Bank of England

Financial Policy Summary and Record of the Financial Policy Committee meeting on 13 March

27 March 2024

This is the record of the Financial Policy Committee meeting held on 13 March 2024.

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/2024/march-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 Policy meeting will be on 11 June 2024 and the Record of that meeting will be published on 27 June 2024.

Financial Policy Summary, 2024 Q1

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. While the central economic outlook has improved somewhat since the December 2023 Financial Stability Report (FSR), some risks to financial stability globally have increased. It is concerning that risk premia across a range of markets have fallen further and several are close to historical lows, despite the fact that the adjustment to higher interest rates continues to pose challenges, and geopolitical risks are heightened. **So far, UK borrowers have been broadly resilient to the impact of higher interest rates. The UK banking system is well capitalised, with the ability to support households and businesses even if economic and financial conditions were to be substantially worse than expected.**

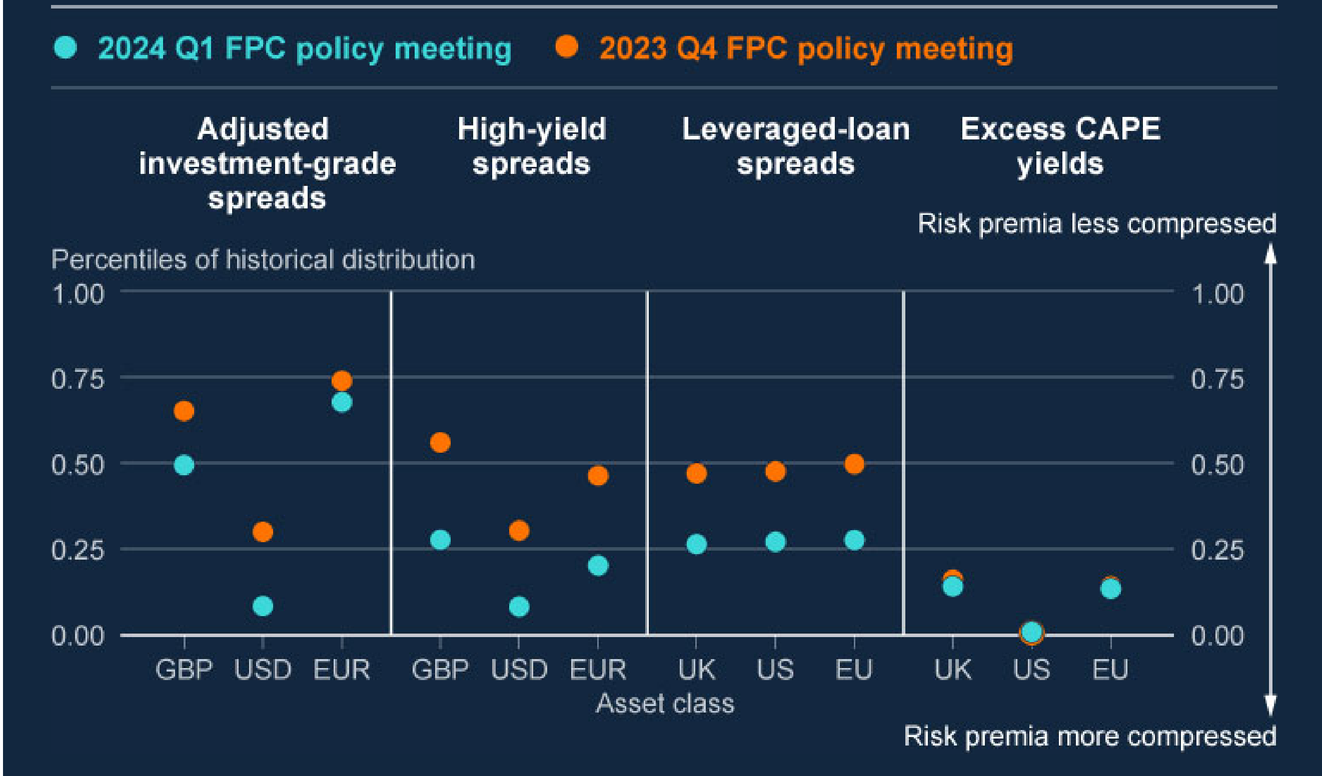
Developments in financial markets

Expected policy rates and long-term government bond yields in advanced economies are both a little lower than at the time of the December 2023 FSR. Global GDP growth has remained subdued, although US growth in 2023 Q4 was stronger than anticipated. UK GDP is expected to start growing again during the first half of this year. But risks to the macroeconomic outlook remain, with market interest rate volatility still elevated by historical standards.

Asset valuations across a range of markets have continued to rise. This has pushed measures of risk premia further below historical averages across a number of asset classes (Chart 1). These moves, in a challenging risk environment, suggest that investors are putting less weight on risks to growth or to the path of interest rates necessary to bring inflation back to target sustainably. US equity risk premia remain particularly low, and corporate bond spreads – particularly for the riskiest companies – have tightened further, despite rising default rates. **The risk of a sharp correction in a broad range of asset prices and a widening in credit spreads – for example due to the materialisation of downside risks to growth, interest rates remaining higher than expected, or a deterioration in geopolitical conditions – has therefore grown since 2023 Q4.** Such a correction could crystallise longstanding vulnerabilities in market-based finance – which remain significant – potentially leading to dysfunction in core markets, amplifying any tightening in credit conditions.

Chart 1: Measures of risk premia across a range of asset classes have fallen and are compressed in historical terms

Current level of selected risk premia metrics as a percentile of historical values, compared to levels seen at 2023 Q4 FPC policy meeting [(a)]



Sources: Bloomberg Finance L.P., Datastream from LSEG, ICE BofAML, LCD, an offering of Pitchbook, and Bank calculations.

(a) Risk premia data are a percentile of five-day rolling average (except for leveraged-loan (LL) spreads). Percentiles are calculated from 1998 for investment-grade spreads and high-yield bond spreads, 2013 for LL spreads and 2006 for excess cyclically-adjusted price-to-earnings (CAPE) yields. Data updated to 13 March 2024, except for LL spreads which are updated to 8 March 2024. Investment-grade spreads are adjusted for changes in credit quality and duration. All data is daily except for LL spreads which are weekly.

Finance for riskier corporates could be particularly vulnerable to a significant deterioration in investor risk sentiment. The private equity sector, which is closely related to private credit and leveraged lending, plays an important role in channelling finance to the UK real economy. The sector has grown rapidly over the past decade when interest rates have been relatively low. More recently, higher interest rates have made it more difficult for private equity funds to raise investment, contributing to downward pressure on asset valuations, and default rates on debt linked to private equity have increased. The extent of transparency around asset valuations, overall levels of leverage, and the complexity and interconnectedness of the sector make assessing financial stability risks difficult and mean that risks need to be managed carefully, both by those in the sector and by their

counterparties. The FPC will publish a further assessment of these risks in its June 2024 FSR.

Global vulnerabilities

Global risks have continued to increase and remain material, against the backdrop of heightened geopolitical tensions. Households, businesses and financial institutions overseas continue to adjust to higher interest rates. Some risks have already started to crystallise, most notably in commercial real estate (CRE) markets globally and in the mainland China property sector.

CRE prices have fallen sharply in many advanced economies and could fall further, leading to losses for creditors. A number of smaller banks with significant exposures to CRE, in jurisdictions such as the US, the EU and Japan, have seen large reductions in their equity prices. Stresses in exposed banks could affect UK financial stability through a number of channels, including macroeconomic and financial market spillovers, contagion to funding conditions for UK banks, and a reduction in overseas finance for the UK CRE sector leading to further downward pressure on UK valuations.

Financial stability spillovers from the adjustment in the mainland China property market have largely been limited so far, but significant downside risks remain. The Chinese authorities have provided support but the adjustment in the property sector, alongside broader structural trends, is likely to weigh on growth in China for some time. More widespread crystallisation of risks in mainland China could lead to more pronounced spillovers in Hong Kong. Spillovers could also affect the UK and other countries. The 2022/23 ACS results indicate that major UK banks would be resilient to very significant declines in property prices in mainland China and Hong Kong.

Some lenders to Chinese property developers, for example those active in offshore markets or via wealth management products, may be especially exposed to losses as these risks crystallise. This could represent another material potential channel of contagion if financial institutions have concentrated exposures to such lenders.

High public debt levels in major economies could have consequences for UK financial stability, particularly in an environment of tighter financial conditions. A deterioration in market perceptions of the path for public debt globally could lead to market volatility and interact with vulnerabilities in market-based finance, potentially tightening credit conditions for households and businesses. Increased debt servicing costs for governments as debt is refinanced could also reduce their capacity to respond to future shocks.

UK household and corporate debt vulnerabilities

While household finances remain under pressure from increased living costs and higher interest rates, the outlook for UK households has improved somewhat since 2023 Q4. The share of households spending a high proportion of their available income on servicing mortgage debt, taking into account the cost of essential items, is expected to increase marginally over the next two years but remain well below pre-global financial crisis (GFC) levels. Owner-occupier mortgage arrears have increased moderately but remain low, as strong nominal wage growth over recent quarters combined with low unemployment have helped to contain the rise. Mortgage arrears are likely to increase further but remain well below post-GFC levels, absent a very significant rise in unemployment.

In the UK, corporates remain broadly resilient to high interest rates and weak growth. But the full impact of higher financing costs has not yet been passed through to all borrowers, and will be felt unevenly. Some smaller or highly leveraged UK firms may struggle to service their debt and some borrowers may be more exposed to refinancing risk. Corporate insolvencies continued to rise over 2023 Q4, albeit from low levels. UK CRE continues to face pressures that are weighing on prices and making refinancing challenging, particularly in sectors most affected by structural challenges such as some offices and retail. The pace at which UK CRE prices are falling has slowed in recent quarters, although significant risks remain. **The results of the 2022/23 ACS showed that major UK banks would be resilient to a much larger fall in CRE prices than those already observed.**

UK banking sector resilience

The UK banking system has the capacity to support households and businesses even if economic and financial conditions were to be substantially worse than expected.

The UK banking system is well capitalised and UK banks maintain strong liquidity positions. The aggregate profitability of major UK banks is expected to remain robust. Nevertheless, indicators of the market value of major UK banks' future profitability, such as their average price to tangible book ratios, remain subdued. The FPC will publish further analysis of UK banks' price to book ratios in its June 2024 FSR.

Asset quality has been resilient, despite the challenging risk environment. While arrears continued to edge upwards across loan portfolios in 2023 Q4, this was broadly as banks expected, and their forward-looking indicators of asset quality improved over the quarter.

Some forms of lending, such as to finance CRE investments, buy-to-let, and highly leveraged lending to corporates are more exposed to credit losses as borrowing costs rise. There is a wide range of business models among smaller and medium-sized UK banks, some of which

are specialised in particular activities or serve particular sectors. In a more challenging environment, these business models will be impacted by different risks in different ways.

UK credit conditions are broadly unchanged. Those households and businesses most impacted by the macroeconomic outlook continue to face tighter credit conditions than others**. The FPC continues to judge that credit conditions overall reflect changes to the macroeconomic outlook rather than defensive actions by banks to protect their capital positions.**

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 Bank's desk-based stress test exercise this year will further inform the FPC's monitoring and assessment of the resilience of the UK banking system to downside risks.

Operational resilience

The FPC has today published a Financial Stability in Focus on its approach to operational resilience. Alongside work by the Bank of England, Prudential Regulation Authority and the Financial Conduct Authority, this work aims to bridge the gap between firm-level and system-wide operational resilience.

Operational incidents pose an increasing risk to financial stability, given growing digitalisation and interconnectedness (including via greater outsourcing) in the financial system. Although individual firm-level operational resilience provides the essential foundation for operational resilience across the system, **firms and Financial Market Infrastructures must also factor in the potential impacts on the wider financial system from weaknesses in their own operational resilience and actions they might take in response to incidents, as they take steps to build their resilience.**

The FPC will continue to further its analysis of operational resilience. The Committee will also continue its programme of cyber stress testing, monitor the implementation and outcomes of the new critical third parties regime, and consider whether to set impact tolerances for additional vital services beyond payments. The FPC will start the next cyber stress test in Spring 2024, with the findings expected to be published in the first half of 2025.

Record of the Financial Policy Committee meeting on 13 March 2024

1. The Committee met on 13 March 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 and, on that basis, agreed its intended policy action. 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

2. The FPC judged that the overall risk environment remained challenging. While the central economic outlook had improved somewhat since the December 2023 Financial Stability Report (FSR), some risks to financial stability globally had increased. It was concerning that risk premia across a range of markets had fallen further and several were close to historical lows, despite the fact that the adjustment to higher interest rates continued to pose challenges, and that geopolitical risks were heightened. So far, UK borrowers had been broadly resilient to the impact of higher interest rates. The UK banking system was well capitalised, with the ability to support households and businesses even if economic and financial conditions were to be substantially worse than expected.

Developments in financial markets

3. The FPC observed that expected policy rates and long-term government bond yields in advanced economies were both a little lower than at the time of the December 2023 FSR, although they had been volatile over that period. Expected policy rates and long-term interest rates fell significantly in December in expectation of central banks reducing interest rates by more than previously expected, but retraced somewhat in January and February due to resilient US economic data and a change in market perceptions on the expected path of interest rates, now expecting them to be higher for longer.

4. The FPC noted that risk premia across a range of asset classes, which were already compressed on some metrics, had tightened further since the November 2023 Policy meeting. The somewhat stronger growth outlook had pushed measures of risk premia further below historical averages, with some currently in the lowest decile of their historical distribution.

5. Equity prices had increased across advanced economies, particularly in the US. This was largely driven by a rally in a few large technology companies. The excess cyclically-adjusted price-to-earnings (CAPE) yield – a measure of the excess return that investors expect from

equities relative to government bond yields – on US equities had remained close to the bottom percentile of its historical distribution. Investor risk appetite in credit markets had also been strong, leading to compressed spreads and strong issuance. Investment grade, high-yield and leveraged loan spreads had fallen to around two-year lows, despite an increase in corporate defaults. However, market participants were generally expecting that defaults had reached their peak and would begin to decline later this year.

6. The FPC judged that these moves, in a challenging risk environment, suggested that investors were putting less weight on risks to growth or the path of interest rates necessary to bring inflation back to target sustainably. The risk of a sharp correction in a broad range of asset prices and a widening in credit spreads – for example due to the materialisation of downside risks to GDP growth, interest rates remaining higher than expected, or a deterioration in geopolitical conditions – had therefore grown since 2023 Q4.

7. If these downside risks materialised, riskier borrowers could be impacted by higher borrowing costs, particularly given the existing backdrop of higher rates and this could be particularly acute for those needing to refinance debt at these higher rates. Corporates relying on equity financing would also be impacted. These risks were heightened in riskier credit markets such as leveraged loans and private credit, both of which were often linked with private equity sponsored activity.

8. The FPC noted that any such correction could be amplified by longstanding vulnerabilities in market-based finance, which remained significant. Should such vulnerabilities crystallise in the context of sharp movements in asset prices they could potentially lead to dysfunction in core markets, amplifying any tightening in credit conditions, and so affect households and businesses.

Private equity

9. The private equity sector played an important role in channelling finance to the UK real economy, particularly for riskier businesses. That sector had grown rapidly over the last decade when interest rates had been relatively low.

10. However, the Committee noted that the sector had faced challenges adjusting to the higher rate environment: fund raising appeared to have become more difficult; traditional exit routes (such as initial public offerings) had slowed; default rates on leveraged loans, which were often used to finance private equity sponsored activity, had increased, and there was evidence that valuations in some sectors had come under pressure.

11. At the same time, some sponsors and investors appeared to be seeking solutions to monetise assets and maintain returns, either by selling assets into secondary markets, if possible, or through increasing leverage (for example via secured borrowing against a fund's assets). The FPC noted that this demand for additional leverage was often being met by

banks, who had multiple forms of credit exposure to the sector at the fund, sponsor, and portfolio company levels.

12. Moreover, some private equity sponsored companies were turning to refinancing solutions which delayed the crystallisation of risks, such as 'amend and extend' or 'payment in kind' agreements, which could help smooth through the stress but in turn add to corporate debt burdens. The Committee noted that these dynamics may have increased the risk of larger than expected credit losses being incurred in the future.

13. Overall, the FPC highlighted that the extent of transparency around asset valuations, overall levels of leverage, and the complexity and interconnectedness of the sector made assessing financial stability risks difficult and meant that risks needed to be managed carefully, both by those in the sector and by their counterparties. Furthermore, given the sector's role in channelling finance to the UK real economy via private equity sponsored companies, the FPC also highlighted the importance of evaluating the impact of the dynamics in the sector from a UK investment and employment perspective, including as part of the Committee's secondary objective to support the economic policy of the Government.

14. Going forward, the FPC would continue its evaluation of risks from private equity and interconnected markets, drawing on supervisory and market intelligence and the data sources available, and would publish a further assessment of these risks in the June 2024 FSR.

Global vulnerabilities

15. The FPC noted that the outlook for global growth had improved somewhat since the December 2023 FSR, in part reflecting looser global financial conditions, though overall it remained subdued. Headline inflation had continued to decline in advanced economies, but consumer services price inflation in particular remained elevated, reflecting persistent domestic inflationary pressures.

16. The FPC judged that global risks had continued to increase and remained material, against the backdrop of heightened geopolitical tensions. These risks could spill over to UK financial stability through a number of different channels, including direct exposures of UK financial institutions, macroeconomic impacts, financial market contagion and changes in the provision of overseas financing to the UK. Elections in a number of countries this year could also lead to market volatility.

17. Some risks had already started to crystallise, most notably in commercial real estate (CRE) markets globally and in the mainland China property sector. Financial stability spillovers from the adjustment in the mainland China property sector had largely been limited so far, but significant downside risks remained. Activity in the property sector had declined sharply, with total sales falling by 18% in 2023. Prices had also fallen, but to a more limited

extent. The IMF had estimated that inventories of unsold properties at the end of 2023 had risen to just over 1 billion square metres of floor space, which is around the entire amount of floor space sold in 2023. Over half of China's largest property developers had missed bond payments without agreed extensions. The property downturn had also put pressure on local government finances by reducing the revenue raised through land sales. The Chinese authorities had provided support that had prevented disorderly defaults for property developers and limited spillovers, against the backdrop of a longer-term strategy to reduce speculation in the sector. The largest Chinese banks appeared to have relatively contained exposures to property developers directly but their exposure to the broader property sector was larger.

18. The adjustment in the property sector, alongside broader structural trends, was likely to weigh on growth in China for some time. More widespread crystallisation of risks in mainland China could lead to more pronounced spillovers in Hong Kong. Spillovers could also affect the UK and other countries. The 2022/23 Annual Cyclical Scenario (ACS) had indicated that major UK banks would be resilient to a severe global recession that included very significant declines in property prices in mainland China and Hong Kong.

19. Beyond such potential direct impact, some lenders to Chinese property developers, for example those active in offshore markets or via wealth management products, may be especially exposed to losses as these risks crystallise. This could represent another material channel of contagion if financial institutions had concentrated exposures to such lenders. The FPC noted that information on such private credit was very limited.

20. CRE prices had fallen sharply in many advanced economies and could fall further, leading to losses for creditors. Falling valuations were likely to reflect both the impact of tighter financial conditions and a structural decline in demand for certain types of commercial property. A number of smaller banks with significant exposures to CRE in jurisdictions such as the US, the EU and Japan, had seen large reductions in their equity prices. Stresses in exposed banks overseas could affect UK financial stability through a number of channels, including macroeconomic and financial market spillovers, contagion to funding conditions for UK banks, and a reduction in overseas finance for the UK CRE sector leading to further downward pressure on UK valuations. A significant share of US CRE debt was held outside the banking sector. There was less visibility on the composition of this debt and the potential for exposures to be interconnected.

21. Households, businesses and financial institutions overseas continued to adjust to higher interest rates. The FPC judged that while household and corporate balance sheets in advanced economies remained resilient in aggregate, riskier corporate borrowing, such as private credit and leveraged loans, remained particularly vulnerable. Some banks in a number of jurisdictions continued to be exposed to unrealised losses on bond portfolios, although there had been little sign of funding pressures. Deposits in smaller US banks had remained stable in aggregate. The Federal Reserve had ceased extending new loans

through its Bank Term Funding Program, which had been introduced in March 2023 to provide an additional source of liquidity to banks. Some advanced economy life insurers also faced losses on bond portfolios and were exposed to sectors still adjusting to a higher interest rate environment, such as private credit and private equity, and CRE. In its October 2023 Global Financial Stability Report, the IMF highlighted that life insurers owned by private equity firms, a fast-growing subsector, had particularly large exposure to illiquid credit investments, and the Financial Stability Oversight Council, in its 2023 Annual Report, noted that US life insurers had meaningful exposures to CRE.

22. The FPC noted that high public debt levels in major economies could have consequences for UK financial stability and interact with other risks, particularly in an environment of tighter financial conditions. Public sector debt levels had risen significantly in recent years and faced continued pressures from structural factors such as demographics and climate change. Moreover, higher interest rates would increase debt servicing costs over time as government debt was refinanced. A deterioration in market perceptions of the path for public debt globally could lead to market volatility and interact with vulnerabilities in market-based finance, potentially tightening 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.

23. Japanese long-term interest rates had risen over the past year as the Bank of Japan changed the way it conducted its yield curve control policy. 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 and could spill over to asset prices in other countries. But so far market moves had remained orderly.

24. Geopolitical risks remained high reflecting developments in the Middle East and the continued war in Ukraine. Such risks increased the uncertainty around the economic outlook and could lead to financial market volatility. Geopolitical risks could interact with each other and increase the likelihood of other vulnerabilities crystallising, amplifying the impact on global and UK financial stability. Climate-related weather events could also lead to macroeconomic disruption and losses for investors and insurers.

UK debt vulnerabilities

UK household resilience

25. While household finances remained under pressure from increased living costs and higher interest rates, the outlook for UK households had continued to improve somewhat since Q4. Higher mortgage rates would continue to pass through to mortgagors as their fixed rate deals expired and they refinanced, but average quoted mortgage rates had decreased slightly since December 2023. The aggregate mortgage debt service ratio (DSR) was projected to increase from 7.0% in 2023 Q3 to 8.4% by the end of 2026, slightly below the

December projection of 8.8%. The proportion of households with high cost of living adjusted debt service ratios (COLA-DSRs)[1] was expected to increase marginally from 1.4% in 2023 Q3 to 1.6% by end-2024. But the projection was broadly unchanged since December and well below the peak of 3.4% in the global financial crisis (GFC). This had been supported by a more favourable outlook for unemployment, interest rates and a return to positive real income growth. However, NMG Consulting survey results suggested that mortgagors with high COLA-DSRs had smaller savings buffers in 2023 Q3, both relative to the previous year and compared with other mortgagors, making them more vulnerable to further shocks.

26. The share of owner-occupier mortgages in arrears of 2.5% or more of the outstanding balance increased from 1.0% in 2023 Q3 to 1.1% in 2023 Q4 but remained low in historical terms, as strong nominal wage growth over recent quarters combined with low unemployment had helped to contain the rise. Owner-occupier mortgage arrears were expected to increase further but were likely to remain well below their early 1990s and post-GFC peaks of 4.0% and 2.4% respectively, absent a very significant rise in unemployment.

27. More than half of the mortgages in arrears were originated prior to 2008. The resilience of the UK household sector reflected, at least in part, the FPC's mortgage market interventions and the Financial Conduct Authority's (FCA) responsible lending requirements, which limit the build-up of household indebtedness to unsustainable levels. New lending at high loan-to-income (LTI) ratios (at or greater than 4.5) had been low, with all major lenders having significant headroom below the FPC's 15% limit. And raising a deposit remained the biggest barrier to accessing the mortgage market.

28. The FPC noted that the annual repossession rate in 2023 was 0.02% of all mortgages, significantly below the early 1990s rate of nearly 0.7%, the 2008 rate of 0.2%, and the historical average of 0.1%. Lenders should only use repossession as a last resort after exhausting all reasonable efforts to address the borrower's position, and more recently firms had been given extensive guidance from the FCA on borrower forbearance and support. The FPC therefore expected repossession rates to remain low but would continue to monitor developments.

29. The FPC noted that the trend towards longer-term mortgages had continued. In 2023 Q4, almost 50% of all new mortgages were issued at terms of 30 years or longer. This had eased affordability constraints for many borrowers, but the FPC noted that this trend could affect future borrower and lender resilience through three channels. First, longer mortgage terms meant a higher risk of debt being pushed into old age. For 40% of new mortgages in 2023 Q4, borrowers would be past the current state pension age at the end of their mortgage term. Second, longer mortgage terms allow borrowers to afford a larger loan amount for a

[1] COLA-DSRs are constructed by dividing a household's debt repayments by their income adjusted for taxes and costs of essentials. Households with high COLA-DSRs (above 70%) are more likely to face repayment difficulties, default or cut back sharply on spending.

given DSR, hence increasing leverage. Third, longer mortgage terms led to slower principal repayments, and thus greater persistence of household debt in the economy – likely reducing the flexibility available for borrowers in the face of future shocks.

30. All three channels could make borrowers more sensitive to negative shocks, increasing the risk of future consumption cuts and defaults. More persistent debt would increase loan-to-value ratios (LTVs) on the stock of debt and so could lead to higher losses in the event of default. But the FPC noted that existing FPC and FCA policies sought to mitigate these risks. And there was currently no evidence that older borrowers or mortgagors with longer terms were more likely to be in arrears. The FPC noted that it would continue to monitor this structural change towards longer-term mortgages and any potential risks to financial stability through any of the channels.

31. The FPC judged that while lending to low-income households was less likely to pose financial stability risks, reflecting the fact they were less likely to be mortgagors, their budgets remained under significant pressure with high levels of food bank usage, energy debt, and late rent payments increasing. Third-sector organisations had reported separately, and via the Bank's Agents, that many households had been cutting back on essential and non-essential consumption as a result of financial challenges. More generally, the Bank's Agents had reported that consumption of both durables and services remained weak.

UK corporate resilience

32. In the UK, corporates remained broadly resilient to high interest rates and weak growth. The amount of outstanding corporate debt relative to corporate earnings had continued to fall since its recent pandemic-era peak.

33. Nevertheless, the full impact of higher financing costs had not yet been passed through to all borrowers and would be felt unevenly. Some smaller or highly leveraged UK firms may struggle to service their debt and some borrowers may be more exposed to refinancing risk.

34. The debt-weighted proportion of medium and large corporates with interest coverage ratios (ICRs) below 2.5 was estimated to have increased to 36% at end-2023 as debts repriced at higher rates. But this remained some way below previous peak levels of 52.9% in 2006 and 48.3% in 2020 and little changed from the December 2023 FSR projection. As evidenced by the 2022/23 ACS results, major UK banks would be resilient in the event that a severe macroeconomic scenario led to significantly increased levels of corporate debt defaults.

35. The FPC noted that refinancing risks remained, particularly in riskier market-based finance segments, such as high-yield bonds, private credit and leveraged loans, all of which were often linked with private equity activity. Staff analysis indicated that the bulk of outstanding market-based UK corporate debt was due to mature in or after 2026. While this

provided time for firms to adjust, continuing refinancing pressures may lead to some firms taking defensive actions, such as cutting employment or investment.

36. The FPC noted that DSRs had risen for more vulnerable SMEs (in the tail of the distribution) since the December 2023 FSR and that corporate insolvencies continued to rise. The corporate insolvency rate had risen to around 53.7 per 10,000 active companies in 2023 – the highest level since 2014 Q3. However, the 2023 insolvency rate remained much lower than the peak rate of 94.8 insolvencies per 10,000 active companies during the GFC. In addition, insolvency numbers remained dominated by micro and small companies. SME debt constituted a relatively small share of major UK bank exposures and therefore the FPC judged that it did not pose a significant financial stability risk via the lender resilience channel.

37. However, the FPC noted that pressures on SMEs could pose a risk via the real economy because they accounted for over half of UK employment and around 40% of investment. The **Finance and Investment Decisions survey** run in 2023 revealed that SMEs reported financial constraints and economic uncertainty as the key reasons for underinvestment. Half of SMEs reported that they used only internal funds to finance investment.

38. Similar to the situation globally, there were a number of headwinds facing the UK CRE market that were weighing on prices and making refinancing challenging. These headwinds included structural challenges such as the cost of upgrading buildings to meet regulatory and other requirements to reduce carbon emissions, as well as cyclical pressure. Office and retail investments faced additional challenges, including the post-pandemic shift to more remote working and the ongoing shift from physical to online shopping. UK CRE prices had fallen by just under 22% between end-June 2022 and end-December 2023 although the rate of decline had slowed in recent quarters. The initial adjustment was rapid by international standards, with prices declining faster than in the US or European markets. Further price falls could present a risk to lenders if they materially reduced the value of the collateral held against their loans.

39. The FPC noted that major UK banks were less exposed to UK CRE compared with previous cycles, and that the results of the 2022/23 ACS – which included a 45% decline in UK CRE prices from their mid-2022 levels – showed that major UK banks would be resilient to a much larger fall in CRE prices relative to those already observed.

UK banking sector resilience

40. 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 Q4, major UK banks remained well capitalised, with a CET1 ratio of 14.7%, and they maintained strong liquidity positions, including with an aggregate 3-month moving average liquidity coverage ratio (LCR) of 147%.

41. In aggregate, small and medium-sized UK banks and building societies were also well capitalised and maintained strong liquidity positions. They had an aggregate CET1 ratio of 17.9% as of 2023 Q4 and an LCR of 254% as of December. 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.

42. The FPC judged that the overall risk environment remained challenging. There was a continued increase in arrears across some UK banks' loan portfolios in Q4. Nevertheless, major UK banks' forward-looking indicators of asset quality had improved in Q4, suggesting that the continued deterioration in performance had been broadly as banks had expected. Some forms of lending, such as to finance certain CRE investments, buy-to-let, and highly leveraged lending to corporates – as well as lenders that were more concentrated in those assets – were more exposed to credit losses as borrowing costs rise.

43. 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.

44. In January, the FCA had announced it would review historical motor finance commission arrangements and sales. This had been followed by share price declines for the UK banks that had been most active in this business line, as markets had priced in expectations of redress costs.

45. 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. There had been a shift away from non-interest-bearing sight deposits, towards interest-bearing sight or time deposits. Major UK banks' holdings of government bonds in their high-quality liquid assets (HQLA) had increased as central bank reserves had reduced i.e. the share of reserves in HQLA had fallen from 67% in February 2022 to 55% in December 2023. Banks were preparing for the end of the Term Funding Scheme with additional incentives for SMEs (TFSME). It was important that banks incorporate all these factors into their liquidity management and planning.

46. Net interest margins had declined somewhat from their recent peaks. However, the aggregate profitability of major UK banks was expected to remain robust, with net interest margins expected to remain higher than 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. Nevertheless, indicators of the market value of major UK banks' future profitability, such as their average price to tangible book ratios, remained subdued. The FPC would continue to monitor the implications of this for financial stability and would include further analysis in the June 2024 FSR.

47. Credit conditions had been broadly unchanged. Although there had been some increase in mortgage product availability and approvals in January, conditions remained tighter for the household and corporate borrowers most impacted by the macroeconomic outlook, including for businesses in vulnerable sectors and for some SMEs.

48. While the flow of gross lending to SMEs contracted by 5% in Q4, it remained close to 2019 levels, and the stock of lending remained 14% higher than in 2019 due in part to the Covid-era loan schemes. Within those gross flows, lending to sectors most affected by the outlook had seen volumes fall below 2019 levels, reflecting a combination of demand and supply factors. In the Q4 Credit Conditions Survey, lenders reported a small improvement in credit availability for SMEs relative to the previous quarter. Lenders also reported that SME demand for credit had been weaker than normal, suggesting that this could have been due to high current levels of indebtedness due to the Covid-era loan schemes.

49. The FPC continued to judge 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 UK banking system remained well capitalised with headroom over regulatory requirements and buffers. The FPC would continue to monitor UK credit conditions for signs of unwarranted tightening.

The UK countercyclical capital buffer rate decision

50. 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.

51. 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. Movements in key indicators had been mixed since the previous quarter. Indicators of terms and conditions in financial markets in particular had become more stretched, while several indicators relevant to banks' UK exposures, including household debt-to-income, corporate gross debt to earnings and domestic credit growth, remained around or below long-term averages.

52. Market expectations for interest rates were a little lower than at the FPC's November 2023 Policy meeting. UK corporates remained broadly resilient and the projected share of firms with low ICRs was broadly in line with previous projections. But some vulnerable

corporates remained under pressure from higher financing costs. The outlook for UK households had improved further since December due to lower current and expected mortgage rates. The share of households with high COLA-DSRs was projected to increase only marginally over the next two years, similar to what was expected in the previous quarter. But debt vulnerabilities were still expected to increase as higher interest rates continue to pass through to mortgagors.

53. 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 had indicated that the major UK banks were resilient to a severe stress scenario. Credit conditions remained tighter for smaller businesses and those sectors most exposed to the macroeconomic outlook – including construction, retail and hospitality. The FPC continued to judge that credit conditions overall reflected changes to the macroeconomic outlook rather than defensive actions by banks to protect their capital positions.

54. Given this context, the Committee discussed possible future paths for the UK CCyB rate. The overall risk environment had remained challenging. While the central economic outlook had improved slightly, some risks to financial stability globally had increased. The adjustment to higher interest rates had continued to pose challenges, and geopolitical risks were heightened. In financial markets, a further compression of risk premia had increased the risk of a sharp fall in asset prices across several markets, should downside risks crystalise. Building additional resilience against the risks to UK banks from such an occurrence, by raising the CCyB, would have a smaller economic impact if started earlier. However, the UK banking system remained resilient, with the capacity to meet credit demand from creditworthy households and businesses, even if economic and financial conditions were to be substantially worse than expected. The Bank's desk-based stress test exercise this year would further inform the FPC's monitoring and assessment of the resilience of the UK banking system to potential downside risks.

55. 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.

56. 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.

57. Consistent with the FPC's CCyB Policy Statement, 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.

Operational resilience

Importance of operational resilience for financial stability

58. One of the **medium-term priorities** of the FPC was to continue to improve macroprudential oversight of operational resilience, by focusing on the risks that could lead to system-wide operational disruption. Operational resilience is the ability of individual firms, financial market infrastructures (FMIs) and the wider financial system to prevent, adapt and respond to, as well as recover and learn from, operational disruptions.

59. The FPC reiterated the growing importance of operational resilience for maintaining UK financial stability. Increased digitalisation and innovation in the financial system had brought benefits and opportunities, but these developments alongside the associated increase in interconnectedness had increased the potential for operational incidents to impact financial stability. Operational resilience would become increasingly important as new and evolving technologies played a greater role in the provision of financial services and as business models continued to change. The FPC also noted that previous operational incidents, including recent ransomware attacks, highlighted the growing risk to financial stability from operational issues and the importance of system-wide resilience.

The FPC's approach to assessing financial stability risks from operational incidents

60. In view of the importance of system-wide operational resilience to financial stability and the continued provision of vital financial services, the FPC had developed its approach to assessing financial stability risks from potential operational incidents, which would be published alongside the Record in the **Financial Stability in Focus (FSIF)** on its approach to operational resilience.

61. The FPC considered that firm-level operational resilience, built by individual firms and FMIs, provided the essential foundation for operational resilience across the system. It noted that the likelihood that an individual firm or FMI would experience an operational incident was determined by vulnerabilities including operational weaknesses, risks associated with transformation and the need to adapt or deliver change programmes, and firm-level dependence on data. These vulnerabilities should be, and could only be, addressed by firms' and FMIs' operational risk management processes and by implementing the operational resilience policies set by their microprudential regulators, including the Bank, the Prudential

Regulation Authority (PRA) and the FCA, which aim to ensure that any disruption to important business services does not impact the objectives of those regulators and the Bank's Financial Stability Objective. The Committee noted that when building and maintaining their own operational resilience, firms and FMIs must also factor in the potential impacts on the wider financial system from weaknesses in their own operational resilience and actions they might take in response to incidents.

62. The FPC noted, however, that resilience of individual firms alone might not be sufficient to ensure system-wide resilience; some additional vulnerabilities existed at the level of the entire system. These vulnerabilities could result from a number of factors: interconnectedness, complexity and opacity, which meant that operational disruptions, and responses to those disruptions, could have knock-on impacts in the system; concentration, which meant that an incident in one provider of a given service could have a disproportionate impact on the system; correlation and common vulnerabilities which could lead to one source of disruption having widespread impacts across the financial sector; and system-wide dependence on data given the criticality of timely access to accurate data to the functioning of the financial system.

63. The operational resilience policies set by the Bank, the PRA and the FCA helped to bridge the gap between firm-level and system-wide operational resilience. Given the risks to financial stability from operational disruptions, the FPC expected that relevant firms[2] and FMIs, e.g. those that were required to take account of risks to UK financial stability under the operational resilience policies, should consider the vital services which were important to financial stability when they identified their important business services. These vital services included:

- payments, clearing and settlement, and other related activity such as custody services;
- deposit taking and the provision of credit, as well as equity capital, including activity in primary and secondary fixed income and equity markets, as well as repurchase agreements (repos) and securities lending; and
- insurance and the facilitation of transactions involving derivatives (for example, for hedging), and activities which support the functioning and supply of liquidity in markets (for example, secondary market making).

64. The FPC would regularly review the operational resilience policy toolkit – with regard to new threats, changes in technology and changes in how the financial system provides vital

[2] As set out in **PS6/21 'Operational resilience: Impact tolerances for important business services' (bankofengland.co.uk)** this includes firms identified by the PRA as other systemically important institutions (O-SIIs) and insurers with gross written premiums exceeding £15 billion or technical provisions exceeding £75 billion, both on a three-year rolling average.

services – and would explore ways to continue to build system-wide resilience to operational disruption, including through:

- assessing potential system-wide gaps in, or risks to, operational resilience, which are not adequately covered by firm-level or microprudential policies;
- continuing to conduct cyber stress testing and considering stress testing for other possible operational disruptions;
- monitoring the implementation and outcomes of the regime for critical third parties; and
- considering whether to set impact tolerances for additional vital services beyond payments.

Cyber stress test 2024

65. Since 2019 the Bank had used regular cyber stress tests to assess the financial system's ability to absorb and restore functioning in severe but plausible scenarios of operational disruption. The FPC had considered details of the next exploratory cyber stress test, which was due to start in Spring 2024 with the findings expected to be published in the first half of 2025. It was expected that this test would be used to explore firms' capabilities and the potential financial stability impact of a hypothetical scenario involving data integrity disruption to wholesale payments and settlement.

Critical third parties

66. The FPC had previously raised the potential for increasing reliance by firms and FMIs on critical third parties (CTPs) to pose a threat to financial stability. Following the creation of a statutory CTP framework, the Bank, the PRA and the FCA (the regulators) published a **Consultation Paper** in December 2023 with proposed requirements and expectations to manage risks posed by CTPs. The regulators' proposals aim to reduce the risk of systemic disruption to the financial sector from CTPs and enhance system-wide operational resilience. The proposals followed the **Discussion Paper** published in July 2022.

The resilience of market-based finance

67. Vulnerabilities in certain parts of market-based finance remained significant. These vulnerabilities could amplify downside risks in financial markets if they were to crystallise, particularly in the context of sharp movements in asset prices, leading to dysfunction in core markets and a tightening in credit conditions for households and businesses. 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 (FSB) international work programme to increase the resilience of market-based finance.

68. Alongside international policy work, the FPC was working to reduce vulnerabilities domestically where it was effective and practical to do so.

Resilience of liability-driven investment funds

69. In **November 2022**, the FPC had recommended that regulatory action be taken, as an interim measure, by the Pensions Regulator (TPR), in co-ordination with the FCA and overseas regulators, to ensure liability-driven investment (LDI) funds remained resilient to the level of interest rates they could withstand at that point. In turn, in March 2023, the FPC had set out a **steady-state resilience standard for LDI funds** to be resilient to a yield shock of around 250 basis points, at a minimum, in addition to the resilience required to manage other risks and day-to-day movements in yields, and had recommended that TPR implement this standard as the supervisory and regulatory body for workplace pension schemes. The FPC also recommended that TPR should have mechanisms for monitoring LDI resilience and have the remit to take into account financial stability considerations in its work on a continuing basis.

70. The FPC welcomed progress made against its November 2022 and March 2023 Recommendations, as set out in TPR's 25 January 2024 letter to the Governor of the Bank of England. In April 2023, TPR had published guidance on the use of leveraged LDI strategies. This had set out a steady-state resilience standard for LDI funds, including expectations for recapitalisation periods, and included detail on practical steps trustees can take to manage risks when using leveraged LDI.

71. There had been continued progress in the implementation of the resilience standard the FPC recommended for LDI funds, and several steps had been taken by authorities to ensure that it would be met on an ongoing basis. The FPC observed that this resilience standard was continuing to function well, with funds maintaining higher levels of resilience compared with prior to the LDI episode in September 2022. Areas for improvement that FPC had identified in its October 2023 Record, including slow recapitalisation periods by some LDI managers, were being addressed via collaboration between domestic and international authorities.

72. The FPC also welcomed recent consultations by the Central Bank of Ireland (CBI) and Luxembourg's Commission de Surveillance du Secteur Financier (CSSF) on macroprudential measures for sterling LDI funds. If put into effect, these measures would complement existing guidance by UK authorities to maintain the resilience of the LDI sector.

73. The FPC welcomed TPR's efforts to enhance its data collection and capabilities and ongoing collaboration between UK authorities on LDI data monitoring. Addressing data gaps and embedding the more regular use of data analytics was essential to building a deeper understanding of vulnerabilities and resilience in the LDI sector as well as market-based finance more broadly. The FPC observed that continued and effective cross-authority

collaboration had been an essential component of its Recommendations to TPR, and supported ongoing collaboration on a range of issues, including the Bank's System-Wide Exploratory Scenario (SWES).

74. The FPC noted that, in its response to the Work and Pensions Select Committee on the use of LDI by defined benefit pension schemes, the Government had stated that it accepted the FPC's Recommendation that TPR should incorporate financial stability considerations in its decision making and balance them with its objectives as a pensions regulator.

FCA consultation on improving transparency for bond and derivatives markets

75. The FPC had previously noted that there would be value in exploring ways to enhance market intermediation capacity in a stress, without compromising dealer resilience, including through potential changes to market structure. The 2022 FSB report on Liquidity in Core Government Bond Markets concluded that while no reform was a silver bullet to enhance the resilience of core government bond markets, policies to enhance the risk monitoring and the preparedness of market participants, such as increasing the level of transparency in domestic government bond markets could be considered by individual jurisdictions.

76. In that context the FPC welcomed the FCA consultation paper on **Improving transparency for bond and derivatives markets** that was published on 20 December 2023, containing proposals to revise the transparency framework through changes to scope and calibration as well as through improved information content.

77. The FPC judged that, in addition to advancing the FCA's objectives to enhance market integrity and promote effective competition, an appropriately calibrated transparency regime would support UK financial stability.

78. The FPC welcomed the FCA's focus on proportionate calibration which sought to support continued liquidity provision by dealers. From a financial stability perspective there was a need to balance the potential benefits from better and more timely transparency with potential costs to market liquidity. For example, proposals which aimed to increase transparency should ensure that they do not significantly harm the ability of market participants, such as dealers, to offer liquidity in larger sizes due to them not being given adequate time to hedge their positions. The FPC also discussed the importance of considering the structure of different markets in a way that did not add unnecessary complexity when calibrating the regime.

79. The FPC noted that greater transparency could support UK financial stability by helping to increase both the number of participants and their trading volumes, supporting market liquidity in normal and stressed conditions and through providing market participants with the information necessary to improve their liquidity risk management. It would enable market participants to better estimate market depth and the cost of unwinding their positions,

improving their ability to manage liquidity risks, which is first and foremost their responsibility. This in turn could reduce the risk of demand for liquidity, including that from non-bank financial institutions (NBFIs), rising unduly in stress.

80. Greater market transparency of both price and trade size would also support the future implementation of the international policy work led by the FSB to increase the resilience of market-based finance. This included the work coordinated by the FSB to enhance the liquidity preparedness of non-bank market participants for margin and collateral calls, as well as the FSB's recommendations for open-ended funds (OEF), which aims to significantly strengthen the liquidity management by OEF managers compared to current practices. The FPC noted that both policy initiatives were examples where market transparency data could provide market participants with the tools to better manage the risks they faced.

81. The FPC would continue to engage with the FCA on the progress of their consultation and its outcome later in the year.

Development of the NBFI lending tool

82. The FPC welcomed ongoing work to strengthen the Bank's toolkit 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, where possible, 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 and less moral hazard. The FPC noted that the first step in this process would be to design a facility that will enable the Bank to lend to eligible pension funds, insurance companies and LDI funds against UK gilts in times of system-wide stress. Second, and over time, the Bank would consider how this tool might be broadened to include a wider range of NBFIs as counterparties.

Libor transition

83. The FPC received an update on the transition away from Libor and welcomed the smooth cessation of the USD Libor panel at end-June 2023. It continued to support the view that synthetic versions of Libor were a temporary solution, and that active transition of legacy contracts provided the best route to certainty for parties to contracts referencing Libor.

84. The FPC welcomed the fact that the final synthetic GBP Libor setting would cease on 28 March and noted that all remaining synthetic Libor settings had planned end dates in 2024. It encouraged participants to maintain momentum on transition efforts to minimise remaining exposures ahead of these dates.

85. The Committee welcomed the further reduction in the stock of legacy USD Libor exposures, and consequently judged that the financial stability risk in the UK associated with USD Libor had effectively been mitigated.

86. The FPC re-iterated its view that rates based on the Secured Overnight Financing Rate (SOFR) provided more robust alternatives than USD credit sensitive rates, and that these latter rates had the potential to reintroduce many of the financial stability risks associated with Libor.

87. The Committee re-iterated its caution on the use of term SOFR, outside of the specific use cases recommended by industry working groups, to ensure markets transition to the most robust benchmarks.

Financial stability and climate change

88. The FPC was briefed on the Bank's latest work on the financial risks from climate change, including physical risks and risks from the transition to net-zero. The FPC noted that these risks were relevant to its primary objective. Since the publication of the Results of the Climate Biennial Exploratory Scenario (CBES) in 2022, the Bank and the FPC had continued to build their understanding of how these risks might arise. The FPC noted that risks are rising as the physical impacts of climate change emerge and the economy and individual firms take steps to transition. The Committee would publish an update on its approach to evaluate how climate change could impact UK financial stability in the June 2024 FSR.

Resolution framework

89. The FPC welcomed HM Treasury's consultation on Enhancing the Special Resolution Regime, relating to a new mechanism to support small bank resolution, which closed on 7 March. The FPC supported this work to learn lessons from the March 2023 global banking sector stress and to enhance the UK bank resolution regime. As such, the FPC underlined the importance of the timely implementation of a new mechanism to support small bank resolution.

The following members of the Committee were present at the 13 March 2024 Policy meeting:

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

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

Annex: Financial Policy Committee policy decisions

Outstanding FPC Recommendations and Directions (as at the date of the FPC's meeting on 13 March 2024).

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 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 13 March 2024, unchanged from its 21 November 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.[3] 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

[3] 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,[4] and the FCA has issued general guidance.[5]

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[6].

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[7] (see Annex), together with the original Recommendation (now implemented).

The PRA has published its approach to implementing this Direction and Recommendation[8].

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[4] 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.
[5] See www.fca.org.uk/publications/finalised-guidance/fg17-2-fpc-recommendation-loan-income-ratios-mortgage-lending.
[6] https://www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021
[7] https://www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2022/fpc-summary-and-record-october-2022.pdf
[8] 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)