



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

30 November 2015

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#### FUNDING FOR LENDING SCHEME

Thank you for your letter of 30 November 2015, outlining the rationale and objectives for the extension to the Funding for Lending Scheme (FLS). You and I have agreed that the FLS will remain open for a further two years and will be gradually wound down, before closing in January 2018.

The Bank of England and the Treasury introduced the FLS in July 2012 at a time of turmoil in financial markets, stemming from the ongoing effects of the financial crisis and heightened uncertainty in the euro area. This was contributing to steep rises in funding costs for UK banks, which risked a more significant deterioration in credit conditions for UK households and businesses. Since its introduction, the FLS has contributed to a sustained fall in bank funding costs, which has fed through into improvements in credit conditions for households and businesses.

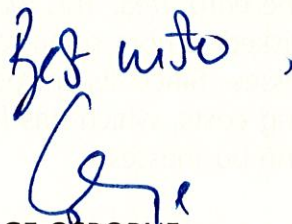
Over the course of the scheme, funding support through the FLS has been withdrawn from where conditions have improved, and targeted where credit remained tightest. In November 2013 we agreed to remove the incentives on household lending, reflecting the improvements in credit conditions for households and the recovery in the UK housing market at that time. In December 2014 we agreed to remove incentives on lending to large businesses, following improvements in credit conditions facing those firms, and thereby focusing the scheme on supporting lending to small and medium-sized enterprises (SMEs).

Since then, credit conditions for SMEs have shown a further gradual improvement, although they remain tighter than for other firms. Survey evidence, including from the Bank's Credit Conditions Survey, has indicated the availability of credit to SMEs has increased. Net lending to SMEs has continued to improve, and was £1.7 billion over January to September. In line with this trend, net lending to SMEs by FLS participants has also improved, to £0.6 billion on average in the first two quarters of 2015, higher than the average of -£0.5 billion over 2014.

In remaining open for two more years, the FLS will continue to support improvements in SME credit conditions. But as conditions have normalised further, it is right that we begin to wind down the scheme. As your letter notes, from February 2016 participants will no longer generate new borrowing allowances through their net lending to SMEs. Borrowing allowances that participants have built up from earlier net lending will remain available to use. These allowances will be withdrawn gradually, by 25 percentage points each quarter, to ensure that the FLS is phased out in a manageable way for participants.

The FLS will also continue to complement other initiatives to support SME credit conditions and competition in banking. Many challenger banks have drawn funding from the scheme, based on their positive net lending to the economy, which has supported their growth and helped to boost competition in the market. Further, we have agreed that newer lenders authorised since April 2013 will be able to access the FLS and generate new borrowing allowances as the scheme is wound down for existing participants. These newer lenders would not otherwise have been able to generate a significant borrowing allowance, and so this change ensures that they are not put at a competitive disadvantage at an early stage of their growth.

I am confident that these changes announced today will build on the success of the FLS and ensure it is withdrawn successively, while minimising risks to the recovery. I can confirm that the scheme remains within the remit of the Bank of England, and will continue to be overseen by a Joint Oversight Board of Bank and Treasury senior officials.

A handwritten signature in blue ink, appearing to read 'Geo Osborne', with a large, stylized initial 'G' below it.

GEORGE OSBORNE