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News release

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Financial Policy Committee statement from its policy meeting, 26 September 2014

The Chancellor of the Exchequer announced in June that HM Treasury wanted to grant the Bank of England's Financial Policy Committee (FPC) additional powers to guard against financial stability risks from the housing market before the end of this Parliament. The FPC therefore discussed this at its meeting on 26 September and is announcing today its recommendation to HM Treasury on the form of these powers:

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.

These instruments would sit alongside the FPC's power of Direction on sectoral capital requirements and its responsibility for setting the countercyclical capital buffer (CCB) rate, and complement the FPC's existing powers of Recommendation. The FPC judges that, taken together, these instruments are necessary, and should be sufficient, to tackle risks to financial stability that could emerge from the housing market in the future, rather than indicating likely FPC policy decisions in the short term.

The FPC is publishing today a separate Statement that sets out its rationale and supporting material for this recommendation. The FPC intends to issue a draft Policy Statement to inform Parliamentary debate. If the FPC is granted these powers, it will publish a final Policy Statement that outlines its approach to using them, including the indicators that it will monitor regularly.

The FPC is also publishing a letter to the Chancellor giving its first annual assessment of the impact on financial stability of the Help to Buy: Mortgage Guarantee Scheme, including, as requested, whether the parameters of the scheme – the house price cap for eligibility in the scheme and the fee charged to lenders – remain appropriate. The Committee does not see a case for changing the fee or the house price cap on financial stability grounds at this point. In forming this assessment, the Committee was notified by HM Treasury that the fees for the scheme would remain the same for 2015, with prices set on an actuarially fair basis and according to State Aid rules. The Committee will continue to monitor the impact of the scheme as part of its regular assessment of risks to financial stability and can make recommendations on it at any time.

The FPC also reviewed its assessment of the outlook for financial stability and progress against its existing policy recommendations.

Since the Committee met in June, geopolitical and event risks appear more marked. In the United Kingdom, there had been intense focus on the referendum on Scottish independence. In the run-up to that referendum, the FPC was briefed on the financial stability risks associated with possible outcomes and on the Bank's contingency planning to mitigate those risks. Global economic prospects remain modest. Growth in the euro area in particular had disappointed in the first half of 2014 and inflation fell further below target. In this context, monetary policy has remained highly accommodative internationally. Markets appear to expect a gradual exit from low rates in the United Kingdom and the United States, while the ECB has cut its benchmark interest rate and announced a package of new stimulus measures. In emerging markets, growth forecasts are also slightly lower, with concerns about the sustainability of credit growth and property markets in China persisting.

Financial markets have remained remarkably resilient to geopolitical and event risk with continuing signs of yield-seeking behaviour. There were some falls in risky asset prices internationally during the summer and a pick-up in market volatility, but these proved largely temporary. A larger shock could still be amplified through the financial system, particularly if the apparent narrowing of the compensation required by market participants for liquidity risk were to unwind. This risk is heightened by what appears to be a continued structural reduction in liquidity in some financial markets. The Committee is considering the resilience of market liquidity as part of its medium-term priority on supporting diverse and resilient market-based finance.

In the United Kingdom, economic growth has been robust and broadly based. While the housing market remains a source of risk to financial stability, activity appears to have eased slightly and the MPC's latest projections are consistent with the rate of increase in house prices moderating earlier than previously expected. UK commercial property markets have been recovering rapidly, supported by buoyant conditions for new lending.

The major UK banks remain on a path of gradually improving resilience, with reduced leverage and increased capital ratios and lower reliance on wholesale funding since the crisis. But uncertainty remains over potential further global conduct-related actions. The results of the 2014 stress tests will give a fuller view of the major UK banks' capital resilience.

In light of its assessment of the outlook for financial stability, the FPC decided to keep the CCB rate for UK exposures at 0%. It will expect to reciprocate foreign CCB rates, in order to support the resilience of the global financial system. In that context, the FPC decided also to recognise the 1% CCB rates set recently by the Norwegian and Swedish authorities. These would apply to UK regulated firms with relevant exposures to these countries from 3 October 2015.

With regard to the FPC's existing recommendations:

•The FPC judges that its June recommendation to lenders on the interest rate stress test to use when assessing affordability in mortgage lending is implemented, by virtue of existing FCA rules (MCOB 11.6.18(2)). The FCA will continue to monitor that mortgage lenders are having regard to the recommendation when carrying out the interest rate stress test, as part of supervision. At the time of the FPC's meeting, the PRA Board was due to finalise the rule that would put into force the FPC's recommendation on a limit on loan-to-income ratios in mortgage lending. The PRA Board subsequently confirmed this rule at its meeting on 30 September. The FCA is implementing the measure for affected FCA-regulated firms via general guidance.

•The FPC judges that the PRA has implemented its recommendations to work with the banking industry to ensure greater consistency and comparability of Pillar 3 disclosures of major UK banks and building societies, and to ensure that all major UK banks and building societies comply fully with the October 2012 recommendations of the Enhanced Disclosure Task Force upon publication of 2013 annual reports.

•The FPC also judges that it is now appropriate to publish a recommendation that it had initially made privately in June 2013 to the Bank of England and the FCA, that they should promote the development of contingency plans in the event that Libor or other interest-rate benchmark quotes became unavailable. At that stage it had decided not to publish the recommendation, as permitted under Section 9U(8)(b) of the Bank of England Act 1998, because of the risk of precipitating the unavailability of benchmark quotes that the recommendation was seeking to avoid. The FPC closed the recommendation in September 2013, because interest-rate benchmark contingency planning was then taking place under the auspices of the Financial Stability Board. On 22 July 2014, the FSB published its report on Reforming Major Interest Rate Benchmarks, which includes details on contingency planning; the FPC judges that publication of its recommendation is therefore no longer against the public interest.

•The FPC noted that progress was under way on its existing recommendations on stress testing and resilience to cyber attack and it would review these in more detail at future meetings.

The Committee's public consultation on the Leverage Review closed on 12 September. A total of 26 responses were received. The Committee noted that a common theme in the feedback was around the need for guidance over how the proposed framework would be calibrated. In the light of that feedback and to support HM Treasury in its consultation on, and impact assessment of, the Committee's proposals, the Committee decided to bring forward its view on the appropriate calibration of the leverage ratio framework. That view will be recorded in its final proposals for the leverage ratio framework, which will be published at the end of October.

Key Resources

Financial Policy Committee statement on housing market powers of Direction from its policy meeting, 26 September 2014

Letter from the Governor to the Chancellor on assessment of help to buy: mortgage guarantee

Letter from the Chancellor to the Governor on assessment of help to buy: mortgage guarantee (HMT website)