FSR Opening Remarks

The FPC is responsible for identifying risks to financial stability and for taking action to ensure the UK financial system can serve UK households and businesses in bad times as well as good. In this quarter, these responsibilities have taken the FPC from capital to credit to cyber.

The FPC views the risks from the global environment as material and having increased in recent months. In particular:

- Developments in Italy underline vulnerabilities created by high levels of public debt and the interlinkages between banks and sovereigns in a currency union.
- Tightening conditions in US dollar funding markets are creating headwinds to growth and increasing risks in some emerging markets. In addition, debt levels in China remain highly elevated, while the rebalancing of that economy is still underway.
- And trade tensions have intensified.
- These conditions could crystallise the longstanding risks of a snap back in interest rates and a tightening in global financial conditions, with negative spillovers to the UK.

Domestically, the FPC continues to judge that, apart from those related to Brexit, risks remain standard overall. In other words, most financial stability indicators are neither elevated nor subdued.

- Levels of household and corporate debt relative to incomes remain materially below their pre-crisis peaks. Growth in overall credit remains broadly in line with that of nominal GDP. In addition, the debt service burdens of households and businesses are low, and it would take a sharp increase in UK interest rates, without any corresponding rise in incomes, to bring them back to historic averages.
- Since the Committee last met in March, the costs of bond finance for both UK corporates and banks have risen.
- In the housing market, although UK lenders have increased spreads on mortgages, overall mortgage costs remain low. But weak demand has meant only modest mortgage credit growth, and the FPC's mortgage market measures continue to insure against a reduction in underwriting standards.

- Consumer credit growth has decelerated in recent months though it is still expanding faster than nominal GDP. The Committee has acted to ensure lenders are able to absorb severe losses on consumer credit, and there are signs of reduced availability of domestic credit.
- Although non-bank lending to riskier companies has been expanding rapidly, lending by banks to such highly levered firms has been muted, limiting the increase in overall corporate leverage and containing the risks to the financial system.
- In this standard risk environment, the FPC is maintaining the UK countercyclical capital buffer (CCyB) rate at 1%.

The FPC continues to assess the risks of disruption to UK financial services arising from Brexit, and we are acting in three principal ways to reduce the impact of these risks on UK households and businesses.

First, we are ensuring that the UK banking system could continue to lend to UK households and businesses even in the event of a disorderly, cliff-edge Brexit, however unlikely that may be.

- In particular, the 2017 stress test encompassed a wide range of UK macroeconomic outcomes that could be associated with Brexit, meaning Brexit risks do not warrant additional capital buffers for UK banks.
- It is worth recalling that the capital strength of major UK banks has tripled since 2007, with the aggregate Tier 1 capital ratio rising to 17% Q1, and that the contingent liquidity of banks (including their liquid asset buffers) has risen ten-fold over the same period to more than 100% of short term liabilities potentially subject to run risk.

Second, the FPC has identified the most important risks from a cliff-edge Brexit to the provision of financial services, and it has outlined the necessary steps to address them. As detailed in the FPC's updated checklist published today, progress has been made but material risks remain.

- At the March EU Council an implementation period was agreed until end 2020, subject to finalisation and ratification of the Withdrawal Agreement between the EU and the UK.
- The European Union (Withdrawal) Act has received Royal Assent.
- The UK Government has committed to legislate, if necessary, to put in place a temporary permissions regime to enable EU-based financial companies to continue to provide financial

services to UK end‑users. Once enacted, this will mitigate a number of risks of disruption to UK customers including those relating to insurance contracts.

- The biggest remaining risks of disruption are areas where action is needed by both UK and EU authorities, such as ensuring the continuity of the £96 trillion of existing derivative contracts (in both cleared and uncleared markets).
- Based on our experience and knowledge of these markets, it will not be possible, ahead of March 2019, for private financial institutions on their own to mitigate fully the risks of disruption to financial services.
- The UK Government's Temporary Permissions regime would provide the UK side of the solution.
- The EU has not yet indicated their solution to these fundamental issues which would be expected to have more material impacts on the costs and availability of finance on the continent in the unlikely event of a disorderly Brexit.
- The FPC welcomes the establishment in April of a technical working group, chaired by the European Central Bank and Bank of England, on risk management in the area of financial services in the period around 30 March 2019.

Third, the FPC has made clear that, irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibilities, the Committee will remain 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.

The FPC is increasingly focusing on operational risks. The FPC announced today that it will set standards on firms' recovery plans following cyber attacks—known as 'impact tolerances'.

- Firms have primary responsibility for their ability to resist and recover from cyber attacks.
- To guide firms in their planning, the FPC will set 'impact tolerances', specifically the time after which a disruption of vital financial services could cause material economic impact.
- Firms will be expected to demonstrate their ability to meet the FPC's impact tolerances in 'severe but plausible' scenarios. The FPC will assess this via cyber stress tests, developed in coordination with other authorities, including the National Cyber Security Centre.
- If firms cannot demonstrate they are able to withstand these tests, remedial action plans will have to developed and agreed with supervisors.

- The Bank plans to launch a pilot of the approach to operational resilience in 2019, and will publish further details in 2018 Q4.
- These tests build on the FPC's broader cyber strategy which includes regular penetration testing of the 30 largest firms, consistent supervisory follow up on the key findings of those tests, improved cyber governance within firms, new communications protocols and robust international coordination arrangements including through our leadership of the G7 Cyber Expert group.

Conclusion

Events of the past few months are a reminder that many of the most important risks to financial stability in the United Kingdom originate beyond our shores.

- The recent tightening in global financial conditions could be a precursor to a much more substantial snapback in world interest rates and more challenging bank, corporate and sovereign funding conditions.
- Rising protectionist sentiment could sap some of the current strength of the global economy and reduce the size of sustainable external imbalances.
- While UK authorities are putting in place measures to address financial stability risks that can be dealt with unilaterally, the complete set of mitigants to the risks of a cliff-edge Brexit also rely on the efforts of EU authorities; and
- Cyber risks to UK financial services could originate from anywhere on the planet.

The FPC is working to ensure that the UK financial system has the necessary resilience to meet the needs of UK households and businesses in good times and bad, whether risks originate at home or abroad.