Bank of England

Record of the Financial Policy Committee meeting on 19 September 2024

2 October 2024

This document serves as a summary of the FPC's headline judgements, actions and policy decisions, focusing on changes since Q2, and a record of the FPC meeting held on 19 September 2024. It combines the separate Financial Policy Summary and FPC Record that the FPC has published in previous quarters.

This document is available on the Record page of our website:
https://www.bankofengland.co.uk/financial-policy-summary-and-record/2024/october-2024

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 His 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 meeting will be on 15 November 2024 and the record of that meeting will be published on 29 November 2024.

Record of the Financial Policy Committee meeting on 19 September 2024

Headline judgements and policy actions

- **Risks to UK financial stability are broadly unchanged since the June 2024 Financial Stability Report (FSR).** Significant financial market and global vulnerabilities remain.
- **There was a significant spike in volatility across global financial markets in August. Although short-lived, the extent of the moves, in response to relatively limited economic news, illustrates the potential for vulnerabilities in market-based finance to amplify shocks. But while there was evidence that investor deleveraging had amplified price moves, it did not spillover or materially affect the functioning of core markets. It might have done so if subsequent economic news had not been positive or deleveraging had been more significant or broad-based.**
- **Valuations across several asset classes, particularly equities, quickly returned to stretched levels following the episode. Markets remain susceptible to a sharp correction, which could affect the cost and availability of credit to UK households and businesses, with investors sensitive to short term developments in a challenging global risk environment.** Global vulnerabilities remain material, as does uncertainty around the geopolitical environment and global outlook.
- **There have been further signs of easing in UK credit conditions, reflecting improvements to the macroeconomic outlook. In aggregate, UK household and corporate borrowers remain resilient to the higher interest rate environment** although some highly leveraged firms, including smaller and private equity backed businesses, remain under pressure.
- **The UK banking system remains in a strong position to support households and businesses, even if economic and financial conditions were substantially worse than expected. The FPC decided to maintain the UK countercyclical capital buffer at its neutral rate of 2%.**
- **As part of its annual review of the leverage ratio Direction, the FPC confirmed that the UK leverage ratio framework remained appropriate.** The FPC welcomed the Bank and the PRA's engagement with firms on the normalisation of central bank balance sheets and the financial stability role of central bank reserves, and noted that such discussions would inform future FPC annual reviews.

At the FPC's meeting on 19 September, the Committee also:

- Welcomed the 12 September publication of the PRA's second near-final policy statement on the implementation of **Basel 3.1 standards in the UK** and **the PRA's Consultation Paper on the Strong and Simple Framework.**
- Welcomed the **continued progress to maintain a credible resolution regime** captured in the published findings of the Bank's second assessment of the eight major UK banks' resolvability under the Resolvability Assessment Framework. It also welcomed the introduction of the Bank Resolution (Recapitalisation) Bill to Parliament.
- Received an update on the **progress of firms and financial market infrastructures (FMIs) towards implementing the operational resilience policies** set by the Bank, PRA and FCA. Despite progress, more work is needed to address vulnerabilities. As firms and FMIs seek to comply with the policies, the FPC noted that they must focus on their roles in the financial system and broader economy, and engage with other firms, other FMIs and the wider market on the potential impact of their own disruption and actions they might take.
- Discussed **the development of the Bank's new tools for lending to non-bank financial institutions (NBFIs) in the event of severe gilt market disruption that threatened UK financial stability**, and approved the scope and principles determining their design. The FPC encouraged potential counterparties, such as insurers, pension schemes and LDI funds, to familiarise themselves with the expected design and features of the Contingent NBFI Repo Facility and to assess what steps they would need to take to be ready to sign up to the facility when applications open.
- Discussed the **benefits and risks of the use of stablecoins for wholesale purposes**. Given the potential benefits, the FPC supported monitoring developments, but considered that there were risks to the stability of the value of stablecoins and that this could have financial stability implications in wholesale markets. More broadly, the FPC had a low risk appetite for a significant shift away from central bank money as the primary settlement asset in the financial system.
- Discussed **tokenisation, including of money market funds (MMFs)** and the impact this could have on how MMF shares are managed and utilised. The FPC noted that the Bank/FCA Digital Securities Sandbox would be an appropriate way to observe the potential benefits and risks of tokenisation to financial stability.
- Supported international work to address **risks to financial stability from procyclicality in margin requirements** and vulnerabilities in the NBFI sector. The FPC looked forward to the proposals being finalised by relevant standard-setting bodies.
- Discussed the **main channels through which Artificial Intelligence (AI) could have financial stability implications**. The FPC agreed to develop further its understanding of those channels and to publish an assessment of them, as well as its approach to monitoring financial stability risks from AI, in a report in the first half of 2025.

Record of the Financial Policy Committee meeting on 19 September 2024

1. The Committee met on 19 September 2024 to agree its view on the outlook for UK financial stability. The FPC discussed the risks faced by the UK financial system and assessed the resilience of the system to those risks. On that basis, the Committee agreed its intended policy action.

2. The 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 is able to absorb rather than amplify shocks and serve UK households and businesses.

Developments in financial markets and vulnerabilities in market-based finance

3. The FPC noted that several factors had contributed to a significant short-lived spike in volatility and falls in equity indices across global financial markets in early August. The release of weaker than expected US jobs data on 2 August had caused markets to reassess expectations of US and global growth. Results for US-tech companies associated with AI had also been weaker than expected. Shifting interest rate differentials between the US and Japan led to the unwind of the Yen carry trade (participants borrowing cheaply in Yen to purchase other assets). Volatility in bond markets rose and implied equity volatility (measured by the VIX) also spiked significantly. The deleveraging of other common trades, including short volatility positions, exacerbated the moves. Such leveraged strategies can amplify volatility when asset prices fall. Most market moves were short-lived, however, in large part due to positive subsequent macroeconomic news, with the majority of equity indices and corporate bond spreads returning to, or close to, their initial levels.

4. In 2024 H1, the FPC had already emphasised the risk of a sharp market correction. In that context, the FPC discussed how to interpret this episode of market volatility. Members emphasised that the evidence of deleveraging behaviour amplifying sharp moves in some markets supported the FPC's previously communicated view that vulnerabilities in market-based finance (MBF) continued to have the potential to amplify market corrections significantly, which could impact the price and availability of credit for households and businesses. Whilst a broader spillover to core market functioning did not materialise on this occasion, had subsequent macroeconomic news not been positive, further deleveraging could have occurred. MBF vulnerabilities (eg fund liquidity mismatches and hedge fund leverage) remained elevated.

5. Members noted that it was important to understand why the deleveraging behaviour did not spill over materially to core rate markets, including repo markets, which continued to function well. Such a spillover would have posed broader financial stability risks, including by

interacting with MBF vulnerabilities to amplify the shock further, and by increasing the cost and availability of credit to households and corporates, increasing refinancing challenges.

6. The FPC discussed the reasons why core markets had remained insulated from the shock, beyond the fact that subsequent macroeconomic news had been positive. First, although levels of margining in certain markets such as equities and foreign exchange had risen sharply, as central counterparties (CCPs) increased margin requirements consistent with the increased volatility, there was a more limited impact across wider financial markets and the size and persistence of the shock was such that firms were sufficiently prepared. No defaults were reported, firms raised no issues with clients' abilities to meet margin calls, and there were no concerns about counterparty credit, which otherwise may have increased funding pressures. Clearing infrastructure and margining systems were also reported to have operated well amid the sell-off.

7. Second, hedge fund net short positioning in US Treasuries futures was not materially unwound. This had been in contrast to the deleveraging that occurred in March 2020. Widening pressure on the US Treasuries cash-futures basis (the spread between government bond rates and corresponding futures contract) had been mitigated, in this instance, by repo markets continuing to function well, the lack of counterparty credit concerns, and the timing of the episode; the proximity to the futures roll date reduced risk and increased liquidity. This had alleviated the spill-over effects of broader market volatility onto the cash-futures basis trade, reducing deleveraging pressure. Market intelligence had also suggested that these investors had not been materially affected by the unwinding of yen carry trades.

8. Vulnerabilities associated with this trade remained, however. Since the June FSR, hedge fund net short positioning in US Treasuries futures had continued to rise, reaching a new peak of around $1trillion, compared to a previous peak of around $875 billion. Relative to the size of the US Treasury market, this was larger than the previous high reached in 2019. Asset managers had continued to build long positions in Treasuries futures, with hedge funds taking the other side of these positions. Deleveraging of these positions, which had the potential to amplify the transmission of a future stress, could be brought about by several factors, including: if repo market functioning were to deteriorate materially; if counterparty credit risk were to increase; or if investors in the basis trade were to take losses on other positions. It was important for financial institutions to be prepared for such severe but plausible stresses.

9. Measures of equity risk premia (eg the excess cyclically-adjusted price-to-earnings (CAPE) yield) remained close to historical lows in the US, EU, and UK following the episode and risk premia in some other markets were also still compressed. Market contacts noted the apparent disconnect between stretched valuations and risks to global growth, as well as the degree of sensitivity to short-term news. Markets therefore remained susceptible to a sharp

correction, with investors sensitive to developments in what remained a challenging global risk environment.

10. Since the June 2024 FSR, both short-term policy rate expectations and longer-term government bond yields had fallen across the US, UK and euro-area, which should lower debt-servicing pressures on borrowers.

Global vulnerabilities

11. The central outlook for UK-weighted global growth had remained broadly unchanged in the Monetary Policy Committee's (MPC) August Monetary Policy Report (MPR) forecast, with a modest increase in growth projected by the MPC over the medium-term. The FPC judged that global vulnerabilities remained material, as did uncertainty around the central outlook for global growth.

12. As the FPC had previously noted, the current period of elevated geopolitical risk and uncertainty, as well as structural trends such as demographics and climate change, could place further pressure on sovereign debt levels and borrowing costs. High public debt levels in major economies could have consequences for UK financial stability and interact with other risks. A deterioration in market perceptions of the long-term path of public debt globally could lead to market volatility and interact with vulnerabilities in market-based finance, in particular if those markets also feature prominently in leveraged trading strategies. This could lead to a tightening in credit conditions for households and businesses. Increased servicing costs for governments as debt is refinanced could also reduce their capacity to respond to future shocks. The FPC would continue to monitor these risks and take into account the potential for them to crystallise other financial vulnerabilities and amplify shocks.

13. At its 30-31 July meeting, the Bank of Japan had increased its key policy rate to 0.25% and communicated the tapering of its monthly purchases of Japanese government bonds. Recent market volatility underscored potential risks associated with this monetary policy normalisation, which were important for financial institutions to be prepared for. Japanese asset price moves could have an impact in a number of countries globally, for example if the price moves led to substantial reallocations of portfolio holdings across jurisdictions, including emerging market economies. Further rises in domestic yields in Japan could also generate unrealised losses due to interest rate risk on debt security holdings across some Japanese banks.

14. Commercial real estate (CRE) vulnerabilities remained material in advanced economies, in part due to the significant refinancing challenges that remained for CRE borrowers in the higher interest rate environment. Stresses in global CRE markets could affect UK financial stability through several channels, including a reduction in overseas finance for the UK CRE sector.

15. Vulnerabilities in the mainland Chinese property market had continued to crystallise, with new and existing home prices falling further. Commercial and residential property markets in Hong Kong were under pressure from similar factors weighing on markets in other advanced economies but signs of spillovers from vulnerabilities in mainland China remained limited. The 2022/23 ACS results had indicated that major UK banks would be resilient to a severe downturn and very significant declines in property prices in mainland China and Hong Kong.

UK household and corporate debt vulnerabilities

16. The FPC noted that the UK macroeconomic outlook had continued to improve since its 2024 Q2 meeting. The path for UK GDP was a little stronger, and CPI inflation was slightly lower, in the MPC's August MPR projection relative to the May MPR. In August, the MPC cut Bank Rate by 25 basis points to 5 per cent. The path for Bank Rate expected by market participants over the coming two years had also fallen by around 75 basis points.

17. Overall, mortgagors continued to be resilient to higher interest rates, although some lower income households and renters remained under pressure. Mortgage rates were lower than at the time of the FPC's Q2 meeting. This would have already started to benefit those on floating rates, who represented around a fifth of borrowers. Given that around a third of mortgagors had not yet refinanced at higher interest rates, however, the aggregate household mortgage debt service ratio (DSR) was still projected to increase, broadly in line with expectations at the time of the June FSR, but remain well below 1990s and global financial crisis (GFC) peaks. The proportion of mortgagors spending more than 70% of the cost-of living adjusted disposable income on mortgage payments was expected to remain broadly flat, well below pre-GFC peaks. Mortgage and consumer credit arrears were largely unchanged since the June FSR and remained low by historical standards.

18. In aggregate, UK corporates had continued to be resilient to the current economic outlook, including high interest rates, with aggregate measures of UK corporate debt vulnerability significantly below their pandemic peaks. The FPC continued to expect them to remain so, but there were still pockets of vulnerability among highly leveraged corporates, including private equity backed businesses, and small and medium sized enterprises (SMEs). Insolvencies had continued to be concentrated among very small businesses associated with a relatively small proportion of bank debt. Firms in more vulnerable sectors such as construction, wholesale and retail trade, and accommodation and food service activities made up around half of cases.

19. While corporate debt issuance had continued to be strong in Q3, a significant portion of market-based UK corporate debt was due to mature in coming years. The challenge faced by corporates that need to refinance their debt could be heightened if recent market volatility translated into a more sustained rise in yields and weaker liquidity. The most highly leveraged and lowest rated corporates were likely to be more exposed to this risk.

UK banking sector resilience

20. The UK banking system remained well capitalised with strong liquidity positions. The aggregate price to tangible book ratio of the major UK banks was around 0.9, suggesting that in aggregate the banks' expected return on tangible equity was close to their cost of equity. Net interest margins had been stable in Q2 and were expected to remain around long run average levels.

21. There had been further evidence of easing in credit conditions, with gross volumes for mortgage and corporate lending rising to around pre-Covid average levels in Q2. Lending rates continued to move closely in line with expected policy rates. Consistent with changes in the macroeconomic outlook, both credit demand and availability had increased.

22. As the FPC had previously noted, a number of system-wide factors were likely to affect bank funding and liquidity in the coming years, including as central banks normalise their balance sheets, unwinding the extraordinary measures put in place following the GFC and the Covid pandemic. It was important that banks factor these system-wide trends into their liquidity management and planning over the coming years. As part of the normalisation of balance sheets, the MPC had announced it would reduce the stock of asset purchases by £100 billion over the 12 months ahead, £87 billion of which would come through maturing gilt holdings.

23. The FPC noted that usage of the Bank's short-term repo facility had increased, consistent with the facility's intended purpose of ensuring interest rate control as the MPC unwinds its asset purchases. The Bank had welcomed banks' willingness and operational readiness to use this facility, and encouraged lenders to prepare for increased usage of both short-term and long-term repo operations as the Bank of England's balance sheet moved further through the transition towards a steady state.

24. The FPC maintained its judgement that the UK banking system had the capacity to support households and businesses, even if economic and financial conditions were to be substantially worse than expected.

The UK countercyclical capital buffer rate decision

25. The FPC discussed its setting of the UK countercyclical capital buffer (CCyB) rate. The Committee reiterated that its principal aim in setting the CCyB rate was to help ensure that the UK banking system was better able to absorb shocks without an unwarranted restriction in essential services, such as the supply of credit, to the UK real economy. Setting the UK CCyB rate enables the FPC to adjust the capital requirements of the UK banking system to the changing scale of risk of losses on banks' UK exposures over the course of the financial cycle. The approach therefore includes an assessment of financial vulnerabilities and banks' capacity to absorb losses on their UK exposures, including the potential impact of shocks.

26. In considering the appropriate setting of the UK CCyB rate, the FPC discussed its judgements around underlying vulnerabilities that could amplify economic shocks. While the central UK economic outlook had improved slightly, significant financial market and global vulnerabilities remained. But those indicators directly relevant to banks' UK exposures, including household debt-to-income, corporate gross debt to earnings and domestic credit growth, continued to be around or below long-term averages.

27. The FPC observed that UK banks' resilience continued to be supported by relatively strong asset quality and strong capital positions. The FPC judged that further signs of easing credit conditions reflected changes to the macroeconomic outlook.

28. In view of these considerations, the FPC decided to maintain the UK CCyB rate at 2%. Maintaining a neutral setting of the UK CCyB rate in the region of 2% would help to ensure that banks continued to have capacity to absorb unexpected future shocks without restricting lending in a counterproductive way.

29. The FPC recognised the continued uncertain environment and reiterated that it would continue to monitor the situation closely and stood ready to vary the UK CCyB rate in either direction - in line with the evolution of economic and financial conditions, underlying vulnerabilities, and the overall risk environment. The results of the Bank's desk-based stress test exercise, which the committee would discuss in Q4, would further inform the FPC's monitoring and assessment of the resilience of the UK banking system to downside risks.

2024 review of the FPC’s Leverage Ratio framework

30. In line with its statutory obligations, the FPC reviewed its Direction and Recommendation to the PRA on the leverage ratio, issued in September 2022 and September 2021 respectively.

31. The FPC continued to consider a leverage ratio to be an essential part of the framework for capital requirements for the UK banking system, and judged that the leverage ratio set out in the 2022 Direction and 2021 Recommendation should remain unchanged.

32. Having regard to the interaction between monetary and macroprudential policy, the Committee confirmed the appropriateness of continuing to exclude central bank reserves from the leverage ratio, and of not recalibrating the minimum leverage ratio requirement of 3.25% to reflect an increase in reserves since 2016. The FPC would keep this under review as part of future reviews of the leverage ratio framework.

33. The FPC welcomed the Bank and PRA’s engagement with firms on the normalisation of central bank balance sheets and the financial stability role of central bank reserves, and noted that such discussions would inform future annual FPC reviews of its leverage ratio framework.

34. The FPC noted a **PRA announcement** that the thresholds for application of the leverage ratio requirement were being reviewed. The Committee would discuss the outcome of this work at a future meeting.

Basel 3.1

35. The FPC welcomed the **publication** of the PRA's second near-final policy statement on the implementation of Basel 3.1 standards in the UK on 12 September 2024. The first near-final policy statement was published in December 2023. Together, these publications would implement the final package of prudential reforms developed by the Basel Committee on Banking Supervision in response to the GFC, aligning the UK's banking system with international standards and promoting its resilience.

Strong and Simple framework

36. The FPC **welcomed** the PRA's **Consultation Paper** - the Strong and Simple Framework: the simplified capital regime for Small Domestic Deposit Takers (SDDTs). The FPC supported the proposal to descope SDDTs from the CCyB and Capital Conservation Buffer to allow the creation of the new Single Capital Buffer (SCB) for these firms. The SCB would simplify the capital regime for SDDTs while maintaining the overall level of resilience. The FPC judged that the UK CCyB would continue to be effective in protecting the supply of credit to the UK real economy, as it would continue to apply to the vast majority of lending by the banking system to UK households and firms.

Resolution framework

37. The FPC noted the **published** findings of the Bank's second assessment of the eight major UK banks' resolvability under the Resolvability Assessment Framework and the conclusion that they provide further reassurance that a major UK bank could enter resolution safely if needed: remaining open and continuing to provide vital banking services, with shareholders and investors—not public funds—first in line to bear the costs of failure. The FPC welcomed the Bank's continued progress to maintain a credible and effective resolution regime, and to undertake targeted work with firms ahead of the next assessment, as well as the significant progress made by major UK banks in enhancing their preparations for resolution and embedding resolvability within their organisations. Maintaining a credible and effective resolution regime was a continuous process, and both authorities and firms needed to respond as the financial system and regulatory landscape evolves.

38. The FPC welcomed the introduction of the **Bank Resolution (Recapitalisation) Bill** to Parliament on 18 July. The FPC supported this targeted enhancement of the UK bank resolution regime in light of the resolution of SVB UK in 2023. The FPC also noted the Bank's work to operationalise the resolution regime for CCPs, as legislated for by Parliament in

2023. This helped to ensure resolution arrangements across the financial sector were credible, effective, and proportionate.

Operational resilience

39. The FPC was updated on progress by firms and FMIs towards implementing the operational resilience policies set by the Bank, PRA and FCA. The policies required relevant firms and FMIs to identify important business services and set impact tolerances with consideration to financial stability in terms of the wider financial sector and UK economy. Firms and FMIs were expected to demonstrate their ability to meet the policies by 31 March 2025.

40. Despite progress, firms and FMIs must continue to address vulnerabilities and ensure that they can remain within impact tolerances even under severe but plausible scenarios. The FPC noted that they must focus on their roles in the financial system and broader economy, and engage with other firms, other FMIs and the wider market on the potential impact of their own disruption and actions they might take in response to disruption.

41. The FPC further noted that building resilience to operational risks is a continuous process, and that it would continue to monitor how the progress of firms and FMIs meet the requirements of the operational resilience policies.

The resilience of market-based finance

The Bank's development of new liquidity tools to support financial stability

42. The FPC received an update on the work the Bank has been doing to develop new tools for lending to NBFIs in the event of severe gilt market dysfunction that threatened UK financial stability. As part of its responsibilities under the **Principles of Engagement** governing the Bank's balance sheet, the FPC approved the scope and principles determining the design of these new tools to ensure that they would be effective in ensuring the stability of the UK financial system:

The scope and principles determining the design of new tools for lending to NBFIs in the event of severe gilt market dysfunction

Scope

Purpose – to address severe gilt market dysfunction that threatens UK financial stability arising from shocks that temporarily increase non-banks' market-wide demand for liquidity.

Circumstances for use – as a backstop in preference to asset purchases where lending is likely to be effective in tackling gilt market dysfunction and when the demand for liquidity is outside the reach of the Bank's existing facilities to lend to banks.

Principles

Principle 1: Maintaining the incentive to build resilience and leaning against moral hazard – The tool needs to be designed such that it is consistent with the FPC's broader approach to building non-bank resilience, and maintains incentives for firms to build their own resilience. The tool should act as a backstop, be designed in a way to minimise moral hazard, and not counteract efforts to increase private sector self-insurance.

Principle 2: Effectiveness in tackling gilt market dysfunction – The tool needs to be designed such that it can deliver its purpose of addressing severe gilt market dysfunction arising from shocks that temporarily increase non-banks' demand for liquidity. It should do so by providing liquidity on terms such that: a) relevant eligible firms avoid undertaking forced gilt sales which can cause or amplify market dysfunction and b) the chance that asset purchases are needed is reduced.

43. As a first phase in this work, the Bank was putting in place a new Contingent NBFI Repo Facility (CNRF). The CNRF, which would be activated at the Bank's discretion[1] during times of severe gilt market stress that threatened UK financial stability, would allow participating eligible pension funds, insurance companies and LDI funds to borrow cash against gilts at times of severe market dysfunction.[2] The CNRF was expected to be open for eligible firms to sign up in 2024 Q4.

44. The FPC welcomed the progress the Bank had made in developing the CNRF. The Committee encouraged potential counterparties to familiarise themselves with the expected design and features of the CNRF and to assess what steps they would need to take in order to be ready to sign up to the facility when it opens for applications, to ensure that they would be operationally ready to use the facility if needed when it is activated during a market-wide stress. It is in the collective interests of all market participants that this new facility is effective at delivering liquidity to eligible counterparties when activated in order to restore UK financial stability.

45. The FPC would be kept updated on progress on the level of sign up to the facility as well as the Bank's work to explore how to design a facility that could reach a broader set of NBFIs relevant to the functioning of core UK markets.

46. The FPC considered that resilience standards for MBF should be developed in coordination with work to enhance central bank tools to respond in stress. It was vital that domestic and international regulators continue to develop and implement policies that

[1] The **Principles of Engagement** note that in extraordinary circumstances, the FPC may make recommendations to the Bank relating to addressing market dysfunction that threatens UK financial stability (but does not have the power to approve / disapprove the use of any particular tool). The Bank can also choose to take action independently in which case it "will consult or, at a minimum, inform the FPC, bearing in mind the circumstances, such as the urgency of market developments".
[2] See this **Market Notice** and **Explanatory Note** for further detail.

mitigate vulnerabilities in the system of MBF to ensure that it could absorb and not amplify severe but plausible shocks. As part of the Bank's work to design a facility that could reach a broader set of NBFIs, it would engage closely with firms, industry bodies and regulators.

Policy work to address financial stability risks from margin requirements

47. The FPC had previously[3] highlighted the need for further policy work to address risks arising from procyclicality in margin requirements as part of addressing vulnerabilities in the NBFI sector. In cleared markets, NBFIs could struggle to predict initial margin calls during periods of market volatility and there could be added uncertainty about how clearing members would pass on these margin calls to their clients. Separately, in some bilateral markets such as government repo, very low or zero haircuts could allow NBFIs to take on excessive leverage. The bilateral and centrally cleared markets were interconnected, with investors in certain cases able to choose between the two. This interconnection leads to transmission of stress between the bilateral and cleared markets, and underscores the need for risk assessment and policy to consider them holistically. These dynamics were currently being explored through the Bank's system-wide exploratory scenario exercise.

48. Proposals by the Basel Committee on Banking Supervision, the Bank for International Settlements' Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions that were **consulted** on earlier this year, seek to improve the transparency of initial margin calls in centrally cleared markets, and will require CCPs to further consider the potential procyclicality of margin calls by enhancing their evaluation of the responsiveness of initial margin models. The FPC supported this work to reduce potential risks arising from margin reactivity while ensuring robust management of counterparty credit risk in cleared markets, and looked forward to the proposals being finalised by relevant standard-setting bodies, incorporated into their respective policy frameworks and subsequently implemented by relevant authorities and industry.

49. Alongside greater transparency, the FPC supported other international work on margin, including the Financial Stability Board's **consultation** on enhancing the liquidity preparedness of non-bank market participants to face spikes in margin and collateral calls. As these activities often involve taking on leverage, which can amplify liquidity stress, it was important that international work to identify and mitigate risks associated with non-bank leverage continues to progress.

Innovation in wholesale markets

50. The FPC and the Financial Markets Infrastructure Committee (FMIC) met jointly to discuss innovation in wholesale markets.

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[3] **Financial Stability Report June 2024**

Wholesale uses of systemic stablecoins

51. In November 2023, the Bank **published** its proposed regulatory regime for systemic payment systems using stablecoins and related service providers, alongside a separate publication by the FCA proposing a regime for non-systemic stablecoins. The Bank's proposed regime focused on sterling-denominated stablecoins that were intended to be used for retail purposes, and the Bank noted it would consider the risks and benefits of the use of stablecoins for wholesale purposes.

52. As such, the FPC discussed the implications of wholesale use of systemic stablecoins. The FPC noted that there were potential benefits of this. For example, stablecoins, like other forms of tokenised assets, could offer a reduction in settlement times, mitigating settlement risk and improving efficiency. They could also simplify the structure and chain of intermediaries within wholesale transactions and enable further automation, offering new functionalities and efficiencies.

53. The FPC had previously noted the importance of new forms of money respecting the principle of 'singleness of money', whereby all different forms of money must be exchangeable with each other at par value at all times. Even if stablecoins were backed with central bank deposits, there remained risks to the stability of the value of the stablecoin, for example as a result of operational risks or an imbalance between the supply and the demand for stablecoins, including if financial market participants run to this new low-risk asset at times of stress. If the value of stablecoins were to deviate from par, this would compromise their acceptance as a settlement asset and could have broader consequences for trust in money. These risks were particularly acute in wholesale markets given their systemic nature and could have financial stability implications.

54. The FPC noted that further technological solutions, business and risk management practices or regulation might mitigate these financial stability risks in future. The FPC supported their exploration given the potential benefits of wholesale use of stablecoins. More broadly, the FPC had a low risk appetite for a significant shift away from central bank money as the primary settlement asset in the financial system, given its role as a vital anchor for confidence. The FPC supported exploring how the benefits of innovation in money and payments could be harnessed, including central bank money alternatives that were compatible with distributed ledger technology, like improvements to central bank provided infrastructure or wholesale central bank digital currency technology.

Wholesale uses of tokenised funds

55. The FPC was briefed on potential uses of tokenisation, including for money market funds (MMFs) and the impact this could have on how MMF shares are managed and utilised.

56. Fund tokenisation activity was already emerging and there were potential efficiency gains and cost reduction from using new technology to administer fund shares. It also had the potential to affect what was used as collateral in the financial system. The FPC discussed the potential benefits and risks of using tokenised MMF shares as collateral in uncleared transactions. For example, it could reduce some liquidity mismatch risks in stress events by reducing the need for investors to redeem their MMF shares for cash to meet short-term liquidity needs—such as margin calls—where market participants could transfer tokenised MMF shares instead. But this activity could also create new risks particularly in more severe stress events where funds need to suspend redemptions, or where confidence was lost that the MMF unit could be redeemed at par.

57. The FPC noted that these benefits and risks could be explored further through the Bank/FCA Digital Securities Sandbox (DSS), and that this was consistent with the objective of the DSS, to experiment with new technologies and practices in traditional financial markets. Recognising that innovation in this area need not be limited to the DSS, the FPC would also monitor new and existing fund tokenisation activity taking place outside of the DSS.

Financial stability risks from artificial intelligence

58. In December 2023, the FPC agreed to further consider the financial stability risks from Artificial Intelligence (AI) and Machine Learning (ML) in 2024. The FPC therefore discussed the main channels through which AI could have financial stability implications, and the proposed approach to monitoring those risks.

59. The use of AI in the financial sector could deliver benefits, by driving greater operational efficiency, improving portfolio diversification and risk management, and providing new products and services. However, the adoption of AI could also introduce or amplify existing systemic risks. Both microprudential and macroprudential risks were seen as relevant to an assessment of the systemic risks from AI.

60. The FPC noted that uncertainty over the future evolution in the use and sophistication of AI systems, and how they are used in financial services and the broader economy, meant that the Committee’s assessment of systemic risks was likely to continue to evolve. The potential future impact of, and subsequent risks from, AI were also highly uncertain.

61. The Bank and FCA had taken steps to understand and address the microprudential risks from AI in regulated firms. This included a **Discussion Paper** and subsequent **Feedback Statement** on the implications of AI and ML for the prudential and conduct supervision of firms. In contrast, the macroprudential implications of AI had been less explored in regulatory work to-date.

62. Good firm-level risk management was the foundation of managing systemic risks from AI. Specifically, the most advanced AI models, including those based on Generative AI, could pose significant data (eg bias and privacy concerns), model risk (eg explainability), governance (eg predictability and incentive alignment) and risk management challenges. If the use of these advanced models became widespread, particularly in core financial applications, crystallisation of these risks could have systemic implications. As AI models become more powerful and autonomous, and as adoption increases, it would be important to ensure that regulatory frameworks that are neutral to different technologies are able to mitigate these risks sufficiently.

63. At the level of the financial system as a whole, macroprudential risks from AI could arise through structural vulnerabilities. Specifically, disruptions to or issues with common AI model technology and infrastructure systems (eg third party providers of services such as data or cloud infrastructure) might impact the AI models of many firms simultaneously.

64. Macroprudential risks could also arise because of externalities which have procyclical implications for financial markets, though the likelihood of these materialising was uncertain and debated. For example, common model dependencies could result in increasingly correlated trading strategies, and as AI-based trading algorithms become more sophisticated, they could adaptively learn and exploit the strategies of other participants in a manner which, whilst individually rational, could be destabilising for financial markets overall.

65. Systemic risks might also arise from the impact of AI outside the financial system, with second-order impacts on financial services (eg AI-enabled cyber attacks). The FPC noted the importance of the broader economy-wide context when considering the systemic risks from AI. The FPC received an update on broader AI policy context, including legislative developments in the UK and EU.

66. When considering next steps, the FPC supported the Bank, in collaboration with other regulatory bodies, taking actions to enable the effective monitoring of the systemic risks from AI. Developing an effective monitoring framework to understand the most material changes in the use and risks from AI was necessary in order to judge how well captured these risks were in existing regulatory approaches. The FPC also intended to clarify and set out the main systemic risk channels from AI, and planned to publish that assessment, and its proposed approach to monitoring those risks, in a Financial Stability in Focus report in the first half of 2025.

The following members of the Committee were present at the 19 September 2024 Policy meeting:

Andrew Bailey, Governor
Nathanaël Benjamin
Colette Bowe
Sarah Breeden
Jon Hall
Randall Kroszner
Clare Lombardelli
Liz Oakes
Dave Ramsden
Nikhil Rathi
Carolyn Wilkins
Sam Woods

Gwyneth Nurse attended as the Treasury member in a non-voting capacity

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 digital assets, including wholesale stablecoins and tokenised MMFs, and that he would not receive the related papers.

- Under the same provisions, Liz Oakes had notified the Committee of her position as an independent non-executive director on the boards of ecommerce payment businesses of the private equity investor Advent International, which has a majority shareholding in Mangopay. It was agreed that she would recuse herself from discussions on payment systems and stablecoins, including the Committee's discussion on innovation in wholesale markets, and that she would not receive the related papers.

Annex: Financial Policy Committee policy decisions

Outstanding FPC Recommendations and Directions (as at the date of the FPC's meeting on 19 September 2024)

On 23 March 2023, the FPC made the recommendation (23/Q1/2) that:

- The Pensions Regulator (TPR) should have the remit to take into account financial stability considerations on a continuing basis. This might be achieved, for example, by including a requirement to have regard to financial stability in its objectives, which should be given equal weight alongside other factors to which TPR is required to have regard. The FPC noted that in order to achieve this, TPR would need appropriate capacity and capability.

Other FPC policy decisions which remain in place

The following text 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.

Countercyclical capital buffer rate

The FPC agreed to maintain the UK CCyB rate at 2% on 19 September 2024, unchanged from its 11 June 2024 Policy meeting. 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.[4] 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.

[4] See the **Financial Stability section** of the Bank's website: **www.bankofengland.co.uk/financial-stability**.

The PRA and the FCA have published their approaches to implementing this Recommendation: the PRA has issued a policy statement, including rules,[5] and the FCA has issued general guidance.[6]

Leverage Ratio

In September 2021, the FPC finalised its review of the UK leverage ratio framework, and issued a Direction and Recommendation to implement the outcome of the review as set out in its October 2021 Record.[7]

In October 2022, in line with its statutory obligations, the FPC completed its annual review of its Direction to PRA. The FPC revoked its existing Direction to the PRA in relation to the leverage ratio regime, and issued a new Direction on the same terms as in September 2021 with the addition of discretion for the PRA to set additional conditions to the central bank reserves exclusion.

The full text of the FPC's Direction to the PRA on the leverage ratio is set out in the Annex of the October 2022 Record[8], together with the original Recommendation (now implemented).

The PRA has published its approach to implementing this Direction and Recommendation[9].

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[5] See PRA Policy Statement PS9/14, **'Implementing the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending'**, October 2014
[6] See **www.fca.org.uk/publications/finalised-guidance/fg17-2-fpc-recommendation-loan-income-ratios-mortgage-lending.**
[7] **https://www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021**
[8] **https://www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2022/fpc-summary-and-record-october-2022.pdf**
[9] **PS21/21 | CP14/21- The UK leverage ratio framework | Bank of England (https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework)**