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RECORD OF THE FINANCIAL POLICY COMMITTEE MEETING

22 MARCH 2017

This is the record of the Financial Policy Committee meeting held on 22 March 2017.

It is also available on the Internet:

<http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2017/record1704.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 a committee of the Bank of England.

The FPC's next policy meeting will be on 21 June 2017 and the record of that meeting will be published on 4 July.

RECORD OF FINANCIAL POLICY COMMITTEE MEETING HELD ON 22 MARCH 2017

At its meeting on 22 March 2017, the Financial Policy Committee (FPC):

- Maintained the UK countercyclical capital buffer (CCyB) rate at 0%. It reaffirmed its support for the clear supervisory expectation of the Prudential Regulation Authority (PRA) that firms should not increase dividends and other distributions as a result of the UK CCyB rate being maintained at 0%.
- Considered that the following Recommendation that it had made to HM Treasury in September 2014 had been implemented by legislative action in April 2015 and December 2016:
 - 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; b) debt to income ratios, including interest coverage ratios in respect of buy-to-let lending.
- Considered that the following Recommendation that it had made to the PRA in May 2016 had been implemented, following the PRA finalising its relevant policy in February 2017:
 - The PRA should seek to ensure that, where systemic buffers apply at different levels of consolidation, there is sufficient capital within the consolidated group, and distributed appropriately across it, to address both global systemic risks and domestic systemic risks.

1. The Committee met on 22 March 2017 to agree its view on the outlook for financial stability and, on the basis of that, its intended policy action.
2. The FPC assessed the outlook for financial stability by identifying the risks faced by the UK financial system and assessing the resilience of the system to those risks. In doing so, its aim was to ensure the financial system can continue to provide essential services to the real economy, even in adverse circumstances.

Risks to financial stability

3. The Committee reviewed financial system and economic developments since its previous meetings in November 2016.

Global environment

4. In the global economy, near-term prospects had improved. In the United States, investors and businesses expected an expansion in fiscal policy and there had also been some expectation of more supportive fiscal policy in the euro area. Survey indicators of growth in global economic activity had reached their highest level in around two years in January, and in February the Monetary Policy Committee had revised up its outlook for UK-weighted world GDP growth in 2017 by a quarter of a percentage point. Consistent with that, over the period since November, equity prices had risen further internationally and short and long-term interest rates had increased in some economies.

5. However, risks remained elevated. Debt levels had continued to increase in China. Total social financing had increased by 15.5%¹ over the previous year and corporate credit had risen to 166% of nominal GDP in the latest data. Following falls in previous months, Chinese foreign exchange reserves had stabilised at around \$3 trillion in February, supported by more restrictive capital controls and a tightening in domestic financial conditions. In some euro-area economies, sovereign debt positions remained vulnerable to a further rise in the cost of borrowing for governments or a weakening in growth prospects.

¹ After adjusting for the statistical effect of replacing local government borrowing through financing vehicles with the issuance of municipal bonds.

6. Policy uncertainty was also high across a range of advanced economies. The precise nature, size and timing of any fiscal measures in the United States remained unclear. There was greater uncertainty about policies supporting global trade and cross-border financial integration. And exit negotiations between the United Kingdom and the European Union were expected to begin shortly.

EU withdrawal

7. The FPC noted that there were a range of possible outcomes from the exit negotiations. Risks to financial stability would be influenced by the orderliness of the adjustment to the new relationship between the United Kingdom and the European Union. The FPC would oversee contingency plans to mitigate risks to financial stability as this process unfolded.

8. It would assess the financial stability implications of firms' plans to adapt to the United Kingdom's withdrawal from the European Union. The FPC supported the work of the PRA and FCA to ensure regulated firms had comprehensive plans in place to operate in a range of possible outcomes. Sudden adjustment could disrupt the provision of market liquidity and investment banking services, particularly to the EU real economy, which could spill back to the UK economy through trade and financial linkages. Over a longer horizon, the FPC was alert to the potential for greater complexity in firms' business structures to reduce the resilience of the UK financial system and was examining appropriate mitigants.

9. In reviewing potential 'tail' risks, the FPC had an initial discussion of the risks if the United Kingdom were to withdraw from the European Union without a negotiated agreement, in the absence of an adjustment period, and where market participants had not been able to prepare fully by the point of withdrawal. These fell into two broad categories:

- Direct risks to the provision of financial services. This included: loss of cross-border banking services; disruption to market liquidity caused by fragmentation of securities and derivatives trading; disruption to clearing infrastructure; and loss of authorisations and associated uncertainty around the continued enforceability and performance of some financial contracts.
- Macroeconomic shocks that might also test the resilience of the financial system. This included the possibility of some direct disruption to economic activity – for

example, because of non-tariff barriers to trade. It also included the risk of a sharp re-evaluation of the strength of, and uncertainty around, the UK economic outlook; this could prompt a sudden fall in confidence and increase in risk aversion towards UK assets.

10. The FPC asked the Bank to institute regular monitoring of these risk channels and the mitigants in place or being developed to address them. It asked for frequent reporting to the FPC, including between its official meeting cycles. The FPC also requested that stress scenarios be developed against which the resilience of the UK financial system could be assessed.

11. This work would support the FPC in overseeing contingency plans in place to maintain financial stability in a range of possible outcomes.

12. The FPC agreed that publication of its discussion was against the public interest during the period when contingency planning was being undertaken. Disclosure could act to raise the probability of risks being triggered and run counter to the objective of contingency planning. In addition, disclosure could prejudice the negotiations with the EU around the UK's withdrawal. The Committee therefore decided to defer publication, under Section 9U of the Bank of England Act 1998. The earliest date on which the information might be published was likely to be after the United Kingdom had exited from the European Union; the FPC would review whether publication was still against the public interest at that point.²

Asset prices

13. The high degree of uncertainty in many advanced economies appeared not to be fully reflected in asset prices, which had risen sharply in recent months, or in measures of market volatility, which remained subdued. In Europe, government bond yields had increased relative to German Bunds for a wide range of economies in the euro area since November, and forthcoming elections in that region had the potential to increase asset price volatility. Measures of market implied volatility had fallen since the November *Financial Stability Report* (FSR) and a number remained near historic lows.

² The text in this and the three preceding paragraphs was omitted from the version of the Record that was initially published on 4 April 2017. The Committee agreed at its 20 November 2018 meeting to publish this text, for the reasons set out in the Record of that meeting.

14. In the United Kingdom, real interest rates had fallen further and there had been a broad-based increase in the price of risky assets. Ten year real yields – based on RPI inflation indexed government bond yields – had fallen to -1.9%, 20 basis points lower than at the time of the November *FSR* and 90 basis points lower than prior to the EU referendum. This suggested that investors were factoring in weak UK growth prospects and high uncertainty. However, such factors were not obviously priced into other assets. The spread between bonds issued by UK companies and the government had narrowed and remained low by historical standards. In the residential real estate market, house price growth had continued to outpace growth in rents in Q4. And in the commercial real estate market, prices had started growing again in Q4, following their post-referendum falls. Yields remained a little above pre-referendum levels in aggregate, but in the prime London office segment of the market yields had fallen back to pre-referendum levels.

Domestic credit conditions and consumer credit

15. UK household indebtedness remained high by historical standards and had begun to rise relative to incomes. The share of new owner-occupier mortgages extended at a loan-to-income multiple at or above the 4.5 threshold that the FPC had introduced in 2014 in its loan-to-income flow limit Recommendation had remained constant in 2016 Q4; but the share extended at a loan-to-income multiple just below that threshold had continued to rise.

16. Consumer credit had been growing particularly rapidly. It had reached an annual growth rate of 10.9% in November 2016 – the fastest rate of expansion since 2005 – before easing back somewhat in subsequent months. Growth had been broad-based across different segments of the market. Dealership car finance had seen the fastest expansion in recent years, but credit cards and personal loans had contributed materially to the acceleration in consumer credit in 2016.

17. The Committee noted that an easing in credit supply conditions appeared to have contributed to the growth in consumer credit, with intense competition in some segments of the market. This had been evident, for example, in: the gradual extension of interest-free periods on credit card balance transfer offers; an increase in maximum loan limits in some parts of the unsecured personal loan market; and a compression in the cost of borrowing through unsecured personal loans compared to the cost of borrowing on a secured basis through mortgages in recent years.

18. The Committee considered the potential channels through which consumer credit could pose risks to financial stability. The Committee discussed both a direct channel, stemming from potential losses to lenders on consumer credit portfolios, and indirect channels, stemming from the possibility that high levels of debt, or an abrupt reduction in credit supply, could pose risks to consumption and broader macroeconomic stability, and hence the resilience of the financial system.

19. On the direct channel, consumer credit accounted for less than 10% of major UK banks' total stock of lending to domestic real economy borrowers. This compared with a share of around 70% for mortgage lending. But bank stress tests had shown that the scale of losses on consumer credit books in an economic downturn was likely to be greater than that on mortgage lending. For example, in the 2016 stress test, stressed impairments on UK consumer credit exposures totalled around £18.5bn, compared with £11.8bn for UK mortgages. The 2016 stress test had ensured that banks were capitalised to withstand a severe stress, including to their consumer credit exposures as at the end of 2015, and maintain the supply of lending to the real economy.

20. Given the shorter maturity of these exposures, the credit quality of the stock of consumer credit had the potential to deteriorate quickly, especially in an environment of very rapid credit growth. If recent strong growth had been driven by weaker underwriting standards, this could reduce the resilience of lenders to shocks. The FPC judged that underwriting standards should be monitored closely.

21. The Committee also noted potential vulnerabilities stemming from interest-free offers on credit cards, including their accounting treatment which allowed lenders to record interest income during the period of the interest-free offer based on estimates of future interest payments. These estimates were highly dependent on assumptions around the future behaviour of borrowers at the end of the interest-free period, which was uncertain.

22. On the indirect channels, the stock of UK consumer credit debt was around 15% of annual UK household income, compared with 102% for mortgage debt. But consumer credit had a disproportionate impact on household debt servicing costs because high interest rates and short maturities led to higher repayments for a given loan amount. As a result, the proportion of households with high consumer credit debt service ratios was broadly equivalent to that with high mortgage debt service ratios.

23. A key difference with mortgage lending was that – in response to adverse shocks – consumer credit borrowers were more likely to default on their debts. This meant that, everything else equal, consumer credit borrowers were less likely to prioritise debt repayments over consumption. Given that, the Committee judged that this indirect channel was less material than for mortgage debt.

24. Beyond vulnerabilities associated with the stock of debt, the Committee also discussed the extent to which an abrupt tightening in the supply of consumer credit could have an adverse impact on aggregate consumer spending. It noted that, unlike mortgage debt, there was no collateral channel operating in the consumer credit market; in the mortgage market, a loosening in the supply of credit in an upswing could lead to higher collateral values, further increasing both the demand for and supply of credit, with the reverse happening in a downswing. Further, flows of consumer credit accounted for a relatively small share of consumption, so, in practice, volatility in the supply of credit probably would not be a material driver of fluctuations in consumption. The Committee asked for further analysis on the precise importance of this.

25. Overall, the Committee judged that, relative to mortgage debt, consumer credit was less likely to pose a risk to broader macroeconomic stability through its effect on household spending. Instead, the recent rapid growth in consumer credit could principally represent a risk to lenders if accompanied by weaker underwriting standards.

26. The Committee noted that several reviews related to the consumer credit market were already in train. The PRA had launched a targeted review of the credit quality of new lending by a cross-section of PRA-regulated lenders in the three main segments of the market: credit cards, personal loans and dealership car finance. And the FCA was undertaking a review into its rules and guidance on creditworthiness assessments used in the consumer credit market. The 2017 stress test and reviews by the PRA and FCA would shed further light on whether the recent rapid growth in consumer credit and any possible deterioration in credit quality had affected banks' resilience.

27. The FPC supported this work and would review the findings and any implications for financial stability in coming months.

Overall assessment

28. Overall, the FPC judged that the level of risk to UK financial stability was broadly unchanged but its assessment of the relative weight on the various risks had shifted somewhat. In light of this assessment, the FPC then considered its decision on the appropriate setting of the UK countercyclical capital buffer (CCyB) rate, and for the scenario for the Bank's annual cyclical stress test.

Resilience of the UK financial system

UK CCyB rate setting

29. The Committee reviewed the particular circumstances that had led it to cut the UK CCyB rate to 0% in July 2016. Cutting the rate had been a response to greater uncertainty around the UK economic outlook and an increased possibility that material domestic risks could crystallise in the near term. The FPC's action had served to ensure banks did not hoard capital and restrict lending in those conditions.

30. In July 2016, the FPC had accompanied its decision to cut the buffer rate to 0% by setting out that it expected to maintain a 0% UK CCyB rate until at least June 2017, absent any material change in the outlook. The purpose of this guidance had been to provide banks with the clarity necessary to facilitate their capital planning.

31. The FPC agreed to maintain the UK CCyB rate at 0% in March.

32. At its next meeting, the first following the expiry of the 2016 guidance, the FPC would make a full assessment of whether to return the UK CCyB rate to a more neutral level, consistent with its stated approach to setting the CCyB in a standard risk environment. Any increase in the UK CCyB rate would normally come into effect with a twelve month lag.

33. The Committee's intention was to adjust the buffer rate – both up and down – in line with the possible losses the banking system could incur on its UK exposures, if risks were to materialise. Risks – and therefore potential losses – tended to increase as asset prices, risk appetite and credit growth relative to income increased.

34. The FPC had made clear in its strategy that it expected to vary the UK CCyB rate gradually and for the rate to be in the region of 1% in a standard risk environment. This approach

was likely to be more robust to the inherent uncertainty in assessing the risk level, while also reducing the economic cost of using this macroprudential tool.

35. The FPC's current assessment, as discussed earlier when considering risks to financial stability, was that the risk-taking environment domestically was at a standard level. Year-on-year growth in overall credit to the domestic private non-financial sector was 5.0% in 2016 Q3, in line with annual growth in nominal GDP of 4.9% in 2016 Q4. This contrasted with the Basel credit-to-GDP gap which the Committee was required by statute to take into account when setting the UK CCyB rate. The gap – defined as the difference between the ratio of credit to GDP and a simple, statistical estimate of its long-term trend – remained negative in 2016 Q3. As the Committee had observed at previous meetings, the long-run trend on which the indicator was based gave undue weight to the rapid build-up in credit prior to the global financial crisis and was therefore not always reliable.

Scenario design for the 2017 stress test for major UK banks

36. The Committee noted that the Bank would publish the cyclical and exploratory scenarios for the 2017 stress test of major UK banks shortly after the FPC's policy meeting. This would incorporate the FPC's views of the risk environment into the scenario.

37. Under the Bank's annual cyclical scenario (ACS) approach, the size of the shocks to different sectors of the UK economy and for other economies were adjusted each year to deliver a similar stressed outcome unless the assessment of vulnerabilities warranted a change to that outcome. In this way, the stress test scenario is explicitly countercyclical.

38. The stressed outcome for UK activity and unemployment in the 2017 ACS would be the same as in 2016; but for the global economy, the stressed outcome would be worse than in 2016, largely reflecting continued rapid growth of credit in China. The 2017 ACS would incorporate a rise in Bank Rate, differentiating it from the 2016 exercise in which Bank Rate was cut to zero. This was not designed to change the overall severity of the stress: in aggregate, banks were likely to see higher impairments but also higher interest income. Rather, it would allow the FPC, and the Prudential Regulation Committee (PRC), to investigate the sensitivity of banks' balance sheets to higher interest rates, while the additional exploratory scenario tested banks against persistently low rates.

39. The results of the test would be published in November 2017 and would inform policy responses to ensure that the banking system had sufficient capital to absorb losses and maintain the supply of credit to the real economy, even in a severe stress. The benchmarks – or hurdle rates – above which banks would be expected to maintain their capital positions in the 2017 ACS would be set on the same basis as in the 2016 test. All participating banks would be expected to meet their minimum CET1 capital requirements, which averaged 6.5% in 2016. Globally systemic banks would be held to a higher standard. Failure to meet these standards in the stress would generally result in banks being required to take action to improve their positions, if they had not already done so.

40. In line with its published stress testing approach, the Bank would be running, for the first time, a second stress test in 2017. This would involve an exploratory scenario that would be used to probe the resilience of the system to risks that may not be neatly linked to the financial cycle. It was intended as a complement to the ACS. The scenario would change each time it was run, reflecting particular concerns at the time.

41. Linked to the FPC's previous assessment of longer-term risks to the resilience of the UK banking system, the 2017 exploratory scenario would consider how the resilience of the UK banking system might evolve if recent headwinds to bank profitability persisted and intensified. The test would incorporate weak global growth, persistently low interest rates, falling world trade and cross-border banking activity, increased competitive pressure on large UK banks from smaller banks and non-banks and a continuation of costs related to misconduct. It would have a seven-year horizon to capture these long-term trends.

42. The exploratory scenario would not be focused on bank capital adequacy. Instead, it would focus on how, rather than whether, banks would meet regulatory requirements and build sustainable business models in such an environment. Its purpose was to explore the impact of banks' actions on both the real economy and the future resilience of the system to shocks.

43. The results publication would disclose aggregate results, including coverage of the economic impact of any strategic decisions banks make, and analysis on the implications for the future resilience of the banking sector. The Bank did not intend to publish individual bank results under the exploratory scenario, based on considerations around the possible commercial sensitivity of the projections banks will provide.

Bank capital and capital framework

44. The aggregate Tier 1 capital position of major UK banks was 15.1% of risk-weighted assets in December 2016. In December 2015, as part of establishing the framework of capital requirements for UK banks, the FPC had set out that the appropriate Tier 1 capital requirement for the UK banking system, in aggregate and net of any countercyclical capital buffer, was 13.5% of risk-weighted assets, as currently measured. It had noted that this would fall if shortcomings in the current regime for calculating risk weights were addressed. The FPC would therefore review this benchmark in light of the outcome of ongoing negotiations to finalise Basel III standards and the implementation of IFRS 9 accounting standards, due to come into effect in 2018.

45. The leverage ratio of the major UK banks in aggregate was 5.3% of total exposures in December 2016. Major UK banks currently faced a leverage ratio requirement and buffers that amounted to, in aggregate, 3.3% of total exposures. In July 2016, the FPC had decided to exclude central bank reserves from the leverage ratio exposure measure to ensure that it did not impede monetary policy or UK banks' usage of liquidity facilities. At that point, the Committee had noted that if no offsetting action were taken, excluding central bank reserves from the exposure measure would lead to a reduction in the nominal amount of capital needed to meet the UK leverage ratio standard. The FPC had been clear that this was not its intention, and that it therefore planned to recalibrate the leverage ratio in 2017. In line with this commitment, the FPC reaffirmed that it intended to take action at its next meeting to adjust the UK leverage ratio standard accordingly.

46. The Committee noted that the average price-to-book ratio for major UK banks had increased by almost 50% relative to the low-point in 2016. But the ratio remained below one, at around 0.8. The Committee noted evidence that equity prices of UK banks could be explained by anticipated misconduct redress costs and weak expected operating profitability of investment banking services in particular, rather than by market concerns about asset quality. For major global banks generally, the correlation between price-to-book ratios and expected returns on equity was currently above 90%, and much higher than the correlation between price-to-book ratios and measures of asset quality.

Resolution and resolvability

47. As part of setting out the framework of capital requirements for UK banks in December 2015, the FPC had listed a number of assumptions on which its view on the appropriate Tier 1

capital requirements for the UK banking system had been based. It had committed to keep these assumptions under review, in particular as new evidence became available, ahead of a fuller review of the overall framework in 2019. One of these assumptions was on the impact of the introduction of effective arrangements for resolving failing banks on appropriate capital standards. Without an effective resolution regime, it was likely that capital standards would need to have been higher to compensate for the higher probability and cost of crises.

48. The FPC reviewed the progress that has been made towards making major UK banks fully resolvable and the analysis on resolution that the Bank proposed to submit to the Treasury Committee.

49. The FPC noted that the United Kingdom had in place a comprehensive bank resolution regime. The regime gave the Bank – as the resolution authority – a wide toolkit, including powers to ‘bail in’ shareholders and creditors of failed banks. Banks had significantly increased their loss-absorbing capacity. In addition to £340bn of going-concern capital, banks had issued a further £65bn of holding company debt which could readily be bailed in. To meet new loss-absorbency requirements, banks would need to issue around an additional £150bn of eligible equity and debt by 2022. Regulatory reforms, such as the Basel Committee on Banking Supervision’s total loss absorbing capacity deductions standard, should, once fully implemented, mitigate contagion risks associated with imposing losses on investors rather than on the government.

50. Firm-specific barriers to resolvability were also in the process of being addressed, and co-operation between the UK and key host jurisdictions globally had increased materially. This cooperation was crucial, given the international nature of many major banks operating in the United Kingdom. In this context, members also noted that UK financial stability depended on the home country authorities of globally systemic banks active in the UK continuing to have processes that allowed for orderly resolution of these institutions.

51. The evidence suggested that market participants viewed the resolution regime in the United Kingdom as credible. The average credit rating uplift for the largest UK banks had fallen from four notches in 2010 to one notch currently. Based on estimates, funding cost advantages that large UK banks received from investor expectations of government support had decreased from around £45bn in 2010 to less than £5bn. International evidence suggested that, post-crisis,

the variation in debt prices that was driven by bank-specific factors had increased from one quarter to three quarters of the total variation. This suggested that investors increasingly differentiated between risky and less risky banks, which should reduce banks' incentives to take excessive risks. The FPC noted that by 2019, the Bank would provide summaries of major UK banks' resolution plans and its assessment of their effectiveness, including any further steps that need to be taken.

52. Overall, therefore, the Committee judged that progress remained on track to ensure that the largest banks were fully resolvable by 2022. In light of that, the FPC's 2015 judgement on the appropriate Tier 1 capital ratio for the UK banking system in aggregate of 13.5% of risk-weighted assets remained unchanged. The FPC would keep its judgement under review and monitor developments regularly. It would take further steps if necessary, including by revising its judgement as to the appropriate level of capital requirements.

53. The Committee examined the case for increasing capital standards in the near term, and then adjusting them back down as progress was made to make banks fully resolvable. It considered that the benefit of increasing capital ratios quickly so that there was substantial additional capital in place for the period between now and 2022, only then to reverse them, was unlikely to outweigh the economic costs of such a path and its negative impact on the financial system's ability to support the wider economy. Recent stress tests had shown that the UK banking system had sufficient capital currently to withstand and continue to lend during a severe synchronised economic, market and conduct redress cost shock.

Commitment to prudential standards

54. The FPC reaffirmed that, given its statutory responsibility to protect and enhance the resilience of the UK financial system, it remained committed to the implementation of robust prudential standards. In the FPC's judgement, this required a level of resilience to be maintained in the United Kingdom that is at least as great as that currently planned, which itself exceeds that required by international baseline standards. This reflected, in part, the scale of the UK financial system that is, by asset size, around ten times GDP.

55. As home to the leading international financial centre, resilience of the UK financial system depended in part on standards applied in other jurisdictions. At a minimum, those should be consistent with agreed common international baseline standards – the quality of which, through

the G20 reform agenda, had been substantially increased since the financial crisis. Absent consistent implementation internationally and appropriate supervisory cooperation, the FPC would need to assess how best to protect the resilience of the UK financial system.

Interest-rate benchmark reforms and contingency planning

56. The FPC was briefed on the progress of reforms to interest rate benchmarks. It had previously discussed this in 2013 and 2014, when it had been concerned by the risks to financial stability associated with Libor or other interest-rate benchmark quotes becoming unavailable. It had issued at that time a recommendation to the Bank and FCA to promote the development of credible contingency plans, working with other authorities and bodies. Subsequently, the Financial Stability Board (FSB) in July 2014 had published a report on *Reforming Major Interest Rate Benchmarks*.

57. Since the FSB's report, and despite significant improvements to the methodology and governance of Libor, it had become increasingly apparent that the scarcity of term unsecured deposit transactions posed a risk to the medium-term sustainability of term Libor benchmarks. As the FPC had observed in 2013, the disruption to financial stability could be large in the event that Libor became unavailable, given both the scale of contracts in which Libor was still used as a reference rate and the lack of clarity on the legal position of contracts should Libor or other benchmarks become unavailable. The Committee agreed that market reliance on the Libor benchmark created a financial stability risk.

58. Mr Bailey updated the Committee on the continued work being done internationally to address these risks in the jurisdictions in which Libor was widely used as a reference rate. There were three parts to the work: encouraging the development and usage of near risk-free transactions-based interest-rate benchmarks as alternatives to Libor; developing robust contractual fallback provisions for new and existing Libor contracts; and maintaining Libor in the interim. This latter included work by the FCA to prepare a consultation on the use of its powers to compel Libor panel banks to continue to make submissions, should that prove necessary.

59. Given the risks to financial stability of Libor and similar interest-rate benchmarks becoming unavailable before any alternatives had been implemented, the FPC asked for a further update on progress following planned international discussions later in the spring.

60. The Committee agreed that publication of its discussion at this point was against the public interest, because there was a possibility that publication could precipitate the risks that the action underway was seeking to avoid. It therefore decided to defer publication, under Section 9U of the Bank of England Act 1998. It was not possible to agree now the date at which this text would be published, but the Committee would keep this under review.³

Regular reviews, including of existing Directions and Recommendations

Existing Recommendations

61. *Powers of Direction over housing instruments (14/Q3/1)*: Parliament had granted powers of Direction over buy to let mortgage lending to the FPC in December 2016, following consultation by HM Treasury. Powers of Direction over owner-occupied mortgage lending had already been granted to the FPC and had come into force in April 2015. This meant that the FPC now had the power to direct 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 loan to value ratios and debt to income ratios, including interest coverage ratios in respect of buy-to-let lending. The FPC therefore considered that its Recommendation to HMT on these powers had been fully implemented.

62. *CBEST vulnerability testing (15/Q2/3)*: The FPC noted that there had been further progress in the number of firms having completed CBEST tests since the November 2016 FSR. It planned to do a fuller review of progress, and consider next steps, in Q2.

63. *Distribution of capital to meet 'fair shares' of systemic buffers (16/Q2/1)*: Following its previous consultation in H2 2016, the PRA had published on 1 February 2017 its Policy Statement on the implementation of ringfencing.⁴ This outlined how it would implement the FPC's Recommendation to the PRA that it should seek to ensure that, where systemic buffers apply at different levels of consolidation, there is sufficient capital within the group, and distributed appropriately across it, to address both global systemic risks and domestic systemic risks. The

³ The text in this and the four preceding paragraphs was omitted from the version of the Record that was initially published on 4 April 2017. The Committee agreed at its 20 September 2017 meeting to publish this text, for the reasons set out in the Record of that meeting.

⁴ <http://www.bankofengland.co.uk/pr/Pages/publications/ps/2017/ps317.aspx>

FPC agreed that, now the PRA's Policy Statement was in place, it could consider its Recommendation as implemented.

Sterling Monetary Framework

64. Since 2014, the FPC had been contributing to the Bank's annual review of the Sterling Monetary Framework (SMF), by members giving views on whether the SMF's liquidity insurance facilities remained fit for purpose from a macroprudential perspective. As part of confirming this ahead of the Bank's 2017 review, the FPC reviewed developments in the SMF over the previous year. These included the additional indexed long-term repo operations that the Bank had announced prior to the EU referendum, and the increased number of SMF participants over the course of the year. In the FPC's view, and given developments in the SMF since the Bank's 2016 review, the SMF's liquidity insurance facilities remained fit for purpose from a macroprudential perspective.

65. The Bank's 2017 annual review of the SMF would be published later in the year.

Remit and recommendations

66. On 8 March, the FPC had received from the Chancellor a letter setting out the economic policy of HM Government as required under Section 9D of the Bank of England Act 1998 (as amended) and his recommendations to the FPC as required under Section 9E of that Act. The FPC would respond in due course.

The following members of the Committee were present:

Mark Carney, Governor

Jon Cunliffe, Deputy Governor responsible for financial stability

Ben Broadbent, Deputy Governor responsible for monetary policy

Charlotte Hogg, Deputy Governor responsible for markets and banking

Sam Woods, Deputy Governor responsible for prudential regulation

Alex Brazier

Anil Kashyap

Donald Kohn

Richard Sharp

Martin Taylor

Andrew Bailey, Chief Executive of the Financial Conduct Authority

Charles Roxburgh attended as the Treasury member in a non-voting capacity.

As permitted under the Bank of England Act 1998, Anthony Habgood was present as observer in his role as Chairman of Court.

ANNEX: PREVIOUS FPC POLICY DECISIONS

Outstanding FPC Recommendations and Directions

Identifier ^(*)	Recommendation/Direction
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.

(*) Each Recommendation and Direction is listed with an identifier to allow tracking of progress. For example, '14/Q3/1' refers to the first Recommendation made at the 2014 Q3 meeting.

Other FPC policy decisions which remain in place

The table below sets out previous FPC decisions, which remain in force, on the setting of its policy tools. The calibration of these tools is kept under review.

Topic	Calibration
Countercyclical capital buffer (CCyB)	In July 2016, the FPC reduced the UK CCyB rate from 0.5% to 0% of banks' UK exposures with immediate effect. Absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK CCyB rate until at least June 2017. This rate is reviewed on a quarterly basis. The United Kingdom has also reciprocated a number of foreign CCyB decisions — for more details see the Bank of England website. ⁵ Under PRA rules, foreign CCyB rates applying from 2016 onwards will be automatically reciprocated up to 2.5%.
Prevailing FPC Recommendation on mortgage affordability tests	When assessing affordability in respect of a potential borrower, UK mortgage lenders are required to have regard to any prevailing FPC Recommendation on appropriate interest rate stress tests. This requirement is set out in FCA rule MCOB 11.6.18(2). ⁶ In June 2014, the FPC made the following Recommendation (14/Q2/1): <i>When assessing affordability, mortgage lenders should apply an interest rate stress test that assesses whether borrowers could still afford their mortgages if, at any point over the first five years of the loan, Bank Rate were to be 3 percentage points higher than the prevailing rate at origination. This Recommendation is intended to be read together with the FCA requirements around considering the effect of future interest rate rises as set out in MCOB 11.6.18(2).</i>
Recommendation on loan to income ratios	In June 2014, the FPC made the following Recommendation (14/Q2/2): <i>The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) should ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at loan to income ratios at or greater than 4.5. This Recommendation applies to all lenders which extend residential mortgage lending in excess of £100 million per annum. The Recommendation should be implemented as soon as is practicable.</i> The PRA and the FCA have published their respective approaches to implementing this Recommendation: the PRA has issued a policy statement, including rules, ⁷ and the FCA has issued general guidance. ⁸

⁵ <http://www.bankofengland.co.uk/financialstability/Pages/fpc/ccbrates.aspx>

⁶ <https://www.handbook.fca.org.uk/handbook/MCOB/11/6.html>

⁷ <http://www.bankofengland.co.uk/prafca/Documents/publications/ps/2014/ps914.pdf>

⁸ <http://www.fca.org.uk/news/fg14-08>