

BROOKINGS

QUALITY. INDEPENDENCE. IMPACT.

Financial Policy Committee at the Bank of England

Presentation at the Federal Reserve Board of Governors
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Thank you to Pari Sastry for research assistance.

Who we are

- 5 Internal Members
 - » 3 overlap with Monetary Policy Committee (MPC)
 - » 3 overlap with Prudential Regulation Authority (PRA)
- Head of Financial Conduct Authority (FCA)
- 4 External Members
- HM Treasury nonvoting member

Our Objectives

FPC

1. Identify, monitor and take action to **remove or reduce systemic risks** with a view to enhancing and protecting the resilience of the UK financial system.
2. Subject to that, **support the economic policy of the Government** (growth and employment)

MPC

1. Stable prices (2% inflation target) and confidence in the currency

HMT 'Remit and Recommendations to the FPC'

- Annual letter from the Chancellor setting out government's economic policy
- Recommendations to the FPC on:
 - » Interaction between primary and secondary objectives
 - » FPC/MPC interaction
 - » Risks to public funds
 - » Regulatory perimeter
 - » Accountability
 - » Medium-term priorities

How we operate

- The FPC meets quarterly – broadly four elements to a round:
 - » Briefing (Bank staff/ MI/ other regulators)
 - » Key issues (established by FPC)
 - » Policy discussions (recommendations/ directions)
 - » Communication

How we operate

- Decision by consensus
 - » (contrast with MPC)
- Proportionality and Cost-Benefit
- European context

Our Powers

- Recommendation:
 - » To anyone
 - » To PRA/FCA
 - › Can be on a comply or explain basis

- Direction:
 - » Tools approved by Parliament
 - » Must be complied with
 - » Consultation can be suspended (by Treasury)
 - » Requires policy statement on how it will be exercised

Our Powers of Direction

- Current:
 - » Countercyclical Capital Buffer
 - » Sectoral Capital Requirements
 - › Core indicators
- Proposed:
 - » Housing
 - › Debt-to-income
 - › Loan-to-value
 - › Interest coverage for buy-to-let
 - » Leverage
 - › Base level
 - › Countercyclical Buffer
 - › SIFI buffer

What we've done

- Regular Duties
 - » Publishing Financial Stability Report
 - › (semi-annual)
 - » Set Countercyclical Capital Buffers
 - › (quarterly)
 - » Monitor regulatory perimeter
 - › (annual)

Our Recommendations – (1)

(by broad category)

1. Information

- » Ask FCA or PRA to drill down
 - › CRE forbearance
 - › Euro area break-up risk
 - › Interest rate risk

- » Increase Bank Transparency
 - › Publish leverage ratios
 - › Implement Enhanced Disclosure Taskforce (EDTF) recommendations
 - › Consistent and comparable Pillar 3 disclosures

Our Recommendations – (2)

(by broad category)

2. Build bank capital

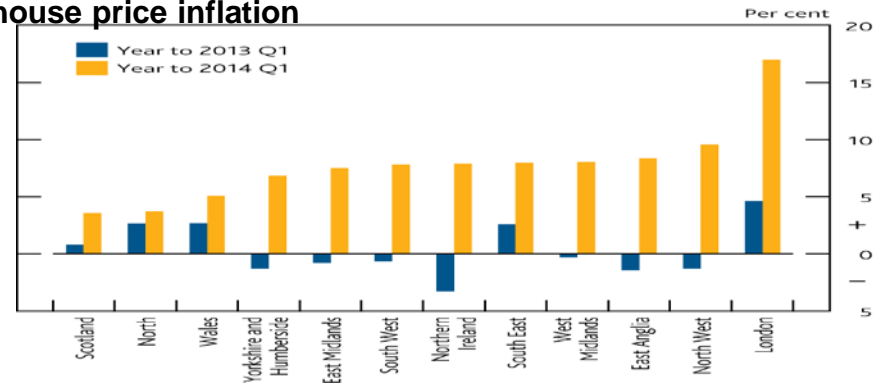
- » Without reducing lending to UK real economy
 - Strongly-worded suggestions
 - Capital headwinds exercise
 - Concurrent stress test
 - › Impetus
 - › Scenario
 - › Hurdle
 - › Response?

3. Housing

House price inflation has increased in all areas of the United Kingdom during the past year



Annual house price inflation

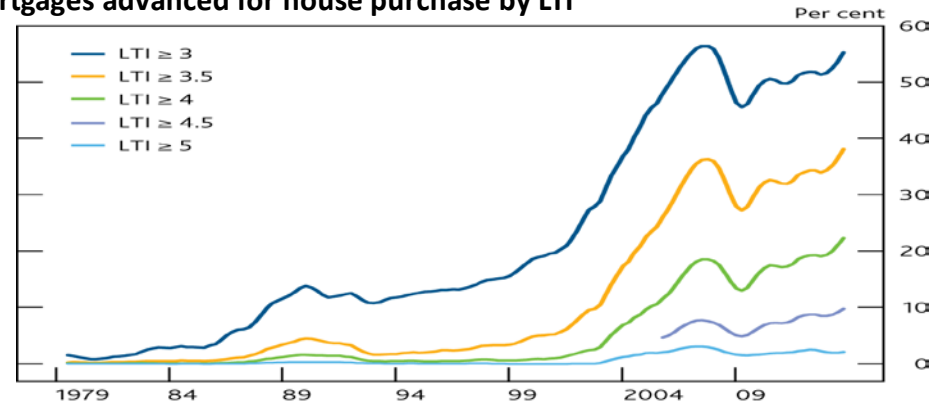


Sources: Halifax, Nationwide and Bank calculations.

The share of new mortgages with LTI multiples above 4.5 has risen to a new peak



New mortgages advanced for house purchase by LTI

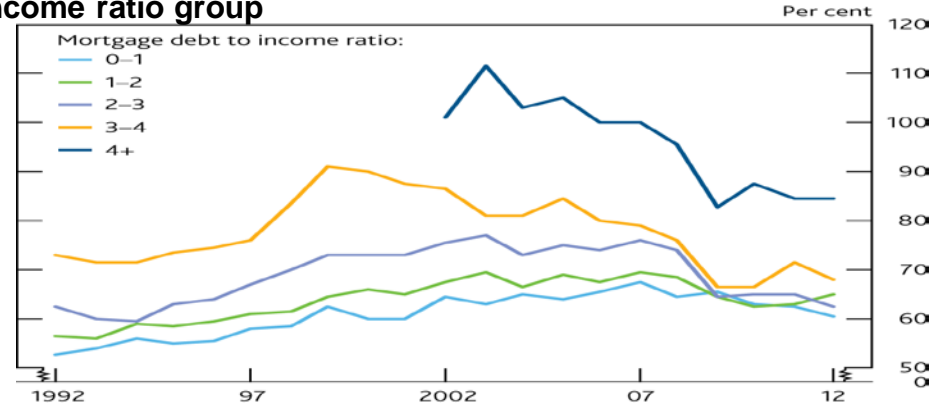


Sources: Council of Mortgage Lenders, FCA Product Sales Data (PSD) and Bank calculations

Households with higher debt to income ratios cut spending by more in the crisis



UK mortgagors' non-housing consumption as a share of income by debt to income ratio group



Sources: Department of Communities and Local Government, Living Costs and Food Survey, ONS and Bank calculations.

Our Recommendations

Recommendation 1

When assessing affordability, **mortgage lenders should apply an interest rate stress test that assesses whether borrowers could still afford their mortgages if, at any point over the first five years of the loan, Bank Rate were to be 3 percentage points higher than the prevailing rate at origination.** This recommendation is intended to be read together with the FCA requirements around considering the effect of future interest rate rises as set out in MCOB 11.6.18(2).

Recommendation 2

The PRA and the 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.

Additional Thoughts

- Insurance against deteriorating standards
- Heavily indebted households and financial stability
 - » externality
 - » Financial variable – debt
 - » But not intermediation
- Other actions on housing:
 - » Funding-for-lending restriction
 - » Help-to-buy evaluation

Our Role in Monetary Policy

FS Knockout and Forward Guidance

- On 7 August 2013, the MPC announced a policy of explicit forward guidance. This would only cease to hold if one of three ‘knock-outs’ were breached, one of which – the FS knock-out – lies in the hands of the FPC.
- It is breached if “the Financial Policy Committee (FPC) judges that **the stance of monetary policy poses a significant threat to financial stability that cannot be contained by the substantial range of mitigating policy actions** available to the FPC, the FCA and the PRA in a way consistent with their objectives”.

(no longer in effect)