BANK OF ENGLAND

Financial Policy Summary and Record of the Financial Policy Committee Meeting on 23 September 2021

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This is the record of the Financial Policy Committee meeting held on 23 September 2021.

It is also available on the Internet: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021

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 29 November 2021 and the record of that meeting will be published on 13 December.

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.

The outlook for financial stability

Support for the economy during the recovery

The UK financial system has provided support to households and businesses to weather the economic disruption from the Covid pandemic, reflecting the resilience that has been built up since the global financial crisis alongside the exceptional policy responses of the UK authorities.

UK GDP is projected to recover further over the remainder of the year towards its pre-pandemic level, although the outlook for the economy remains uncertain. The pace of recovery has slowed recently, and inflationary pressures have risen.

Households and businesses are likely to need continuing support from the financial system as the economy recovers and the Government's support measures continue to unwind. The UK banking system has the capacity to continue to provide that support. The FPC continues to judge that the banking sector remains resilient to outcomes for the economy that are much more severe than the Monetary Policy Committee's central forecast in the August Monetary Policy Report.

The FPC expects banks to use all elements of their capital buffers as necessary to support the economy through the recovery. It is in banks' collective interest to support viable, productive businesses, rather than seek to defend capital ratios by restricting lending.

To support bank lending to households and businesses as the economy recovers, the FPC is maintaining the UK Countercyclical Capital Buffer (CCyB) rate at 0%. The FPC has previously stated that it expects to maintain a 0% UK CCyB rate until at least December 2021. It will re-evaluate the appropriate level of the UK CCyB rate in light of the risk environment at that time. In line with the standard implementation period, any subsequent increase would not be expected to take effect until the end of 2022 at the earliest.

The FPC will also consult on a proposal to change the metric used to determine Other Systemically Important Institutions (O-SII) buffer rates to exclude central bank reserves, effective from the 2023 Prudential Regulation Authority (PRA) assessment of individual firm buffer rates. The FPC also welcomes the PRA's intention to continue to freeze O-SII buffer rates until that point. This will ensure that the increase in central bank reserves since the start of the pandemic will not result in higher regulatory capital buffers for banks before the FPC's proposals can come into effect.

Domestic debt vulnerabilities

As the economy continues to recover, the FPC will remain vigilant to debt vulnerabilities in the financial system that could amplify risks to financial stability.

UK house price growth has reached levels last seen before the global financial crisis and housing market activity has been strong, reflecting a mix of temporary policy support and factors that could prove more persistent. Strength in the housing market has historically been associated with riskier lending practices. However, there is little evidence so far of a deterioration in lending standards or a material increase in the number of highly indebted households.

The FPC has Recommendations in place which limit a deterioration in mortgage underwriting standards or a rapid build-up in the share of highly indebted households. The FPC is due to finalise its review of the calibration of its mortgage market Recommendations in December 2021.

The FPC judges that UK corporate debt vulnerabilities have increased moderately over the Covid pandemic so far. The increase in indebtedness has not been large in aggregate, and debt-servicing remains affordable for most UK businesses. Large increases in interest rates or severe earnings shocks would be needed to impair businesses' ability to service their debt in aggregate.

The increase in debt in the UK corporate sector has been concentrated in some sectors and types of businesses, in particular in small and medium-sized enterprises (SMEs). Many of these SMEs had not previously borrowed and some would not have previously met lenders' lending criteria. The increase in debt - though moderate in aggregate - has likely led to increases in the number and scale of more vulnerable businesses. As the economy recovers and Government support, including restrictions on winding up orders, falls away, business insolvencies are expected to increase from historically low levels.

The FPC continues to judge that the UK financial system is resilient to risks from the UK corporate and household sectors. The FPC will monitor the evolution of vulnerabilities as the economy recovers and remains vigilant to risks building up over the medium-term.

Global debt vulnerabilities

Debt vulnerabilities globally have also increased during the pandemic. Across advanced economies, corporate debt-to-GDP ratios have increased in aggregate by 10 percentage points since the end of 2019. Higher leverage and greater risk-taking abroad could directly increase the risk of losses for UK institutions on their foreign exposures. UK banks, however, have limited direct exposures to the most vulnerable sectors and so far debt servicing generally remains affordable. Corporate debt vulnerabilities in other countries could have more indirect spillovers to the UK.

Concerns about the ability of Evergrande Group, one of China's largest property developers, to meet its financial obligations have been associated with recent volatility in international markets, and could pose risks to the wider property sector in China with potential spillovers internationally. The FPC has previously highlighted the risks associated with the rapid rise in debt more broadly in China and continues to monitor any of these potential risks to UK financial stability. While there is uncertainty as to how these risks might crystallise, the interim results of the 2021 Solvency Stress Test (SST) indicate that the UK banking system is resilient to the direct effects of a severe downturn in China and Hong Kong, and sharp adjustments in global asset prices.

Increased risk taking in global financial markets

The FPC judges there is evidence that risk-taking remains elevated in a number of markets relative to historic levels.
Following the Covid shock, central banks cut interest rates and undertook asset purchases to support economic activity and prevent an unwarranted tightening of financial conditions for corporates and households. Since then, risky asset prices have increased and, in a number of markets, asset valuations appear elevated relative to historical norms. This partly reflects the improved economic outlook, but may also reflect a 'search for yield' and higher risk-taking in a low interest rate environment.

Asset valuations could correct sharply if, for example, market participants re-evaluate the prospects for growth, inflation or interest rates. Any such correction could be amplified by vulnerabilities in market-based finance that were exposed in March 2020. This could have consequences for market functioning and financial conditions, and hence the real economy.

Risks in leveraged loan markets globally continue to build. There are signs of continued loosening in underwriting standards and increased risk-taking in some investment banking businesses. These risks can affect UK financial stability through the direct impact on banks and the indirect impact of losses spreading through other parts of the global financial system. The core UK banking system is resilient to direct losses associated with leveraged lending, as demonstrated by the interim results of the 2021 SST.

Building the resilience of the financial system

Market-based finance

The March 2020 stress exposed a number of vulnerabilities in market-based finance. The FPC set out the next steps needed to enhance the resilience of market-based finance in July, and strongly supports the current work, co-ordinated internationally by the Financial Stability Board (FSB), to assess and remediate the underlying vulnerabilities. Such work is necessarily a global endeavour, reflecting the international nature of these markets and their interconnectedness. The Bank, the Financial Conduct Authority (FCA) and HM Treasury are fully engaged in this work programme, and the G20 will be updated on progress in October.

Until this work results in an increase in the resilience of non-bank financial institutions, the financial stability risks exposed in March 2020 will remain. And while central banks may need new and more targeted tools to deal effectively with financial instability caused by market dysfunction, central bank interventions cannot be a substitute for internationally co-ordinated reforms that enhance the resilience of the non-bank financial sector.

Cryptoasset and associated markets and services continue to grow and to develop rapidly. Such assets are becoming increasingly integrated into the financial system. The FPC judges that direct risks to the stability of the UK financial system from cryptoassets are currently limited. However, regulatory and law enforcement frameworks, both domestically and at a global level, need to keep pace with developments in these fast-growing markets in order to manage risks and to maintain broader trust and integrity in the financial system.

The FPC will continue to pay close attention to developments, including the relationship between cryptoassets and the UK financial system, and thereby seek to ensure resilience to systemic risks that may arise from further developments in cryptoasset markets. **The FPC considers that financial institutions should take a cautious and prudent approach to any adoption of these assets.**

Productive finance to support the economic recovery

The supply of finance including for productive investment is important both for financial stability and long-term growth and can help to support the recovery from the pandemic. The FPC welcomes the Productive Finance Working Group’s final report, which sets out the case for long-term investment via a ‘Long-Term Asset Fund’ (LTAF) vehicle, and recommendations to help make progress on removing barriers to investment in less liquid assets.

Understanding how the provision of finance to SMEs is developing is important for the FPC’s understanding of the vulnerabilities associated with SME indebtedness and for the FPC’s secondary objective, but is impaired by data gaps. The FPC welcomes the upcoming Bank survey on UK businesses’ financing decisions, which will seek to address some of these gaps.

Libor transition

Most Libor benchmarks, as well as new use of any continuing Libor benchmarks, are due to stop by the end of 2021. The FPC welcomes the progress that has been made so far in transitioning away from Libor and the marked increases in use of risk-free rates over recent months, in particular the recent positive progress in the transition to the Secured Overnight Financing Rate (SOFR) in USD markets. SOFR-based rates provide more robust alternatives than the credit sensitive rates that have begun to be used in some USD markets. The FPC emphasises that market participants should use the most robust alternative benchmarks available in transitioning away from use of Libor to minimise future risks to financial stability.

Critical third parties

The increasing reliance by the financial system on critical third parties (CTPs), including cloud service providers, can bring benefits to the financial sector, including improved operational resilience. However, the increasing criticality of the services that CTPs provide, alongside concentration in a small number of providers, pose a threat to financial stability in the absence of greater direct regulatory oversight.

Regulated firms will continue to have primary responsibility for managing risks stemming from their outsourcing and third-party dependencies. However, additional policy measures, some requiring legislative change, are likely to be needed to mitigate the financial stability risks stemming from concentration in the provision of some third-party services. These policy measures should include: an appropriate framework to designate certain third-party service providers as critical; resilience standards; and resilience testing. **The FPC supports the intention of the Bank, PRA and FCA to publish a joint Discussion Paper in 2022 on these issues.**

The FPC strongly supports UK financial authorities' continued engagement with initiatives by the UK Government to strengthen cross-sectoral oversight of third-party service providers to multiple parts of the UK's critical infrastructure, as well as in international workstreams at the FSB and other bodies, and with overseas financial regulators.

Record of the Financial Policy Committee meeting held on 23 September 2021

1. The Committee met on 23 September 2021 to agree its view on the outlook for UK financial stability and, on the basis of that, its intended policy action. The FPC discussed the risks faced by the UK financial system and assessed the resilience of the system to those risks. Its aim was to ensure the UK financial system was prepared for, and resilient to, the wide range of risks it could face – so that the system could serve UK households and businesses in bad times as well as good.

2. The UK financial system had provided support to households and businesses to weather the economic disruption from the Covid pandemic, reflecting the resilience that had been built up since the global financial crisis (GFC) alongside the exceptional policy responses of the UK authorities. Households and businesses were likely to need continuing support from the financial system as the economy recovered and the Government's support measures continued to unwind. While the outlook remained uncertain and debt vulnerabilities had increased moderately during the pandemic, the UK banking system had the capacity to continue to provide that support.

Macroeconomic back-drop

3. The Committee noted the Monetary Policy Committee's (MPC's) central forecast for UK GDP and the outlook for world activity set out in the August 2021 *Monetary Policy Report (MPR),* with UK GDP projected to recover further over the remainder of the year, reaching its pre-pandemic level in 2021 Q4.

4. However, the outlook for the economy remained uncertain. The pace of the recovery had slowed recently relative to what the MPC had expected in the August *MPR*, and near-term inflationary pressures appeared somewhat stronger. The FPC also noted that downside risks to growth remained that could pose a threat to financial stability, particularly in the short term. For example, there could be a greater impact from Covid on activity, especially if any further new variants of the virus emerged for which there was significantly lower vaccine efficacy.

5. As the economy continued to recover, the FPC would remain vigilant to debt vulnerabilities that could amplify risks to financial stability. Aggregate debt in the UK corporate sector had increased moderately over the Covid pandemic so far. The increase in debt had probably increased the number and scale of more vulnerable businesses. In addition, global debt vulnerabilities had increased during the pandemic, and had the potential to impact UK financial stability.

6. Following the Covid shock, central banks had cut interest rates and undertaken asset purchases to support economic activity and prevent an unwarranted tightening of financial conditions

for corporates and households. Since then, risky asset prices had increased and, in some markets, asset valuations appeared elevated relative to historical norms. This partly reflected the improved economic outlook, but may also reflect a ‘search for yield’ and higher risk-taking in a low interest rate environment. Asset valuations could correct sharply if, for example, market participants re-evaluated the prospects for growth, inflation or interest rates. Any such correction could be amplified by vulnerabilities in market-based finance.

7. Macroprudential policy helps to protect the UK financial system against such risks were they to crystallise. For example, the Bank’s annual stress tests assess and help ensure the resilience of major UK banks and building societies (‘banks’). And international work to address vulnerabilities in the non-bank financial sector globally continued, coordinated by the Financial Stability Board (FSB).

Global vulnerabilities

8. The FPC was briefed on a range of international risks that could be relevant for UK financial stability, and in particular those which related to global debt vulnerabilities.

9. The FPC judged that debt vulnerabilities globally had increased during the pandemic. As in the UK, the pandemic represented a substantial shock to households and businesses in other economies. Across advanced economies, corporate debt-to-GDP ratios had increased in aggregate by 10 percentage points since the end of 2019 as GDP fell and debt increased. Higher leverage and greater risk-taking abroad could directly increase the risk of losses for UK institutions on their foreign exposures. Corporate debt vulnerabilities in other countries could also have more indirect spillovers to the UK. For example, they could increase the risk of a sharp tightening in global financial conditions and macroeconomic downturns in other countries that could transmit to the UK economy.

10. Government and central bank policy support had helped to limit the size of the disruption from the pandemic. Moreover, UK banks had limited direct exposures to the most vulnerable sectors and so far debt servicing generally remained affordable. Staff analysis, which would be set out in a *Financial Stability in Focus (FSIF)* report, published alongside the Record, suggested that the share of companies in the US and the euro area with low interest coverage ratios (ICRs) had increased somewhat during the pandemic but remained towards the bottom of historical ranges. In addition, a significant share of credit growth had been government guaranteed which should limit the direct risks to the financial systems in those economies.

11. The risks arising from these global debt vulnerabilities could be amplified by further economic shocks arising from the effects of the pandemic or a sharp tightening in global financial conditions. However, any future increases in borrowing costs, or falls in earnings, would need to be substantial to have a material impact on US and euro area corporates’ ability to service their debt. Staff analysis

indicated that it would require an increase in borrowing costs of around 270 basis points in the euro area and 190 basis points in the US to bring the share of firms with low ICRs to the top of their respective historical ranges. A correction in overseas asset prices, particularly if it had consequences for market functioning, could also impact UK companies by affecting their ability to raise finance overseas or even in domestic markets if tighter global financial conditions spilled over to those in the UK.

12. Concerns about the ability of Evergrande Group, one of China's largest property developers, to meet its financial obligations had been associated with recent volatility in international markets. A disorderly failure could pose risks to the wider property sector in China with potential spillovers internationally. The equity prices of some other Chinese property companies had also fallen. The FPC had previously highlighted the risks associated with the rapid rise in debt more broadly in China, and would continue to monitor any of these potential risks to UK financial stability. Over the past decade, Chinese private non-financial debt had risen from 145% of GDP to 220%. If such risks were to materialise, they could potentially affect UK financial stability through many channels, for instance, a tightening in global and UK financial conditions or spillovers from a macroeconomic downturn in China. While there was uncertainty as to how these risks might crystallise, the interim results of the 2021 Solvency Stress Test (SST) indicated that the UK banking system was resilient to the direct effects of a severe downturn in China and Hong Kong, and sharp adjustments in global asset prices.

Corporate and household resilience

Corporate resilience

13. The Covid pandemic and the measures taken to contain it have had a significant and uneven impact on UK businesses. The FPC's *FSIF* report would provide a detailed assessment of how the pandemic had affected financial stability risks arising from businesses' balance sheets. The *FSIF* and this document together record the Committee's judgements in relation to corporate resilience and summarise the Committee's associated deliberations.

14. The FPC noted that a healthy business sector was important for a strong economy, and a well-functioning financial system in the long term. Consistent with its primary objective of supporting financial stability, the FPC sought to ensure that any build-up of debt vulnerabilities in the corporate sector did not pose risks to the wider financial system, which could ultimately undermine the ability of the financial system to serve UK households and businesses in bad times as well as good. High levels and rapid build-ups of corporate debt could pose risks to UK financial stability via direct losses to lenders and investors, or via the impact on the real economy from cuts in employment or investment by credit constrained or deleveraging businesses.

15. The FPC judged that UK corporate debt vulnerabilities had increased moderately over the Covid pandemic so far. UK corporate debt-to-earnings had increased from 322% in December 2019 to 349% by 2021 Q1, partly due to a temporary fall in earnings as a result of the measures introduced to contain the pandemic. This compares to a high of 377% in the GFC.

16. However, the FPC noted that some sectors (such as accommodation and food) had been disproportionately impacted by the pandemic. Consistent with that, the increase in indebted businesses had also been unevenly distributed. Staff analysis suggested that around two-thirds of the increase in debt since end-2019 was accounted for by small and medium-sized enterprises (SMEs). Many of these SMEs had not previously borrowed and some would not have previously met lenders' lending criteria. This reflected both that SMEs were more likely to operate in sectors that had been affected more by the pandemic, and the increase in supply of credit brought about by the government-sponsored loan schemes. Staff analysis also suggested that some SMEs may have taken on additional debt for precautionary reasons and so may not have translated into increased vulnerability: 32% of limited liability SMEs with debt had sufficient cash to repay all debts in full.

17. The FPC judged that the increase in debt – though moderate in aggregate – was likely to have increased the number and scale of more vulnerable businesses. Around 10% of companies in the sample of SMEs had estimated repayments greater than 15% of their total current account inflows and debt levels of more than 10 times their cash levels (or were in their overdraft).

18. Consistent with that, some SMEs were likely to face acute financial pressures going forward. This was despite much of this debt being issued at low interest rates for initial periods of up to six years. According to the latest BVA/BDRC SME Finance Monitor, 7% of all SMEs were concerned about their ability to make repayments, compared to a pre-pandemic level of 4%. Concern about making repayments was found to be highest among SMEs that had either borrowed for the first time or had taken out new borrowing during the pandemic.

19. The FPC judged that debt-servicing remained affordable for most UK businesses. Previous staff analysis indicated a turning point in the relationship between ICRs and the probability of firm distress at an ICR of around 2.5. Reflecting falling borrowing rates, the share of companies with ICRs lower than 2.5 had been trending steadily downwards since the early 2000s despite increases in corporate debt.

20. The FPC noted that large increases in interest rates or severe earnings shocks would be needed to impair businesses' ability to service their debt in aggregate. Staff analysis showed that if borrowing costs were to increase by 200bps (conservatively assuming immediate pass-through to borrowing rates, and earnings remaining flat), the share of listed and private companies with an ICR below 2.5 would increase by 12 percentage points but would remain well below the historic peak.

Large companies in the US and euro area were more sensitive. The same increase in borrowing costs in the US would increase the share of listed companies with an ICR below 2.5 by 16 percentage points to around the historic peak (see ‘Global vulnerabilities’, above).

21. As the economy recovered and government support, including restrictions on winding up orders, fell away, the FPC expected business insolvencies to increase from historically low levels. Compared with the average level of insolvencies pre-Covid, there had been at least 6,000 fewer insolvencies since the start of the Covid pandemic than might have been expected at the beginning of 2020. The FPC noted that some insolvencies may have been prevented but others would likely materialise as support measures unwound and repayments on new borrowing became due.

22. The FPC judged that risks from distress to businesses for the UK banking sector were encompassed by the FPC’s 2021 SST. A number of factors helped mitigate direct risks to the banking system: (i) most new bank lending issued during the pandemic had been guaranteed by the Government, (ii) UK banks had limited exposures to sectors with particularly low aggregate ICRs, and (iii) UK banks had made provisions for expected impairments on lending.

23. The FPC judged that viable businesses were likely to need continuing support from the financial system as the economy recovered and the Government’s support measures unwound over the coming months, and that the UK banking system had the capacity to provide that support.

24. The FPC continued to judge that the UK financial system was resilient to vulnerabilities in the UK corporate sector. But the evolution of vulnerabilities would depend on the path of the recovery from the pandemic as well as developments in financial markets, including leveraged lending (see ‘Financial markets’ below). The FPC would continue to monitor developments closely and remained vigilant to risks building up over the medium-term.

Household resilience

25. The FPC noted that UK house price growth had reached levels last seen before the GFC. Despite the slowing in July as the stamp duty holiday began to taper ahead of its September end date, house prices increased by over 10% in the three months to July 2021 compared to the same period in 2020. Housing market activity had been strong, reflecting a mix of temporary policy support and other Covid-related factors that could prove more persistent. The latter included increased household saving through the pandemic, as well as increased demand for space, with higher price inflation recorded outside of London and for larger properties. The future evolution of demand and prices would depend in part on the extent to which these more structural explanations for the increase in demand persisted.

26. Strength in the housing market had historically been associated with riskier lending practices. The FPC's mortgage market Recommendations were in place to limit a deterioration in underwriting standards or a rapid build-up in the share of highly indebted households. The FPC was due to finalise its review of the calibration of its mortgage market Recommendations in December 2021.

27. So far there had been little evidence of a deterioration in lending standards or a material increase in the number of highly indebted households. The share of new lending at loan-to-income (LTI) ratios at or above 4.5 was 10.7% in 2021 Q2, compared to 9.5% in 2020 Q1. That remained well below the FPC's LTI flow limit of 15%. Lending at high loan-to-value (LTV) ratios remained significantly below pre-Covid levels, despite increasing recently. The share of new lending at LTV ratios at or above 90% was 10.2% in 2021 Q2, compared to 19.4% in 2020 Q1. While interest rates on all mortgages continued to fall recently, with those on low LTV products slightly below pre-Covid levels, those for high LTV products remained higher. Average interest rates on mortgages with an LTV of 90% were around 50bps higher in August 2021 than in February 2020. The share of households with high debt servicing ratios of at least 40% fell to 1.0% in June, roughly back to pre-Covid levels.

Bank resilience

28. The FPC discussed the resilience of the UK banking system, including its ability to withstand future shocks and maintain credit supply.

29. Despite an historic fall in UK output in 2020, and whilst the economic outlook continued to be uncertain, banks' capital and liquidity positions remained strong. Their aggregate Common Equity Tier 1 (CET1) ratio remained flat in 2021 Q2 at 16.1%, compared to 14.8% in 2019 Q4. Banks' liquidity coverage ratios continued comfortably to exceed regulatory guidelines.

30. The FPC noted that the banking system, with support from government-guaranteed lending schemes, had provided credit to UK businesses helping them to cushion the impact of the pandemic on their cash flows.

31. As the economy recovered and government support measures unwound, UK households and businesses were likely to need continued support from the financial system. The FPC remained of the view that it was in banks' collective interest to continue to support viable, productive businesses, and that capital buffers were there to be used if needed.

32. Following the decision by the Prudential Regulation Committee (PRC) that extraordinary guardrails on shareholder distributions were no longer necessary, banks had resumed distributions, paying £2.3bn in H1 2021.

33. The FPC noted a number of developments that could affect bank capital positions over coming quarters. For example, the benefit from IFRS 9 transitional relief would taper away and relief on the existing stock of provisions might also decrease as some assets moved into default and became ineligible for it. As a result of these effects, banks' capital ratios were expected to fall back over coming quarters towards pre-pandemic levels.

34. Overall, the FPC continued to judge that the UK banking system remained resilient to outcomes for the economy that were much more severe than the MPC's central forecast in the August *MPR*.

Financial markets and market-based finance resilience

35. The FPC observed that, in general, risky asset prices were broadly unchanged since the July *Financial Stability Report (FSR)*. At that time, the FPC had judged that asset valuations in some markets appeared elevated relative to historical norms. Increases in asset prices earlier in the year had partly reflected the improved economic outlook, but might have also reflected a 'search for yield' in a low interest rate environment, and higher risk-taking.

36. The FPC judged there was evidence that risk-taking remained elevated in a number of markets relative to historical levels. It was most pronounced in corporate bond and Collateralised Loan Obligation markets, where spreads were near the extremes of their distribution, and was more marked in the US than in the UK.

37. The immediate risks relating to 'fallen angels' - corporate bonds downgraded from investment-grade to high-yield - had been low in 2021 so far, but the FPC judged that risks were elevated at slightly longer time horizons. The value of sterling bonds at risk of downgrade one to two years in the future was almost three times as high as at the beginning of 2020.

38. The FPC noted that risks in the leveraged loan markets globally had continued to build. Global leveraged lending flows were elevated relative to historical levels. Looser underwriting standards had become increasingly prevalent, with the proportion of covenant-lite lending at around record highs in the UK and globally, and there had been signs of continued risk-taking in some investment banking businesses. Loan documentation had continued to deteriorate more generally. There were now fewer restrictions on borrowers' ability to increase their borrowing, borrowers could make significant adjustments ("add backs") to their earnings, and lenders had less control over

borrowers' collateral. Headline debt to earnings before interest, tax, depreciation and amortisation (EBITDA) ratios were around historical highs, and the widespread use of earnings adjustments and documentary weaknesses meant those headline leverage ratios would understate true risk taking in many cases. The FPC also judged that price terms on leveraged loans did not appear to reflect increased risks, with spreads flat relative to pre-Covid. These developments could increase potential losses in a future stress, and defensive actions by highly leveraged firms had also been shown to amplify economic downturns.

39. These risks can affect UK financial stability through the direct impact on banks and the indirect impact of losses spreading through other parts of the global financial system. The FPC judged that the core UK banking system remained resilient to direct losses associated with leveraged lending as demonstrated by the interim results of the 2021 SST.

40. The FPC noted that asset valuations could correct sharply if, for example, market participants re-evaluated the prospects for growth, inflation, or interest rates. Any such correction could be amplified by vulnerabilities in market-based finance that were exposed in March 2020. This could have consequences for market functioning and financial conditions, and hence the real economy.

41. The FPC re-iterated that the structural vulnerabilities in the system of market-based finance, exposed in March 2020, remained. For instance, vulnerabilities associated with liquidity mismatch in corporate bond funds were higher than pre-Covid. Assets under management in US and emerging market open-ended corporate bond funds were around 140% of their pre-Covid levels (including valuation effects), while in UK-focused funds they were around 110%[1]. The share of liquid assets held by corporate bond funds had decreased to below pre-Covid levels. This could increase potential risks to market functioning if it resulted in forced asset sales by funds during a stress. And while hedge fund net borrowing via repo had fallen compared to pre-Covid, the amount of securities purchased on margin by investors, mainly by hedge funds, remained high. As the FPC had noted previously, the failure of the family office Archegos had already demonstrated the effects that leverage in the non-bank sector could have on other counterparties and global financial markets. The FPC emphasised the importance of international authorities seeking to learn both firm-specific lessons and implications for the system more broadly.

42. It was important that market-based finance was resilient to, and did not amplify, shocks. The FPC had set out the next steps needed to enhance the resilience of market-based finance in July, and strongly supported the current work, coordinated internationally by the FSB, to assess and remediate the underlying vulnerabilities. Such work was necessarily a global endeavour, reflecting

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[1] Source: EPFR Global

the international nature of these markets and their interconnectedness. The Bank, the FCA and HM Treasury were fully engaged in this work programme, and the G20 would be updated on progress in October.

43. The FPC judged that until this work resulted in changes in policy that delivered an increase in the resilience of non-bank financial institutions, the financial stability risks exposed in March 2020 would remain. The FPC also noted the debate around the role of central banks and whether new liquidity tools were needed that was underway in a number of jurisdictions, including as part of the Bank's recent review of its official market operations. While central banks might need new and more targeted tools to deal effectively with financial instability caused by market dysfunction, central bank interventions could not be a substitute for internationally coordinated reforms that enhanced the resilience of the non-bank financial sector. The Bank had been leading international thinking in this area, and would consider its next steps on this topic over the coming period.

44. The FPC also discussed the extremely rapid growth in cryptoasset and associated markets and services. The FPC had previously noted that cryptoassets with no intrinsic value were volatile making them unsuitable to be widely used as money or a store of value. Some may prove worthless. Other cryptoassets propose to maintain a stable value by holding a pool of backing assets, in a bid to make them suitable for payment and settlement purposes. The FPC had previously set out principles that these kinds of cryptoassets – known as stablecoins – would need to meet before they could be acceptable for widespread adoption as a means of payment. In particular, they would need to be regulated and supervised to deliver the same level of public confidence as commercial bank money.

45. There were signs that cryptoassets generally were becoming more connected to and integrated within the financial system. For example, a growing number of financial institutions were offering, or planning to offer, cryptoassets custody, trading and derivative services for use by a broad range of clients.

46. The FPC judged that direct risks to the stability of the UK financial system from cryptoassets were currently limited. However, given the speed of developments in these areas, it was important to be forward-looking. It was also important to manage other risks – such as consumer and investor protection, market integrity, money laundering and terrorist financing – although the responsibility for managing those risks lay outside the FPC's remit.

47. Regulatory and law enforcement frameworks, both domestically and at a global level, needed to keep pace with developments in fast-growing cryptoasset markets and services in order to manage risks and maintain broader trust and integrity in the financial system.

48. The FPC would continue to pay close attention to developments, including the relationship between cryptoassets and the UK financial system, and would thereby seek to ensure resilience to systemic risks that might arise from further developments in cryptoassets and associated markets and services. The FPC considered that financial institutions should take a cautious and prudent approach to any adoption of these assets.

49. The FPC also discussed recent developments in energy markets. Gas prices had risen markedly and were expected to remain elevated in the near-term. Although financial stability risks were limited at present, Bank staff would continue to monitor developments in financial markets linked to the energy sector.

The UK Countercyclical Capital Buffer rate decision

50. The FPC reiterated that its policy was to vary the UK Countercyclical Capital Buffer ('CCyB') rate in line with system-wide risks to the UK banking sector and to set the UK CCyB rate in the region of 2% when the risk environment was judged to be standard. This approach aimed to ensure that the buffer is large enough to create capacity for banks to lend through downturns.

51. The FPC had reduced the UK CCyB rate to 0% in March 2020 to support the ability of banks to extend credit to households and businesses at a challenging and highly uncertain time. The Committee continued to judge that it was in banks' collective interest to support viable households and businesses, and reinforced its expectation that banks' capital buffers could be used as necessary to support the economy.

52. Taking into account its discussion on the economy and the financial system, the FPC agreed that it was appropriate to maintain the UK CCyB rate at 0% in 2021 Q3. The FPC had previously stated that it expected to maintain a 0% UK CCyB rate until at least December 2021.

53. As it had set out in Q2, the Committee would monitor a range of factors to inform its decision around when to increase the UK CCyB rate, including the evolution of the economic recovery, prevailing financial conditions and the outlook for banks' capital. The pace of return to a standard UK CCyB rate would depend on banks' ability to rebuild capital while continuing to support the UK economy, households and businesses.

54. The FPC noted a number of developments which could affect the UK risk environment outlook, and in turn would be relevant for its decisions about both when and how fast to increase the UK CCyB rate. In recent months, the rollout of the UK's vaccination programme had led to an improvement in the UK economic outlook, but downside risks remained and the outlook remained uncertain. UK GDP was projected to recover further over the remainder of the year towards its pre-

pandemic level, although the pace of recovery had slowed recently, and inflationary pressures had risen.

55. Some vulnerabilities, particularly those relating to financial risk taking were around pre-Covid levels, and corporate debt vulnerabilities had increased moderately. The FPC had previously judged these as consistent with a risk environment that warranted a 2% UK CCyB rate. Banks' capital positions remained strong, as they had not suffered material losses to date during the pandemic – in part reflecting Government support for the economy. In July 2021 the PRC had decided to remove its extraordinary guardrails on shareholder distributions, and in H1 banks had cautiously started to release part of their stock of credit provisions.

56. On the other hand, the implications of these developments for the size - and pace - of any increase in the UK CCyB rate would need to be balanced against the fact that downside risks to, and uncertainty over, the economic recovery, and therefore banks' capital positions, remained. As the economy recovered and adapted to post-pandemic conditions and government support measures unwound, households and businesses were likely to need continuing support from the financial system. The Committee agreed that, even though the economic outlook had improved, developments related to Covid would continue to be a source of uncertainty in the near-term. This uncertainty was also reflected in some banks' decisions to reflect only partially the improved economic outlook in their provision releases.

57. The FPC would re-evaluate the appropriate level of the UK CCyB rate in December 2021 in the light of the risk environment at the time. In line with the standard implementation period, any subsequent increase would not be expected to take effect until the end of 2022 at the earliest.

Other Systemically Important Institutions (OSII) Buffer Rates

58. As the FPC had previously noted in its December 2020 Record, UK banks' 'total assets', the metric used to calibrate O-SII buffer rates, had grown significantly during 2020 in part due to the MPC's expansion of central bank reserves through the Asset Purchase Facility. Without the PRA's action to freeze O-SII buffer rates in December 2020, some banks may have faced incentives to constrain lending to the real economy, in order to avoid sharp increases in regulatory capital buffers.

59. Accordingly, in 2021 Q3, the FPC reviewed its O-SII buffer framework: the criteria for assessing the extent to which the failure or distress of a firm might pose a risk to the financial system, and how the scores derived from those criteria map to O-SII buffer rates.

60. The FPC decided it would consult on a proposal to change the metric used to determine O-SII buffer rates from total assets to the UK leverage exposure measure, effective from the PRA's 2023

assessment of individual firm buffer rates. Using the UK leverage exposure measure to determine buffer rates would exclude central bank reserves, meaning that the framework would not tighten as a result of an expansion of central bank balance sheets, thereby reducing the risk of the framework introducing a drag on lending. It would also bring in off-balance sheet items, in particular committed but undrawn credit facilities, which were an important component of overall credit supply during the pandemic.

61. The FPC also judged that the thresholds used to determine O-SII buffer rates should be adjusted alongside the proposed change to the metric, in order to prevent an overall tightening or loosening of the framework relative to its pre-Covid level. More detailed proposals would be set out in an FPC consultation paper later this year.

62. The FPC welcomed the PRA's intention to continue to freeze O-SII buffer rates for a further year until 2023, at which point the proposed changes to the FPC's framework would become effective. This would ensure that the increase in central bank reserves since the start of the pandemic would not result in higher regulatory capital buffers for banks before the FPC's proposals came into effect. Rates set in 2023 would then come into effect from January 2025. The freeze, together with the FPC's proposals for the changes to the framework, should give firms clarity for capital planning and lending decisions, and allow firms time to adapt to the proposed changes should they be implemented.

Productive finance

63. The Committee discussed the supply of productive finance to UK corporates and, in particular, SMEs, and judged this to be important both for financial stability and long-term growth. The impact of the pandemic on the UK corporate sector had brought into sharper focus the need to ensure that the financial system could intermediate the supply of productive finance to companies as the economy recovered.

64. In the UK, SMEs made an important contribution to the economy, but experienced more restricted access to external finance. In aggregate, the most significant form of external finance to SMEs had continued to be bank financing. Following the pandemic, SMEs' reliance on bank finance had increased further, and SMEs' aggregate indebtedness had increased materially over 2020, as discussed earlier.

65. The Committee noted several government initiatives that had sought to improve SMEs' access to finance. These included the British Business Bank, which had provided lenders with government guarantees to cover a proportion of losses on portfolios of SME lending. Government-backed lending schemes in response to Covid had also increased the supply of finance to SMEs.

Government-funded investment programmes delivered through British Patient Capital and British Business Investments had begun the shift towards addressing equity financing gaps for innovative, high growth potential companies, and proposals such as the Open Data Initiative would also allow SMEs to access a wider range of bank and non-bank finance.

66. The Committee had previously discussed the industry Working Group on Productive Finance, jointly convened by the Bank, HM Treasury, and FCA. Later in September, the Working Group would publish its final report, supporting the need for long-term investments in vehicles such as the Long-Term Asset Fund. The report would also set out a roadmap of recommendations aimed at removing barriers to investing in long-term less liquid assets. The Committee welcomed the Working Group's report as an initiative that could enhance access to long-term investment.

67. The Committee noted that a clearer understanding of the provision of finance to SMEs was needed to assess the vulnerabilities associated with SME indebtedness and for the FPC's secondary objective, but that this was impaired by data gaps. The Committee welcomed a planned Bank survey of UK businesses' financing conditions, which would start in 2022. The results of the survey would improve the Bank and FPC's understanding of the barriers to accessing external finance and other factors that productive businesses considered in their financing decisions.

Critical third parties (CTPs), including cloud service providers (CSPs)

68. As the FPC noted in its July meeting, there was an increasing reliance by the financial system on CTPs, including CSPs. This trend was not exclusive to the UK financial services sector - financial institutions globally, and other sectors of the UK economy, were following a similar trajectory.

69. Moreover, the FPC recognised the potential benefits for individual firms, including financial market infrastructures (FMIs), of using cloud services (provided they configured and oversaw them properly), for example through better operational resilience than their on-site information communications technology (ICT) infrastructure. Outdated, on-site ICT systems could pose significant cyber and other operational risks for firms.

70. However, the increasing criticality of the services that CTPs provided to UK financial firms, and the fact that the provision of these services was often concentrated in a small number of third parties, which were very difficult to substitute, posed a threat to UK financial stability in the absence of greater direct regulatory oversight.

71. Regulated firms currently had, and would continue to have, primary responsibility for managing the risks stemming from their outsourcing and other third party dependencies. However, additional policy measures, some requiring legislative change, were likely to be needed to mitigate

the financial stability risks stemming from concentration in the provision of some third party services to UK firms. These measures would include:

- **An appropriate framework for designating** certain third party service providers as 'critical', including criteria and a governance process. CSPs were likely to be an important subset of CTPs, but there would also be others including smaller, less well-known third party service providers and certain sub-contractors in third party service providers' supply chains whose disruption or failure could also have a systemic impact (critical fourth parties);

- **resilience standards** for CTPs in respect of any critical services they provided to UK firms, which should build on the operational resilience framework introduced by the UK financial authorities in March 2021. Among other areas, these standards may focus on CTPs' response and recovery capabilities to disruption and their substitutability; and

- **resilience testing** of CTPs based on the proposed standards and building on existing testing frameworks and sector exercises developed by the UK financial authorities e.g. CBEST and SIMEX. These tests and sector exercises of CTPs could potentially be carried out in collaboration with overseas financial regulators and other relevant UK authorities.

72. The FPC welcomed the engagement between the Bank, FCA and HMT on how to tackle these risks. The FPC supported the intention of the Bank, PRA and FCA to publish a joint Discussion Paper (DP) in 2022. The aims of the DP would be to inform future regulatory proposals relating to CTPs (particularly on technically complex areas, such as resilience testing) and to provide input from the Bank, PRA and FCA to UK cross-sectoral and international financial regulatory debates on CTPs.

73. The proposed additional measures would seek to strengthen the resilience of the UK financial system but would not be able, nor intend, to eliminate all possible forms of operational disruption originating from third party service providers. That approach aligned to the UK authorities' regulatory framework for operational resilience, which required firms to identify their most important business services and agree a maximum, tolerable level of operational disruption (known as an 'impact tolerance') for each of these services.

74. The FPC recognised that there were limits to the extent to which financial regulators in any given jurisdiction could mitigate the risks posed by certain CTPs, such as CSPs. Any proposed additional measures would reflect, and be limited by, the Bank's, PRA's and FCA's respective

statutory objectives. Consequently, the FPC also strongly supported the UK financial authorities' continued engagement with:

- initiatives by the UK Government to strengthen cross-sectoral oversight of any CTPs which also provide services to other parts of the UK's critical infrastructure;
- international discussions and workstreams of international standard-setting bodies including the Basel Committee on Banking Supervision and FSB; and
- bilateral engagement with overseas financial supervisory authorities.

Review of the UK leverage ratio framework

75. In April 2015, the FPC had been granted powers to direct the PRA to set minimum leverage ratio requirements and buffers as part of its statutory responsibility for removing and reducing systemic risks. The FPC had published a Policy Statement[2] to set out how it expected to calibrate and apply these powers on 1 July 2015.

76. In July 2016, the FPC had recommended that the PRA update the leverage ratio total exposure measure to exclude assets constituting claims on central banks, where they are matched by deposits, denominated in the same currency, and of identical or longer maturity.[3]

77. In 2021 Q2, the Committee had conducted a comprehensive review of the UK leverage ratio framework in the light of revised international standards, and its commitment to review its policy approach. On 29 June 2021, the FPC and PRA had published a consultation document, which outlined changes that the FPC were proposing to make to the UK leverage ratio framework, and the PRA's proposed approach to implementing those changes. The consultation had closed on 24 August.

78. The FPC considered the responses to the consultation carefully. The Committee decided to make one change to the draft Direction, namely to replace 'deposits' with 'liabilities' in the language describing the central bank claims exclusion matching criteria. The FPC judged that the impact of widening the exclusion in this way would be small for both deposit-takers and investment firms, but would improve fairness across the firms impacted and proportionality across business models, which would support competition, consistent with the FPC's secondary objective.

[2] The Financial Policy Committee's powers over leverage ratio tools December 2020 update (bankofengland.co.uk)

[3] This had been intended to ensure that the leverage ratio framework did not act as a barrier to the effective implementation of any monetary policy measures that lead to an increase in claims on central banks, and did not act as a disincentive for firms to use central bank liquidity facilities. The FPC had also subsequently recommended that the PRA recalibrate the minimum leverage ratio capital requirement for major UK banks and building societies to 3.25%, in order to avoid an effective easing in the UK leverage ratio framework. The PRA had updated the framework so as to comply with that recommendation in 2017.

79. There were other issues raised in the responses to the consultation, which the FPC carefully considered but, on balance, judged did not warrant further changes to its proposed framework at this time.

80. The FPC's deliberations and judgements relating to the responses to the consultation would be set out in an FPC Consultation Response document[4], which would be published on the same day as this Record.[5] The FPC also agreed to publish an update to its Policy Statement "The Financial Policy Committee's powers over leverage ratio tools", to reflect the results of its review of the leverage ratio framework, on the same day.

81. The FPC issued its Direction and Recommendation in relation to the leverage ratio regime, in the form set out in the Annex of this Record. The FPC would conduct regular reviews of the leverage ratio framework in line with its statutory obligations.

Libor transition

82. The Committee received an update on the transition away from Libor. Most Libor benchmarks, as well as new use of any continuing Libor benchmarks, were due to stop by the end of 2021. The FPC welcomed the progress that had been made so far in transitioning away from Libor and the marked increases in use of risk free rates over recent months.

83. The FPC also welcomed steps being taken by the FCA towards publication by ICE Benchmark Administration of synthetic versions of the 1, 3 and 6-month tenors of GBP and JPY Libor after the end of the year in order to support the orderly transition of certain legacy contracts.

84. The FPC noted that active transition of legacy contracts remained of key importance and provided the best route to certainty for parties to contracts referencing Libor.

85. The FPC noted the positive progress in the transition to the Secured Overnight Financing Rate (SOFR) in USD markets following the 'SOFR first' initiative on 26 July 2021. Increased liquidity in SOFR markets had allowed the US Alternative Reference Rate Committee to recommend CME Group's forward-looking SOFR term rates. The Committee noted that SOFR-based rates (particularly compounded SOFR and, in certain use cases, term SOFR) provided more robust alternatives than the credit sensitive rates that had begun to be used in some USD markets. The FPC emphasised that market participants should use the most robust alternative benchmarks available in transitioning away from use of Libor to minimise future risks to financial stability. The

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[4] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework
[5] Paragraphs 3.1 – 3.47 (within the chapter FPC consultation: feedback to responses) of the FPC Consultation Response / PRA Policy Statement 21/21 forms part of the Record of this FPC meeting for the purposes of section 9U of the Bank of England Act 1998.

FPC noted that the FCA had asked any UK-regulated market participants looking to use credit sensitive rates to raise this with their FCA supervisors before doing so.

86. The FPC also welcomed the introduction in Parliament of the Critical Benchmarks (References and Administrators' Liability) Bill, to support the orderly wind-down of critical benchmarks such as Libor.

The Bank's official market operations

87. Since 2014, the FPC had been contributing to the Bank's review of its official market operations, by members giving views on whether the Bank's liquidity insurance facilities remained fit for purpose from a macroprudential perspective.[6] On 4 October, the Bank would publish its 2021 in-depth three-year report which included a focus on the Bank's response to Covid. As an input to the report, the FPC reviewed developments in the Bank's liquidity insurance facilities since 2017.

88. In the FPC's view, and recognising ongoing work to improve liquidity provision beyond the banking system by considering new and targeted tools to tackle future market dysfunction, the Bank's liquidity insurance facilities remained fit for purpose from a macroprudential perspective.

Financial services and the UK's new relationship with the EU

89. The UK authorities remained committed to mutual regulatory and supervisory co-operation with the EU authorities. Alongside co-operation with other regulatory authorities globally, this would continue to promote an open and resilient financial system to the benefit of all participants.

90. The FPC continued to monitor risks to its objectives that could arise from changes to the provision of cross-border financial services in the future. For example the risk of disruption that could arise when the EU's temporary equivalence and recognition determinations for UK central counterparties expire on 30 June 2022.

91. Consistent with its statutory responsibilities, the FPC remained 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 standards, as well as maintaining UK authorities' ability to manage UK financial stability risks.

[6] As discussed in the The Bank of England's response to the Independent Evaluation Office's evaluation of its approach to providing sterling liquidity, the Bank has moved to a mixed review model for its Sterling Monetary Framework (SMF) annual report: undertaking an in-depth review at least once every three years and light-touch reviews in other years. The FPC contribute to the in-depth reviews in accordance with the FPC Concordat.

92. The FPC would take note of the findings of the International Monetary Fund's Financial Sector Assessment Program (FSAP) review of the UK's financial sector. The FSAP would provide a robust independent assessment of standards in the UK.

The following members of the Committee were present:

Andrew Bailey, Governor

Colette Bowe

Sarah Breeden

Ben Broadbent

Jon Cunliffe

Jon Hall

Anil Kashyap

Dave Ramsden

Nikhil Rathi[7]

Elisabeth Stheeman

Carolyn Wilkins

Sam Woods

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

In accordance with the relevant provisions of the Bank of England Act 1998, Jon Hall had notified the Committee of his shareholding at Guardtime (a blockchain based information security provider). It was agreed that he would recuse himself from discussions on cryptoassets, and that he would not receive the related papers.

[7] Nikhil Rathi sent his apologies for the latter half of the meeting but had sent comments in advance which Andrew Bailey shared with the Committee.

ANNEX: FPC POLICY DECISIONS

Outstanding FPC Recommendations and Directions (as at the date of the FPC's meeting on 23 September 2021)

<table>
<tr><th>Topic</th><th>Calibration</th></tr>
<tr><td>Leverage ratio</td><td>In September 2021, the FPC directed the PRA to implement the following measures (the 'leverage measures') in relation to the following firms (each a 'relevant firm'):

each major UK bank, building society or investment firm;
each UK bank, building society or investment firm with significant non-UK assets; and
any holding company approved or designated by the PRA whose consolidated situation (including, where that holding company is part of a RFB sub-group, the consolidated situation of that sub-group) is comparable to any other relevant firm.

The leverage measures are to:

require each relevant firm to hold sufficient Tier 1 capital to satisfy a minimum leverage ratio of 3.25%;
secure that each relevant firm ordinarily holds sufficient Tier 1 capital to satisfy a countercyclical leverage ratio buffer rate of 35% of its institution-specific countercyclical capital buffer rate, with the countercyclical leverage ratio buffer rate percentage rounded to the nearest 10 basis points;
secure that if a relevant firm is a G-SII it ordinarily holds sufficient Tier 1 capital to satisfy a G-SII additional leverage ratio buffer rate of 35% of its G-SII buffer rate; and
secure that if the relevant firm is a relevant O-SII it ordinarily holds sufficient Tier 1 capital to satisfy a O-SII additional leverage ratio buffer rate of 35% of its O-SII buffer rate.

The leverage measures are to be applied:

on a consolidated basis in respect of the UK consolidation group of the relevant firm;
on a sub-consolidated basis in respect of any RFB sub-group that contains a relevant firm ('RFB sub-consolidated basis'); and
on an individual basis or, at the PRA's discretion, on a sub-consolidated basis (in respect of the relevant firm and one or more of its subsidiaries), for relevant firms that are not subject to the leverage measures on the basis of their consolidated situation pursuant to the preceding bullet points.

Where the leverage measures are to be applied on a consolidated or RFB sub-consolidated basis, they may be applied to a holding company approved or designated by the PRA, as appropriate.

In designing its approach to exercising its discretion over the appropriate level of consolidation at which to implement the leverage measures, the PRA should have regard to, among other things:

the desirability of alignment between the levels of application of the leverage measures and measures under the risk weighted capital framework; and
the potential for the leverage measures applied on an individual basis to disproportionately impact the capital position of relevant firms driven by their group structure, given the potential consequences for the provision of market liquidity in aggregate for the UK financial system.

For the purposes of the leverage measures, the FPC specified the following:</td></tr>
</table>

	• The total exposure measure shall exclude any assets constituting claims on central banks, where they are matched by liabilities accepted by the firm that are denominated in the same currency and of identical or longer maturity.
	• The minimum proportion of common equity Tier 1 that shall be held is:
	   o 75% in respect of the minimum leverage ratio requirement;
	   o 100% in respect of the countercyclical leverage ratio buffer; and
	   o 100% in respect of the G-SII and O-SII additional leverage ratio buffers.
	
	The FPC also recommended to the PRA that in implementing the minimum leverage ratio requirement it specifies that additional Tier 1 capital should only count towards Tier 1 capital for these purposes if the relevant capital instruments specify a trigger event that occurs when the common equity Tier 1 capital ratio of the institution falls below a figure of not less than 7%.

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 to maintain the UK CCyB rate at 0% in September 2021, unchanged from March 2020. 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