participating in the FSB's review.

The non-bank financial system will always have some need for additional liquidity in stress. It is important to ensure that this need can be met in ways that avoid forced sales of assets and disruption to market functioning. Prudent management by non-bank intermediaries of their own liquidity positions is essential for their resilience to stress. Seeking to increase the supply of liquidity from banks to non-banks in stress by compromising on the resilience of banks would not be acceptable or effective.

In addition, the FPC considers it important to examine whether central banks should have facilities to provide liquidity to the wider financial system in stress, in order to support market functioning. Any such backstop of liquidity would need to be provided in a way that is not just effective and efficient but that also, through appropriate pricing and accompanying regulatory requirements, reduces incentives for excessive risk taking in the future.

Domestic review of funds and productive finance

HM Treasury has recommended that the FPC consider how the UK financial system could better support the supply of finance for productive investment. As part of that work, the FPC is seeking to address distortions that discourage the use of funds with longer redemption notice periods or closed-ended funds. Such funds are suited to highly illiquid long-term assets, such as real estate, infrastructure and unlisted equity and therefore offer opportunities to increase the supply of productive finance.

The FPC had already concluded that greater alignment of funds' notice periods, pricing approaches and asset liquidity would help to remove some distortions.

The FPC judged that the FCA's recent proposals to extend the redemption notice periods for open-ended property funds were better aligned with principles the FPC had previously set out to address liquidity mismatch in open-ended funds. The FPC considered that, from the perspective of financial stability, and given the illiquidity of property assets in stressed conditions, there would be benefits from extending notice periods to at least as far as the range proposed in the consultation.

More broadly, to increase the supply of productive finance, the FPC considers that further work is now needed by authorities, funds, platforms and investment managers acting in concert to ensure that pools of capital are able to be deployed into fund structures with longer notice periods.

Record of the Financial Policy Committee meeting held on 30 September 2020

1. The Financial Policy Committee (FPC) met on 30 September 2020 to agree its outlook for financial stability and, on the basis of that, its intended policy action. It discussed the risks faced by the UK financial system and assessed the resilience of the system to those risks.

2. The Committee noted the challenging backdrop to its discussion. There was a range of near-term risks facing the UK financial system. Further economic disruption and market volatility could result from: the evolution of the Covid-19 pandemic and measures taken to protect public health; the transition to new trading arrangements between the European Union (EU) and the United Kingdom; and various geopolitical risks. Against that backdrop, the FPC conducted its review of financial stability including the outlook for continued provision of support by the financial system to households and businesses.

Macro-economic and financial market back-drop

3. The Committee reviewed economic and market developments since August.

4. UK GDP had fallen by 20% in Q2 – in line with the estimate in the August Monetary Policy Report (MPR) – and by a cumulative 22% over the first half of 2020. Some indicators – such as from high frequency payments data – suggested that aggregate consumer spending had returned to its start-of-year level. But the FPC noted that, and as had been highlighted by the Monetary Policy Committee (MPC) at its September meeting, it was still unclear whether the recovery in household spending would be sustained over the rest of the year.

5. The FPC observed that market functioning had not materially changed since the August Financial Stability Report (FSR). Conditions in secondary bond markets remained stable, with bid-offer spreads settling somewhat at about pre-Covid-19 levels. Bond fund inflows had also supported market functioning.

6. The FTSE All-Share had fallen slightly since the August FSR, and had underperformed other major indices. The FPC noted that this might have reflected a number of factors, including that UK Index being skewed towards sectors that have been hard hit by the pandemic and a discount related to the uncertainty of the form of the UK's future relationship with the EU.

The performance of the UK financial system during the Covid-19 pandemic

7. The Committee reviewed how the financial system had supported households and corporates through the Covid-19 disruption and how it was meeting the demand for credit.

8. On the assumption that the economy followed the central path in the August MPR, the August FSR had estimated a total cash flow deficit for UK corporates of up to £200bn in the 2020-2021 financial year. Of this, around £125bn related to larger companies, and around £40-70bn to smaller companies. UK corporates had raised a total of £78bn net finance since the onset of the crisis. After a sharp increase at the beginning of the crisis, the demand for new finance had eased off in recent months for both small and large corporates: in August, net finance raised had been around £6bn, similar to pre-Covid-19 levels.

9. The FPC noted the gap between the estimated cash-flow deficit and net finance raised and considered the possibility that some companies might be responding to cash flow pressure through adjustments that do not involve borrowing, such as running down cash balances, asset sales and cost-cutting or even ceasing their operations, all of which would reduce the amount of external finance required to finance companies' cash-flow deficits. For example, as an upper bound, given that many companies might prefer to preserve existing cash balances, larger firms' cash buffers could potentially fill around two-thirds of their deficits.

10. Supervisory and market intelligence suggested that the initial shock from the impact of Covid-19 had been bridged for most firms. There had not been widespread reports of companies that were unable to access finance, UK corporate insolvencies remained low, and lending through government-backed loan guarantee schemes had levelled off, with £57bn being approved through schemes by mid-September compared to £31bn by May. This suggested that the demand for finance was largely being met by the supply of credit. However, intelligence from the Bank's regional Agents suggested that there were some pockets of unmet borrowing needs which might translate into signs of distress in the coming months.

11. While the number of UK corporate insolvencies had remained low to date, the FPC judged it would probably increase. Some companies may struggle because they were highly leveraged or unprofitable prior to March and others faced pressure because of structural changes in the economy.

12. It was likely that, when these government-backed loan guarantee schemes closed to new applications, the cost of credit provided to companies would increase given the uncertainty about the economic outlook. The FPC agreed that it would monitor closely the evolution of corporate credit conditions as these schemes closed to new applications.

13. The FPC considered conditions for households. The Committee noted the analysis from the August FSR which estimated that the share of households with high mortgage debt-to-service ratios would likely increase to 1.4% by the end of 2020, still below the pre-global financial crisis peak of 2.7%, and would fall marginally by the end of 2021. The FPC considered that these estimates were subject to considerable uncertainty given the risks to the economic outlook.

14. At the peak in June, over 1.8 million mortgage payment holidays had been granted to UK households, so that debt-servicing pressures had remained low even as incomes had been under pressure.

15. Looking across 2020 as a whole, housing market activity had been weaker than in recent years, reflecting the very low level of transactions and approvals in Q2. But housing market activity had picked up rapidly in Q3. Approvals for house purchases had reached their highest levels since October 2007. The FPC considered that the recovery was largely due to pent-up demand and the announcement in early July of the stamp duty holiday for all residential properties on the portion of the property valued below £500,000.

16. Having been at unusually low levels by historical standards before March, the spread over the risk-free rate on mortgages at higher loan-to-value (LTV) ratios had increased in recent months. In August, the spread over the risk-free rate on 2 year 90% LTV mortgages was 2.82%, 0.28pp higher than in July and 1.07pp higher than in March. In March, lenders had largely withdrawn from high LTV lending and had only just begun to return. The FPC considered that this was likely to reflect uncertainty about the prospects for the economy, unemployment and house prices.

17. There had been an increase in the proportion of lending at loan-to-income (LTI) multiples above 4.5 in recent months, and June had seen the biggest month-on-month pick-up in the share of high LTI mortgage lending since the FPC mortgage market recommendations were introduced in 2014. This was likely to partially reflect a more conservative income assessment by several large lenders. Nonetheless, the latest data for Q2 showed that there remained significant headroom below the FPC's loan-to-income flow limit of a maximum of 15% of loans at or above a 4.5 LTI in aggregate and for the majority of lenders. The FPC would monitor this, as well as the overall degree of support for households over coming months, in particular the treatment of stressed borrowers, together with the extent to which those on payment holidays were able to return to full payments.

Other near-term risks

18. There could be disruption to businesses and economic activity at the end of the transition period with the EU. At that point, the UK would leave the EU's Single Market and Customs Union and trading arrangements would change. Customs and some regulatory checks would be introduced at the border, market access arrangements would change for services and, if the UK and EU did not reach a free trade agreement, tariffs would be introduced. Survey evidence suggested that many businesses were not yet fully prepared for these changes. The Government was providing guidance to businesses and investing in infrastructure to support the flow of trade.

19. The FPC also considered risks to the global outlook that might affect UK financial stability. The path for global activity had evolved broadly as envisaged in the August MPR. Following a sharp rebound in May and June as Covid-19-related restrictions had been eased, the pace of improvement in activity appeared to have slowed. World GDP was expected to have increased by around 4¾% in 2020 Q3, leaving it around 7¾% below its 2019 Q4 level. The economic news had been broadly in line with expectations in the euro area and China, but a little stronger in the United States.

20. The outlook for global activity remained highly uncertain, and heavily dependent on the path of the Covid-19 virus. While in the United States new cases had fallen back from their peak in July, there had been increases in most European countries. Further disruptions to activity as a result of the virus could increase the risks associated with UK banks' exposures in the affected countries and generate additional macroeconomic spillovers to the UK economy.

21. The Committee noted that the risks to UK financial stability would also depend on geopolitical developments. In particular, against the backdrop of Covid-19-related uncertainty, an intensification of geopolitical tensions could lead to a deterioration in risk sentiment and volatility in financial markets.

22. Trade tensions between the United States and China remained elevated, including disputes over the use of Chinese technology in the United States. It was also possible that further measures could be implemented by the United States in response to the national security law that came into force in Hong Kong in June. The US presidential election in November provided a further source of uncertainty and potential financial market volatility.

The resilience of the UK banking system

23. The August FSR had included the Committee's assessment of the resilience of the banking system utilising a reverse stress testing exercise. The FPC reviewed developments since August and considered the outlook for bank resilience.

24. The reported capital ratios of the major UK banks and building societies ("banks") had improved further in the first half of 2020, despite incurring aggregate impairment losses of £18bn so far this year. Pre-provision earnings of £23bn, the cancellation of outstanding 2019 dividend payments and transitional relief under International Financial Reporting Standard 9 (IFRS 9) had collectively offset the effect of the rise in impairments. However, the Committee expected capital ratios to fall back somewhat over the coming quarters, as loan defaults were likely to rise and risk weighted assets to increase. Analyst expectations were consistent with this outlook and bank equity valuations implied both further losses for banks and a high degree of uncertainty about the extent of these losses.

25. Default rates had not yet risen across most asset classes in the first half of 2020. This was unsurprising given the extensive levels of borrower support, including the Coronavirus Job Retention Scheme (CJRS), payment holidays supporting retail borrowers, and the government-backed loan guarantee schemes supporting businesses' cash-flow needs.

26. The FPC therefore considered it necessary to assess the resilience of banks not only through their current capital positions but also through stress tests, which showed that the UK banking system remained resilient to a very wide range of possible economic outcomes. It had the capacity to continue to support households and businesses. This reflected the build-up, since the global financial crisis, of substantial buffers of capital. In August, the FPC judged that, even if the recent economic disruption were to be followed by events with an economic impact worse than that seen since March, and unemployment were to rise to around 15%, the cumulative losses incurred by banks since the beginning of the pandemic would deplete only around 60% of their buffers of capital.

27. The FPC noted that buffers of capital exist to be drawn down in stress; this enabled banks to continue to support the economy while weathering losses. The FPC expected all elements of capital buffers to be used as necessary. In support of this, the FPC had already taken action to ensure the usability of buffers to support lending to the real economy by reducing the UK countercyclical capital buffer (CCyB) rate to 0% in March 2020.

28. The FPC considered that cutting support to the economy to avoid the use of capital buffers would be costly for the wider economy and consequently for the banks themselves. In this regard, the FPC noted a risk that some banks could be reluctant to use capital buffers fully, perhaps because of perceptions of possible reactions by rating agencies and investors. It was also possible that the framework of capital requirements could give rise to incentives to maintain capital ratios above key thresholds. The Basel Committee had committed to monitoring risks and vulnerabilities to the global banking system from Covid-19 and pursuing additional measures if needed. The FPC supported the Bank on its work with international colleagues in the Basel Committee to continue to monitor the situation and assess the extent to which temporary changes to the capital framework may be necessary to promote the use of capital buffers for their intended purpose.

UK Countercyclical Capital Buffer rate

29. At its Policy meeting on 9 March, the FPC had reduced the UK CCyB rate to 0%.

30. Cutting the UK CCyB rate to 0% reinforced the FPC's expectation that all elements of the substantial capital and liquidity buffers built up by banks could be drawn on, as necessary, to support the economy.

31. The FPC had been continuing to monitor closely credit conditions in the UK, including data and intelligence on households and corporates, as well as bank lending and take up of Government schemes. As required by legislation when setting the UK CCyB rate, the Committee reviewed the Basel 'buffer guide' – which reflects the difference between the ratio of credit to GDP and a statistical estimate of its long-term trend.

32. The FPC agreed that it was appropriate to maintain the UK CCyB rate at 0% in 2020 Q3.

33. The FPC reaffirmed that it was important that banks should have clarity about the period of time it expected the UK CCyB rate to remain at 0%. It restated both of its previous judgements: (i) that it expected to maintain a UK CCyB rate of 0% until at least March 2021, and (ii) that the pace of return to a standard times UK CCyB rate would depend on banks' capital depletion over the period, and their ability to rebuild whilst supporting the UK economy, households and businesses. Due to the usual 12 month implementation lag, any subsequent increase in the rate would not be expected to take effect until March 2022 at the earliest.

34. As the outlook evolved, the FPC would continue to monitor closely the credit conditions faced by UK households and businesses, and stood ready to take any further actions deemed appropriate to support UK financial stability.

Provision of financial services at the end of the transition period with the EU

35. The FPC updated its assessment of actions to avoid disruption to the provision of financial services at the end of the transition period with the EU (see Tables 1 and 2).

36. The FPC continued to judge that, most risks to UK financial stability that could arise from disruption to the provision of cross-border financial services at the end of the transition period had been mitigated. The mitigation of these risks reflected extensive preparations made by authorities and the private sector over a number of years.

37. The EU had adopted a decision to provide equivalence to the future UK legal and supervisory framework for Central Counterparties (CCPs) until June 2022, and UK CCPs had been recognised by the European Securities and Markets Authority. This would allow EU financial firms to continue to use UK CCPs after the end of the transition period, mitigating the financial stability risk in markets for cleared derivatives.

38. Financial institutions were continuing to make preparations and engage with clients and customers to minimise any disruption and it was important that they continue to do so.

39. Financial stability was not the same as market stability or the avoidance of any disruption to users of financial services. Some market volatility and disruption to financial services, particularly to EU-based clients, could arise. For example, some EU-based clients and customers may not have access to all existing services after the end of the transition period. Some UK banks had already begun notifying EU-based customers that they would not continue to provide certain retail banking services in some jurisdictions.

40. 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 was at least as great as that currently planned, which itself exceeded that required by international baseline standards, as well as maintaining UK authorities' ability to manage UK financial stability risks.

Global efforts to address issues in non-bank financial intermediation

41. The FPC discussed work to review and address the resilience of market-based finance, domestically and internationally.

42. Large-scale central bank policy intervention stabilised markets in March after an abrupt and disruptive 'dash for cash' in the non-bank financial system resulted in forced sales of assets and put pressure on the functioning of a range of important markets. Markets had since functioned well, although further episodes of market disruption were possible in the event of very sharp changes in economic prospects due to the crisis.

43. Given that, it was crucial that the causes of the disruptive 'dash for cash' were fully analysed and that, where necessary, remedial action was taken to ensure the resilience of the financial system. Recognising the global nature of markets, work to assess and ensure the resilience of non-bank financial intermediation is being internationally co-ordinated.

44. The FPC saw a need to examine and address the:

- mismatch between the liquidity of assets held in open-ended funds – including money market funds – and the redemption terms offered by those funds. This mismatch could exacerbate stress in the financial system.

- demands of non-bank financial intermediaries for liquidity in stress. These had arisen in the March stress from forced unwinding of leveraged positions and from increases in derivative margin calls.

45. The FPC welcomed the Financial Stability Board (FSB)'s holistic review of resilience in the non-bank financial intermediation sector in light of the Covid-19 shock, due to be delivered to the G20 Summit in November. The Bank and the FCA had been actively participating in the FSB's review. In addition, the FSB had begun a mapping exercise of the critical connections between traditional banking and non-bank sectors in a cross-border setting. These work streams would inform future steps of the FSB in 2021 to improve the resilience of non-bank financial intermediation while preserving its benefits.

46. The non-bank financial system would always have some need for additional liquidity in stress. It was important to ensure that this need could be met in ways that avoided forced sales of assets and disruption to market functioning. Prudent management by non-bank intermediaries of their own liquidity positions was essential for their resilience to stress. Seeking to increase the supply of liquidity from banks to non-banks in stress by compromising on the resilience of banks would not be acceptable or effective. While the effect of post-crisis banking reforms on the functioning of core markets should be examined, it would be detrimental to financial stability overall if this were to be achieved by compromising on the resilience of banks. Such action could make the supply of private liquidity more fragile in stress.

47. In addition, the FPC considered it important to examine whether central banks should have facilities to provide liquidity to the wider financial system in stress, in order to support market functioning. Any such backstop of liquidity would need to be provided in a way that was not just effective and efficient but that also, through appropriate pricing and accompanying regulatory requirements, reduced incentives for excessive risk taking in the future.

48. The FPC would review progress on these work streams in 2020 Q4, following the delivery of the FSB's review to the G20 in November.

Domestic review of funds and productive finance

49. HM Treasury had recommended that the FPC consider how the UK financial system could better support the supply of finance for productive investment. As part of that work, the FPC was seeking to address distortions that discouraged the use of funds with longer redemption notice periods or closed-ended funds. Such funds were suited to highly illiquid long-term assets, such as real estate, infrastructure and unlisted equity and therefore offered opportunities to increase the supply of productive finance.

50. The FPC had already concluded that greater alignment of funds' notice periods, pricing approaches and asset liquidity would help to remove some of these distortions.

51. 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. A survey on funds' liquidity management, including swing pricing and liquidity classification, had been sent to a number of funds in August, having been postponed earlier in the year to reduce the operational burden on firms at that time. The FPC would discuss the findings from the survey, and the overall progress of the review, in 2020 Q4.

52. The FPC judged that the FCA's recent proposals to extend the redemption notice periods for open-ended property funds were better aligned with principles the FPC had previously set out to address liquidity mismatch in open-ended funds. The FPC considered that, from the perspective of financial stability, and given the illiquidity of property assets in stressed conditions, there would be benefits from extending notice periods to at least as far as the range proposed in the consultation.

53. Wider alignment of redemption terms of open-ended funds with their asset liquidity could, as the FPC had agreed in December 2019, help to encourage investments in funds with long notice periods or closed-ended funds and therefore provided opportunities to increase the supply of productive finance. The FPC considered that further work was now needed by authorities, funds, platforms and investment managers acting in concert to ensure that pools of capital were able to be deployed into fund structures with longer notice periods.

54. The FPC also recognised the importance of addressing liquidity mismatches in open-ended funds internationally, given the global nature of asset management, and within that, the UK's role. The Bank would continue to engage with the FSB and the International Organisation of Securities Commissions (IOSCO), as well as other authorities, on this topic.

Libor transition

55. The Committee received an update on the transition away from Libor. Following the UK Government's earlier announcement of its intention to amend and strengthen the UK's regulatory framework for critical benchmarks, the relevant changes were expected to be laid before Parliament in the Financial Services Bill in this Parliamentary session. The International Swaps and Derivatives Association was also expected to release its IBOR Fallbacks Protocol subject to remaining regulatory clearances. In sterling markets, it was also anticipated that lenders would make available loan products based on alternatives to Libor by 30 September 2020, in line with a key milestone recommended by the Sterling Risk-Free Rate Working Group.

56. As the FCA had made clear, decisions about what would happen to the various Libor settings at the end of 2021 could be announced as soon as the final weeks of 2020. The Committee noted that the objective of planning for the end of Libor was to minimise disorderly outcomes and risks to financial stability, by removing reliance on Libor in new and existing business. To this end, the

Committee noted the recent progress in sterling markets and reiterated that market participants must continue to accelerate their plans to eliminate reliance on Libor benchmarks before end-2021.

Systemic Risk Buffer review and CRD V implementation[1]

57. Under the UK legislation implementing the systemic risk buffer (SRB), the FPC was required to review the framework used to guide the setting of the SRB every two years. The FPC's framework must set out criteria for assessing the domestic systemic importance of banks and building societies; a methodology for measuring and scoring the criteria; and for each score specify a corresponding 'SRB rate'. The Prudential Regulation Authority (PRA) then applied the FPC framework to all ring-fenced banks and to large building societies that hold more than £25 billion in deposits and shares (excluding deferred shares).

58. The FPC conducted its review of the criteria, methodology and mapping of the framework. It noted that more than 80% of SRB institutions' balance sheet activity comprises cash and the provision of real economy lending; the correlation remained strong between total assets and combined market shares in household and Private Non-Financial Corporations (PNFC) lending; and wide buckets between SRB rate thresholds of £145 billion had allowed most firms to expand since the introduction of the regime without crossing an SRB rate threshold.

59. The FPC decided no changes to the framework were necessary at this time, not least as buffer rates were currently maintained at the level set in December 2019 and would not be reassessed until December 2021. Any decision on buffer rates taken in December 2021 would take effect from January 2023 in line with the PRA's policy. The FPC would keep this judgement under review in light of any further information that became available during the Covid-19 shock.

60. The FPC also noted that the introduction of the Capital Requirements Directive V (CRD V), as transposed in the UK by HM Treasury, would require the legal basis for the SRB to change from December 2020. As such, the FPC would replace the SRB framework with the other systemically important institutions (O-SII) buffer framework. Other than changing the name of the buffer, the framework would remain substantively unchanged, and the economic substance of the buffer would not be impacted. The FPC noted the PRA's plans to launch a consultation on its proposals to apply the O-SII buffer to firms instead of the SRB from December 2020, in line with the FPC approach.

[1] The FPC discussed these issues by written procedure.

The following members of the Committee were present:

Andrew Bailey, Governor

Colette Bowe

Alex Brazier

Ben Broadbent

Jon Cunliffe

Jon Hall

Anil Kashyap

Donald Kohn

Dave Ramsden

Elisabeth Stheeman

Sam Woods

Charles Roxburgh attended as the Treasury member in a non-voting capacity.

Christopher Woolard, interim Chief Executive of the Financial Conduct Authority, had participated in the FPC's discussions of these topics in September but was unavoidably unable to attend on 30 September. Andrew Bailey and the rest of the Committee recorded their thanks for Chris' contributions to the FPC since he joined in March.

As permitted under the Bank of England Act 1998, Anne Glover was present at the 30 September meeting as observer in her role as a member of Court.

Table 1 Checklist of actions to avoid disruption to end-users of financial services at the end of the transition period

This checklist reflects the risk of disruption to end-users including households and companies if no further arrangements are put in place for cross-border trade in financial services for the end of the transition period on 31 December 2020. The risk assessment takes account of progress made in mitigating any risks. It assesses risks of disruption to end-users of financial services in the UK and, because the impact could spill back, also to end-users in the EU.[(a)]

Risks of disruption are categorised as low, medium or high. Arrows reflect developments since the FPC's previously published checklist in the August 2020 *Financial Stability Report*. Blue text is news since then.

The checklist is not a comprehensive assessment of risks to economic activity arising from the end of the transition period. It covers only the risks to activity that could stem from disruption to provision of cross-border financial services.

	Risk to UK	Risk to EU	
Ensure a UK legal and regulatory framework is in place			The passage of the EU (Withdrawal) Act 2018 and secondary legislation has ensured that an effective framework for the regulation of financial services will be in place, and that EU financial services companies can continue to serve UK customers. Some secondary legislation is still required to ensure new EU legislation and provisions coming into force in 2020 can operate effectively in the UK following the end of the transition period. The State Aid (Revocations and Amendments) statutory instrument has been laid. If passed, this would ensure the Bank of England can continue to provide certain types of emergency lending, should it be needed in future.
Insurance contracts			The UK Government has legislated to ensure that the 16 million insurance policies that UK households and businesses have with EU insurance companies can continue to be serviced after the end of the transition period. UK insurance companies have restructured their business in order to service the vast majority of their £60 billion of EU liabilities. They plan to continue to progress restructuring most of the remaining liabilities through the end of 2020. The European Insurance and Occupational Pensions Authority (EIOPA) has published recommendations to national authorities supporting recognition or facilitation of UK insurance companies' continued servicing of EU contracts at the end of the transition period.
Asset management			Co-operation agreements between the Financial Conduct Authority (FCA), the European Securities and Markets Authority (ESMA) and EU National Competent Authorities have been agreed, and will apply from the end of the transition period. This enables EU asset managers to delegate the management of their assets to the UK. The UK Government has legislated for EU asset management firms to continue operating and marketing in the UK. And to operate in the EU, the largest UK asset managers have completed their establishment of EU authorised management companies.
Banking services			The UK Government has legislated to ensure that UK households and businesses can continue to be served by EU-based banks after the end of the transition period. EU authorities have not taken similar action. As a result, major UK-based banks are transferring their EU clients to subsidiaries in the EU so that they can continue providing services to them. All material subsidiaries are now authorised, fully operational and trading. Firms continue to build the capacity of their EU entities. On average, over two thirds of clients — including larger clients which represent a greater share of activity — of major UK-based banks have now completed the necessary documentation to enter into derivative trades with the EU entities. The number of clients actively trading in the new entities is materially lower. Some operational risks therefore remain, including if many clients seek to migrate to the EU entities in a short period of time. These could amplify market volatility. The EU has stated that in the short to medium term it will not assess the equivalence of the UK's regulatory and supervisory regime to its own for the purposes of MiFIR[(b)] Article 47, which covers investment services. This would have allowed for material cross-border access for investment services, further reducing the residual risk of disruption.

(a) In most cases, the impact on EU end-users will apply to the wider European Economic Area (EEA).
(b) Markets in Financial Instruments Regulation.

	Risk to UK	Risk to EU	
Over-the-counter (OTC) derivative contracts (uncleared)			Certain 'lifecycle'[(c)] events may not be able to be performed on UK/EEA uncleared derivative contracts after the end of the transition period. In the absence of mitigating actions, this could compromise the ability of derivatives users to manage risks. There are £17 trillion of uncleared derivative contracts between the EU and UK, of which £13 trillion is currently due to mature after 31 December 2020. Some uncleared derivative transactions will no longer be exempt from certain EU requirements, including the clearing obligation. The UK Government has legislated to ensure that EU banks can continue to perform lifecycle events on contracts they have with UK businesses. The European Commission has not reciprocated for UK-based banks' contracts with EU businesses. Some EU member states have permanent or temporary national regimes which could enable lifecycle events on certain contracts to be performed. UK firms are prioritising the novation of at-risk contracts, but progress will be dependent upon client engagement. The EU has stated that in the short to medium term it will not assess the equivalence of the UK's regulatory and supervisory regime to its own for the purposes of MiFIR Article 47, which covers investment services. This would have mitigated risks of disruption to lifecycle events on the majority of contracts.
OTC derivative contracts (cleared)			The UK Government has legislated to ensure that UK businesses can continue to use clearing services provided by EU-based clearing houses after the end of the transition period. The EU has adopted a decision to provide equivalence to the future UK legal and supervisory framework for central counterparties (CCPs) until end-June 2022, and UK CCPs have been recognised by ESMA. This will allow UK CCPs to continue servicing EU clearing members after the end of the transition period. The Bank and ESMA have put in place a new co-operation agreement to support this activity. There are currently £59 trillion of derivative contracts between UK CCPs and EU clearing members, £48 trillion of which is due to expire after December.
Personal data			The UK Government has legislated to allow the free flow of personal data from the UK to the EU after the transition period. The European Commission is undertaking an assessment of the adequacy of the UK's data protection standards. If the EU does not deem the UK's data regime adequate, both UK and EU households and businesses may be affected due to the two-way data transfers required to access certain financial services. Companies can add standard contractual clauses (SCCs) into contracts in order to comply with the EU's cross-border personal data transfer rules in the absence of adequacy. UK firms are generally well advanced in implementing these clauses.

(c) These lifecycle events include amendments, compressions, rolling of contracts or exercise of some options.

Table 2 Other risks of disruption to financial services

These risks could cause disruption to economic activity if they are not mitigated and there are no further financial services arrangements in place at the end of the transition period. The FPC judges their disruptive effect to be somewhat less than that of those issues in its checklist.

Access to euro payment systems	The Single Euro Payments Area (SEPA) schemes are currently used by UK payment service providers (PSPs, including banks) to make lower-value euro payments such as bank transfers between businesses, mortgage and salary payments on behalf of their customers. The European Payments Council has confirmed that the UK will retain SEPA access after the end of the transition period subject to its continued compliance with the established participation criteria. Once the UK becomes a third country, processing some payments — notably direct debits — will require additional information to be included for the payment instructions to meet regulatory requirements. Firms continue to put the necessary information in place where possible, but may not resolve all information gaps in time. This could result in disruption to both EEA and UK customers and businesses seeking to make and receive payments. UK firms will also need to maintain access to TARGET2 to use it to make high-value euro payments. UK banks intend to access TARGET2 through their EU branches or subsidiaries or correspondent relationships with other banks.
Ability of EEA firms to trade on UK trading venues	EU-listed or traded securities are traded heavily at UK venues which offer deep liquidity pools for a range of securities traded by UK and EU firms. The EU's Trading Obligations require EU investment firms to trade EU-listed or traded shares and some classes of OTC derivatives on EU trading venues or venues in jurisdictions deemed equivalent by the EU. The UK will also have analogous trading obligations when the transition period ends. Firms and venues are taking action to ensure they can trade securities and affected derivatives in both the EU and UK and other equivalent jurisdictions after the end of the transition period. However, the process of adjustment might pose operational risks. And it would fragment liquidity across jurisdictions and venues. The EU and UK could deem each other's regulatory frameworks as equivalent for the purposes of relevant regulations, thereby comprehensively mitigating risks of disruption. ESMA has proposed excluding from the EU Trading Obligation EU shares which are traded on third-country venues in the local currency of the third country. Absent a finding of equivalence, this would provide a partial mitigant to risks of disruption. It is unclear whether the proposal will be adopted as action is required on the part of the European Commission and co-legislators to effect the proposal before the end of the transition period.
Servicing banking and insurance customers	Major UK banks' and insurers' continued actions to prepare their EU subsidiaries will enable their provision of new services to many EU customers after the end of the transition period. The ability of UK banks and insurers to continue providing some services to customers — particularly retail customers — resident in the EU will be determined by national regimes. The scope and availability of national regimes is decided by individual EU member states. Depending on the national regime in place, the ability of UK banks and insurers to provide certain services to EU-based customers may be impaired. Some UK banks have begun notifying EU-based customers that they will not continue to provide certain retail banking services in some jurisdictions. As referred to above, EIOPA has published recommendations to national authorities supporting recognition or facilitation of UK insurance companies' continued servicing of EU contracts at the end of the transition period.
Financial market infrastructure	After the end of the transition period, UK financial market infrastructures (FMIs) will no longer be protected under EU law against payments or transfers being revoked, or collateral being clawed back, in the event that an EEA member enters insolvency. EEA countries accounting for most of the EEA members of UK FMIs have implemented national legislation intended to provide settlement finality protection in the event of insolvency of local firms using financial market infrastructure in non-EU countries. However, some member states will need to take additional steps to maintain settlement finality protection, and in some member states, UK FMIs need to apply for protections under national regimes. The UK Government has legislated transitional provisions to allow central securities depositories (CSDs) established outside the UK to continue to provide CSD services in the UK after the transition period. However, for UK CSDs to continue to provide CSD services to issuers in respect of securities issued under EU law after the end of the transition period, the UK and UK CSDs will respectively require either permanent or temporary equivalence and recognition from EU authorities.

Prudential requirements	The UK Government has legislated to allow regulators to delay the impact on UK-based firms of prudential requirements on EU exposures that would apply after the transition period. UK regulators intend to delay the application of some requirements for 15 months, to end-March 2022. EU regulations will subject EU banks' and insurance companies' UK exposures to stricter capital and liquidity requirements. Some restrictions might also be imposed for EU Money Market Funds and institutional investors on holdings of UK-managed or located exposures. If the EU and UK were to deem each other's regulatory and supervisory regimes as equivalent, this would avoid the application of some of these requirements.
Credit rating agencies (CRAs)	EU rules will prevent some banks and insurance companies in the EU from calculating prudential requirements using ratings issued by UK CRAs unless the ratings are endorsed by an EU CRA after the end of the transition period. In advance of the UK's withdrawal from the EU, the FCA and ESMA reached a co-operation agreement and undertook assessments to facilitate endorsements. The FCA and ESMA have confirmed that their co-operation agreement will apply from the end of the transition period and are engaged to ensure the assessments also continue to apply. The largest UK CRAs have EU entities. The decision to endorse ratings ultimately lies with the CRA.

ANNEX: 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 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 to maintain the UK CCyB rate at 0% in September 2020, unchanged from March. This rate is reviewed on a quarterly basis. The UK has also reciprocated a number of foreign CCyB rate 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%.
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-ratios-mortgage-lending