



BANK OF ENGLAND

News release

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Financial Policy Committee Statement from its policy meeting, 22 March 2017

1. At its meeting on 22 March, the Financial Policy Committee (FPC) reviewed developments since its meetings on 23 and 29 November 2016. The FPC assessed the outlook for UK financial stability by identifying the risks faced by the UK financial system and assessing the resilience of the system to them. In doing so, its aim is that the financial system can continue to provide essential services to the real economy, even in adverse circumstances.

Risks

2. **The FPC judges that the overall level of risk to UK financial stability is broadly unchanged since its last meetings but its assessment of the relative weight on the various risks has shifted somewhat. Policy uncertainty is high across a range of advanced economies.**
3. **In the global economy, although near-term prospects have improved, risks remain elevated.** Debt levels have continued to increase in China. In some euro-area economies, sovereign debt positions remain vulnerable to a further rise in the cost of borrowing for governments or a weakening in growth prospects. There is greater uncertainty about policies supporting global trade and cross-border financial integration. The high degree of uncertainty in many advanced economies appears not to be fully reflected in asset prices, which have risen sharply in recent months, or in measures of market volatility, which remain subdued.
4. **UK household indebtedness remains high by historical standards and has begun to rise relative to incomes. Consumer credit has been growing particularly rapidly.** This could principally represent a risk to lenders if accompanied by weaker underwriting standards. The FPC judges that these standards should be monitored closely. It supports a review launched by the PRA into the credit quality of new lending by PRA-regulated lenders and a review by the

FCA into its rules and guidance on creditworthiness assessments used in the consumer credit market. The FPC will review these findings over the coming months.

5. **Exit negotiations between the United Kingdom and the European Union are expected to begin shortly.** There are a range of possible outcomes. Risks to financial stability will be influenced by the orderliness of the adjustment to the new relationship between the United Kingdom and the European Union. The FPC will oversee contingency plans to mitigate risks to financial stability as this process unfolds.

6. **The FPC will assess the financial stability implications of firms' plans to adapt to the United Kingdom's withdrawal from the European Union.** The FPC supports the work of the PRA and FCA to ensure regulated firms have 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 is alert to the potential for greater complexity in firms' business structures to reduce the resilience of the UK financial system and is examining appropriate mitigants.

UK countercyclical capital buffer

7. **The FPC is maintaining the UK countercyclical capital buffer (CCyB) rate at 0%, consistent with its July 2016 guidance that it would maintain the UK CCyB rate at 0% until at least June 2017.**

8. **The cut in the CCyB rate to 0% in July 2016 was 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 served to ensure banks did not hoard capital and restrict lending in those conditions.

9. **At its next meeting, the FPC will assess whether to return the UK CCyB rate to a more neutral level, consistent with its stated approach to setting the UK CCyB rate in a standard risk environment.** Any increase in the UK CCyB rate would normally come into effect with a twelve month lag.

Stress testing

10. **In the annual cyclical stress test of the UK banking system, the sizes of the shocks to different sectors and economies are adjusted each year to deliver a similar stressed**

outcome. The scenario for the 2017 cyclical stress test, which the Bank is announcing today, reflects the FPC's current assessment of the level of risks. The results of the test (to be published in November 2017) will inform policy responses to ensure that the banking system has sufficient capital to absorb losses and maintain the supply of credit to the real economy, even in a severe stress.

- 11. The Bank is today announcing further details of an additional stress test, the 2017 exploratory stress test, in line with its stated stress testing approach. This will consider how the resilience of the UK banking system might evolve if recent headwinds to bank profitability persist and intensify.** The test will 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 will have a seven-year horizon to capture these long-term trends and will act as a complement to the annual cyclical stress test.

Resilience of the UK banking system

- 12. The aggregate Tier 1 capital position of major UK banks was 15.1% of risk-weighted assets in December 2016.** The FPC judges the appropriate Tier 1 capital requirement for the UK banking system, in aggregate and net of any countercyclical capital buffer, to be 13.5% of risk-weighted assets, as currently measured. The FPC will review this benchmark in the light of the outcome of ongoing negotiations to finalise Basel III standards and the implementation of IFRS 9.
- 13. Major UK banks currently face a leverage ratio requirement and buffers that amount to, in aggregate, 3.3% of total exposures.** The leverage ratio of the major UK banks was 5.3% in December 2016. In July 2016, the FPC 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. The FPC intends at its next meeting to adjust the UK leverage ratio framework to offset the loosening effect of excluding central bank reserves from the exposure measure. This will ensure that the exclusion of central bank reserves does not mechanically lead to a reduction in the nominal amount of capital needed to meet the UK leverage ratio standard.
- 14. Given its statutory responsibility to protect and enhance the resilience of the UK financial system, the FPC remains committed to the implementation of robust prudential standards.** In the FPC's judgement, this requires 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 reflects, in part, the scale of the UK financial system that is, by asset size, around ten times GDP.

15. **As home to the leading international financial centre, resilience of the UK financial system depends 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, has 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.
16. **An important part of the post-crisis reform agenda has been to end the problem of banks that are ‘too big to fail’. The FPC has reviewed progress towards making major UK banks fully resolvable, as part of its commitment to keep under review the assumptions made in setting the framework of capital requirements for UK banks.** It judges that progress remains on track to ensure that the largest banks are fully resolvable by 2022. This assessment has been set out in more detail in the Bank’s submission to the Treasury Committee inquiry on UK bank capital. By 2019, the Bank will provide summaries of major UK banks’ resolution plans and its assessment of their effectiveness, including any further steps that need to be taken.

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