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RECORD OF THE INTERIM FINANCIAL POLICY COMMITTEE MEETING

19 MARCH 2013

This is the record of the Interim Financial Policy Committee meeting held on 19 March 2013.

It is also available on the Internet:
http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2013/record1304.pdf

In June 2010 the Chancellor of the Exchequer set out a plan for fundamental changes to the system of UK financial regulation. In January 2012 the Government introduced the Financial Services Bill to Parliament, which received Royal Assent in December 2012. The legislation established a Financial Policy Committee (FPC) as a Committee of the Bank of England's Court of Directors on 1 April. The responsibility of the Committee 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, and subject to that, supporting the economic policy of Her Majesty's Government, including its objectives for growth and employment.

Prior to the statutory FPC, the Court had created an interim FPC to undertake, as far as possible, the future statutory FPC's macroprudential role. Although lacking the statutory powers of Direction and Recommendation of the statutory FPC, the interim FPC contributed to maintaining financial stability by identifying, monitoring and publicising risks to the stability of the financial system and advising action to reduce and mitigate them. It also carried out preparatory work and analysis in advance of the creation of the permanent FPC.

The statutory FPC will meet on 18 June and the record of that meeting will be published on 1 July.

RECORD OF INTERIM FINANCIAL POLICY COMMITTEE MEETING HELD ON 19 MARCH 2013

The interim Financial Policy Committee voted unanimously for the following six policy recommendations:

1. **The Prudential Regulation Authority (PRA) should assess current capital adequacy using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights.**
2. **The PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies hold capital resources equivalent to at least 7% of their risk-weighted assets, as assessed on the basis described in Recommendation 1. Relative to that benchmark, major UK banks and building societies in aggregate currently have a shortfall in capital of around £25 billion.**
3. **The PRA should consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, where there are uncertainties about assets not covered in the FSA's assessment of future expected losses or risk weights analysis, or where banks are highly leveraged relating to trading activities.**
4. **The PRA should ensure that major UK banks and building societies meet the requirements in Recommendations 2 and 3 by issuing new capital or restructuring balance sheets in a way that does not hinder lending to the economy. Any newly-issued capital, including contingent capital, would need to be clearly capable of absorbing losses in a going concern to enable firms to continue lending.**
5. **The PRA should ensure that major UK banks and building societies have credible plans to transition to meet the significantly higher targets for capital and the leverage ratio that will come into effect in 2019 after full implementation of Basel III, the trading book review and surcharge for systemically important banks, and after HM Government's implementation of the ICB proposals, in ways consistent with sustainable expansion of the UK economy.**
6. **Looking to 2014 and beyond, the Bank and PRA should develop proposals for regular stress testing of the UK banking system. The purpose of those tests would be to assess the system's capital adequacy. The framework should be able to accommodate any judgements by the Committee on emerging threats to financial stability.**

The macroeconomic and financial environment

1. The Committee reviewed financial system and economic developments since the November 2012 *Financial Stability Report.*

2. Over recent weeks concerns about the stability of the Cypriot banking system had risen sharply. The UK authorities were monitoring events closely. At the time of the Committee's meeting there had been minimal signs of spillovers to other financial systems, but there was a risk that this situation could change.

3. For much of the earlier part of the period, market concerns over risks from the euro area had eased somewhat. Earlier signs of a sharp reduction in euro-area cross-border capital flows had partially reversed. A number of euro-area banks and sovereigns – including those from some of the most vulnerable countries – had been able to issue debt in public markets in the early part of 2013. But the improvement in the global economy had continued to lag behind that in financial markets, especially in the euro area. And underlying economic imbalances remained material, with uncertainty persisting about how they would be resolved in the medium term.

4. Looking over the period as a whole, the improvement in global financial markets that had been evident since the middle of 2012 had been sustained. Equity indices had risen by over 20% since June 2012. Some financial market indicators of near-term risk, such as the VIX index, had fallen to their lowest levels since prior to the financial crisis in 2007. In part that reflected exceptionally accommodative monetary policies by many major central banks. It was also consistent with a perception among some contacts that the most significant downside risks had attenuated. But market sentiment may be taking too rosy a view of the underlying stresses.

5. The Committee noted market intelligence that pointed to increasing investor risk appetite. This was evident in the re-emergence of some elements of behaviour in financial markets not seen since before the financial crisis, including a relaxation in some US credit markets of non-price terms and increased issuance of synthetic products. Such signals were clearly not on the scale seen prior to 2007 and were less evident in Europe. At this stage, they did not appear indicative of widespread exuberance in markets. But developments would need to be monitored closely.

6. UK credit conditions appeared to have improved since November. The fall in bank funding costs that had been observed in 2012 H2, in part related to the Funding for Lending Scheme, had begun to feed through to lower fixed-rate mortgage interest rates and to retail unsecured loan rates, but less so to smaller companies. Survey evidence pointed to greater credit

availability to households and medium and large-sized companies. But despite some apparent easing in supply conditions, UK lending growth had remained subdued.

7. Backward-looking indicators of the resilience of the UK banking system had remained broadly unchanged. Recent data indicated that the overall capital ratio of major UK banks and building societies had increased by around 1 percentage point in 2012, but largely due to a reduction in risk-weighted assets. Banks' liquidity and funding positions had improved, with customer deposits increasing in 2012 and central bank actions leading to large holdings of reserves. Interconnectedness within the banking system appeared to have declined further: on some measures major UK banks' intra-financial system large exposures had fallen by around 80% from levels at the height of the financial crisis in 2008.

Resilience of the UK financial system

8. At its November 2012 meeting the FPC had recommended that "*the FSA takes action to ensure that the capital of UK banks and building societies reflects a proper valuation of their assets, a realistic assessment of future conduct costs and prudent calculation of risk weights. Where such action reveals that capital buffers need to be strengthened to absorb losses and sustain credit availability in the event of stress, the FSA should ensure that firms either raise capital or take steps to restructure their business and balance sheets in ways that do not hinder lending to the real economy*".

9. In discussing the implementation of this recommendation the Committee agreed that it needed to make three key judgements. First, it needed to determine the basis on which to assess capital adequacy and resilience. Second, drawing on work by the Financial Services Authority (FSA), it needed to assess the scale of adjustment that it was appropriate to make to measures of banks' capital to reflect a realistic assessment of asset valuations and future conduct costs, as well as prudent risk weights. And third, it needed to make a judgement about the capital resilience, as proxied by capital ratios, that banks were likely to need in the current conjuncture to absorb losses and so sustain credit availability in the event of stress.

Measuring capital adequacy

10. On the first issue, the Committee agreed that its starting point should be to measure both capital and risk-weighted assets, wherever possible, using the end-point definitions in the Basel III framework, with adjustments made to asset valuations and risk weights where appropriate. In assessing resilience it made no sense to include in the calculation of net worth, and so in

regulatory capital, items that were not capable of absorbing loss in a bank in a stress and so allowing it to remain a going concern. Indeed, investors internationally were already focused on Basel III definitions of capital in their assessment of banks' resilience. The decision to use Basel III definitions was quite separable from a decision about the target level of capital that banks should be held to: it in no way implied that the FPC was requiring immediate implementation of the full Basel III capital ratio standard.

11. Second, the Committee agreed that capital adequacy should be assessed after taking account of the adjustments identified by the FSA to reflect expected losses and to risk-weighted assets. That would provide a clearer metric of how much capital banks had available at present to absorb unexpected losses.

Adjustments to current capital positions

12. The next key judgement was the scale of adjustment needed to banks' current capital base to reflect a realistic assessment of asset valuations and future conduct costs, as well as prudent risk weights. The FSA had examined each of these three areas across a range of UK banks and building societies.[1] These included large institutions, firms with significant portfolios of higher-risk loans, and firms that calculated risk weights using model-based approaches.

13. First, the FSA had selected a range of loan portfolios across which to review valuations. These included some of the largest and riskiest loan portfolios, including UK commercial real estate loans and exposures to the most vulnerable euro-area periphery countries. UK retail mortgage portfolios were also considered given their size and levels of forbearance. On average the loans reviewed represented around half of the total loan portfolios and a fifth of the overall balance sheets of the institutions considered. Given the continued exceptional economic circumstances, with losses continuing to arise from pre-crisis lending, the FSA had assessed expected losses which might arise over a three-year period, net of provisions already taken. That went beyond the usual deduction from capital for one-year modelled expected losses in excess of accounting provisions. The FSA had also looked at how banks valued securities and other trading assets to assess the extent to which accounting valuations of these assets were overstated relative to a more prudent approach that placed greater emphasis on the inherent uncertainty around the

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[1] As set out by the FSA in "Methodology note on calculating capital pressures" at http://www.fsa.gov.uk/library/communication/statements/2013/methodology-note-on-calculating-capital-pressures.

value at which positions could be exited. Taken together, the FSA had concluded that a conservative adjustment for these valuation issues would be around £30 billion.

14. Second, the FSA, drawing on expertise within its Conduct Business Unit, had considered the potential future costs that firms might incur over a three-year period as a result of fines related to the setting of LIBOR and redress payments linked to the mis-selling of payment protection insurance and interest rate swaps. Some banks had increased provisions for such costs recently. After taking those into account, the FSA judged that identified costs over a three-year period could exceed provisions by around £10 billion.

15. Third, the FSA had considered whether capital adequacy could be overstated because of insufficiently prudent risk weights being applied to banks' assets to determine capital ratios. The FSA had reviewed the risk weights applied to corporate and financial institution exposures and UK mortgages, which represented around 70% of assets in the banking book for which firms use models to determine risk weights. This work had factored in actions already taken to tackle concerns about the robustness of model-based estimates, including the introduction by the FSA of an approach for assigning risk weights for commercial real estate exposures ("slotting") and floors for risk weights on sovereign exposures. The FSA judged that a more prudent approach would raise risk-weighted assets by some £170 billion (equivalent to about £12 billion of capital at a 7% equity ratio).

16. In considering the implications of the FSA's work, members noted that, especially in current conditions, the Committee should take a conservative and comprehensive view of capital adequacy. Members noted that any point estimates in the three areas were inevitably uncertain. As an example, members noted that potential losses on exposures to commercial real estate could be lower than the FSA judgement if market conditions improved rapidly; but losses could be understated if current weak economic conditions persisted and loans needed to be written down. Similarly, the FSA had considered the impact of requiring banks to make a prudential adjustment to the accounting valuation of their assets and liabilities held at fair value. But the size of these adjustments could be significantly higher than the FSA had estimated. Past evidence from supervisory exercises, for example, pointed to large variations across banks in the marks used for some hard-to-value assets. This was of a particular concern given trading books could be large.

17. Members also discussed the coverage of the FSA exercise. The FSA had prioritised those areas that it judged most material. But the coverage of the valuation work was partial, excluding for example lending to large corporates outside the commercial real estate sector and to small and medium-sized enterprises. With regard to risk weights, members recognised that the FSA

exercise had focused on a specific set of assets in the banking book. Uncertainty around the level of, and variability across firms in, risk weights against trading portfolios had not been considered, but could be significant. International work was underway in these areas, including a fundamental review of the trading book regime and ongoing investigations into the consistency of model-based capital requirements.

18. Taken together, the FSA judged that adjustments in the three broad areas considered would be equivalent to around a £50 billion reduction in the available regulatory capital of the major UK banks and building societies in aggregate. The Committee agreed to take that judgement as a central estimate of the adjustment required to gauge underlying capital adequacy. It also agreed that it would need to take account of the uncertainty around the estimates, stemming in part from the partial scope of the exercise, in reaching its judgement on actions banks needed to take.

19. **Recommendation 1: The Prudential Regulation Authority (PRA) should assess current capital adequacy using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights.**

Strengthening capital buffers

20. The Committee's third key judgement related to the capital buffers required by banks in the current conjuncture.

21. In framing this discussion, the Committee noted that UK banks' resilience had improved considerably since its low point when the banking crisis broke in 2007, as a result of capital raising and actions to reduce the riskiness of balance sheets. But members remained concerned about the capacity of some banks to absorb unexpected losses and so sustain credit availability in the event of adverse developments. Uncertainty about capital adequacy could dent investor confidence and, in turn, contribute to inhibiting the ability of banks to extend loans to the real economy. It was striking that better-capitalised UK banks had been expanding lending to the real economy since mid-2012 while other institutions had been contracting lending. The Committee agreed that a line needed to be drawn under doubts about UK banks' capital adequacy.

22. The Committee began by noting that the Basel III framework would require banks to meet a 7% ratio of equity capital to risk-weighted assets, made up of a 4.5% minimum plus a 2.5%

capital conservation buffer to absorb unexpected losses. For systemically important banks, there would be an additional requirement of up to 2.5%, taking the total to 9.5%, assuming that no countercyclical buffer was also required. In parallel, UK banks would also need to meet requirements imposed by the implementation of the Independent Commission on Banking (ICB) recommendations. Members noted that banks would need to transition towards these higher levels over time. Discussion focused around how quickly that should be required given current circumstances.

23. Members agreed that a sufficiently high level of capital buffer was required to provide adequate insurance against the material risk of further losses, including from the possibility of stress in the euro area. It was noted that investors might be willing to provide funding only to those banks with capital ratios materially above the 4.5% regulatory minima; and historical experience of crises suggested losses had at times exceeded the 2.5% conservation buffer in the Basel framework. That could imply ratios above 7% would be required. But members took comfort from their decision to adopt the more exacting Basel III definitions of capital and to adjust for the issues identified by the FSA, while mindful of the inherent uncertainties around this work.

24. Taking those considerations together, members agreed that banks' near-term objective should be to achieve by end 2013 a common equity tier 1 capital ratio, based on Basel III definitions and after the required adjustments, of at least 7% of risk-weighted assets. In reaching that decision, it was noted that there was no plausible target threshold that could provide complete insurance against losses in the current environment. Some members were still concerned that a 7% adjusted capital cushion might not provide enough resilience to absorb unexpected losses and support greater lending to the UK economy. Given the partial coverage of the FSA exercise, ongoing economic uncertainties, and high historical loss experience, those members were inclined to put in place additional up-front insurance through a higher capital ratio target, but recognised that required capital ratios for UK banks would rise further as Basel III was phased in and the recommendations of the ICB were implemented. As such, they could agree with the 7% ratio as the near-term objective. The actions that banks would need to take to strengthen capital adequacy to the 7% level would depend on whether, and if so how far, their adjusted capital fell short of that level (and any incremental requirements from the PRA). Some banks, even after the adjustments described above, had capital ratios in excess of 7%; for those that did not, the aggregate capital shortfall at end 2012 was around £25 billion. Though risks in the current conjuncture pointed to a need to raise capital relatively quickly, it was also noted that a requirement to strengthen capital adequacy too rapidly might force some banks to accelerate asset disposals, which could adversely

affect valuations. That said, recent examples of capital issuance internationally, including by some institutions with relatively low market valuations, demonstrated that UK banks could raise capital if necessary.

25. Some members noted that the leverage of some large firms would remain very high even after the FSA adjustments and achievement of a 7% capital ratio threshold: more than 25% of UK banking assets, equivalent to over 100% of UK GDP, would be housed in institutions with leverage levels in excess of 40 times equity. That left little margin for error against a backdrop of low growth in the advanced economies, continued threats to stability, and the uncertainties around the FSA's estimates. As such, the Committee agreed that the PRA should have regard to high levels of leverage, as well as concentrations of exposures to vulnerable assets and uncertainties around the FSA estimates, in its determination of individual bank capital requirements.

26. **Recommendation 2: The PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies hold capital resources equivalent to at least 7% of their risk-weighted assets, as assessed on the basis described in Recommendation 1. Relative to that benchmark, major UK banks and building societies in aggregate currently have a shortfall in capital of around £25 billion.**

27. **Recommendation 3: The PRA should consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, where there are uncertainties about assets not covered in the FSA's assessment of future expected losses or risk weights analysis, or where banks are highly leveraged relating to trading activities.**

28. While implementation of these recommendations by individual firms was not a matter for the FPC, banks' collective approach to strengthening resilience was relevant from a macroprudential perspective. The Committee noted that banks could strengthen buffers via issuance of new equity capital. Banks should continue to exercise restraint on distributions and compensation. Contingent capital could in principle be used to mitigate certain types of tail risk. For example, Basel III-compliant tier 1 contingent capital could be used to meet recommendation 3 as it would help to reduce leverage levels in normal times and could convert to equity or be written down to absorb losses in a stress, provided the capital-related triggers were high enough. To be effective these instruments would need to include triggers that would deliver additional loss-absorbing capacity while an institution was still clearly a going concern. Disposal of non-core assets or businesses could also be an effective way for a firm to build its resilience, but would need to be done in a way that did not hinder lending to households and businesses.

29. **Recommendation 4: The PRA should ensure that major UK banks and building societies meet the requirements in Recommendations 2 and 3 by issuing new capital or restructuring balance sheets in a way that does not hinder lending to the economy. Any newly-issued capital, including contingent capital, would need to be clearly capable of absorbing losses in a going concern to enable firms to continue lending.**

30. The FPC agreed that implementation of these recommendations should be monitored and asked the PRA to report back in 2014 Q1 on progress made during 2013. It could not be ruled out that unanticipated events would require further action to increase the resilience of the UK financial system in the period ahead. But, in light of the recommendations made at the meeting, it was agreed that it should not be necessary to issue further recommendations on capital in the immediate future.

31. Looking to 2014 and beyond, members noted that further increases in capital ratios would be required as banks transitioned to full Basel III, met the requirement for systemically important banks, and any changes to capital requirements arising from the ongoing work in Basel around risk weights for trading assets. In parallel, banks would need to meet requirements imposed by the implementation of the ICB recommendations. As banks moved to these higher capital requirements, the FPC would need to assess regularly the resilience of the banking system in light of its judgement of threats to stability. The US authorities, for example, had developed a regular stress testing approach. The Committee saw the desirability of adopting a stress testing framework to assess capital adequacy regularly but agreed that the approach best suited to the UK banking system would require careful reflection.

32. **Recommendation 5: The PRA should ensure that major UK banks and building societies have credible plans to transition to meet the significantly higher targets for capital and the leverage ratio that will come into effect in 2019 after full implementation of Basel III, the trading book review and surcharge for systemically important banks, and after HM Government's implementation of the ICB proposals, in ways consistent with sustainable expansion of the UK economy.**

33. **Recommendation 6: Looking to 2014 and beyond, the Bank and PRA should develop proposals for regular stress testing of the UK banking system. The purpose of those tests would be to assess the system's capital adequacy. The framework should be able to accommodate any judgements by the Committee on emerging threats to financial stability.**

Disclosure of risk-weighted asset calculations

34. The Committee also discussed the desirability of requiring banks to report risk-weighted assets on both a model-driven and on a standardised basis. That would provide greater transparency for investors and a platform for banks to communicate more clearly about the factors driving their risk weight calculations. The Committee noted that it had already made several recommendations aimed at providing additional information on bank solvency, including on disclosure of leverage ratios in November 2011 and on Pillar 3 disclosures in June 2012. There were also a number of initiatives underway domestically and internationally, including by the Enhanced Disclosure Task Force, to improve the calculation and disclosure of risk weight calculations. The Committee agreed to evaluate at its June 2013 meeting whether further action was appropriate in the light of these related initiatives.

Previous policy recommendations

35. The Committee reviewed progress in implementing the Committee's other outstanding recommendations. In summary:

- Action continued in response to the September 2011 recommendation to HM Treasury to ensure that EU legislation did not constrain the Committee's use of macroprudential policy instruments. EU authorities were close to agreeing the Capital Requirements Directive and Regulation. The latest version provided national authorities with scope to deploy certain macroprudential policy instruments, including the countercyclical capital buffer and sectoral capital requirements.

- Action was also underway in response to the December 2011 recommendation to the FSA to encourage banks to disclose their Basel III leverage ratios by the start of 2013. Some UK banks and building societies had already disclosed leverage ratios on this basis and others had indicated they would do so as they made their end-2012 reports.

- A further recommendation, made in June 2012, to ensure greater consistency and comparability of banks' Pillar 3 disclosures was being taken forward by the FSA and the British Bankers' Association. Some specific improvements – including the reconciliation of accounting and Basel III regulatory capital measures – were being reflected in the end-2012 accounts. But others were likely to take longer to implement.

- Finally, in response to a recommendation made by the Committee in June 2012, UK banks had taken a number of actions to assess, manage and mitigate specific risks to their balance sheets stemming from current and future potential stress in the euro area. In particular,

balance sheets had been adjusted better to match local assets with local liabilities to mitigate potential currency risk. Given the potential for financial stresses in the euro area to re-emerge, the Committee agreed that it was important that banks continued to take action in this area.

- The Committee agreed that its November 2012 recommendation on capital was superseded by the recommendations described above.

The following members of the Committee were present:

Mervyn King, Governor
Paul Tucker, Deputy Governor responsible for financial stability
Charles Bean, Deputy Governor responsible for monetary policy
Andrew Bailey, Head of the Prudential Business Unit of the Financial Services Authority
Adair Turner, Chairman of the Financial Services Authority
Alastair Clark
Michael Cohrs
Andrew Haldane
Robert Jenkins
Donald Kohn
John Kingman attended as the Treasury member.

Martin Wheatley, Head of the Conduct Business Unit of the Financial Services Authority and CEO Designate of the Financial Conduct Authority, also attended in a non-voting capacity.

ANNEX: EXTANT FPC RECOMMENDATIONS

Each recommendation is listed with an identifier to allow ongoing tracking of progress. For example, '11/Q3/3' refers to the third recommendation made at the 2011 Q3 meeting.

11/Q3/3: The Committee urged HM Treasury to continue its efforts to ensure that developments in European legislation did not provide an impediment to the ability of the Committee to use macroprudential policy instruments in the interests of financial stability in the United Kingdom, as envisaged in the consultation documents proposing the establishment of the FPC.

11/Q4/3: The Committee recommends that the FSA encourages banks to disclose their leverage ratios, as defined in the Basel III agreement, as part of their regular reporting not later than the beginning of 2013.

12/Q2/3: The Committee recommends that banks work to assess, manage and mitigate specific risks to their balance sheets stemming from current and future potential stress in the euro area.

12/Q2/5: The Committee recommends that UK banks work with the FSA and the British Bankers' Association to ensure greater consistency and comparability of their Pillar 3 disclosures, including reconciliation of accounting and regulatory measures of capital, beginning with the accounts for the current year.

13/Q1/1: The Prudential Regulation Authority (PRA) should assess current capital adequacy using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights.

13/Q1/2: The PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies hold capital resources equivalent to at least 7% of their risk-weighted assets, as assessed on the basis described in Recommendation 1. Relative to that benchmark, major UK banks and building societies in aggregate currently have a shortfall in capital of around £25 billion.

13/Q1/3: The PRA should consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, where there are uncertainties about assets not covered in the FSA's assessment of future expected losses or risk weights analysis, or where banks are highly leveraged relating to trading activities.

13/Q1/4: The PRA should ensure that major UK banks and building societies meet the requirements in Recommendations 2 and 3 by issuing new capital or restructuring balance sheets in a way that does not hinder lending to the economy. Any newly-issued capital, including contingent capital, would need to be clearly capable of absorbing losses in a going concern to enable firms to continue lending.

13/Q1/5: The PRA should ensure that major UK banks and building societies have credible plans to transition to meet the significantly higher targets for capital and the leverage ratio that will come into effect in 2019 after full implementation of Basel III, the trading book review and surcharge for systemically important banks, and after HM Government's implementation of the ICB proposals, in ways consistent with sustainable expansion of the UK economy.

13/Q1/6: Looking to 2014 and beyond, the Bank and PRA should develop proposals for regular stress testing of the UK banking system. The purpose of those tests would be to assess the system's capital adequacy. The framework should be able to accommodate any judgements by the Committee on emerging threats to financial stability.