BANK OF ENGLAND

Mark Carney
Governor

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Dear Andrew,

I am writing in response to your letter of 8 November regarding the Financial Policy Committee's (FPC) role in HM Government's Help to Buy scheme. I would hope that your letter and this response will serve to deepen public understanding of the scope and limits of FPC responsibilities.

As you are aware, the legislation that created the FPC tasked it with contributing to the protection and enhancement of financial stability in the UK and, subject to that, with supporting the Government's economic policy. The legislation makes clear that the Committee's responsibility lies primarily in the identification, monitoring, and reduction of systemic risks to the UK financial system. The FPC is resolutely focused on discharging these responsibilities.

The FPC will publish its latest assessment of the risks to financial stability in its *Financial Stability Report* on 28 November. The *Report* will set out the FPC's assessment of the risks posed by recent and prospective developments in the housing market, any actions that the FPC intends to take in light of that assessment, as well as the range of tools that would be available to it and other bodies to address any vulnerabilities that might emerge in the future.

In addition to its powers of direction, the FPC has broad powers to make recommendations to discharge its functions. These can be made to a wide range of bodies, including HM Treasury (HMT), and could include recommendations on Government policies.

The fact that the FPC is focused on its core responsibilities does not of course preclude the Chancellor asking for advice on specific topics from time to time.

Specifically, the FPC has been asked to offer advice to HMT in the event that an extension of Help to Buy is proposed after three years. If an extension were to be considered, the Chancellor would ask the FPC to assess the impact on financial stability and, in this regard, assess whether a continuation of the scheme could pose a risk to financial stability. It would be for the Government to decide the course of action in response to this advice.

Subsequent to this request, in his written statement to Parliament of 8 October, the Chancellor asked the FPC to contribute to an annual review of the ongoing impact of the Help to Buy scheme. Starting in September 2014, and in line with its statutory objectives, the FPC will provide an assessment of the impact of the scheme on financial stability, and whether the key parameters of the scheme – the house price cap and the fee charged to lenders – remain appropriate. The Bank publicly welcomed this request and the FPC will make recommendations to HMT on the impact and calibration of the scheme as required.

For the avoidance of doubt, let me stress three important points. First, the FPC has no power to require HMT to vary the terms of, or close, the Help to Buy scheme. The FPC only has the authority to make recommendations in connection with such matters. Second, the FPC is not constrained by the Government's timetable for any such advice; it could make recommendations at any time. Third, the FPC would consider the merits of any possible change to the parameters of Help to Buy in the context of its assessment of the risks to financial stability arising from the housing market and the use of the considerable range of other tools over which it has influence.

Below I provide answers to your specific questions.

(i) *Can you confirm that, contrary to remarks of several ministers, the FPC does not have a veto on any decision to maintain the scheme during its planned three year life or later, were it to be extended?*

I can confirm that the FPC does not have a veto on the scheme. The FPC has been asked to provide advice to the Chancellor on the terms of the Help to Buy scheme on an annual basis starting from September 2014. The Chancellor has indicated that if the Government wishes to extend the scheme beyond its three year life, the Chancellor will ask the FPC to assess the impact of the scheme on financial stability and to advise whether, in light of this assessment, the FPC would be content that its continuation would not pose a risk to financial stability. The FPC of course has powers to make recommendations on the scheme at any time in the light of the scheme's impact on financial stability.

(ii) *With respect to the authority to assess the impact of the scheme on financial stability and make recommendations, has the Chancellor's statement extended in any way what the FPC already considered its statutory role to be?*

The Chancellor's statement has not extended the statutory role of the FPC. The FPC's statutory objective is to contribute to the protection and enhancement of the stability of the financial system of the UK and, subject to that, to support the economic policy of HM Government, including its objectives for growth and employment. The FPC's responsibility relates primarily to identifying and taking action to remove or reduce systemic risks to the resilience of the UK financial system.

(iii) *What specific advice has the FPC, or the PRA, already offered with respect to the design of the scheme?*

The FPC was not involved in the design of the scheme. At the FPC's meeting on 18 September 2013 the Treasury member of the FPC informed the FPC that the pricing of the scheme would be on a self-financing, commercial basis, and could in principle be changed during the lifetime of the scheme. The Committee did not, however, provide any advice on that pricing, or on other aspects of the scheme's design.

The PRA has provided advice to HMT on the design of the scheme insofar as was necessary to ensure firms were able to comply with the relevant eligibility conditions and prudential requirements set out in the Capital Requirements Regulation (CRR) which will apply from 1st January 2014. The PRA provided comments to HMT on the way in which CRR would treat such guaranteed loans, including the application of relevant CRR rules on securitisation, and in particular:

(a) the prudential treatment of the cap under the scheme on HMT's liability guarantee to each participating lender using the Internal Ratings Based approach to credit risk;

(b) parts of the draft scheme that the PRA considered to require amendment in order to satisfy the CRR's prudential conditions, in particular in respect of when and how claims could be made; and

(c) the potential capital impact of the scheme for a hypothetical high Loan-to-Value mortgage loan.

The PRA's view of the applicable prudential capital treatment of Help to Buy Guarantee loans and other mortgage insurance schemes with similar contractual features, under the CRR, is set out in the PRA's statement on the topic[1].

The PRA also responded to HMT's requests for a high-level review of the externally-developed Expected Loss model framework that HMT used in setting the fee, and discussion of the credit quality criteria to be applied under the scheme. Final decisions on the expected loss model and credit quality criteria were made by HMT.

[1] http://www.bankofengland.co.uk/pra/Pages/publications/banking/helptobuy.aspx

(iv) *The Chancellor's Statement "proposed that the FPC advise him on whether the key parameters of the scheme - the house price cap and the fee charged to lenders - remain appropriate". Has this taken the FPC beyond what it, prior to the statement, considered its statutory role to be? Does it, in your view, take it beyond the role described by Mervyn King? Does the Bank of England now consider itself a co-designer of the Help to Buy scheme?*

The Chancellor's statement is in line with the statutory role of the FPC – to identify, monitor and take action to remove or reduce risks that will affect the stability of the UK financial system as a whole.

(v) *Can you confirm that the advice of both the FPC and PRA on the Help to Buy scheme will relate specifically to its likely effects on financial stability, and not to its likely effects on home ownership? In the Bank's view does the responsibility for the scheme's effects on home ownership remain solely with H.M. Treasury?*

Issues related to home ownership are the responsibility of the Government and Parliament. The FPC's advice, when sought, will be grounded in its financial stability objective. In the same way, the PRA will consider potential imbalances in the housing market in the context of its statutory objective to promote the safety and soundness of firms participating in the scheme.

(vi) *In providing advice on the design of the scheme has the PRA, or the FPC, taken careful consideration of any risks that may, as a consequence, be added to the balance sheet of banks which participate?*

The FPC has not provided advice on design of the scheme. Prior to PRA-regulated firms' engagement in the scheme, the PRA is discussing with firms the nature and extent of their intended involvement, including projected lending volumes, capital requirements, consequent amendments to firms' business plans, and implications for firms' systems and controls.

(vii) *Has the Financial Policy Committee considered whether a Memorandum of Understanding clarifying the scope and limits of the Bank's responsibilities with respect to Help to Buy would be appropriate?*

HMT sent a memo to the FPC on 9 September on the Help to Buy scheme, explaining the expected role of the FPC should a future Government consider extending the scheme. The FPC is in no doubt as to its statutory responsibilities, including those that relate to the Help to Buy scheme.

(viii) *Has the Chairman of Court, or the Court collectively, examined any of these questions? If so when and what did they conclude?*

Court has been kept informed of developments around the Help to Buy scheme. At one of its regular meetings on 14 November, Court was briefed on the Chancellor's request for the FPC to provide advice on the Help to Buy scheme. It noted that the request did not in any way extend or constrain the responsibilities or powers of the FPC or PRA.

I trust this letter provides clarity on the role of the FPC in relation to the Help to Buy Scheme, and I look forward to a continuing and constructive dialogue with the Treasury Committee on all matters relating to financial stability.

Yours ever,