

Publication date: 8 July 2015

RECORD OF THE FINANCIAL POLICY COMMITTEE MEETING

24 JUNE 2015

This is the record of the Financial Policy Committee meeting held on 24 June 2015.

It is also available on the Internet:

<http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2015/record1507.pdf>

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 established as a sub-committee of the Bank of England's Court of Directors.

The FPC's next policy meeting will be on 23 September and the record of that meeting will be published on 1 October.

RECORD OF FINANCIAL POLICY COMMITTEE MEETING HELD ON 24 JUNE 2015

At its meeting on 24 June, the Financial Policy Committee gave a Direction and agreed a Recommendation to the PRA to implement the leverage ratio framework for the major UK banks and building societies, agreed a replacement to an existing Recommendation on cyber risk and set the UK countercyclical capital buffer rate:

- 1. The FPC directs the PRA to implement in relation to each major UK bank and building society on a consolidated basis measures to:**
 - **require it to hold sufficient Tier 1 capital to satisfy a minimum leverage ratio of 3%;**
 - **secure that it 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 it is a Global Systemically Important Institution (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.**

The minimum proportion of common equity Tier 1 that shall be held is:

- **75% in respect of the minimum leverage ratio requirement;**
- **100% in respect of the countercyclical leverage ratio buffer; and**
- **100% in respect of the G-SII additional leverage ratio buffer.**

Common equity Tier 1 may include such elements that are eligible for grandfathering under Part 10, Title 1, Chapter 2 of Regulation (EU) No 575/2013 as the PRA may determine.

- 2. The FPC recommends 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%.**
- 3. The FPC recommends that the Bank, the PRA and the FCA work with firms at the core of the UK financial system to ensure that they complete CBEST tests and adopt individual cyber resilience action plans. The Bank, the PRA and the FCA should also establish arrangements for CBEST tests to become one component of regular cyber resilience assessment within the UK financial system.**
- 4. The FPC set the countercyclical capital buffer rate for UK exposures at 0%.**

1. The Committee met on 24 June to agree its view on the outlook for financial stability and, on the basis of that, its intended policy action. It assessed the outlook for financial stability by identifying the risks faced by the financial system and weighing them against the resilience of the system. In light of the developments relating to Greece that occurred over the weekend following this meeting, the Committee met again on 29 June to review those developments and re-assess the financial stability outlook. The record of that meeting is covered within Annex 1 of this document.

The macroeconomic and financial environment

2. The FPC identified the main risks facing the financial system in the United Kingdom as: the global environment; the reduction in market liquidity in some markets; the United Kingdom's current account deficit; the housing market in the United Kingdom; consequences of misconduct in the financial system; and cyber attack.

Global risks

3. The Committee judged that some risks from advanced economies had diminished since December. In the euro area, policy action by the European Central Bank (ECB) had reduced tail risks associated with deflation and high indebtedness. The Committee drew comfort from an economic recovery in the euro area that, Greece aside, appeared to be strengthening and broadening. Euro-area GDP growth was estimated to have been 0.4% in the first quarter and survey indicators suggested a further pick-up in growth in Q2, consistent with the Monetary Policy Committee's (MPC's) May *Inflation Report* forecasts, which had factored in growth of 1.5% across 2015 as a whole. Reflecting policy actions taken by the ECB, the growth outlook was stronger than that at the time of the FPC's December FSR.

4. With regards to Greece, uncertainties remained about the government's ability to meet debt repayments falling due during the summer, with €1.6bn of payments due before the end of June and a further €7.3bn due over July and August. The Greek government's ability to make these payments was reliant on an agreement between Greece and its euro-area partners to unlock a further disbursement of funds.

5. At the time of its policy meeting, negotiations between Greece and its official creditors were ongoing and the FPC judged the risks in relation to Greece and its financing needs to be particularly acute. Uncertainty over the outcome of those negotiations had prompted a re-emergence of deposit flight from the Greek banking system, with the data to end-April showing deposit outflows of €30bn since the turn of the year. The direct exposures of UK banks to Greece

were very small but those to peripheral euro-area economies were more significant, amounting to 60% of common equity Tier 1 (CET1) capital.

6. Given the above material risks, the Bank had continued to work closely with HM Treasury and the FCA to ensure contingency plans were in place.

7. Outside the euro area, economic growth appeared to have strengthened across other advanced economies in the second quarter of the year, following relatively weak growth in the first quarter. Whilst activity in the United States had been broadly flat in the first quarter, survey indicators pointed towards a resumption of GDP growth at a close-to-trend rate in Q2. The US and UK private sectors had deleveraged considerably since the crisis, with the respective household debt to income ratios in those countries 30pp and 22pp lower than the pre-crisis peak. For other advanced economies, however, household debt levels were still rising relative to GDP.

8. The Committee judged financial stability risks from emerging market economies to have increased since December. After a period of strong capital inflows and rising private sector debt, a number of emerging market economies were experiencing slower growth and might now face more difficult financing conditions. The increase in private sector debt had been particularly marked in China, Brazil and Turkey, all of which had experienced a slowdown in growth. In a number of emerging market economies, businesses had issued a large volume of dollar-denominated debt. The Committee considered that strengthening of the US dollar, alongside a potential eventual rise in US dollar interest rates, might pose a threat to the ability of those businesses to meet their obligations. Over the past year, the US dollar had appreciated by 18% against a basket of major emerging market economy currencies.

9. In China, growth had continued to slow since the *December Report* after a rapid build-up of indebtedness. Chinese equity markets had recently been very volatile following rapid increases over the past year. Policymakers continued to face challenges in sustaining growth, managing financial stability and moving towards greater openness. The Committee noted that, were there to be a sharp slowdown in China, it would be likely to have significant spillovers to the global economy.

10. The FPC agreed it would remain alert to these developments and had incorporated stresses in Europe, China and emerging market economies into the 2015 stress test of major UK banks.

Market liquidity risks

11. The Committee remained concerned that some fixed-income markets had become less liquid which, particularly where market participants were not fully alive to liquidity risks, could have the potential to propagate and amplify stressed conditions.
12. In light of these concerns the Committee had, at its previous policy meeting, asked Bank and FCA staff to work together to deepen understanding of the channels through which UK financial stability could be affected by a market correction and an associated reduction in market liquidity. As part of those efforts, staff were asked to gather information from asset managers in the United Kingdom about their strategies for managing the liquidity of their funds in normal and stressed scenarios. In advance of its June policy meeting, staff presented an interim report to the Committee ahead of a final report being prepared prior to the September policy meeting.
13. There was some evidence to suggest that liquidity risks in fixed-income markets were under-priced. In some markets, though average trade sizes and market depth had fallen and prices had become more volatile, estimates of the compensation required by investors to bear liquidity risks were similar to before the crisis. The Committee noted here that greater volatility did not itself threaten financial stability and, to the extent it reflected the introduction of prudential requirements on market-making intermediaries, it was associated with a welcome increase in the resilience of the core of the financial system. Compensation for liquidity risk might have been compressed by an ongoing search for yield in an environment of low risk-free interest rates and large-scale purchases of assets by central banks across advanced economies. Some reallocation of portfolios was an intended consequence of the stance of monetary policy. However, the compensation for bearing credit and liquidity risk in some markets had declined by more than may be warranted by the future economic and financial environment.
14. The Committee judged that a repricing of risk would threaten financial stability if it were to generate sustained illiquidity in, and dislocation of, important financing markets for financial intermediaries and the real economy. This could also affect the resilience of the core banking system. The Committee was alert to this possibility, but judged that further work was required to identify the channels through which a sustained dislocation might occur.
15. Part of the ongoing work focused on open-ended mutual funds, which had almost doubled in size over the past decade. Whilst these funds offered investors the ability to withdraw funds at short notice, some had concentrated holdings in illiquid assets such as emerging market corporate bonds. Early results of a survey, conducted by Bank and FCA staff, of open-ended funds' asset

holdings and liquidity management practices suggested that firms typically had measures in place to manage the risks of heightened investor redemptions, though there was some variation in firms' liquidity risk management practices. Though funds held buffers of cash it was not clear for how long the liquidity buffers could last. And the value of corporate bonds that funds expected to be able to liquidate at a short-term horizon in normal market conditions, taken together, appeared to be large relative to daily market turnover.

16. It remained too soon, however, for the Committee to draw firm conclusions on the extent of financial stability risks posed by these open-ended funds and Bank and FCA staff would engage in further analytical work in the coming months.

17. Globally, the holdings of open-ended mutual funds accounted for only around a tenth of cash securities outstanding and so Committee members asked for work to focus also on the likely behaviour of other important investors in stressed market conditions. A very significant proportion of asset management activity was located in overseas jurisdictions, in particular in the United States, where the UK authorities lacked policy levers. That underlined the importance of the Committee's work in this area being closely aligned with the international work being conducted through the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO).

18. The Committee also asked for further analysis of how changes in market structures might have the potential to act as an amplifier during periods of stress. That work should consider the impact on market dynamics of the shift of market-making activity to firms outside the core banking system, increased flows through mutual funds and exchange-traded funds, the move towards electronic trading in key financial markets, increased automation of trading strategies and high-frequency trading.

19. Ahead of its September policy meeting, the Committee asked for further work on the question of whether and how a sell-off in financial markets could result in a broad and persistent market dislocation that caused risk to flow back to affect the functioning of the core banking system or otherwise disrupt the provision of financial services. In advance of that work being completed, the Committee re-emphasised the need for market participants to be alert to market liquidity risks and to price and manage them prudently.

Risks from the UK current account deficit

20. Domestically, the UK's current account deficit, at 5.5% of GDP in 2014, was large by historical and international standards. Though empirical evidence did not show a strong relationship between the current account and future financial crises, the UK current account was close to the 6% threshold, beyond which IMF analysis suggested that current account deficits left a greater vulnerability. The recent deterioration in the current account had been driven by a fall in UK net investment income, owing to a fall in the returns earned by private non-financial corporates on foreign direct investments, particularly those in the euro area. The continued ease in financing these deficits rested on the credibility of the United Kingdom's macroeconomic policy framework and continuing openness to trade and investment.

21. The United Kingdom current account had been in deficit for most of the period since the 1980s. Analysis of the nature of the capital flows financing the deficit had not suggested a particular vulnerability in addition to the size of the deficit: most of the financing had been from foreign direct investment, equity and longer-term debt including gilts. It had not currently been associated with rapid growth of bank lending. There was no growing currency mismatch in the UK balance sheet, or in particular sectors of the financial system, so the United Kingdom's flexible exchange rate was able to act as a stabilising mechanism in the event of a shock. And the resilience of the UK banking system to an abrupt adjustment of the United Kingdom's external imbalance had been assessed as part of the 2014 stress test.

22. The nature of these financing flows might, however, evolve over time. The FPC noted that, in its May *Inflation Report*, the MPC did not expect a material improvement in the current account deficit over the next three years. Given the Government planned to bring the public sector borrowing position back towards balance that implied a material fall in private sector saving relative to investment. That underlined the need for the FPC to continue to monitor closely the UK current account position, its counterpart financing flows and developments in domestic credit expansion.

Risks from the domestic housing market

23. Given high household indebtedness and its importance as a driver of private sector indebtedness, the Committee continued to monitor closely conditions in UK property markets.

24. Aggregate UK household debt to income at 136%, while having fallen gradually since 2010, remained high compared to historical and international norms. The distribution of debt had

improved marginally, with the tail of households with debt to income ratios greater than 4.0 falling in early 2015. House prices and activity in the housing market had increased again recently, and mortgage rates on many mortgage products were historically low. House prices had grown at an annual rate of 5.6% in the three months to May 2015, compared to 3% in 2014 Q4; and 68,000 mortgages were approved in April, compared with 60,000 per month in 2014 Q4. Given this, the FPC judged that the policies it had introduced in June 2014 to insure against the risk of a marked loosening in underwriting standards and a further significant rise in the number of highly-indebted households remained warranted.

25. Since the FPC's previous policy meeting, the Government had in April provided the FPC with powers of Direction to limit residential mortgage lending at high loan to value or high debt to income ratios for owner-occupied mortgages. The Committee approved and agreed to publish an updated version of its Policy Statement setting out how it intended to use these powers. There were no substantive changes relative to the draft published in February 2015.

26. Neither these new powers of Direction, nor the policy measures enacted through Recommendations by the FPC on housing last year, applied to the buy-to-let market. As it set out in October 2014, HM Treasury would consult later in the year on giving to the FPC the power of Direction to limit residential mortgage lending at high loan to value or high debt to income ratios, including interest coverage ratios, for buy-to-let lending.

27. The Committee noted the continued growth of buy-to-let mortgage lending, with these loans now accounting for 15% of the stock of outstanding mortgages and nearly 20% of the flow of new mortgage lending in 2015 Q1. And the number of buy-to-let products at a loan to value ratio above 80% was 50% higher than 18 months ago.

28. The Committee noted that its actions to insure against future risks applied only to the owner-occupied segment of the housing market and, given this asymmetry, it was possible for risks to financial stability to be transferred to the buy-to-let segment.

29. Without presuming the outcome of HM Treasury's consultation on Direction powers for the FPC in this area, or pre-judging whether any policy action was warranted, the Committee asked the Bank to prepare further work, ahead of its September meeting, on the buy-to-let market to: (i) collect further data; (ii) identify and quantify the channels through which buy-to-let lending might threaten financial stability; and (iii) determine what regulatory tools might be used, through the FPC's powers of Recommendation, to mitigate any financial stability risks that were identified. As with the work carried out last year for the owner-occupied market, this assessment

would need to investigate both the narrow – through potential losses on buy-to-let loans –and broad – through the wider impact of increased indebtedness on the macroeconomy’s sensitivity to shocks – links back to financial stability.

Risks from misconduct

30. The Committee judged that addressing misconduct was essential for rebuilding confidence in the financial system. Misconduct had undercut public trust and hindered progress in rebuilding the banking sector after the crisis. It had also posed risks to systemic stability, with direct economic consequences. The fines imposed on and redress payments required of UK banks, at £30 billion, were equivalent to around all of the external capital that they had raised privately since 2009.

31. Substantial progress had been made in identifying and addressing misconduct, including through reform both of regulation and market and firm-level structures, systems and controls. The UK authorities had recently set out a further set of initiatives in the Fair and Effective Markets Review, and the United Kingdom was leading work to shape standards internationally through the FSB and IOSCO.

32. The Committee emphasised the need for firms to continue to make adequate provisions for the cost of additional redress, align remuneration policy with risk-taking and ensure that accountability of key individuals is clear. The FPC would review the adequacy of sector-wide projections of future misconduct costs in the 2015 stress test.

Risks from cyber attack

33. The financial system continued to face operational risk from frequent cyber attacks and awareness of this risk had continued to grow. In recognition of this growing threat, the FPC had in June 2013 recommended that HM Treasury, working with the relevant government agencies, the PRA, the Bank’s financial market infrastructure supervisors and the FCA work with the core UK financial system and infrastructure providers to put in place a programme of work to improve and test resilience to cyber attack.

34. The FPC’s Recommendation had provided a catalyst for action. Core firms had completed a cyber self-assessment questionnaire, with formal action plans now in place for the majority of these firms to address the findings. The authorities, having consulted with industry, had put together a bespoke, intelligence-led, cyber security testing framework, known as CBEST, for these firms. And the authorities had been working, together with the sector, to ensure effective

information flow between all stakeholders in and out of crisis. CBEST testing was, however, only voluntary and some core firms had yet to complete it or go through a scoping and testing phase. In addressing cyber risks it was crucial to have a regularly-updated assessment of the resilience of core institutions and infrastructure.

35. The FPC judged that further action was needed across three broad areas to form a comprehensive strategy for mitigating cyber risks:

- Defensive resilience capabilities: The CBEST tests conducted so far needed to be broadened to cover all core firms and arrangements put in place to make them a component of a regular cyber resilience assessment for the UK financial system. Firms' approach to mitigating cyber risks needed to be broader in focus than just technology. People mattered as much for cyber security as technology. Attackers could exploit weaknesses in personnel security (for example, deceiving employees so that they revealed passwords) before turning to more sophisticated hacking.
- Recovery capabilities: the continued and evolving nature of the threat from cyber attacks meant that a successful attack was inevitable, leaving effective recovery capabilities essential. The capability to resume vital services quickly and reliably after an attack required effective backup and recovery systems. Cyber attacks could, however, spread between connected systems, requiring, unlike normal business continuity arrangements, sufficient segregation between primary and backup systems. There was a trade-off between the segregation of the two systems, and so the protection of the backup system from cyber risk, and the speed with which a recovery plan could be executed. This suggested the financial system as a whole might need the capability to cope with core services being unavailable for a period of time whilst backup systems were being brought on line.
- Effective governance: the Committee attached particular importance to the boards of firms treating cyber risk as a core strategic issue and being ready to challenge senior management where resilience and recovery plans were inadequate. The responsibility for cyber resilience and for recovery planning lay with each respective firm's board as a whole. The PRA's Senior Managers Regime would provide a framework through which to hold firms' senior management to account in this area.

36. In the light of this assessment, the FPC decided to replace its previous Recommendation with the following Recommendation that:

The Bank, the PRA and the FCA work with firms at the core of the UK financial system to ensure that they complete CBEST tests and adopt individual cyber resilience action plans. The Bank, the PRA and the FCA should also establish arrangements for CBEST tests to become one component of regular cyber resilience assessment within the UK financial system.

37. In making this Recommendation, the FPC considered the costs and benefits involved. The Recommendation aimed to mitigate the risk of cyber attacks on core firms. While it was not reasonably practicable to quantify the benefits of cyber resilience, the Committee considered that these were substantial. The direct costs to firms of CBEST testing were estimated to be around £150,000 per test. This included the cost of accredited third party threat intelligence and accredited penetration testers. There would be additional costs related to the use of firms' internal resources to administer the test, and to implementing the resulting action plans. The Committee judged that the overall costs were low relative to the benefits of improving resilience to a severe cyber attack. The FPC also considered that the Recommendation would have a positive impact on the PRA and FCA's objectives.

38. The FPC also endorsed a broader work programme that staff at the Bank, the PRA, FCA and HMT (the authorities) had prepared to complement this Recommendation by considering how capabilities in both defensive resilience and recovery could be best established across the financial system. That work programme would focus on:

- Reviewing the list of core firms to ensure that it captured those most critical to financial stability in the event of a major cyber attack, including those not regulated by the authorities;
- Defining and developing a clear set of capabilities that would enhance ex-ante cyber resilience within the UK financial system and improve the effective ex-post collective capability of the sector and the authorities to respond to and recover from a major cyber attack;
- Developing cooperation with international authorities to assess and improve cyber resilience in the financial sector, recognising cyber as a potentially cross-jurisdictional threat.

39. The FPC asked for a report on this work programme by the summer of 2016 and would consider the need for further action at that point.

Resilience of the financial system

Core banking system

40. Major UK banks had continued to build capital and improve the resilience of their funding and now reported an average risk-weighted CET1 capital position above 11%. This capital position reflected, in part, the actions taken in response to the 2014 stress test of the major UK banks that had captured some of the main risks that the FPC had judged to be facing the system. It was noted however that, despite this improvement in resilience, the growth in bank lending to the corporate sector remained subdued.

41. Though banks' equity capital was in excess of current requirements, risk-weighted equity capital requirements were set to increase further over the next four years, as the full Global Systemically Important Bank (GSIB) buffers were phased in and as various reviews of the risk-weighted capital framework that were ongoing, including the fundamental review of the trading book, were completed.

42. Major UK banks' average leverage ratio was 4.4% on the Basel definition.

43. Since the Committee's previous policy meeting, Parliament had on 6 April 2015 introduced legislation to give the FPC powers of Direction over the PRA in relation to leverage ratio requirements. This had followed Recommendations made by the FPC as part of its review of the leverage ratio requested by the Chancellor of the Exchequer in November 2013 and published in October 2014.

44. The review of the leverage ratio had set out that, if granted powers of Direction over the leverage ratio, the FPC proposed to direct the PRA to set leverage ratio requirements and buffers for PRA-regulated banks, building societies and investment firms. These requirements would consist of: a minimum leverage ratio requirement; a supplementary leverage ratio buffer for global systemically important institutions and other major domestic UK banks and building societies; and a countercyclical leverage ratio buffer, to apply to all firms from the point that they become subject to the minimum leverage ratio requirement. The review had set out the proposed design and calibration of the leverage ratio framework as well as the extensive impact analysis carried out by the Committee in considering the framework in October 2014.

45. The FPC was required to set out the general policy that it proposed to follow in relation to its powers of Direction over the leverage ratio. It had done this in draft in February 2015 to inform the parliamentary debate on the FPC's proposed new tools on leverage.

46. Following the granting of powers of Direction to the FPC, the Committee approved an updated version of its Policy Statement. It made no substantive changes relative to the draft statement published in February 2015.

47. The Committee then agreed to use its new powers of Direction to implement the leverage ratio framework for major UK banks and building societies as set out in its review of the leverage ratio, which it had proposed should be implemented as soon as was practicable. In using its powers of Direction, the Committee considered that the evidence set out in its review of the leverage ratio and the Policy Statement remained timely and provided a thorough explanation of its policy action.

48. The FPC therefore issued a Direction and Recommendation to the PRA:

The FPC directs the PRA to implement in relation to each major UK bank and building society on a consolidated basis measures to:

- **require it to hold sufficient Tier 1 capital to satisfy a minimum leverage ratio of 3%;**
- **secure that it 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 it is a Global Systemically Important Institution (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.**

The minimum proportion of common equity Tier 1 that shall be held is:

- **75% in respect of the minimum leverage ratio requirement;**
- **100% in respect of the countercyclical leverage ratio buffer; and**
- **100% in respect of the G-SII additional leverage ratio buffer.**

Common equity Tier 1 may include such elements that are eligible for grandfathering under Part 10, Title 1, Chapter 2 of Regulation (EU) No 575/2013 as the PRA may determine.

The FPC recommends 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%.

49. The FPC was required to have regard to the impact of its policies on the PRA's objectives. The Committee considered that the introduction of a leverage ratio framework for major UK banks and building societies would have a positive impact on the resilience of the financial system. It should therefore also have a positive impact on the PRA's general objective to promote the safety and soundness of the firms that it regulated, which includes consideration of financial stability.

50. The Committee was informed that the PRA, anticipating how the FPC would use its powers of Direction as proposed in the review of the leverage ratio, had considered how it would implement the leverage ratio framework. The PRA intended to issue a consultation paper on its proposed implementation of the leverage ratio framework on 10 July, with rules to introduce the leverage ratio framework then expected to be finalised in 2015 Q4, following a three-month public consultation period on the planned rules. The PRA would update FPC on progress implementing the leverage ratio framework ahead of the FPC's next policy meeting.

Risks beyond the core banking system

51. The FPC had a statutory responsibility to identify, assess, monitor and take action in relation to financial stability risk across the whole financial system, including risks arising from beyond the core banking sector. To support this responsibility, the FPC had a power to make Recommendations to HMT on the scope of regulated activities, on the allocation of regulated activities between the PRA and FCA, and more generally in respect of information gathering.

52. The FPC published its first assessment of risk and regulation beyond the core banking sector in June 2014. In that assessment the Committee had focused on investment funds, hedge funds, securities financing transactions, money market funds and finance companies and had concluded that it did not see a case for recommending changes to the regulatory framework.

53. Since then, Bank staff had conducted a high-level review of thirty types of activity beyond the core banking system and, for each of them, made an assessment of the key transmission channels through to financial stability as well as the sources of fragility. That work had considered international work already underway and focused on the materiality of three

transmission channels: (i) the provision of critical services; (ii) risk to systemically important counterparties; and (iii) disruption to systemically important financial markets.

54. On the basis of the evidence currently available the FPC concluded not to recommend a change in how these activities are regulated. But, as noted above, it had concerns over market liquidity and decided to undertake a regular deep analysis of a range of activities. It asked Bank and FCA staff to begin this analysis over the next year with the investment activity of investment funds and hedge funds, the investment and non-traditional, non-insurance activities of insurance companies, and securities financing and derivatives transactions.

Assessment of the outlook for financial stability and countercyclical capital buffer decision

55. The Committee assessed the outlook for financial stability by identifying the risks faced by the financial system and weighing them against the resilience of the system. As noted above, the composition of risks had shifted and the resilience of the system had continued to improve. Overall, the Committee judged that challenges remained but the outlook for financial stability was broadly unchanged relative to that at the time of its December FSR.

56. The FPC considered its setting of the UK countercyclical capital buffer (CCB) rate. In doing so, it weighed the risks facing the UK financial system against the still modest recovery in credit extended to UK households and companies, increased resilience of the financial system and the actions taken in response to the 2014 stress test of major UK banks. It would assess UK banks' ability to withstand risks stemming from the global economy, including emerging market economies and the euro area, as well as financial markets as part of the 2015 stress test.

57. In its discussions, the Committee also considered the Basel 'buffer guide' – a simple metric identified in legislation, which, alongside other variables relevant to risks to the stability of the financial system, provides a guide for the CCB rate based on the gap between the ratio of credit to GDP and its long term trend. Reflecting modest credit growth over the past year, the credit to GDP ratio had fallen by around 5 percentage points over the past twelve months to 145%. As a result, the credit gap measure remained strongly negative and the 'buffer guide' implied that the CCB should be set at 0%. But, as the Committee had discussed in previous meetings, there was no simple, mechanistic link between the buffer guide and the CCB rate.

58. In the light of its view on the overall outlook for financial stability, **the Committee agreed to set the CCB rate for UK exposures at 0%, unchanged from March 2015.** The

Committee also noted that the PRA would reciprocate actions by Norway and Sweden to increase their CCB rates.

Existing Recommendations

59. The Committee reviewed the progress made on implementing its existing Recommendations since its previous policy meeting.

Powers of Direction over housing instruments (14/Q3/1): *The FPC recommends that HM Treasury exercise its statutory power to enable the FPC to direct, if necessary to protect and enhance financial stability, the PRA and FCA to require regulated lenders to place limits on residential mortgage lending, both owner-occupied and buy-to-let, by reference to: (a) loan-to-value ratios; and (b) debt-to-income ratios, including interest coverage ratios in respect of buy-to-let lending.*

60. Legislation, granting the FPC powers of Direction over mortgage lending for owner-occupied properties, had come into force on 6 April. The outstanding element of this Recommendation related to the FPC's Recommendation for powers of Direction over buy-to-let mortgage lending; HM Treasury intended to consult separately on these powers later in 2015. The Committee planned therefore to review this Recommendation later in 2015, following HM Treasury's consultation on powers of Direction over buy-to-let mortgage lending.

Stress testing (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.*

61. The Committee received a preliminary report on options for developing the medium-term approach to stress testing. It would have a fuller discussion in H2, in parallel to considering the overall capital framework for UK banks. The Committee therefore agreed to review this Recommendation again later in the year.

Resilience to cyber attack (13/Q2/6): *HM Treasury, working with the relevant government agencies, the PRA, the Bank's financial market infrastructure supervisors and the FCA should work with the core UK financial system and its infrastructure to put in place a programme of work to improve and test resilience to cyber attack.*

62. As set out above, the FPC, having reviewed progress made across the authorities, agreed to replace this Recommendation with a new Recommendation directed at the Bank, PRA and the FCA in

relation to CBEST cyber vulnerability testing. **The Committee therefore agreed that this Recommendation had been superseded.**

Review of redacted text

63. The Committee reviewed the text that had been redacted from its previous record relating to contingency planning associated with continuing uncertainties in Greece. It agreed that publication of the text remained contrary to the public interest, because there was a risk of exacerbating the risks that the contingency planning was seeking to mitigate. It was not possible to agree now a date at which the text would be published. But the Committee would keep it under review.¹

The following members of the Committee were present; Clara Furse joined the meeting by telephone:

Mark Carney, Governor
Jon Cunliffe, Deputy Governor responsible for financial stability
Andrew Bailey, Deputy Governor responsible for prudential regulation
Ben Broadbent, Deputy Governor responsible for monetary policy
Martin Wheatley, Chief Executive of the Financial Conduct Authority
Alex Brazier
Clara Furse
Donald Kohn
Richard Sharp
Martin Taylor
Charles Roxburgh attended as the Treasury member in a non-voting capacity.

Nemat Shafik, Deputy Governor responsible for markets and banking, also attended the meeting.

As permitted under the Bank of England Act 1998, Anthony Habgood was also present as an observer in his role as member of the Oversight Committee of Court.

¹ The text in this paragraph was omitted from the version of the Record that was initially published on 8 July 2015. The Committee agreed at its September 2015 meeting to release this text, for the reasons set out in the Record of that meeting.

ANNEX 1: DISCUSSION AT SUBSEQUENT MEETING TO FINALISE THE FINANCIAL STABILITY REPORT

1. In view of the major developments relating to Greece, subsequent to its policy meeting, the Committee received further briefing on Monday 29 June on the latest developments, including contingency planning arrangements, and reviewed its assessment of the outlook for financial stability.
2. Following the Greek Government's decision to call a referendum on the terms of the creditors' proposal, there had been a break down in the negotiations on the extension of the European Financial Stability Facility (EFSF) programme of financial assistance for Greece expiring on 30 June. In the light of this, the Eurogroup had decided not to extend that programme beyond 30 June and, subsequently, the ECB had decided not to raise the ceiling on its Emergency Liquidity Assistance. The Greek authorities had also imposed a bank holiday and associated capital controls.
3. The Committee noted that institutional changes and development of policy tools in the euro area since 2012, alongside economic recovery, the reduction in fiscal deficits in a number of other euro-area Member States and strengthening of banking systems, had all contributed to a reduction in the risk of contagion. On 27 June, euro-area Finance Ministers had stated their intent to make full use of all the instruments available to preserve the integrity and stability of the euro area. The ECB Governing Council had also stated its determination to use all the instruments available within its mandate.
4. Nevertheless, the situation remained fluid. The FPC agreed it would continue to monitor developments and remained alert to the possibility that a deepening of the Greek crisis could prompt a broader reassessment of risk in financial markets.
5. In the light of the developments over the weekend, the Committee judged that, though the outlook for financial stability had been broadly unchanged over most of the period since December, given the risks associated with Greece had begun to crystallise in recent days, the outlook had now worsened.
6. The Bank had continued to work closely with HM Treasury, the FCA and European counterparts to put in place contingency plans, some of which had been implemented. The UK authorities would continue to monitor developments and would take any actions required to safeguard financial stability in the United Kingdom.

ANNEX 2: EXTANT FPC RECOMMENDATIONS AND DIRECTIONS

Identifier ⁽¹⁾	Recommendation/Direction
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.
14/Q3/1	The FPC recommends that HM Treasury exercise its statutory power to enable the FPC to direct, if necessary to protect and enhance financial stability, the PRA and FCA to require regulated lenders to place limits on residential mortgage lending, both owner-occupied and buy-to-let, by reference to: (a) Loan-to-Value Ratios; and (b) Debt-to-Income Ratios, including Interest Coverage Ratios in respect of buy-to-let lending.
15/Q2/1(D)	<p>The FPC directs the PRA to implement in relation to each major UK bank and building society on a consolidated basis measures to:</p> <ul style="list-style-type: none"> • require it to hold sufficient Tier 1 capital to satisfy a minimum leverage ratio of 3%; • secure that it 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 it is a global systemically important institution (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. <p>The minimum proportion of common equity Tier 1 that shall be held is:</p> <ul style="list-style-type: none"> • 75% in respect of the minimum leverage ratio requirement; • 100% in respect of the countercyclical leverage ratio buffer; and • 100% in respect of the G-SII additional leverage ratio buffer. <p>Common equity Tier 1 may include such elements that are eligible for grandfathering under Part 10, Title 1, Chapter 2 of Regulation (EU) 575/2013 as the PRA may determine.</p>

⁽¹⁾ Each Recommendation and Direction is listed with an identifier to allow ongoing tracking of progress. For example, '13/Q1/6' refers to the sixth Recommendation made at the 2013 Q1 meeting.

Identifier ⁽¹⁾	Recommendation/Direction
15/Q2/2	The FPC recommends 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%.
15/Q2/3	The FPC recommends that the Bank, the PRA and the FCA work with firms at the core of the UK financial system to ensure that they complete CBEST tests and adopt individual cyber resilience action plans. The Bank, the PRA and the FCA should also establish arrangements for CBEST tests to become one component of regular cyber resilience assessment within the UK financial system.

⁽¹⁾ Each Recommendation and Direction is listed with an identifier to allow ongoing tracking of progress. For example, ‘13/Q1/6’ refers to the sixth Recommendation made at the 2013 Q1 meeting.