Financial Policy Summary and Record of the Financial Policy Committee Meetings on 29 November and 9 December 2021

Publication date: 13 December 2021

This is the record of the Financial Policy Committee meetings held on 29 November and 9 December 2021.

It is also available on the Internet: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2021/december-2021

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 9 March 2022 and the record of that meeting will be published on 23 March 2022.

Financial Policy Summary

The Financial Policy Committee (FPC) seeks to ensure the UK financial system is prepared for, and resilient to, the wide range of risks it could face – so that the system can serve UK households and businesses in bad times as well as good.

The outlook for financial stability

The UK and global economies have continued to recover from the effects of the pandemic. But uncertainty over risks to public health and the economic outlook remains. For example, there are near-term pressures on supply and inflation, and there could be a greater impact from Covid on activity, especially given uncertainties about whether new variants of the virus reduce vaccine efficacy.

Bank resilience

UK banks' capital and liquidity positions remain strong, and they have sufficient resources to continue to support lending to the economy.

The FPC continues to judge that the UK banking system remains resilient to outcomes for the economy that are much more severe than the Monetary Policy Committee's (MPC's) central forecast. This judgement is supported by the final results of the 2021 solvency stress test (SST).

The FPC has tested the resilience of the UK banking system against a much more severe evolution of the pandemic and consequent economic shock. In the SST, major UK banks' and building societies' (banks) aggregate Common Equity Tier 1 (CET1) capital ratio falls by 5.5 percentage points to a low point of 10.5%. This low point compares with a 7.6% reference rate, comprising banks' minimum requirements and systemic buffers.[1] The aggregate Tier 1 leverage ratio low point of 4.8% is also above the reference rate of 3.7%. All eight participating banks remain above their reference rates for both CET1 capital ratios and Tier 1 leverage ratios in the exercise.

As previously indicated, the aim of the SST has been to update and refine the FPC's assessment of banks' resilience and their ability to lend in a very severe intensification of the macroeconomic shock arising from the pandemic. Consistent with the nature of the exercise, the FPC and Prudential Regulation Committee will therefore not use the test as a direct input for setting capital buffers for UK banks. For 2022, the Bank intends to revert to the annual cyclical scenario stress-testing framework and will publish further details on this in 2022 Q1.

Debt vulnerabilities

The FPC remains vigilant to debt vulnerabilities in the economy that could amplify risks to financial stability.

UK household and corporate debt
The FPC judges that domestic debt vulnerabilities have not increased materially over the course of the pandemic.

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[1] See The results of the 2021 solvency stress test of the UK banking system for further information on how the reference rate is calculated.

So far, UK households' finances have remained resilient as Covid-related support measures – such as the furlough scheme and the ability to take a payment deferral on mortgages and consumer credit – have ended. Although house prices in the UK have grown in recent months at their fastest annual rate since the global financial crisis, aggregate mortgage debt relative to income has remained broadly stable since 2009. And the share of households with a mortgage debt-servicing ratio (debt servicing costs as a proportion of income) at or above 40% – a level beyond which households are typically much more likely to experience repayment difficulties – remains broadly in line with 2017–19 averages and significantly below levels seen just prior to the global financial crisis. With all other factors, such as income, held constant, mortgage interest rates would need to increase by around 150 basis points for that share to reach its pre-global financial crisis average.

UK corporate debt vulnerabilities have increased relatively moderately over the pandemic so far. As the economy has recovered and government support has been withdrawn, business insolvencies have increased somewhat, but remain below pre-Covid levels. The increase in indebtedness has been moderate in aggregate, and larger corporates have repaid a significant proportion of the debt that they took on. Debt servicing remains affordable for most UK businesses. It would take large increases in borrowing costs or severe shocks to earnings to impair businesses' ability to service their debt in aggregate.

The increase in debt has likely led to increases in the number and scale of more vulnerable businesses. It has been concentrated in some sectors and types of businesses, in particular in small and medium-sized enterprises (SMEs). For some of these SMEs, borrowing has been precautionary. Many SMEs, however, had not previously borrowed and some would not have previously met lenders' lending criteria. Most of this new bank lending is guaranteed by the Government, which will limit risks to lenders, and was issued at low interest rates and with repayment flexibility which will limit the impact on borrowers.

Global vulnerabilities

Global debt vulnerabilities remain material. Government and central bank policy support in advanced economies has helped to limit the size of the disruption from the pandemic. However, across advanced and emerging market economies, corporate debt to GDP ratios have generally increased, and residential property price growth in many countries has been strong. Higher leverage abroad could increase the risk of losses for UK institutions, including on their foreign exposures.

Long-standing vulnerabilities in the Chinese property sector have re-emerged, against a backdrop of high and rising debt levels in China. A serious downturn in China could have a significant impact on the UK economy. While there is uncertainty as to how these risks might crystallise, the results of the 2021 SST indicate that the UK banking system is resilient to the direct effects of a severe downturn in China and Hong Kong, as well as indirect effects through sharp adjustments in global asset prices.

Risk-taking in global financial markets

Risk-taking in certain financial markets remains high relative to historical levels, notwithstanding recent market volatility. Low compensation for risk in some markets could be evidence of investors' 'search for yield' behaviour, which could reflect the continued low interest rate environment and higher risk-taking. This creates a vulnerability to a sharp correction in asset prices – if for example market participants re-evaluated materially the prospects for growth, inflation or interest rates – that could be amplified by existing vulnerabilities in market-based finance.

Risks in leveraged loan markets globally continue to increase. The post-global financial crisis trends of increased leveraged loan issuance and loosening in underwriting standards in these markets have continued. For example, the share of new lending with few financial maintenance covenants (so-called 'covenant-lite' lending) in these markets is at a record high globally.

The UK countercyclical capital buffer rate

The FPC judges that vulnerabilities that can amplify economic shocks are at a standard level overall, as was the case just before the pandemic. This would be consistent with the UK countercyclical capital buffer (CCyB) rate returning to the region of 2%. However, there continues to be uncertainty about the evolution of the pandemic and the economic outlook. Should downside risks crystallise, the economy could require more support from the financial system.

The FPC is therefore increasing the UK CCyB rate from 0% to 1%. This rate will come into effect from 13 December 2022 in line with the usual 12-month implementation period.

If the UK economic recovery proceeds broadly in line with the MPC's central projections in the November Monetary Policy Report, and absent a material change in the outlook for UK financial stability, the FPC would expect to increase the rate further to 2% in 2022 Q2. That subsequent increase would be expected to take effect after the usual 12-month implementation period.

The FPC's mortgage market Recommendations

An excessive build-up of mortgage debt, often associated with rapid increases in house prices, has historically been an important source of risk to the UK financial system and to the economy. The FPC therefore introduced two Recommendations in 2014 to guard against a loosening in mortgage underwriting standards, which could lead to a material increase in aggregate household debt and the number of highly indebted households: the 'flow limit' which limits the number of mortgages that can be extended at loan to income (LTI) ratios higher than 4.5; and the 'affordability test' which specifies a stress interest rate for lenders when assessing prospective borrowers' ability to repay a mortgage.

In its latest review of the Recommendations, the FPC has concluded that these measures in aggregate continue to guard against a loosening in underwriting standards and a material increase in household indebtedness, which could amplify an economic downturn and financial stability risks.

Since the measures have been introduced, mortgage debt to income has been broadly stable. In the recent period of high house price growth, there has been little evidence of a deterioration in lending standards, a material increase in aggregate household debt or the number of highly indebted households.

The Committee judges that there is no strong evidence that the structural fall in long-term interest rates that has continued since the measures were put in place has reduced the overall level of risk associated with household debt.

Although interest rates are expected to remain low for longer – which, other things equal, implies a reduction in debt-servicing costs for households – both the causes and consequence of the fall in long-term interest rates imply an offsetting increase in risks. In particular, part of the decline in long-term rates since 2014 reflects weaker growth prospects, which are likely to lower household income growth, and so increase the risk from household debt because debt burdens relative to income decline more slowly over time. And if interest rates remain low for longer, there is less scope for them to fall in response to shocks, making indebted households more vulnerable. Furthermore, evidence suggests that, despite the large falls in mortgage interest rates in the recession following the global financial crisis, highly indebted households cut their consumption by more, thereby amplifying the downturn.

The FPC has therefore concluded that the structural decline in interest rates does not, by itself, justify a change in the overall calibration of its mortgage market measures.

In addition, the FPC's analysis suggests that the measures have relatively little impact on mortgage market access, and that raising a deposit remains the most significant barrier to access, particularly for first-time buyers. In aggregate, there remains a significant degree of headroom below the LTI flow limit.

As part of the review, the FPC also considered how its two measures have operated since they were put in place. The LTI flow limit has played the role intended. However, the FPC notes that the stress rate in the affordability test has remained broadly static, reflecting stickiness in reversion rates despite falls in quoted mortgage rates. There is considerable uncertainty about how the stress rate might move in the future.

The FPC's analysis suggests that the LTI flow limit is likely to play a stronger role than the affordability test in guarding against an increase in aggregate household indebtedness and the number of highly indebted households when house prices rise rapidly. A framework without the FPC's affordability test would therefore be simpler and more predictable. It would also reduce the impact on a small proportion of borrowers.

Reflecting these factors, the FPC judges that, on current evidence, the LTI flow limit, without its affordability test but alongside the FCA's affordability testing under its Mortgage Conduct of Business framework, ought to deliver an appropriate level of resilience to the UK financial system, but in a simpler, more predictable and more proportionate way.

The FPC therefore intends to maintain the LTI flow limit Recommendation, but consult, in the first half of 2022, on withdrawing its affordability test.

Building the resilience of the financial system

International progress in building the resilience of market-based finance

In March 2020, vulnerabilities in the system of market-based finance amplified the initial market reaction to the pandemic, contributing to a severe liquidity shock (the 'dash for cash'), which disrupted market functioning and threatened to harm the wider economy. Significant policy action from central banks was needed to restore market functioning.

The FPC strongly supports international work, led and co-ordinated by the Financial Stability Board (FSB), to assess and develop policy responses to address the underlying vulnerabilities in market-based finance that amplified the dash for cash. The FPC welcomes the FSB's analysis of these vulnerabilities, and it endorses the FSB's policy recommendations for money market funds, which now need to be implemented by all jurisdictions. In the FPC's view, **further policy measures are needed to enhance the resilience of market-based finance in other areas including open-ended funds, margin, the liquidity structure and resilience of core markets, and leveraged investors and their prime brokers.**

Absent an increase in the resilience of market-based finance, financial stability risks, including those exposed in March 2020, remain. The work planned by the FSB next year therefore represents an important opportunity to develop policies to address those vulnerabilities. The FPC will continue to monitor progress.

Making progress on mitigating these vulnerabilities is also vital to ensure that interventions by central banks in stress episodes are truly backstops and potential negative side effects to the financial system are effectively mitigated. While central banks may need new and more targeted tools to deal effectively with financial instability caused by market dysfunction, **central bank interventions cannot be a substitute for the primary obligation of market participants to manage their own risk, or for internationally co-ordinated reforms that enhance the resilience of the non-bank financial sector.**

Risks from cryptoassets

Cryptoassets and their associated markets and activities, including decentralised finance, continue to grow and to develop rapidly. The market capitalisation of cryptoassets has grown tenfold since early 2020 to around US$2.6 trillion in November 2021, representing around 1% of global financial assets. The vast majority of this market (around 95%) is made up of 'unbacked' cryptoassets which have no underlying assets. Such cryptoassets have no intrinsic value, are vulnerable to major price corrections and so investors may lose all their investment.

Innovation can bring a number of benefits, including reduced frictions and inefficiencies in financial services. These benefits can only be realised and innovation can only be sustainable if undertaken safely and accompanied by effective public policy frameworks that mitigate risks.

As the FPC has noted, direct risks to the stability of the UK financial system from cryptoassets are currently limited. However, at the current rapid pace of growth, and as these assets become more interconnected with the wider financial system, cryptoassets will present a number of financial stability risks. For example, a large fall in cryptoasset valuations may cause institutional investors to sell other financial assets and potentially transmit shocks through the financial system. The use of leverage can amplify such spillovers further.

Enhanced regulatory and law enforcement frameworks, both domestically and at a global level, are needed to influence developments in these fast-growing markets in order to manage risks, encourage sustainable innovation and maintain broader trust and integrity in the financial system. The FPC welcomes international work on these issues.

Domestically, the FPC supports the work of the HM Treasury-FCA-Bank Cryptoassets Taskforce on assessing the regulatory approach to unbacked cryptoassets and their associated markets and activities, in order to shape developments in this space and support safe innovation.

The FPC also welcomes HM Treasury's proposal for a regulatory regime for 'stablecoins', a type of backed cryptoasset, used as a means of payment. This includes bringing systemic stablecoins into the Bank's regulatory remit.

The FPC will continue to pay close attention to the developments in this area, and will seek to ensure that the UK financial system is resilient to systemic risks that may arise from cryptoassets. Any future regulatory regime should aim to balance risk mitigation with supporting innovation and competition. The FPC considers that financial institutions should take an especially cautious and prudent approach to any adoption of these assets until such a regime is in place.

Record of the Financial Policy Committee meetings held on 29 November and 9 December 2021

1. The Committee met on 29 November 2021 to agree its view on the outlook for UK financial stability and, on the basis of that, its intended policy action. The FPC discussed the risks faced by the UK financial system and assessed the resilience of the system to those risks. Its aim was to ensure the UK financial system was prepared for, and resilient to, the wide range of risks it could face – so that the system could serve UK households and businesses in bad times as well as good.

2. The Committee met subsequently on 9 December 2021 to confirm its response to the final results of the 2021 Solvency Stress Test.

Macro-economic back-drop

3. The UK and global economies had continued to recover from the effects of the pandemic. The Committee noted the Monetary Policy Committee's (MPC's) central forecast for UK GDP and the outlook for world activity set out in the November 2021 Monetary Policy Report (MPR). UK GDP was expected to continue to recover in the near-term, reaching its pre-pandemic level in 2022 Q1. Over the second half of the MPC's forecast period, UK GDP growth was expected to be positive but subdued.

4. But uncertainty over risks to public health and the economic outlook remained. For example, there were near-term pressures on supply and inflation, and there could be a greater impact from Covid on activity, especially given uncertainties about whether new variants of the virus reduced vaccine efficacy. Such risks could affect household and business finances.

5. The FPC would remain vigilant to debt vulnerabilities in the economy that could amplify risks to financial stability.

Bank resilience and the results of the 2021 Solvency Stress Test

6. The FPC discussed the resilience of the UK banking system, including its ability to withstand future shocks and continue to support households and businesses. The FPC also discussed the final results of the 2021 Solvency Stress Test (SST), having previously discussed the interim results at their June meeting.

7. Major UK banks' and building societies' ('banks') aggregate capital ratios had increased further in 2021 Q3, and liquidity ratios remained strong. Their aggregate Common Equity Tier 1 (CET1) capital ratio rose to 16.5% in 2021 Q3, compared to 16.1% in 2021 Q2. Banks' liquidity coverage ratios (LCRs) continued comfortably to exceed regulatory guidelines. Indicators of asset

quality had remained broadly stable since the July *Financial Stability Report* (FSR), supported by the improved macroeconomic outlook.

8. The FPC noted that banks' capital ratios were expected to fall back towards pre-pandemic levels over the coming quarters because of distributions to shareholders and a range of regulatory changes. For example, in early 2022, the treatment of software assets for regulatory capital would be updated requiring all intangible software assets to be fully deducted from regulatory capital resources, and there would also be a reduction in IFRS 9 relief, in line with transitional timelines.

9. The FPC noted that the UK banking system, with support from government-guaranteed lending schemes, had provided credit to UK businesses, helping them to cushion the impact of the pandemic on their cash flows. As the economy recovered and Government support measures unwound, UK households and businesses were likely to need continued support from the financial system. The FPC remained of the view that it was in banks' collective interest to continue to support viable, productive businesses, and that capital buffers were there to be used if needed.

10. The FPC also discussed the results of the 2021 SST, which differed from the usual Annual Cyclical Scenario (ACS). The FPC had calibrated the SST to test the resilience of the UK banking system against a much more severe evolution of the pandemic and consequent economic shock. The SST therefore acted as a cross-check on the FPC's assessment, made in December 2020 following a 'reverse stress test', that banks had sufficient capital to continue to support UK households and businesses even if economic outcomes were considerably worse than expected.

11. The results of the SST showed that in aggregate, banks started the stress test from a robust capital position and, even at the low point, remained some way above the aggregate reference rate (which comprised banks' minimum requirements and systemic buffers, and is adjusted to account for the impact of IFRS 9). Based on these results, the FPC continued to judge that the UK banking system remained resilient to outcomes for the economy that were much more severe than the MPC's central forecast. The detailed results of the 2021 SST would be set out in an accompanying publication to the December FSR.

12. As previously indicated, the aim of the SST was to update and refine the FPC's assessment of banks' resilience and ability to lend in a very severe intensification of the macroeconomic shock arising from the pandemic. Consistent with the nature of the exercise, the FPC and Prudential Regulatory Committee (PRC) would therefore not use the SST as a direct input for setting capital buffers for banks. For 2022, the Bank intended to revert to the ACS stress testing framework and would publish further details on this in 2022 Q1. Due to its countercyclical nature, the ACS stress-testing framework was well suited to informing the setting of capital buffers for the system and banks.

13. The FPC also judged that the results of the SST, together with the central outlook and the return to the ACS framework for 2022, were consistent with the PRC's decision to transition back to its standard approach to capital-setting and shareholder distributions.

UK household and corporate resilience

14. The FPC judged that domestic debt vulnerabilities had not increased materially over the course of the pandemic.

UK household resilience

15. The Committee judged that so far UK households' finances had remained resilient as Covid-related support measures – such as the furlough scheme and the ability to take payment deferral on mortgages and consumer credit – had ended. Aggregate mortgage interest payments accounted for around 2% of household incomes according to the latest data, compared to an average of around 5% in the years leading up to the global financial crisis (GFC). To get back to the pre-GFC average, staff estimates suggested it would take an increase in mortgage interest rates of around 250 basis points, with all other factors, such as income, held constant. The share of households with a mortgage debt-servicing ratio (DSR) (debt servicing costs as a proportion of income) at or above 40% – a level beyond which households are typically much more likely to experience repayment difficulties – increased marginally to 1.4% in 2021 Q3. But the share of households with a DSR at or above 40% remained broadly in line with 2017-2019 averages and significantly below levels seen just prior to the GFC. With all other factors, such as income, held constant, mortgage interest rates would need to increase by around 150 basis points for that share to reach its pre-GFC average of 1.8%.

16. In recent months, UK house prices had grown at around 10%, their fastest annual rate since the GFC. However, there had been limited evidence to date that strength in the housing market had led to a deterioration in lending standards or a material increase in household indebtedness or the number of highly indebted households. The share of new mortgages issued at high loan-to-value (LTV) ratios had increased in recent months, towards pre-pandemic levels. In 2021 Q3, around 16% of new mortgage lending to owner-occupiers was at an LTV ratio of 90% or above, compared with 10% in 2021 Q2 and 20% in 2019 Q4. And the share of new mortgage lending at loan-to-income (LTI) ratios at or above 4.5 was 8.5% in 2021 Q3, compared to 10.6% in 2021 Q2 – well below the FPC's limit of 15%. Aggregate mortgage debt relative to income had remained broadly stable since 2009. Aggregate household indebtedness (excluding student loans) relative to incomes in 2021 Q2 was 125%, little changed since before the pandemic, and down from 144% prior to the GFC.

17. The FPC noted that some households could still be vulnerable if house price growth were to reverse suddenly as this would reduce the value of the collateral held against those households'

mortgages. But analysis by Bank staff suggested that a large part of the strength in the housing market since the start of the pandemic could be attributed to structural changes consistent with a 'race for space'. Other factors such as increased household saving through the pandemic were also likely to have played a role.

UK corporate resilience

18. The FPC noted that corporate sector debt vulnerabilities were little changed since its previous discussion in September and had increased relatively moderately over the pandemic so far. Bank lending conditions to businesses in the UK had remained generally supportive and banks' risk-appetites had largely returned to pre-pandemic levels. Business insolvencies had increased somewhat since the July 2021 FSR, but remained below pre-pandemic levels.

19. The FPC noted that, in aggregate, businesses had continued to repay more finance from banks and financial markets than they raised since the July FSR. Aggregate corporate debt had decreased by £20 billion between 2021 Q1 and 2021 Q2. The increase in corporate debt from 2019 Q4 to 2021 Q2 now stood at £47 billion, representing a relatively moderate 3.5% increase in the total debt stock. This left the UK's corporate debt-to-GDP level at 61%, up marginally from its pre-pandemic level of 59%. The UK's corporate debt-to-earnings ratio was broadly similar to its pre-pandemic level at around 320%. The FPC judged that debt servicing remained affordable for most businesses. For example, the share of large listed businesses with interest coverage ratios (ICRs) below 2.5 was broadly unchanged in 2020 at 29.1%, from 28.4% in 2019, and remained far below its historical high in 2001. It would take large increases in borrowing costs or severe shocks to earnings to impair businesses' ability to service their debt in aggregate. Specifically, it would take a 400bps increase in borrowing costs to return the share of businesses with an ICR < 2.5 to its historical maximum. And it would take a negative shock to earnings before interest and taxes (EBIT) of around 35% to return the share with an ICR < 2.5 to the level seen around the time of the GFC.

20. Within this aggregate picture, however, the FPC noted that pockets of risk remained, and judged that the increase in corporate debt was likely to have increased the number and scale of more vulnerable businesses. The FPC noted that small and medium sized enterprises (SMEs) were more likely to face financial pressures as they were more likely to operate in sectors affected by the pandemic, and had increased their debt more than larger companies. For example, SME debt in aggregate was around 25% higher than pre-pandemic levels, whereas large corporate debt was marginally lower. Although some of the borrowing had been precautionary, many SMEs had not previously borrowed and some would not have previously met lenders' lending criteria. However, the vast majority of this debt had been issued via government-guaranteed loan schemes, which would limit risks to lenders, and most of which had low interest rates that were fixed for the duration of the

loan. Businesses that had borrowed from one of these schemes - the Bounce Back Loan Scheme (BBLS) - were also able to take Pay-As-You-Grow options to reduce their debt burden, such as payment holidays and extending the loan term. Low interest rates and repayment flexibility would limit the burden on these businesses.

21. The FPC judged that the UK financial system was resilient to vulnerabilities in the UK corporate sector.

Global vulnerabilities

22. The FPC was briefed on a range of international risks that could be relevant for UK financial stability, and in particular those which related to global debt vulnerabilities. As the GFC had demonstrated, global debt vulnerabilities could spill over to the UK through several channels.

23. The FPC judged that global debt vulnerabilities remained material, as they had been prior to the pandemic. As in the UK, the pandemic had represented a substantial shock to households and businesses in other countries. Across advanced and emerging market economies corporate debt-to-GDP ratios had generally increased since the start of the pandemic. In 2021 Q2, corporate debt-to-GDP ratios were estimated to have risen in aggregate by around 7 percentage points since the end of 2019, as output had fallen and businesses had borrowed more. While the increase in corporate debt during the pandemic had been highly synchronised across countries, some economies had seen particularly large rises. Advanced economy corporate debt-to-GDP ratios were likely to have declined however in 2021 Q3, driven by the economic recovery and associated pickup in GDP.

24. Government and central bank policy support in advanced economies had helped to limit the size of the disruption from the pandemic, and a significant portion of new debt issued during the pandemic had been covered by government guarantees. Moreover, UK banks had limited direct exposures to the most vulnerable sectors and, as noted in the October 2021 *Financial Stability in Focus*, debt servicing had generally remained affordable. Nonetheless, higher leverage abroad could increase the risk of losses for UK institutions on their foreign exposures. Corporate debt vulnerabilities in other countries could also have more indirect spillovers to the UK. For example, they could increase the risk of a sharp tightening in global financial conditions and macroeconomic downturns in other countries, which could transmit to the UK. The support provided by governments during the pandemic had also led to an increase in public sector debt in both advanced and emerging market economies.

25. There were also pockets of elevated risk that warranted vigilance. While residential property price growth in many countries had been strong, there were particular concerns over longstanding vulnerabilities in the Chinese property sector. Many property developers in China were highly

leveraged and house price to income ratios were elevated in a number of cities. Moreover, there had been increased signs of speculative activity. The proportion of homebuyers in China that already owned at least one dwelling had increased sharply, from 30% in 2008 to 87% in 2018.

26. The FPC had previously highlighted the risks associated with the rapid rise in debt more broadly in China. There were risks that those longstanding vulnerabilities may start to crystallise, and that could spill over to the UK. Some property developers in China had faced liquidity challenges following breaches of Chinese authorities' limits on property sector leverage, as exemplified by concerns over the ability of Evergrande Group, one of China's largest property developers, to meet its financial obligations. So far, contagion from those liquidity stresses had been mainly limited to a few small developers in China.

27. Activity in the Chinese property market had already slowed considerably though and a sharper downturn in the sector could have wider consequences. The real estate sector had been a significant contributor to growth in China over recent years, and was estimated to account for around a quarter of Chinese GDP. There could also be additional amplification effects via Hong Kong to the extent that property markets in mainland China and Hong Kong were closely linked. UK banks had significant exposure to Hong Kong, representing around 160% of their CET1 capital. While there was uncertainty as to how these risks might crystallise, the results of the 2021 SST indicated that the UK banking system was resilient to the direct effects of a severe downturn in China and Hong Kong, as well as indirect effects through sharp adjustments in global asset prices. The 2021 SST embodied sharp falls in output and property prices in both China and Hong Kong.

Risk-taking in global financial markets

28. Market based finance had continued to support corporates in 2021. The FPC noted that conditions in corporate bond markets had remained stable since the July FSR. Spreads on sterling investment-grade and high-yield corporate bonds were slightly wider than at the time of the July Report and still tighter than their pre-Covid levels. UK companies had also raised substantial amounts of equity-based finance: gross equity issuance by UK businesses had been almost £14 billion so far this year, higher than the 2010–19 annual average.

29. The FPC judged that risk-taking in certain financial markets remained high relative to historical levels, notwithstanding recent market volatility. US equity valuations in particular appeared elevated relative to historical norms explained in part by its sectoral mix. Advanced economy corporate bond spreads remained compressed relative to historical averages, and there had also been evidence of strong demand for lower-grade credit, for example UK high yield issuance had been stronger than in recent years.

30. The FPC judged this partly reflected the improved economic outlook, but that the low compensation for risk in some markets could be evidence of investors' 'search for yield' behaviour, which could reflect the continued low interest rate environment and higher risk-taking. This created a vulnerability to a sharp correction in asset prices – if for example market participants re-evaluated materially the prospects for growth, inflation or interest rates. Any such correction could be amplified by existing vulnerabilities in market-based finance. This could have adverse consequences for market functioning and financial conditions, and potentially transmit stress to other parts of the financial system and the real economy.

31. Risks in leveraged loan markets globally had also continued to increase. The post-GFC trends of increased leveraged loan issuance and loosening in underwriting standards in these markets had continued. For example, the share of new lending with few financial maintenance covenants (so-called 'covenant-lite' lending) in these markets was almost at a record high globally. The FPC judged that the core UK banking system remained resilient to direct losses associated with leveraged lending, as demonstrated by the results of the 2021 SST.

32. The Committee also noted that the functioning of some financial markets had been challenged in Q4 as market participants adjusted their inflation and interest rate expectations ahead of key central bank meetings in October and November. In particular, market contacts had noted that liquidity in short-term interest rate markets had been impaired, and market depth – a measure of the size of orders that a market can sustain without impacting the price of a security – had reduced. While market pricing had since stabilised, the FPC judged that this volatility could provide further evidence of the tendency for markets to jump to illiquidity under stress, as it had previously discussed in the December 2019 FSR. Such jumps to illiquidity could impair the ability of global markets to absorb future shocks while still functioning effectively.

The UK Countercyclical Capital Buffer rate decision

33. The FPC discussed its setting of the UK Countercyclical Capital Buffer ('CCyB') rate and the merits of different paces of increase.

34. The FPC reiterated that its policy was to vary the UK CCyB rate in line with system-wide risks to the UK banking sector and to set the UK CCyB rate in the region of 2% when the risk environment was judged to be standard. This approach aimed to ensure that the buffer was large enough to create capacity for banks to lend through downturns.

35. A 2% UK CCyB rate had been due to come into effect by the end of 2020. In March 2020 – as UK financial stability risks from the pandemic became apparent – the FPC had cut the UK CCyB rate

to 0%. In December 2020 the FPC noted that it expected the UK CCyB rate to remain at 0% until at least December 2021.

36. The FPC judged that vulnerabilities that could amplify economic shocks were at a standard level overall, as was the case just before the pandemic. Aggregate debt in the UK corporate sector had increased relatively moderately over the pandemic, concentrated in some sectors and types of businesses – in particular, SMEs. Measures of household debt vulnerabilities remained stable. The FPC also judged that asset valuations in certain financial markets appeared elevated relative to historical norms and that global debt vulnerabilities remained material. This would be consistent with the UK CCyB rate returning to the region of 2%.

37. The FPC also considered the outlook for UK banks' capital and the implications of its decision on the setting of the UK CCyB rate for banks' ability to supply credit to the real economy.

38. Due to the exceptional policy responses of the UK authorities, including Government support for the economy, UK banks had not experienced the losses that might have been expected given the severe economic impact of Covid. Major UK banks' and building societies' capital resources had actually increased since the onset of the pandemic, and were already sufficient to meet the planned level of resilience consistent with the 2% UK CCyB rate announced prior to the pandemic. The FPC noted that an increase in the UK CCyB rate would, therefore, not require major UK banks and building societies to strengthen their capital positions, but could rather be met with existing capital. And so they did not expect that an increase in the UK CCyB rate would materially impact prevailing credit, or wider economic, conditions. The FPC also noted that if banks' capital ratios were to be depleted in a future stress episode, the economic cost of increasing the UK CCyB rate would be higher, and the FPC would always consider this aspect, alongside its judgement on the risk environment, when forming its decision on the pace at which the UK CCyB rate would be increased, in order to ensure banks were able to support the needs of the economy at all times.

39. Given major UK banks and building societies had sufficient capital resources to meet a 2% UK CCyB rate, there was an argument for moving directly to 2%, with the usual 12-month implementation period.

40. However, there continued to be uncertainty about the evolution of the pandemic and the economic outlook. Should downside risks to the recovery crystallise, the UK economy could require more support from the financial system. There were therefore benefits to increasing the UK CCyB rate by a smaller step initially – 1% – in Q4, with a view to moving to 2% in 2022 Q2, absent a material change in the outlook.

41. On that basis, the FPC agreed to increase the UK CCyB rate from 0% to 1%, with binding effect from 13 December 2022, in line with the usual 12-month implementation period. If the UK economic recovery proceeded broadly in line with the MPC's central projections in the November MPR, and absent a material change in the outlook for UK financial stability, the FPC would expect to increase the rate further to 2% in 2022 Q2. That subsequent increase would be expected to take effect in 2023 Q2, following the usual 12-month implementation period.

42. The Committee also noted that its intention to increase the UK CCyB rate in 1% increments on this occasion would not bind its discretion to raise it in larger or smaller steps in other circumstances if the risk outlook warranted such action.

43. The Committee also reiterated that it stood ready to vary the UK CCyB rate in either direction in line with the evolution of economic conditions and the overall risk environment.

The FPC's mortgage market Recommendations

44. The Committee discussed its review of two Recommendations relating to the owner-occupier segment of the mortgage market. The 'loan to income flow limit' capped the number of mortgages extended at loan to income (LTI) ratios of 4.5 or higher to 15% of a lender's new mortgage lending. The 'affordability test', which built on the FCA's Mortgage Conduct of Business (MCOB) framework, specified that lenders should assess whether borrowers could still afford their mortgage if, at any point over the first five years of the loan, mortgage rates were to be 3 percentage points higher than the contractual reversion rate (usually the lender's Standard Variable Rate).

45. The Recommendations had been introduced to guard against a loosening in mortgage underwriting standards, which could lead to a material increase in household indebtedness and the number of highly-indebted households. Historically, a rapid build-up of mortgage debt, often associated with rapid house price growth, had been an important source of risk to the UK financial system and to the economy. Mortgages were UK households' largest financial liability and UK lenders' largest loan exposure. And any loosening in lenders' underwriting standards could lead to excessive mortgage debt and a material increase in the number of more highly indebted households. In an economic downturn, these households were more likely to cut spending sharply, posing risks to the wider economy and ultimately to lenders.

46. Since their introduction in 2014, the FPC had carried out three reviews of the measures in 2016, 2017 and 2019. Its 2021 review included an assessment of the calibration of the Recommendations in light of structural falls in interest rates. The Committee also assessed how each of the Recommendations individually contributed towards reducing risks to financial stability from excessive mortgage debt. In addition, in line with its secondary objective, it considered the impact of

the Recommendations on first time buyers. The analysis underlying the Committee's judgements would be set out in Section 3 of the FSR.

47. The FPC observed that since the introduction of the Recommendations, there had been a structural fall in long-term interest rates. This reflected a persistent decline in the 'equilibrium interest rate' to very low levels, as a result of longer-term structural factors. Some of these factors (such as demographic trends) had been pushing equilibrium real interest rates down for several decades, while others (such as lower trend growth) had emerged or intensified after the GFC. These structural changes could have lowered households' debt servicing costs and so the risks associated with a given level of household debt.

48. The FPC noted that although interest rates were expected to remain low for longer than had been the case when the measures were introduced – which, other things equal, implied a reduction in debt-servicing costs for households – both the causes and consequence of the fall in long-term interest rates implied an offsetting increase in risks. The decline in trend productivity growth and weaker economic prospects seen since the GFC had reduced households' future income growth. This suggested that improved affordability at origination was offset by a slower decline in households' debt burdens relative to income over time. In addition, the structural decrease in interest rates had reduced the space available for interest rate cuts to respond to shocks. This made highly indebted households more vulnerable to such shocks when they occurred. Furthermore, evidence suggested that, despite the large falls in mortgage interest rates during the GFC, highly indebted households cut their consumption by more, thereby amplifying the downturn.

49. Taking these factors together, the Committee concluded that there was no strong evidence that the structural fall in long-term interest rates that had continued since the measures were introduced had reduced the overall level of risk associated with household debt. The FPC therefore judged that the structural decline in interest rates did not, by itself, justify a change in the overall calibration of its mortgage market measures, which were intended to guard against these risks.

50. Since 2014, the FPC had been able to observe how the measures operated in practice, and had benefitted from new analysis and an expanding evidence base. In line with previous reviews, it also considered whether, and to what extent, the Recommendations could have constrained access to the mortgage market in recent years.

51. The Committee noted that, since the measures had been introduced, aggregate mortgage debt to income had been broadly stable. In the recent period of high house price growth, there had been little evidence of a deterioration in lending standards or a material increase in aggregate household debt or the number of highly indebted households.

52. The FPC observed that the measures appeared to have had little direct impact on access to the mortgage market. There continued to be significant headroom below the LTI limit, reflective of lenders' own risk appetites. Analysis suggested that the affordability test had affected a small proportion of borrowers by reducing the amount that they were able to borrow.

53. As part of its secondary objective, the FPC considered the impact of its Recommendations on first-time buyers. Bank staff analysis suggested that the vast majority of renters that were unable to buy the median-valued first-time buyer home in their area were constrained by factors other than the FPC's Recommendations. The Committee therefore judged that, in aggregate, the Recommendations had had a relatively limited effect on mortgage market access and that raising a deposit remained the most significant barrier to accessing the housing market, particularly for first time buyers.

54. The Committee noted some concerns with how the affordability test had operated. In particular the stress rate encapsulated in the affordability test had remained broadly static since introduction, reflecting stickiness in reversion rates despite the falls in quoted mortgage rates. In light of that experience, there was significant uncertainty about how the stress rate might move in future.

55. The FPC therefore examined the potential effect of each of its measures in a scenario of rapidly rising house prices. The analysis suggested that there was significant overlap between the effects of the two measures, and that the LTI flow limit was likely to play a stronger role than the affordability test in guarding against an increase in household indebtedness and the number of highly indebted households during periods of rapid house price growth.

56. Considering all of these factors together, and as would be set out in full in Section 3 of the FSR, the FPC concluded that the LTI flow limit, without the FPC affordability test Recommendation, but alongside the FCA's affordability testing under its MCOB framework, ought to deliver an appropriate level of resilience to the UK financial system, but in a simpler, more predictable and more proportionate way. It would also reduce the impact on a small proportion of potential borrowers by not constraining the amount they could borrow beyond that permitted by the LTI flow limit operating in combination with MCOB.

57. The FPC therefore decided to maintain the LTI flow limit Recommendation and to consult on simplifying the framework by withdrawing its affordability test Recommendation in the first half of 2022. Withdrawing the Recommendation would mean that affordability testing would continue under the MCOB rules. The FCA had confirmed that lenders would clearly be breaching MCOB rules if they only stress tested against a fixed introductory rate where the interest rate would change within 5 years, which meant there would be an expectation that these borrowers would be stress tested using reversion rates in the absence of the FPC's test.

Building the resilience of the financial system

International progress in building the resilience of market-based finance

58. In March 2020, vulnerabilities in the system of market-based finance amplified the initial market reaction to the pandemic, contributing to a severe liquidity shock (the 'dash for cash'), which disrupted market functioning and threatened to harm the wider economy. Significant policy action from central banks was needed to restore market functioning.

59. At its November meeting, the FPC strongly supported international work, led and co-ordinated by the Financial Stability Board (FSB), to assess and develop policy responses to address the underlying vulnerabilities in market-based finance that had amplified this dash for cash. The FPC welcomed the FSB's analysis of these vulnerabilities, and it endorsed the FSB's policy recommendations for money market funds, which now need to be implemented by all jurisdictions.

60. In the Committee's view, further policy measures were needed to enhance the resilience of market-based finance in other areas, including open-ended funds, margin, the liquidity structure and resilience of core markets, and leveraged investors and their prime brokers.

61. Absent an increase in the resilience of market-based finance, financial stability risks including those exposed in March 2020 would remain. The work planned by the FSB in 2022 therefore represented an important opportunity to develop policies to address those vulnerabilities. The FPC noted that it would continue to monitor progress.

62. Making progress on mitigating these vulnerabilities was also vital to ensure that interventions by central banks in stress episodes were truly backstops and potential negative side effects to the financial system and public money were effectively mitigated. While central banks might need new and more targeted tools to deal effectively with financial instability caused by market dysfunction, central bank interventions could not be a substitute for the primary obligation of market participants to manage their own risk, or for internationally co-ordinated reforms that enhanced the resilience of the non-bank financial sector.

Risks from cryptoassets

63. The FPC discussed the continued rapid growth in cryptoassets and associated markets and services, including decentralised finance. The market capitalisation of cryptoassets had grown ten-fold since early 2020 to around US$2.6 trillion as of 24 November 2021 and represented around 1% of global financial assets. The vast majority of this market (around 95%) was made up of 'unbacked' cryptoassets which had no underlying assets. As the FPC had previously noted, these unbacked cryptoassets with no intrinsic value were volatile, making them unsuitable to be widely used as

money or a store of value, and so investors might lose all their investment. Many other cryptoassets claim to maintain a stable value by holding a pool of backing assets, in a bid to make them suitable for payment and settlement purposes; these had also played a role in facilitating speculative investment in unbacked cryptoassets. The FPC had previously set out expectations that these kinds of backed cryptoassets – known as stablecoins – would need to meet before they could be acceptable for widespread adoption as a means of payment.

64. The FPC noted that, alongside their continued rapid growth, cryptoassets were becoming increasingly interconnected with the traditional financial system. For example, some UK and global banks were starting to offer a variety of services, such as cryptoasset derivatives trading and custody services for use by a broad range of clients.

65. The FPC noted that innovation could bring a number of benefits, including reduced frictions and inefficiencies in financial services. But these benefits could only be realised and innovation could only be sustainable if it was undertaken safely and accompanied by effective public policy frameworks that mitigated risks.

66. The FPC judged that direct risks to the stability of the UK financial system from cryptoassets were currently limited. However-at the current rapid pace of growth, and as these assets became more interconnected with the wider financial system, cryptoassets would present a number of financial stability risks. For example, a large fall in cryptoasset valuations could cause institutional investors to sell other financial assets and potentially transmit shocks through the financial system. The use of leverage could amplify such spillovers further.

67. The FPC considered that enhanced regulatory and law enforcement frameworks, both domestically and at a global level, were needed to influence developments in these fast growing markets in order to manage risks, to encourage sustainable innovation and to maintain broader trust and integrity in the financial system. The FPC also noted that existing gaps in the regulatory agenda and inconsistencies in international approaches to regulation could create opportunities for regulatory arbitrage, including across borders. The FPC welcomed the international work on these issues.

68. Domestically, the FPC was also supportive of the work of the HM Treasury-FCA-Bank Cryptoasset Task Force on assessing the regulatory approach to unbacked cryptoassets and their associated markets and activities in order to shape developments in this space and support safe innovation. The FPC also welcomed HM Treasury's proposal for a regulatory regime for stablecoins used as a means of payment. This included bringing systemic stablecoins into the Bank's regulatory remit. Internationally, the FPC noted the CPMI-IOSCO consultation on the applicability of the Principles for Financial Market Infrastructure to stablecoins, which was an important step in establishing international standards for stablecoins used for payments. And the FSB had published

high-level recommendations for the regulation, supervision and oversight of global stablecoin arrangements.

69. The FPC noted that there were currently significant data gaps in cryptoasset markets that impeded a fuller assessment of relevant financial stability risks. The FPC considered that international effort and co-operation would be essential to remediate these data gaps and inconsistencies.

70. The FPC would continue to pay close attention to developments in this area, and would thereby seek to ensure that the UK financial system was resilient to systemic risks that might arise from cryptoassets, and associated markets and services. Any future regulatory regime should aim to balance risk mitigation with supporting innovation and competition. The FPC considered that financial institutions should take an especially cautious and prudent approach to any adoption of these assets until such a regime was in place.

71. It was also important to mitigate other risks – such as consumer and investor protection, market integrity, money laundering and terrorist financing – although the responsibility for mitigating those risks lay outside the FPC's remit.

Productive finance and the FPC's secondary objective

72. The FPC discussed the recently published report of the industry Productive Finance Working Group which aims to develop practical solutions to the barriers to investment in long-term, less liquid assets. The FPC welcomed the start of the next phase of the Group's work to take forward its recently published recommendations. Investment in long-term, less liquid assets could benefit investors, including pension scheme members, provided they were appropriately managed, including with redemption terms that reflect the liquidity of the funds' assets. Investment in such assets could also benefit the broader economy by supporting economic growth, transition to net zero and financial stability, in line with the FPC's primary and secondary objectives.

73. The FPC discussed how, in line with its secondary objective, it supported the Government's economic policy relating to finance for productive investment, and the Government's overall strategy for financial services as set out in the March 2021 Remit letter. The Committee's assessment would be set out in the December 2021 FSR box "The FPC's secondary objective".

74. As part of this discussion, the FPC welcomed the initial findings on the relationship between climate change and the regulatory capital regime as explored in the PRA's Climate Change Adaptation Report.

Libor transition

75. The Committee received an update on the transition away from Libor. All Libor settings will be discontinued in their panel bank form at the end of 2021, with the exception of the Overnight and the 1-,3-,6- and 12-Months US dollar Libor settings that will continue on a representative 'panel bank' basis until end June 2023 to support an orderly winding down of legacy contracts only. Additionally, the FCA had confirmed it would allow the temporary use of 'synthetic' 1-,3- and 6-Months sterling and yen Libor settings in all legacy Libor contracts, other than cleared derivatives, that have not transitioned at or ahead of end-December 2021. The FPC supported the view that synthetic versions of Libor are a temporary solution. In sterling markets, most use of Libor in new contracts had now ceased and been largely replaced by the Sterling Overnight Index Average (SONIA), a risk-free rate produced by the Bank.

76. The FPC welcomed the further progress that had been made in transitioning away from Libor and the marked increases in use of risk-free rates over recent months and the recent passage of the Critical Benchmarks (References and Administrators) Bill through Parliament, which was shortly due to receive Royal Assent. The FPC noted that sufficient sterling risk-free rate liquidity had been established across the full set of SONIA products to support an orderly transition from sterling Libor, and that issuance of sterling Libor products had been largely phased out through a set of industry-recommended milestones.

77. The FPC noted that, despite the ongoing progress in the transition to the Secured Overnight Financing Rate (SOFR) in US dollar markets, further work was required to make sure markets ceased new use of US dollar Libor by the start of 2022. It was the FPC's view that SOFR-based rates provided more robust alternatives than recently created credit sensitive rates (that were being used in some US dollar markets), and the FPC considered these credit sensitive rates to have the potential to reintroduce many of the financial stability risks associated with Libor (for example being based on insufficiently active underlying markets).

78. The FPC noted the importance of an orderly completion of the remaining key operational transitional events ahead of the end of 2021, including central counterparty conversions of outstanding cleared derivatives, and operationalisation of ISDA's fallbacks. The FPC would continue to be vigilant to the management of key operational risks associated with the transition over the coming weeks, including those associated with the implementation of fallback measures.

79. The FPC noted that the active transition of legacy Libor linked contracts remained of key importance and provided the best route to certainty for parties to contracts that reference Libor.

80. The FPC emphasised the importance of market participants now being fully prepared for relevant Libor settings to either cease or become unrepresentative, and to cease new use of the continuing US dollar Libor settings, by the end of this year.

Financial services and the UK's relationship with the EU

81. The UK authorities remained committed to mutual regulatory and supervisory co-operation with the EU authorities. Alongside co-operation with other regulatory authorities globally, this would continue to promote an open and resilient financial system to the benefit of all participants.

82. The FPC continued to monitor risks to its objectives that could arise from changes to the provision of cross-border financial services in the future, for example the risk of disruption that could arise when the EU's temporary equivalence and recognition determinations for UK central counterparties expire, currently due on 30 June 2022. The FPC noted that on 10 November the EU's Commissioner for Financial Services, Financial Stability and Capital Markets Union had announced that the European Commission would soon propose an extension of equivalence for UK central counterparties.

83. Consistent with its statutory responsibilities, the FPC remained committed to the implementation of robust prudential standards in the UK. This would require maintaining a level of resilience that was at least as great as that currently planned, which itself exceeded that required by international standards, as well as maintaining UK authorities' ability to manage UK financial stability risks.

International Monetary Fund's Financial Sector Assessment Program

84. The FPC would take note of the findings of the International Monetary Fund's Financial Sector Assessment Program (FSAP) review of the UK's financial sector. The FSAP would provide a robust independent assessment of standards in the UK.

Other Systemically Important Institutions (OSII) Buffer Rates

85. In October 2021, the FPC had announced its intention to consult on proposals to amend the framework used to determine O-SII buffer rates in line with its 2021 Q3 review. The FPC was now consulting on proposals to change the metric used to determine O-SII buffer rates from total assets to UK leverage exposures, and to recalibrate the thresholds used to determine O-SII buffer rates to prevent an overall tightening or loosening of the framework relative to its pre-Covid level.[1] The FPC published its consultation paper on 15 November, with the consultation period due to close on 15 February 2022.[2]

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[1] The content of the consultation paper was agreed by written procedure on 4 November.
[2] https://www.bankofengland.co.uk/paper/2021/amendments-to-the-fpcs-framework-for-the-o-sii-buffer

Resolvability Assessment Framework

86. The FPC welcomed that the first Resolvability Assessment Framework (RAF) cycle had begun. The RAF was the final major piece in the UK's bank resolution regime, bringing together Bank and PRA resolvability policies that would require major UK banks and building societies to achieve specified outcomes by 1 January 2022 in order to be considered resolvable. The Bank of England, acting in its capacity as the UK Resolution Authority, would publish its first assessment of firms' progress on resolvability, alongside public disclosures by firms, in June 2022. Resolvability is an ongoing obligation for firms. It was important that firms continued to invest in and sustain their capabilities to support the Bank's efforts to maintain an effective resolution regime.

Cyber stress testing

87. In March 2021, the FPC had agreed that the 2022 cyber stress test should target the most systemic contributors in the end-to-end payments chain, as in the event of disruption, their ability to resume services in a timely manner was particularly important for UK financial stability. The Committee further agreed to focus the next cyber stress test on retail payments, so that the results from the test could help shed light on the potential financial stability impact of disruption to retail payments.

88. The FPC welcomed the PRA's decision to invite some of the largest participants (by volume) in the relevant retail payment system to participate in the 2022 cyber stress test, as well as a limited number of firms with a smaller presence in the retail payment system. As noted by the PRA, participation of smaller firms could yield valuable microprudential insights about this part of the sector. It could also provide information about whether the resilience of smaller firms could contribute to financial stability risks given interconnections with the rest of the system.

The following members of the Committee were present:

Andrew Bailey, Governor

Colette Bowe

Sarah Breeden

Ben Broadbent

Jon Cunliffe

Jon Hall

Anil Kashyap

Dave Ramsden

Nikhil Rathi

Elisabeth Stheeman

Carolyn Wilkins

Sam Woods

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

Sam Woods, Nikhil Rathi and Charles Roxburgh were present on 29 November, but were unavoidably unable to attend on 9 December. Sam Woods and Nikhil Rathi communicated their views to the Governor beforehand.

In accordance with the relevant provisions of the Bank of England Act 1998, Jon Hall had notified the Committee of his shareholding at Guardtime (a blockchain based information security provider). It was agreed that he would recuse himself from discussions on cryptoassets, and that he would not receive the related papers.

ANNEX: FPC POLICY DECISIONS

Outstanding FPC Recommendations and Directions (as at the date of the FPC's meeting on 29 November 2021)

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 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 rate	The FPC agreed to increase the UK CCyB rate from 0% to 1% on 29 November 2021, with binding effect from 13 December 2022. 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 test 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.
Leverage ratio	In September 2021, the FPC directed the PRA to implement the following measures (the 'leverage measures') in relation to the following firms (each a 'relevant firm'):

- each major UK bank, building society or investment firm;
- each UK bank, building society or investment firm with significant non-UK assets; and
- any holding company approved or designated by the PRA whose consolidated situation (including, where that holding company is part of a RFB sub-group, the consolidated situation of that sub-group) is comparable to any other relevant firm.

The leverage measures are to:

- require each relevant firm to hold sufficient Tier 1 capital to satisfy a minimum leverage ratio of 3.25%;
- secure that each relevant firm 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 a relevant firm is a 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; and
- secure that if the relevant firm is a relevant O-SII it ordinarily holds sufficient Tier 1 capital to satisfy a O-SII additional leverage ratio buffer rate of 35% of its O-SII buffer rate.

The leverage measures are to be applied:

- on a consolidated basis in respect of the UK consolidation group of the relevant firm;
- on a sub-consolidated basis in respect of any RFB sub-group that contains a relevant firm ('RFB sub-consolidated basis'); and
- on an individual basis or, at the PRA's discretion, on a sub-consolidated basis (in respect of the relevant firm and one or more of its subsidiaries), for relevant firms that are not subject to the leverage measures on the basis of their consolidated situation pursuant to the preceding bullet points.

Where the leverage measures are to be applied on a consolidated or RFB sub-consolidated basis, they may be applied to a holding company approved or designated by the PRA, as appropriate.

In designing its approach to exercising its discretion over the appropriate level of consolidation at which to implement the leverage measures, the PRA should have regard to, among other things:

- the desirability of alignment between the levels of application of the leverage measures and measures under the risk weighted capital framework; and
- the potential for the leverage measures applied on an individual basis to disproportionately impact the capital position of relevant firms driven by their group structure, given the potential consequences for the provision of market liquidity in aggregate for the UK financial system.

For the purposes of the leverage measures, the FPC specified the following:

- The total exposure measure shall exclude any assets constituting claims on central banks, where they are matched by liabilities accepted by the firm that are denominated in the same currency and of identical or longer maturity.
- 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 and O-SII additional leverage ratio buffers.

The FPC also recommended 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%. The PRA has published its approach to implementing this direction and recommendation.[4]

[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
[4] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework