BANK OF ENGLAND

Record of the Financial Policy Committee

June 2020

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This is the Record of the Financial Policy Committee covering decisions taken since 7 May.

It is also available on the Internet: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/june-2020

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 29 July 2020 and the Record of that meeting will be published on 6 August.

RECORD OF THE FINANCIAL POLICY COMMITTEE, JUNE 2020

1. As announced on 3 June, in light of the interim Financial Stability Report (FSR) published in May, the Financial Policy Committee decided on 22 May to delay the publication of the Q2 FSR to Thursday 6 August, and had revised its meeting schedule and work plan accordingly.

2. In the period since its May meeting, the FPC had taken a number of decisions by written procedure. These decisions included the 2020 Q2 setting of the UK Countercyclical Capital Buffer (CCyB) rate, the agreement of the Committee's response to HM Treasury's 2020 remit and recommendations letter, and the postponement of certain planned initiatives in response to the ongoing disruption arising from Covid-19. The Committee also received a written update on the progress of Libor transition.

3. Decisions to postpone certain planned initiatives reflected in part the fact that underlying work being done elsewhere had been delayed in light of the Covid-19 disruption, with resulting implications for the FPC's work programme. The decisions also reflected the focus of the Committee's and Bank staff time on dealing with the disruption and ensuring that the UK financial system could be a source of strength to the economy during this challenging period. The Committee emphasised that these decisions had been taken for pragmatic reasons, given the unprecedented current circumstances, and in no way reflected a change in strategic direction for the FPC in relation to the relevant issues.

4. This Record outlines the decisions, and briefly sets out the considerations which factored in them.

UK Countercyclical Capital Buffer rate

5. At its Policy meeting on 9 March, the FPC had reduced the UK CCyB rate to 0%. The rate had previously been 1% and was due to reach 2% in December 2020.

6. Cutting the CCyB rate to 0% reinforced the FPC's expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks could be drawn on, as necessary, to support the economy.

7. The FPC had been closely monitoring credit conditions in the UK over the challenging period since the start of the disruption associated with Covid-19, including

data and intelligence on households and corporates, as well as bank lending and take up of Government schemes. As required by legislation when setting the UK CCyB rate, the Committee reviewed the Basel ‘buffer guide’ – defined as the difference between the ratio of credit to GDP and a statistical estimate of its long-term trend.

8. The FPC agreed that it was appropriate to maintain the UK CCyB rate at 0% in 2020 Q2.

9. The FPC reaffirmed that it was important that banks should have clarity about the period of time it expected the CCyB rate to remain at 0%. It restated both of its previous judgements: (i) that it expected to maintain a UK CCyB rate of 0% until at least March 2021, absent any material change in the outlook; and (ii) that the pace of return to a standard times UK CCyB rate would depend on banks’ capital depletion over this period, and their ability to rebuild whilst supporting the UK economy, households and businesses. Due to the usual 12 month implementation lag, any subsequent increase would not be expected to take effect until March 2022 at the earliest.

10. As the outlook evolved, the FPC would continue to monitor closely the credit conditions faced by UK households and businesses, and stood ready to take any further actions deemed appropriate to support UK financial stability.

Enduring approach for incorporating IFRS 9 into the capital framework

11. In the December 2019 Financial Stability Report, the FPC had announced that in 2020 it would consider, alongside the PRC, options for a more enduring approach to incorporating the IFRS 9 accounting treatment into bank stress tests and capital requirements. It had said it would use the 2020 annual cyclical scenario (ACS) stress test of major UK banks to pilot options for this enduring approach.

12. Due to the disruption from Covid-19, the FPC, together with the PRC, had agreed in March 2020 to cancel the 2020 ACS; this would preclude the planned piloting of options. In April 2020, the Basel Committee on Banking Supervision had also agreed to allow jurisdictions to extend transitional measures for the implementation of IFRS 9, with relief now extending to 2025. The European Commission had subsequently begun the process of amending the Capital Requirements Regulation to reflect the Basel agreement.

13. Reflecting these developments, and the potential additional learning to be drawn from the revealed impact of IFRS 9 in a live stress environment, the FPC, together with the PRC, decided to postpone any decision on an enduring approach for incorporating IFRS 9 into the capital framework. The Committees agreed that this would also allow them to reflect further feedback from stakeholders on the performance of the provisioning framework in the current stress, and to work with colleagues internationally on an enduring treatment in light of it.

Risks to financial stability from the provision of cloud services

14. The Committee had agreed in December 2019 that it would return to risks from the provision of cloud services to the UK financial sector in 2020. In June 2020, the Committee received a written update and noted that, whilst the adoption of cloud services by financial firms had continued to increase, firms had not yet migrated existing core banking and end-to-end payment services to the Cloud. Some firms were also reassessing their plans to migrate further services and software to the Cloud due to the operational pressures associated with the Covid-19 environment.

15. Given how the risks had evolved since the Committee's last discussion, and in order to focus Committee and Bank staff time on dealing with the Covid-19 disruption, the FPC agreed to return to risks from the provision of cloud services in 2021. Staff would continue to monitor the migration of services to the Cloud and would bring this issue back to the Committee sooner if warranted by developments.

Libor transition

16. In relation to Libor transition, the Committee was made aware of an imminent announcement by the Government of its intention to amend and strengthen the UK's existing regulatory framework for critical benchmarks in advance of the end of 2021, to ensure the FCA had the appropriate regulatory powers to manage and direct any wind-down period prior to eventual Libor cessation. The Committee welcomed the approach taken and noted its strong support for these clearer powers as a means to help mitigate tail risks in the transition.

17. The Government's planned statement would make clear that these measures were intended to facilitate FCA action in certain circumstances to support a narrow pool of 'tough legacy' contracts, which did not contain appropriate fallbacks and could not

realistically be renegotiated ahead of the end of 2021. The Committee noted that, given LIBOR's global usage, the FCA would engage with industry and global counterparts and may consider, among other factors, international impacts before it exercised its new powers. In this context it was recognised that such action may not be possible or appropriate for all LIBOR currencies and that, where these are feasible, industry-agreed fallback arrangements or conversions would remain preferable. This emphasised the importance of continued efforts by firms to reduce the pool of contracts relying on this prospective backstop solution as far as possible in order to minimise uncertainty, consistent with the Committee's existing policy stance.

The FPC's remit response

18. On 11 March 2020, the FPC had received from the Chancellor of the Exchequer a letter specifying the economic policy of HM Government and setting out HM Treasury's recommendations to the Committee under Sections 9D-9E of the Bank of England Act 1998. These recommendations relate to matters that the Committee should regard as relevant to its understanding of the Bank's Financial Stability Objective and the Committee's responsibility in relation to the achievement of that objective, the Committee's responsibilities in relation to support for the Government's economic policy, as well as matters to which the Committee should have regard in exercising its functions. The FPC agreed its response to this letter, which would be published alongside this Record.

The members of the Financial Policy Committee are:

Andrew Bailey, Governor
Colette Bowe
Alex Brazier
Ben Broadbent
Jon Cunliffe
Anil Kashyap
Donald Kohn
Dave Ramsden
Elisabeth Stheeman
Sam Woods
Chris Woolard
Charles Roxburgh (Treasury member in a non-voting capacity)

ANNEX: FPC POLICY DECISIONS

Outstanding FPC Recommendations and Directions

The FPC has no Recommendations or Directions that have not already been implemented.

Other FPC policy decisions which remain in place

The table below sets out 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 rate	The FPC agreed to maintain the UK CCyB rate at 0% in June 2020, unchanged from March. This rate is reviewed on a quarterly basis. The UK has also reciprocated a number of foreign CCyB rate decisions – for more details see the Bank of England website[1]. Under PRA rules, foreign CCyB rates applying from 2016 onwards will be automatically reciprocated up to 2.5%.
Mortgage loan to income ratios	In June 2014, the FPC made the following Recommendation (14/Q2/2): 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. The PRA and the FCA have published their approaches to implementing this Recommendation: the PRA has issued a policy statement, including rules,[2] and the FCA has issued general guidance.[3]
Mortgage affordability	At its meeting in June 2017, the FPC replaced its June 2014 mortgage affordability Recommendation to reference mortgage contract reversion rates: 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, their mortgage rate were to be 3 percentage points higher than the reversion rate specified in the mortgage contract at the time of origination (or, if the mortgage contract does not specify a reversion rate, 3 percentage points higher than the product 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). This Recommendation applies to all lenders which extend residential mortgage lending in excess of £100 million per annum. At its meeting in September 2017, the FPC confirmed that the affordability Recommendation did not apply to any remortgaging where there is no increase in the amount of borrowing, whether done by the same or a different lender.

[1] https://www.bankofengland.co.uk/financial-stability
[2] http://www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps914.pdf
[3] https://www.fca.org.uk/publications/finalised-guidance/fg17-2-fpc-recommendation-loan-income-ratios-mortgage-lending