Bank of England

Financial Policy Summary and Record of the Financial Policy Committee meeting on 21 November

6 December 2023

This is the record of the Financial Policy Committee meeting held on 21 November 2023.

It is also available on the Financial Policy Summary and Record page of our website:
https://www.bankofengland.co.uk/financial-policy-summary-and-record/2023/december-2023

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 Policy meeting will be on 12 March 2024 and the Record of that meeting will be published on 27 March 2024.

Financial Policy Summary, 2023 Q4

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

The overall risk environment

The overall risk environment remains challenging, reflecting subdued economic activity, further risks to the outlook for global growth and inflation, and increased geopolitical tensions. Long-term interest rates in the UK and US are now around their pre-2008 levels. The full effect of higher interest rates has yet to come through, posing ongoing challenges to households, businesses and governments, which could be amplified by vulnerabilities in the system of market-based finance. So far, and while the FPC continues to monitor developments, UK borrowers and the financial system have been broadly resilient to the impact of higher and more volatile interest rates.

Financial market developments

Current market pricing suggests that policy rates in the US, UK and euro area are at or near their peaks, and central banks have emphasised that they expect rates will need to remain at these levels for an extended period, in order to continue to address inflationary pressures. Returning inflation to target sustainably supports the FPC's objective of protecting and enhancing UK financial stability.

Long-term interest rates are high and remain volatile in major advanced economies. Despite falling back somewhat since Q3, US long-dated government bond yields have risen since the July Financial Stability Report (FSR), with UK, euro area and Japanese long-term government bond yields following a similar pattern. Most of the recent upward move in US long-dated yields can be attributed to estimated term premia – the additional compensation that investors require to hold longer term rather than short-term bonds – which have increased from previously low levels. A number of factors could explain the rise in term premia across major advanced economies, including increased uncertainty around the longer-term economic outlook and interest rates, as well as evolving investor expectations of future supply and demand in government bond markets.

The full impact of higher interest rates will take time to come through. Given the impact of higher and more volatile rates, and uncertainties associated with inflation and growth, some risky asset valuations continue to appear stretched. Credit spreads are broadly unchanged since Q3, with the exception of leveraged loan spreads which have

widened a little. Some measures of equity risk premia remain compressed, particularly in the US.

Global vulnerabilities

The adjustment to higher interest rates continues to make it more challenging for households and businesses in advanced economies to service their debts. **Riskier corporate borrowing in financial markets, such as private credit and leveraged lending, appears particularly vulnerable.** Although there are few signs of stress in these markets so far, a worsening macroeconomic outlook, for example, could cause sharp revaluations of credit risk. Higher defaults could also reduce investor risk appetite in financial markets and reduce access to financing, including for UK businesses.

Some banks in a number of jurisdictions have been impacted by higher interest rates. They also remain exposed to property markets, including commercial real estate where prices in some countries have fallen significantly.

High public debt levels in major economies could have consequences for UK financial stability, especially if market perceptions for the path of public sector debt worsen. The FPC will take into account the potential for these to crystallise other financial vulnerabilities and amplify shocks when making its assessment of the overall risk environment.

Vulnerabilities in the mainland China property market have continued to crystallise, and significant downside risks remain. This could lead to broader stresses in other sectors of the mainland Chinese economy, and materially affect Hong Kong. **The results of the 2022/23 annual cyclical scenario indicated that major UK banks would be resilient to a severe global recession that included very significant falls in real estate prices in mainland China and Hong Kong**.

Geopolitical risks have increased following the events in the Middle East, increasing uncertainty around the economic outlook, particularly with respect to energy prices. If these risks crystallised, resulting in significant shocks to energy prices, for example, this could impact on the macroeconomic outlook in the UK and globally, as well as increasing financial market volatility.

UK household and corporate debt vulnerabilities

Since the July FSR, household income growth has been greater than expected. This has reduced the share of households with high cost of living adjusted debt-servicing ratios, and a lower expected path for Bank Rate has reduced the extent to which that share is projected to rise. **Nevertheless, household finances remain stretched by increased living costs and higher interest rates, some of which has yet to be reflected in higher mortgage**

repayments. Arrears for secured and unsecured credit remain low but are rising as the impact of higher repayments is felt by borrowers.

In aggregate, UK corporates' ability to service their debts has improved due to strong earnings growth and the sector is expected to remain broadly resilient to higher interest rates and weak growth. But the full impact of higher financing costs has not yet passed through to all corporate borrowers, and will be felt unevenly, with some smaller or highly leveraged UK firms likely to remain under pressure. Corporate insolvency rates have risen further but remain low.

UK banking sector resilience

The UK banking system is well capitalised and has high levels of liquidity. It has the capacity to support households and businesses even if economic and financial conditions were to be substantially worse than expected. The overall risk environment remains challenging, however, and asset performance deteriorated among some loan portfolios in Q3. Some forms of lending, such as to finance commercial real estate investments, buy-to-let, and highly leveraged lending to corporates – as well as lenders that are more concentrated in those assets – are more exposed to credit losses as borrowing costs rise.

Aggregate net lending remains subdued, driven by reduced demand for credit and a tightening in banks' risk appetites. **The tightening in credit conditions over the past two years appears to have reflected the impact of changes to the macroeconomic outlook, rather than defensive actions by banks to protect their capital positions**.

There is some evidence that net interest margins (NIMs) have peaked. The aggregate profitability of the major UK banks is nevertheless expected to remain robust, with NIMs expected to remain higher than in recent years when Bank Rate had been close to the effective lower bound, and similar to levels seen before the global financial crisis when Bank Rate was comparable to its current level.

Alongside the higher risk-free interest rate environment, a number of system-wide factors are likely to affect funding and liquidity conditions in the UK banking sector over the coming years, including as central banks normalise their balance sheets. Those factors will affect sources of bank funding and could affect their cost – for example through continued competition for deposits and greater use of some forms of wholesale funding. **Banks will need to factor these system-wide trends into their liquidity management and planning over the coming years**.

The impact on individual banks will depend, amongst other things, on their funding structure and business model. Banks have a range of ways in which they can adjust to changing

trends in funding and liquidity, including through their mix of funding and liquid assets, and through the nature, quantity, and pricing of lending they undertake.

The FPC will monitor the implications of these trends for financial stability.

The UK countercyclical capital buffer rate decision

The FPC is maintaining the UK countercyclical capital buffer (CCyB) rate at its neutral setting of 2%. The FPC will continue to monitor developments closely and stands 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 resilience of market-based finance

Vulnerabilities in certain parts of market-based finance remain significant, and in some sectors have increased since the July FSR. Funds investing in riskier corporate credit have seen outflows. Hedge fund net short positioning and asset managers' leveraged net long positions in US Treasury futures have also increased further, which could contribute to market volatility if hedge funds needed to unwind their positions rapidly. While the financial system has so far been broadly resilient to the higher interest rate environment, vulnerabilities in market-based finance could crystallise in the context of higher and more volatile interest rates or sharp movements in asset prices, leading to dysfunction in core markets and amplifying any tightening in credit conditions.

Alongside international policy work led by the Financial Stability Board, the UK authorities are also working to reduce vulnerabilities domestically where this is effective and practical. The FPC welcomes proposals by UK authorities to increase the resilience of UK-based money market funds, which have been published today.

In November, the Bank released the hypothetical scenario for its system-wide exploratory scenario (SWES) exercise. **The SWES will assess the behaviours of banks and non-bank financial institutions during stressed financial market conditions, and how they might interact to amplify shocks to markets core to UK financial stability**. Under the stress scenario, participating firms will model the impact of a shock that is faster, wider ranging and more persistent than those observed in recent events in financial markets.

Record of the Financial Policy Committee meeting held on 21 November 2023

1. The Committee met on 21 November 2023 to agree its view on the outlook for UK financial stability and other matters that would be included in the December 2023 Financial Stability Report (FSR). The FPC discussed the risks faced by the UK financial system and assessed the resilience of the system to those risks and, on that basis, agreed its intended policy action. The FSR and this document together record the judgements of the FPC and summarises the Committee's associated deliberations.

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.

The overall risk environment

3. The FPC judged that the overall risk environment remained challenging, reflecting subdued economic activity, further risks to the outlook for global growth and inflation, and increased geopolitical tensions. Long-term interest rates in the UK and US were now around their pre-2008 levels. The full effect of higher interest rates had yet to come through, posing ongoing challenges to households, businesses and governments, which could be amplified by vulnerabilities in the system of market-based finance. So far, and while the FPC continued to monitor developments, UK borrowers and the financial system had been broadly resilient to the impact of higher and more volatile interest rates.

Developments in financial markets

4. The FPC observed that current market pricing suggested policy rates in the US, UK and euro area were at or near their peaks, and central banks had emphasised that they expected rates would need to remain at these levels for an extended period, in order to continue to address inflationary pressures. The FPC judged that returning inflation to target sustainably would support the FPC's objective of protecting and enhancing UK financial stability.

5. Uncertainty associated with the outlook for inflation and growth remained, interest rates had risen across major advanced economies, and government bond yields remained volatile. Despite falling back somewhat since 2023 Q3, US long-dated government bond yields had risen since the July FSR, with UK, euro area and Japanese long-term government bond yields following a similar pattern. Model estimates suggested that the recent upward move in US long-dated yields was in large part driven by term premia – the additional compensation that investors required to hold longer-term rather than short-term bonds – which had increased from previously low levels. A number of factors could explain the rise in term

premia across major advanced economies, including increased uncertainty around the longer-term economic outlook and interest rates, as well as evolving investor expectations of future supply and demand in government bond markets.

6. The FPC judged that the full impact of higher interest rates would take time to come through. Given the impact of higher and more volatile interest rates, and uncertainties associated with inflation and growth, some risky asset valuations continued to appear stretched. The Committee noted that credit spreads were broadly unchanged since 2023 Q3, with the exception of leveraged loan spreads which had widened a little. Some measures of equity risk premia had remained compressed, particularly in the US.

7. Market perceptions of credit risk remained muted, despite uncertainty around economic growth and the high interest rate environment, as well as the risk of a sharp adjustment in asset valuations. Should growth weaken, a reduction in investor risk appetite could further impact refinancing for highly leveraged borrowers in advanced economies. Financial conditions for these borrowers could tighten further if signs of a slowdown in private markets (such as private credit and private equity) persisted. The FPC noted that any such correction could be amplified by vulnerabilities in market-based finance.

8. The FPC noted that core markets had continued to function normally despite the elevated volatility. But in the current environment liquidity conditions could deteriorate quickly, especially if market volatility was to increase further.

9. Further detail on the analysis underpinning these judgements would be set out in the ‘Developments in financial markets’ chapter of the December 2023 FSR.

Global vulnerabilities

10. The outlook for global growth remained subdued, and long-term interest rates had increased since the July 2023 FSR. Headline inflation remained elevated in advanced economies but was declining, largely reflecting lower inflation rates for energy, food and other goods. Global services inflation was expected to remain elevated in the near term.

11. Geopolitical risks had increased following the events in the Middle East, increasing uncertainty around the economic outlook, particularly with respect to energy prices. If these risks crystallised, resulting in significant shocks to energy prices, for example, this could impact the macroeconomic outlook in the UK and globally, as well as increasing financial market volatility.

12. The adjustment to higher interest rates continued to make it more challenging for households and businesses in advanced economies to service their debts. Riskier corporate borrowing in financial markets, such as private credit and leveraged lending, appeared particularly vulnerable. Although there were few signs of stress in those markets so far, a

worsening macroeconomic outlook, for example, could cause sharp revaluations of credit risk. Higher defaults could also reduce investor risk appetite in financial markets and reduce access to financing, including for UK businesses.

13. Some banks in a number of jurisdictions had been impacted by higher interest rates. They also remained exposed to property markets, including commercial real estate (CRE) where aggregate prices were down by around 10% on a year earlier in both the euro area and the US. The results of the 2022/23 Annual Cyclical Scenario (ACS) suggested that major UK banks were resilient to a severe recession which included very sharp falls in global property prices, well beyond those seen to date. However, some banks in the US and euro area might be more exposed to the property sector, which could create spillovers to the UK via banking and financial market channels.

14. High public debt levels in major economies could have consequences for UK financial stability. They could lead to increases in market volatility – especially if market perceptions for the path of public sector debt worsened – and more volatile capital flows. That could cause losses for financial market participants and other vulnerabilities to crystallise. Higher servicing costs on public sector debt could also reduce governments' capacity to respond to future shocks. The FPC would take into account the potential for these to crystallise other financial vulnerabilities and amplify shocks when making its assessment of the overall risk environment.

15. Vulnerabilities in the Chinese property market had continued to crystallise and significant downside risks remained. Activity in the property sector had declined further, as had property prices. Real estate investment had fallen by around 17% in October relative to a year earlier, and total floor space sold was down by around a fifth. Chinese developers had continued to default in the face of falls in sales and tighter financial conditions. Country Garden, China's largest property developer by sales in 2021, officially entered default on some of its offshore bond repayments. And significant concerns remained around the ability of Evergrande – the world's most indebted property developer – to successfully restructure and meet its debt obligations. The outlook for the mainland Chinese economy more broadly remained subdued.

16. A further deterioration in property activity and prices could pose additional risks to the Chinese economy and its financial sector, particularly if they were to spill over and cause further stresses in other sectors of the economy. This could impact the UK via trade or financial spillovers, including through disorderly asset price adjustments. Hong Kong could be materially affected by a broader crystallisation of risks in mainland China. Chinese authorities had put in place measures to provide some support, aimed at limiting spillovers from losses being borne by creditors, against the backdrop of a longer-term strategy to reduce speculation in the sector.

17. While some UK banks had material exposures to mainland China and Hong Kong, the results of the 2022/23 ACS indicated that major UK banks were resilient to a severe global

recession that included very significant falls in real estate prices in mainland China and Hong Kong. The FPC would continue to monitor closely developments in China, and the potential for spillovers to UK financial stability.

18. Markets had reacted in an orderly manner to announcements by the Bank of Japan that it would conduct its yield curve control policy with greater flexibility. There was a risk that further policy changes could trigger larger or more volatile price adjustments in Japan, which could lead to losses on domestic government bond holdings for some Japanese banks. Major UK banks' holdings of Japanese government bonds were limited, accounting for only 5% of major UK banks' overall holdings of debt securities. Asset price moves in Japan could also spill over to other countries, for example if they led to substantial reallocations of bond holdings across jurisdictions, which could affect financial conditions in the UK.

19. Further detail on the analysis underpinning these judgements would be set out in the 'Global vulnerabilities' chapter of the December 2023 FSR.

UK debt vulnerabilities

UK household resilience

20. The FPC continued to expect the share of households with high cost-of-living adjusted mortgage debt-servicing ratios (DSRs) to increase over the next year to around 1.6% by the end of 2024, as higher interest rate costs were passed through to borrowers. This was expected to remain well below levels seen before the global financial crisis (GFC), of 3.4% in 2007. Since the FPC's October 2023 meeting, quoted fixed interest rates had moderated slightly, and real income had increased by more than expected, although it was still lower than two years ago. These factors were likely to have reduced somewhat the future mortgage debt servicing burden many households would face despite a slightly higher expected increase in unemployment.

21. Owner-occupier mortgage arrears (of 2.5% or more of the outstanding balance) rose slightly in 2023 Q3 but at 1% remained low in historical terms. The FPC Recommendation on loan to income (LTI) limits, FCA affordability tests, and regulatory conduct standards overseen by the FCA, were expected to limit the impact of higher interest rates on mortgage defaults. In addition, the overall household debt to income ratio had been falling in 2023 as a result of strong income growth, and at 139%[1] was at its lowest level since 2002. The FPC

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[1] At the time of the FPC's October 2023 Policy meeting, the debt-to-income ratio estimate was 117% for 2023 Q2. This measure has been subsequently revised to exclude non-profit institutions serving households, more accurately exclude student loans, and to better capture households' actual incomes by additionally excluding gross operating surplus. The revised, higher measure does not reflect an increase in risk as these changes broadly result in a level shift upwards of the measure's whole history.

judged that mortgage arrears were likely to stay well below their 2008 peak, but that view would be challenged if there was a significant rise in unemployment.

22. Higher interest rates, together with some structural factors described in the **July 2023 FSR**, were putting pressure on profitability in the buy-to-let sector. This had led some landlords to sell, or seek to pass on higher costs to renters which could persist for some time. Buy-to-let mortgage arrears had increased over 2023 to 0.6% but from a low base and, on one measure, remained less than a third of their GFC peak.

23. The FPC noted that the annual growth rate for total consumer credit was 8% in September, marginally higher than the preceding months. Within that the annual growth rate for credit card borrowing was 12.5%. Consumer credit arrears had increased over the previous 12 months to 1.3%, and were expected to continue to increase moderately, but remained low relative to historical averages.

24. The FPC noted that the results of the 2022/23 ACS showed that the major UK banks remained well capitalised and able to support households.

The withdrawal of the FPC's Affordability Test Recommendation

25. Consistent with its primary objective of protecting UK financial stability, the FPC had introduced two mortgage market Recommendations in 2014 to guard against a loosening in mortgage underwriting standards that could lead to a material increase in aggregate household debt and the number of highly indebted households in a period of rapid increases in house prices: the LTI flow limit and the Affordability Test Recommendation (ATR).[2]

26. In addition, the FCA's mortgage conduct of business lending (MCOB) rules require lenders to take account of future interest rates when testing borrowers' affordability and to assume that, at a minimum, interest rates rise by 1 percentage point.

27. The FPC had regularly reviewed its mortgage market Recommendations with regard to its primary and secondary objectives. In its **review** in 2021, the FPC had concluded that, given the impact of the FPC's Recommendations in conjunction with the FCA's MCOB rules, the LTI flow limit was likely to play a stronger role than the ATR in guarding against an increase in aggregate household indebtedness and the number of highly indebted households when house prices rise rapidly; and that withdrawing the ATR would create a simpler, more predictable, and more proportionate framework with less overlap with FCA rules, in which the FPC's LTI flow limit in combination with the FCA's MCOB would ensure an

[2] The LTI flow limit restricts a lender's share of new mortgages with LTI ratios at 4.5 or higher, to a maximum of 15%. The ATR required lenders to assess if a borrower could still afford their mortgage if the mortgage rate were to be 3 percentage points higher than the contractual reversion rate.

appropriate level of resilience. Following its review and after consultation, the FPC had withdrawn the ATR with effect from 1 August 2022.

28. The FPC observed on the basis of staff analysis that the withdrawal of the ATR had so far had only a limited effect on borrower resilience, as was expected at the time of withdrawal. The share of new high-LTI lending had decreased noticeably since 2022 Q2, as rising interest rates had tightened affordability constraints and thus reduced the amount that households could borrow. In 2023 Q3, the share of new mortgages with LTI ratios of 4.5 or above stood at 5.5%, compared with 10.0% in 2022 Q2; well below the FPC's flow limit of 15%.[3] It was estimated that the share of new high-LTI lending would have declined a little further to between 4.5% and 4.9% if the ATR had remained.

29. The analysis suggested that the ATR withdrawal had a small impact on access to the mortgage market. Raising a deposit remained the biggest barrier to access. The increase in interest rates since the withdrawal had also made it harder for households to afford a mortgage, and total approvals had fallen by around 44% since the middle of 2022.

30. Staff estimates suggested that total mortgage approvals between August 2022 and September 2023 were between 1% and 5% higher as a result of the withdrawal of the ATR (since the increase in Bank Rate would otherwise have made the ATR more binding). This was equivalent to less than 0.5% of the current stock and small in the context of the 44% fall in total approvals seen since the withdrawal. Had Bank Rate not changed since December 2021 when the FPC decided to consult on withdrawing the ATR, the impact on approvals would have been very much smaller, at less than 1%.

31. The FPC regularly reviews its mortgage market Recommendations to ensure that they remain effective at insuring against a deterioration in lending standards. As part of this, the FPC would continue to monitor the impact of its measures and make further adjustments if necessary.

UK corporate resilience

32. The FPC judged that the UK corporate sector in aggregate remained resilient to high interest rates and weak growth. Total outstanding corporate debt relative to corporate earnings had continued to fall since its recent pandemic-era peak. The net debt to earnings ratio was at its lowest point in the past 20 years at 118% in 2023 Q2 due to continued strong growth in earnings.

33. Nevertheless, the FPC also recognised that some businesses were likely to remain under pressure. The debt-weighted proportion of medium and large corporates with interest coverage ratios (ICRs) below 2.5 was projected to increase throughout 2023 to 37% as debts

[3] Based on FCA Product Sales data, excluding pure and internal remortgages, further advances, second charge mortgages, business loans and lifetime mortgages.

refinanced at higher rates (assuming borrowing was not further reduced). This was a lower than expected increase over 2023 than prior estimates, reflecting new data that indicated robust earnings growth in 2022, and the fall in the market-implied peak level of Bank Rate since July.

34. The FPC noted that SME arrears for non-government guaranteed loans had been rising moderately since 2023 Q1 and now stood at 1.3%. SME debt constituted a relatively small share of major UK bank exposures and therefore the FPC judged that it did not pose a significant direct financial stability risk; however, pressures on SMEs could pose a bigger risk indirectly via the real economy because they accounted for over half of UK employment.

35. As evidenced by the 2022/23 ACS results, major UK banks would be resilient to exposures to corporates in the event that a severe macroeconomic scenario led to significantly increased levels of defaults.

36. The FPC noted that the maturity profile of corporates' debt affected the degree to which corporates would be exposed to higher interest rates, and the extent to which refinancing pressures could pose risks to financial stability. Staff analysis indicated that the bulk of outstanding UK corporate debt on fixed rates was due to mature in or after 2025, therefore limiting refinancing needs in the very near-term, especially for larger firms. Nevertheless, alongside higher borrowing costs for firms on floating rates, refinancing pressures could still impact some riskier borrowers, such as smaller or highly leveraged firms, or those reliant on market-based finance.

37. The FPC noted that there were a number of headwinds continuing to face CRE markets globally that were putting downward pressure on prices and making refinancing challenging. These included structural challenges including the post-pandemic shift to more remote working, the ongoing shift from physical to online shopping, and the cost of upgrading buildings to reduce carbon emissions, as well as cyclical pressure. UK CRE prices had already fallen by nearly 20% since their mid-2022 peak, with the US and euro area also experiencing significant price falls. Further price falls could present a risk to lenders if they materially reduced the value of the collateral held against their loans.

38. The FPC noted that the results of the 2022/23 ACS, which included a 45% decline in UK CRE prices from their mid-2022 levels, evidenced that major UK banks would be resilient to significant further falls in CRE prices relative to those already observed.

39. The FPC noted that stress in non-UK CRE markets could also affect the UK indirectly, if stresses in overseas banks caused, or exacerbated, by actual or expected losses in CRE markets affected developments in UK CRE or funding conditions more generally.

40. Further detail on the analysis underpinning these judgements would be set out in the 'UK household and corporate debt vulnerabilities' chapter of the December 2023 FSR.

UK banking sector resilience

41. The FPC judged 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. In 2023 Q3, major UK banks remained well capitalised, with a CET1 ratio of 14.8% and they maintained strong liquidity positions with an aggregate 3-month moving average liquidity coverage ratio (LCR) of 149%.

42. In aggregate, small and medium-sized UK banks and building societies were also well capitalised and maintained strong liquidity positions. In 2023 Q3, they had an aggregate CET1 ratio of 18.5% and an LCR of 260%. The FPC noted that there was a wide-range of business models amongst smaller and medium-sized UK banks, some of which were specialised in particular activities or served particular sectors. In a more challenging environment, these business models would be impacted by different risks in different ways.

43. The FPC judged that the overall risk environment remained challenging. There had been a deterioration in asset quality amongst some UK banks' loan portfolios in Q3. Nevertheless, major UK banks' forward-looking indicators of asset quality remained stable overall, suggesting that the deterioration in performance was broadly as banks had expected. Some forms of lending, such as to finance CRE investments, buy-to-let, and highly leveraged lending to corporates – as well as lenders that are more concentrated in those assets – were more exposed to credit losses as borrowing costs rise.

44. Current levels of default on the leveraged loan portfolios of UK banks and the decline in property prices in mainland China and Hong Kong property markets remained significantly less severe than those to which major UK banks were tested as part of the 2022/23 ACS stress test.

45. The reduction in credit volumes over the past year had come alongside a weakened outlook for GDP and rising interest rates. Banks had identified increases in credit risk associated with lending to some households and businesses as a result of this challenging environment. The UK banking system remained well capitalised with headroom over regulatory requirements and buffers. As a result of these factors, the FPC judged that the tightening in UK credit conditions seen over the past two years appeared to have reflected the impact of changes to the macroeconomic outlook, rather than defensive actions by banks to protect their capital positions. The Committee would continue to monitor UK credit conditions for signs of unwarranted tightening.

46. The Committee noted that there was some evidence that net interest margins (NIMs) had peaked, and that several banks had revised down their outlook for NIMs. The Q3 results publications for some major UK banks contained a weaker outlook for their profitability, and this contributed to declines in UK banks' share prices. The aggregate profitability of major UK banks was nevertheless expected to remain robust, with NIMs expected to remain higher

than in recent years when Bank Rate had been close to the effective lower bound, and similar to levels seen before the GFC when Bank Rate was comparable to its current level.

Recent developments in UK banks' funding and liquidity

47. Over the past 18 months, risk-free rates had returned to levels last seen prior to the GFC and this had been a key driver of changes in bank funding costs. Alongside this, a number of system-wide factors, including the normalisation of central bank balance sheets following the period since the GFC and the Covid pandemic, were likely to affect bank funding and liquidity conditions in the UK banking sector in coming years. Banks would need to factor these system-wide trends into their liquidity management and planning over the coming years.

48. Consistent with the broader UK macroeconomic outlook, expectations for major UK banks' lending volumes were positive but muted over the next few years, and so deposit growth was expected to remain subdued. In aggregate, lower credit growth and lower deposit growth should offset, leaving the aggregate funding position for banks broadly unchanged. However, individual banks may be affected differently within this aggregate picture.

49. In addition, and in line with the approach set out by the MPC, the Bank was continuing its programme of quantitative tightening (QT) as it unwound extraordinary measures put in place following the GFC and, more recently, to support economic activity during the Covid pandemic. Unwinding holdings in the Bank's asset purchase facility was, all else equal, likely to put downward pressure on the overall level of bank deposits in the system relative to the stock of lending, though there was some uncertainty around the exact impact.

50. Similarly, the funding provided by the Bank as part of the Term Funding Scheme with additional incentives for SMEs (TFSME) was also coming to an end. Banks would continue with their plans to repay drawdowns under TFSME, which was designed to provide temporary, low-cost funding to incentivise the provision of credit to business and households during the Covid-19 period.

51. More broadly, the normalisation of central bank balance sheets had begun to reduce the stock of central bank reserves, which currently made up the largest component of banks' liquid asset buffers. All else equal, this would put downward pressure on banks' liquidity buffers, but banks had a number of options available to them to maintain liquid assets above their target levels.

52. These included the purchase of gilts, or the use of Bank of England facilities which supply central bank reserves in exchange for a wide range of collateral. While demand from the banking system for central bank reserves was highly uncertain and would vary in response to financial and economic conditions, it was likely to be some way below the current level of reserves, and it was also likely to be materially higher at any given level of Bank Rate than it was before the GFC, given a range of changes over that period, such as changes to

funding markets and liquidity regulation. Banks could also manage their liquidity resilience through changes in the mix of their funding – such as the shift from sight to time deposits and to longer term wholesale funding – albeit typically at a greater cost.

53. Taken together, these trends would affect sources of bank funding, and could affect their cost - for example, through continued competition for deposits, and greater use of some forms of wholesale funding. The impact on individual banks would depend on their funding structure and business models. Banks would also need to factor these system-wide trends into their liquidity management and planning over the coming years.

54. The FPC noted that there would be a range of ways in which banks could continue to adjust to these changes over time, including through choices around their funding and liquid asset mix as well as though the nature, quantity, and pricing of lending they undertake.

55. The FPC would monitor the implications of these trends for financial stability.

56. Banks' management of their liquidity positions would also be influenced by lessons from the stress experienced by some parts of the global banking system in early 2023. The FPC noted that the experience illustrated the speed at which liquidity outflows could take place and the importance of being able to monetise liquidity buffers in a stress. In this context, maintaining collateral pre-positioned in central bank facilities was an important source of resilience for banks which experience short-term liquidity stress. Bank staff were contributing to the relevant international work to consider whether lessons could be learnt for the liquidity framework for banks.

57. The Committee also noted that, over the medium-term, new forms of digital money could also influence banking system liquidity. The UK authorities had been considering the policy design choices accompanying those new forms of digital money, including consideration of mitigants to the financial stability risks arising from the potential for a greater proportion of deposits to be withdrawn from a banking system in a stress.

58. Further detail on the analysis underpinning these judgements would be set out in the 'UK bank resilience' chapter of the December 2023 FSR.

The UK countercyclical capital buffer rate decision

59. 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. The UK CCyB rate enables the capital requirements of the UK banking system to be adjusted to the changing scale of risk of losses on UK exposures over the course of the financial cycle. The

approach therefore included an assessment of financial vulnerabilities and banks' capacity to absorb losses on their UK exposures, including their sensitivity to shocks.

60. In considering the appropriate setting of the UK CCyB rate this quarter, the FPC discussed its judgements around underlying vulnerabilities that could amplify economic shocks. In aggregate, these vulnerabilities were broadly unchanged since the previous quarter, with several key indicators, including household debt-to-income and corporate gross debt to earnings, around their long-term averages. However, UK GDP was now projected to be broadly flat over the coming quarters, and there remained considerable uncertainty around the overall risk environment. Financial conditions remained tight, which would put pressure on debt serviceability and could bring greater risk to banks' resilience.

61. The subdued macroeconomic backdrop and the need for corporates to refinance at tighter conditions and higher interest rates meant that a tail of corporates remained under financial pressure. Increases in interest rates were still to pass through to around half of mortgagors, which could put pressure on household debt serviceability. In addition, the FPC noted that market expectations were for interest rates to remain high, which would put continued financial pressures on households and corporates. However, the future share of UK households with high mortgage cost-of-living adjusted DSRs was now projected to be lower than expected last quarter, supported by positive news on income growth. The projected share of corporates with low ICRs at end-2023 had also decreased since last quarter, supported by stronger earnings growth in 2022 than previously projected.

62. The FPC observed that UK banks' resilience was supported by continued robust profitability, relatively strong asset quality and strong capital positions. And the results of the 2022/23 ACS indicated that the major UK banks were resilient to a severe stress scenario. The FPC judged that the marginal tightening in credit conditions in Q3 appeared to have reflected the impact of changes in the macroeconomic outlook, rather than defensive actions by banks to protect their capital positions.

63. Given the major UK banks' strong capital positions, the FPC judged that the UK banking system was in a position to continue to meet credit demand from creditworthy households and businesses. 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. The FPC would continue to monitor UK credit conditions for signs of tightening that were not warranted by changes in the macroeconomic outlook.

64. In view of these considerations, the FPC decided to maintain the UK CCyB rate at 2%.

65. The FPC recognised the continued uncertain environment and reiterated that it 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.

Consistent with the FPC's updated CCyB Policy Statement published in July, if vulnerabilities that could amplify future economic shocks increased to an elevated level, so as to pose greater risks to banks' resilience, the FPC would be prepared to raise the UK CCyB rate above 2%. This would ensure that banks had an additional cushion of capital with which to absorb potential losses, enhancing their resilience and helping to ensure the stable provision of financial services. In contrast, if conditions deteriorated by significantly more than currently expected, in a manner that might otherwise lead banks to restrict lending primarily to defend their capital ratios, the FPC would be prepared to cut the CCyB rate as necessary. This would enable banks to use the released buffer to absorb losses and so be able to support lending.

The resilience of market-based finance

Recent developments

66. The FPC judged that vulnerabilities in certain parts of market-based finance remained significant, and in some sectors had increased since the July 2023 FSR.

67. Funds investing in riskier corporate credit had seen outflows. Some property funds had suspended redemptions due to continued outflows, driven in party by structural challenges in the CRE market and higher interest rates. These funds comprised only a small proportion of the total investor base in UK CRE.

68. Hedge funds remained active in leveraged relative value trading between cash US Treasuries and futures that had contributed to amplifying price moves in March 2020. The FPC would continue to monitor the risks to core market functioning and broader financial stability posed by levered trades in government bond markets, including the extent to which these changes in hedge fund positions were driven by basis trades. The FPC noted that risks related to US Treasury markets could spill over to the UK, although owing to structural differences UK gilt markets did not have the same degree of leveraged basis trading.

69. The FPC noted that the opacity and the lack of frequent re-pricing of private credit assets increased their vulnerability to sharp and correlated falls in value. And given the common features of private credit and leveraged loans, such as the floating rate nature of the lending and links to private equity activity, there was a risk of correlated stresses in these and other interconnected markets, such as private equity. Crystallisation of risks in private markets in other regions could also spill over to UK institutions. Fire-selling and a reduction in risk appetite could be amplified by non-bank financial institutions (NBFIs) with liquidity mismatches and high leverage. Private credit exposures were held by a range of investors including insurers and pension funds. UK insurers' direct exposures to leveraged loans and private credit, including via collateralised loan obligations (CLOs), were small. But UK insurers could be indirectly exposed, for example through interconnectedness with non-UK reinsurers exposed to these markets.

70. The FPC observed that vulnerabilities in market-based finance could crystallise in the context of higher and more volatile interest rates or sharp movements in asset prices, leading to dysfunction in core markets and amplifying any tightening in financial conditions.

71. The FPC therefore noted the urgent need to increase the resilience of market-based finance through internationally-coordinated reforms. The FPC continued strongly to support the Financial Stability Board's international work programme to increase the resilience of market-based finance.

72. Alongside international policy work, the FPC was working to reduce vulnerabilities domestically where it was effective and practical to do so (as discussed below). The FPC would publish an overview of progress in building resilience against key vulnerabilities in market-based finance in the December 2023 FSR.

73.Work was also ongoing to develop the tools the Bank needed to enable it to intervene where liquidity-related dysfunction in core sterling markets threatened financial stability. In system-wide stress scenarios where NBFIs were seeking temporary liquidity, it was preferable to backstop market functioning by lending directly to NBFIs against high quality collateral, rather than with asset purchases. This presented less risk to public funds, less moral hazard, and reduced the risk of confusing perceptions of the stance of monetary policy.

Resilience in liability-driven investment funds

74. The FPC continued to judge that its resilience framework for liability-driven investment (LDI) funds had been functioning broadly as intended in an environment of higher and more volatile market interest rates. The FPC judged that while LDI funds were resilient in aggregate, there remained some areas for improvement for some funds to implement fully the relevant guidance. As noted in the October 2023 Record, some LDI managers' recapitalisation in response to falling gilt prices had been slower than the expected five days. Funds also needed to ensure that their management buffers and triggers took into account the length of time they needed to recapitalise. The FPC noted that it was also important that work continued to put in place a monitoring and enforcement framework for pooled funds by the FCA and relevant international regulators.

Resilience of money market funds

75. The FPC welcomed the FCA consultation paper on money market fund (MMF) regulation that would be published on 6 December 2023, containing proposals to enhance MMF resilience in the UK, including increasing daily and weekly liquid asset requirements to 15% and 50% of assets respectively. The FPC had previously judged that significantly more shorter-maturing assets than currently required was likely to be the most effective way to increase MMF resilience and so reduce risks to financial stability.

System-wide exploratory scenario exercise

76. In November 2023, the Bank had launched the **scenario phase** of the system-wide exploratory scenario (SWES) exercise, which was being carried out to improve understanding of the behaviours of NBFIs and banks in stressed financial market conditions. The Bank had published a set of hypothetical market shocks and a narrative explaining how market conditions evolved in the scenario, and had asked participating banks and NBFIs to submit responses indicating how they would expect to act following such shocks. The Bank would analyse responses to understand any system-level and financial stability implications. The FPC welcomed the launch of the scenario phase of the SWES.

77. Further detail on the analysis underpinning these judgements would be set out in the 'Resilience of market-based finance' chapter of the December 2023 FSR.

Developments in cryptoasset markets

78. As part of its regular horizon scanning to identify emerging risks to the financial system, the Committee had been monitoring risks from cryptoassets and associated activities.

79. Cryptoasset markets had declined in size and activity since their November 2021 peak, and the systemic risks that the FPC previously **outlined** could arise in future had not materialised thus far.

80. Systemic financial institutions' involvement in cryptoassets remained very limited, although some had expressed a desire to increase their cryptoasset activities, for example by acting as dealers or offering custodial services. Risks to core financial markets from cryptoassets remained limited by the degree of institutional cryptoasset adoption, but this could accelerate as regulatory frameworks and market infrastructure developed. In the UK, use of cryptoassets for payments remained very small, but this could change if a sterling-denominated stablecoin for retail payments emerged. Some payment service providers (e.g. PayPal) had recently launched services supporting stablecoins in currencies other than sterling, and had the potential for widescale adoption. The Bank would continue to monitor payment activities in relation to cryptoassets and stablecoins.

81. Against this backdrop, the UK authorities had taken important steps towards putting in place a regulatory regime for the sector. In October 2023, HM Treasury had set out its **approach** to regulating cryptoasset activities and the FCA would now be developing the rules for the regulatory regime. The **Bank** and the **FCA** had also published Discussion Papers on their proposed approach to regulating stablecoins, and the PRA **clarified** its expectations of deposit takers with respect to new forms of digital money.

82. Internationally, standard setters had made good progress in developing a global baseline for regulating cryptoassets, in line with the principle of 'same risk, same regulatory outcome'.

Looking ahead, ensuring a wide and timely implementation of the international regulatory baseline would be key to mitigating the financial stability risks from cryptoassets. Given the risks of regulatory arbitrage, this should include jurisdictions with currently limited regulation and those with large cryptoasset activity.

83. The FPC welcomed these developments and would seek to ensure the UK financial system was resilient to the risks that may arise from cryptoassets and associated activities.

84. Further detail on the analysis underpinning these judgements would be set out in the 'Developments in cryptoasset markets' box of the December 2023 FSR.

Ransomware attack on ICBC Financial Services

85. In November 2023, ICBC Financial Services – the US broker-dealer subsidiary of Industrial and Commercial Bank of China (ICBC) – was reported to have experienced a ransomware attack. The attack impacted its client clearing business and there was some disruption in the US Treasury market. This incident highlighted the importance of operational resilience in maintaining financial stability, and how cyber-attacks in particular could have a significant impact on firms' ability to provide vital services.

86. In July 2019, the FPC had noted the potential risks to financial stability due to concentration in critical 'nodes' of the provision of market access for short-term liquidity providers.

87. The FPC had taken a number of actions to monitor potential systemic risks from cyber attacks, including establishing a cyber-vulnerability testing framework (CBEST), setting an 'impact tolerance' for how quickly the financial system must be able to make critical payments following a severe but plausible cyber or operational incident, and using regular cyber stress tests to test firms' ability to meet the impact tolerance in severe but plausible scenarios. This was in addition to the Bank, PRA and FCA's approach to operational resilience, which asked firms to identify their own important business services, set their own impact tolerances, and ensure they can remain within them.

88. The FPC had a medium-term priority to improve the macroprudential oversight of operational resilience and would provide updates on its work in due course.

Developments in artificial intelligence and financial system adoption

89. The FPC was briefed on the continued adoption of artificial intelligence (AI) and machine learning (ML) in financial services, and its potential financial stability implications.

90. AI and ML had been used in financial services for at least a decade – for example, to support fraud detection and anti-money laundering – but adoption was becoming more widespread and use cases more varied, driven by advances in ML techniques, the greater

availability of data and the falling cost of computing power. AI and ML could deliver significant benefits to the UK financial services sector, by driving greater operational efficiency, improving risk management, and providing new products and services, but it could also pose new or increased risks.

91. Recent developments in Large Language Models (LLMs) had sparked considerable interest in the potential of AI and ML. Novel techniques could pose new challenges, such as a lack of explainability. A number of financial firms, as well as providers of services to the financial sector, had stated publicly that they were experimenting with the use of LLMs, but engagement with regulated financial firms suggested use cases being explored currently were relatively low-risk (for example, search/retrieval of information and generation of outputs for internal use, rather than automating business decisions).

92. While first and foremost it was for firms to ensure that they had appropriately addressed the risks associated with the AI models they employed, it would also be important for microprudential regulation to ensure that firms had sufficient oversight and control over these risks. The Bank, the PRA and FCA had undertaken a significant amount of work in recent years to understand the firm-specific risks associated with the use of AI and ML and were seeking to address them. The Bank, PRA, and FCA had run the AI Public-Private Forum, exploring the benefits and risks associated with the use of AI and ML in financial services. This had identified key risks arising at three levels – data, model risk, and governance. The Bank, PRA, and FCA had published a **Discussion Paper** exploring whether the current regulatory regime was sufficient to address these risks, and **industry feedback** highlighted the importance of a number of issues, including ensuring sufficient explainability and accountability when using third-party AI models or services.

93. Wider adoption of AI and ML could conceivably also pose system-wide financial stability risks, for example by amplifying herding or broader procyclical behaviours or increasing cyber-risk and interconnectedness. Certain third parties providing data and AI models could also emerge as future potential critical third parties as a result of the increasing use of these data and models. The PRA, FCA, and Bank of England as regulator of financial market infrastructures (FMIs), would be publishing a Consultation Paper on critical third parties in December.

94. Given the rapid pace of innovation and potentially widespread use cases, the impact of AI and ML (including LLMs) on financial stability needed careful monitoring and consideration. The FPC would further consider the financial stability risks of AI and ML in 2024 and, working alongside other relevant authorities, would seek to ensure that the UK financial system was resilient to risks that may arise from widespread adoption of AI and ML.

UK central counterparties supervisory stress test

95. The FPC welcomed the publication of the **results** of the Bank's second public Supervisory Stress Test (SST) of UK central counterparties (CCPs), which confirmed the continued resilience of the three UK CCPs to stress scenarios that were of equal and greater severity than the worst-ever historical market stresses. The Reverse Stress Test had also confirmed the CCPs were able to survive more extreme combinations of assumptions.

96. CCPs' results had improved across each of the components of the stress test relative to the previous exercise. This reflected CCPs' financial resources as well as levels of collateralisation that had increased after the periods of higher market volatility in 2022. Given that initial margin had since fallen back as volatility had declined, the Bank sensitivity-tested these results using in-house models, which supported the assessment of UK CCPs' resilience.

97. The FPC noted that the test had also included an assessment of the potential Initial Margin and Variation Margin calls that CCPs' members might face in a stress. This suggested that the largest calls generally fell on the largest financial groups that were better able to manage them.

Funded reinsurance

98. The FPC welcomed the PRA's **consultation** on its expectations of UK life insurers holding or entering into funded reinsurance arrangements in the bulk purchase annuities market, where there was a risk of creating a systemic vulnerability in the form of a large concentrated exposure to correlated, credit-focussed counterparties. While the current risks to UK financial stability from the use of funded reinsurance arrangements by UK insurers remained limited, rapid growth in volumes and complexity of these arrangements could generate risks in the future.

99. Volumes of funded reinsurance were expected to increase to support growth of the bulk purchase annuities market, with industry estimating that insurers could take on more than £500bn of UK pension liabilities (and associated assets) over the coming decade. Such greater use would bring an increased risk of a large-scale funded reinsurance recapture event, in the event that a reinsurer failed. In such circumstance, insurers would suddenly need to take control of large portfolios of assets which may not be sufficient to back their long-term liabilities, while having to set aside capital for risks they had previously passed to a counterparty.

100. Such a recapture of assets and risks were more likely to happen at a time of credit stress, where the insurers' balance sheets were already in stress. As insurers moved to simultaneously transform the recaptured portfolio to achieve compliance, they may, as a sector, further disrupt credit markets. The significant use of funded reinsurance arrangements

could therefore greatly diminish or even reverse life insurers' role as countercyclical actors in credit markets.

101. The FPC agreed with the PRA's intention to continue to monitor how market practice evolves, and to keep under review whether there was a need for further specific policy measures, including that the risks associated with funded reinsurance be considered in the upcoming life insurance stress tests.

The FPC's remit response

102. The FPC would receive a letter setting out the economic policy of His Majesty's Government and Treasury's Recommendations under Sections 9D-9E of the Bank of England Act 1998 from the Chancellor on 22 November 2023. The FPC would respond in due course.

The following members of the Committee were present at the 21 November 2023 Policy meeting:

Andrew Bailey, Governor
Colette Bowe
Sarah Breeden
Ben Broadbent
Jon Hall
Randall Kroszner
Dave Ramsden
Nikhil Rathi
Elisabeth Stheeman
Carolyn Wilkins
Sam Woods

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

Given this was Elisabeth Stheeman's final Policy meeting ahead of her second term ending in February 2024, the Chair, on behalf of the Committee, recorded their thanks for her service to the Financial Policy Committee.

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, including stablecoins, and that he would not receive the related papers.

- Under the same provisions, Carolyn Wilkins had notified the Committee of her Non-Executive Directorship of Intact Financial Corporation (including holding company of Royal Sun Alliance Group). It was agreed that she would recuse herself from discussions on insurance firms 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 21 November 2023).

On 23 March 2023, the FPC made the Recommendation (23/Q1/1) that:

- The severe but plausible stresses to which LDI funds should be resilient should account for historic volatility in gilt yields, and the potential for forced sales to amplify market stress and disrupt gilt market functioning. If LDI funds were not resilient to such a shock, their defensive actions could cause financial instability, tightening credit conditions for UK households and businesses. The FPC judged that these factors meant that the size of the yield shock to which LDI funds should be resilient should be, at a minimum, around 250 basis points.
- Liquid assets held to ensure resilience in the event of such a shock should be unencumbered and immediately available. Fund managers should have scope to consider additional assets, which investors had authorised them to use to meet collateral demands. Managers should apply appropriate prudence in doing this, for example by applying suitable haircuts.
- This minimum level of resilience should be maintained in normal times but could be drawn down on in stress. Minimum resilience around this level would ensure that funds could absorb a severe but plausible historical stress and still have a remaining level of headroom necessary to operate during a period of recapitalisation. This approach was consistent with the regulatory approaches in place for some systemically important financial institutions, where their standards were designed to allow institutions to continue operating after withstanding a severe stress.
- Funds should take into account the nature of their exposures, including duration, leverage, and concentration of holdings, and the liquidity, duration, and convexity of collateral, in modelling their resilience to yield moves.
- Pension schemes using leveraged LDI should be expected to be able to deliver collateral to their LDI vehicles within five days. Funds and schemes unable to implement these operational standards should be required to be resilient to a larger shock, calibrated to their own operational timelines.
- LDI funds should maintain additional resilience over and above the minimum to manage day to day volatility in yields and account for other risks they might face, including operational risks, in order to be able to maintain the minimum level of resilience in normal times. The amount of additional liquidity held should be calibrated by funds according to their own assessments of their exposures and operational

capabilities and other regulatory requirements, as well as interest rate trends and levels of market volatility. While this additional liquidity was expected to vary between funds, when combined with the minimum resilience to yield shocks, overall resilience levels should be broadly consistent with those currently prevailing in current market conditions (i.e. 300-400 basis points). Liquid asset holdings might be safely reduced over time if fund managers were able to demonstrate increased resilience through operational improvements.

In addition, the FPC made the Recommendation (23/Q1/2) that:

- TPR takes action as soon as possible to mitigate financial stability risks by specifying the minimum levels of resilience for the LDI funds and LDI mandates in which pension scheme trustees may invest. To ensure that they were able in practice to do this, it was important that trustees had a simple mechanism for monitoring, and LDI funds disclosing, levels of resilience in dynamic markets.
- TPR should have the ability to employ effective monitoring tools, and to enforce as appropriate in cases of non-compliance with this resilience level. The FPC asked TPR to report back on how it intended to implement the Recommendation.
- 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 21 November 2023, unchanged from its 5 October 2023 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%.

Liability driven investment funds

On 28 November 2022, the FPC recommended (22/Q4/1) that regulatory action be taken by TPR, in coordination with the FCA and overseas regulators, to ensure LDI funds remain resilient to the higher level of interest rates that they can now withstand and defined benefit

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

pension scheme trustees and advisers ensure these levels were met in their LDI arrangements.

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,[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 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 claims exclusion.

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

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

[5] See PRA Policy Statement PS9/14, 'Implementing the Financial Policy Committee's Recommendation on loan to income ratios in mortgage lending', October 2014: www.bankofengland.co.uk/pra/Documents/publications/ps/2014/ps914.pdf.
[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)