“ My Reflections on the FPC’s Strategy”

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The views expressed are my own and should not be taken to represent those of the Bank of England or its policy committees.

Outline

1. Background and FPC remit
2. Making the remit operational
3. Our tools and how do we use them?
4. Lessons learned so far
5. Some remaining challenges

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The FPC

- Modelled on the UK Monetary Policy Committee.
- 13 members – 6 from the Bank of England, the CEO of the conduct regulator, a non-voting member from HM Treasury, and 5 external members.
- 4 policy meetings a year, 2 Financial Stability Reports.
- Where possible, decisions by consensus. But voting possible.

The FPC's powers:

- Recommendations to anybody; 47 thus far, all accepted.
- Binding directions to the microprudential (PRA) and conduct (FCA) regulators.

Our remit

- Responsible for 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.

- Specific systemic risks mentioned in the legislation

  – systemic risks attributable to structural features of financial markets, such as connections between financial institutions,

  – systemic risks attributable to the distribution of risk within the financial sector, and

  – **unsustainable levels of leverage, debt or credit growth**.

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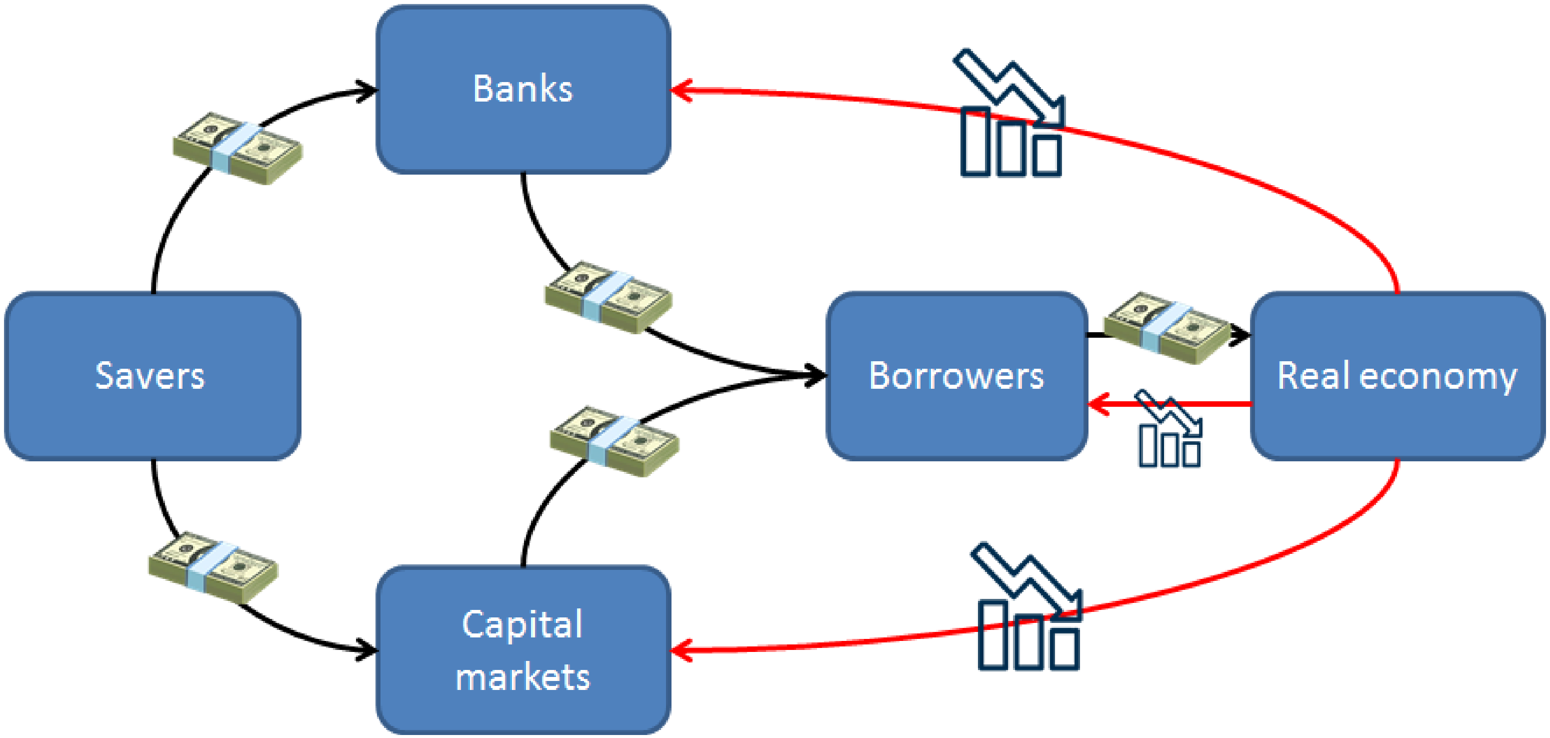
Implicit model of threats to financial stability

1. Households steer their savings through markets and banks

2. There are feedbacks from the condition of the real economy to borrowers, markets and the banking system



3. If either the supply of credit is materially impaired or a significant proportion of borrowers are over-extended, then the economy will suffer

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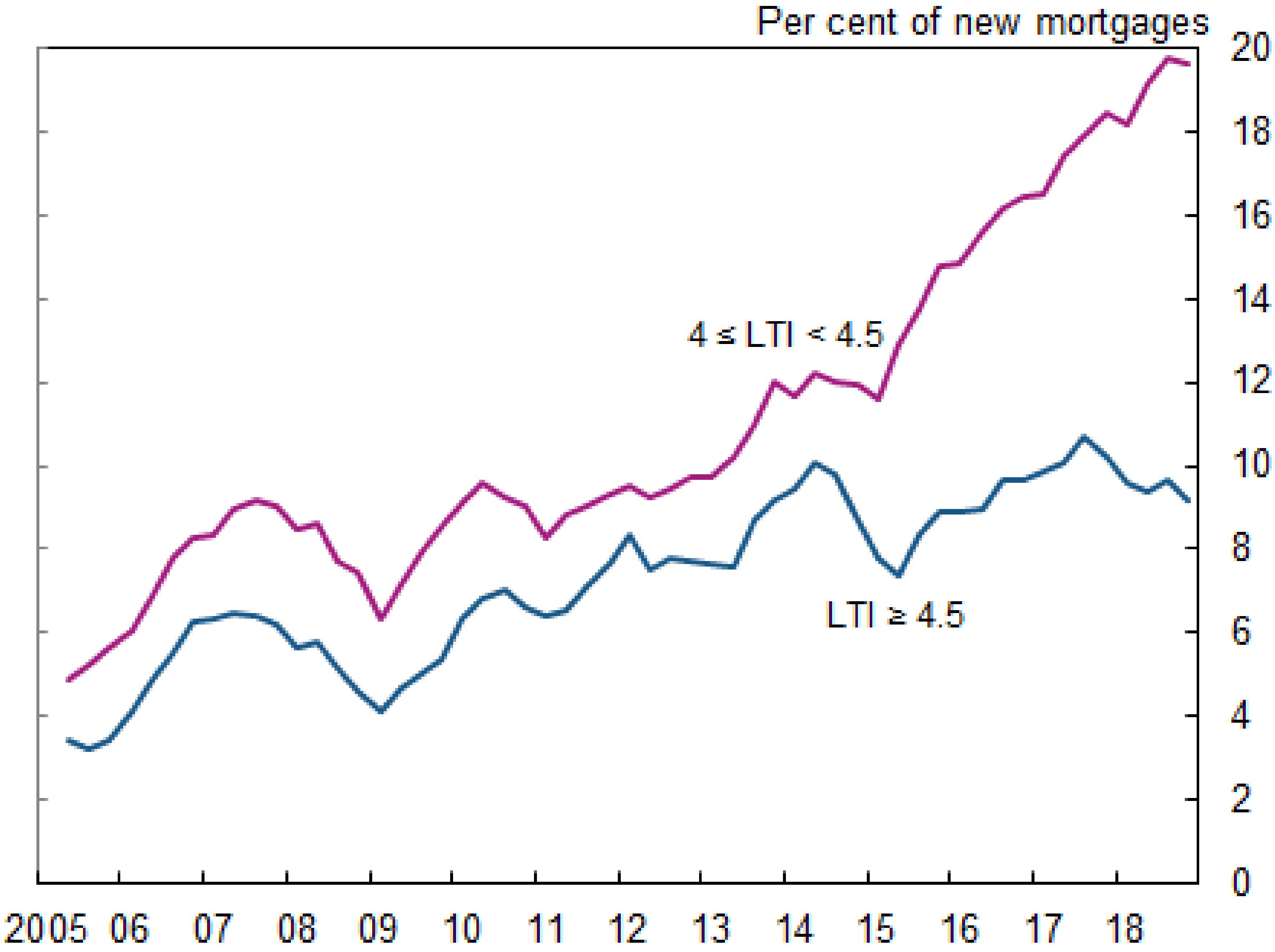
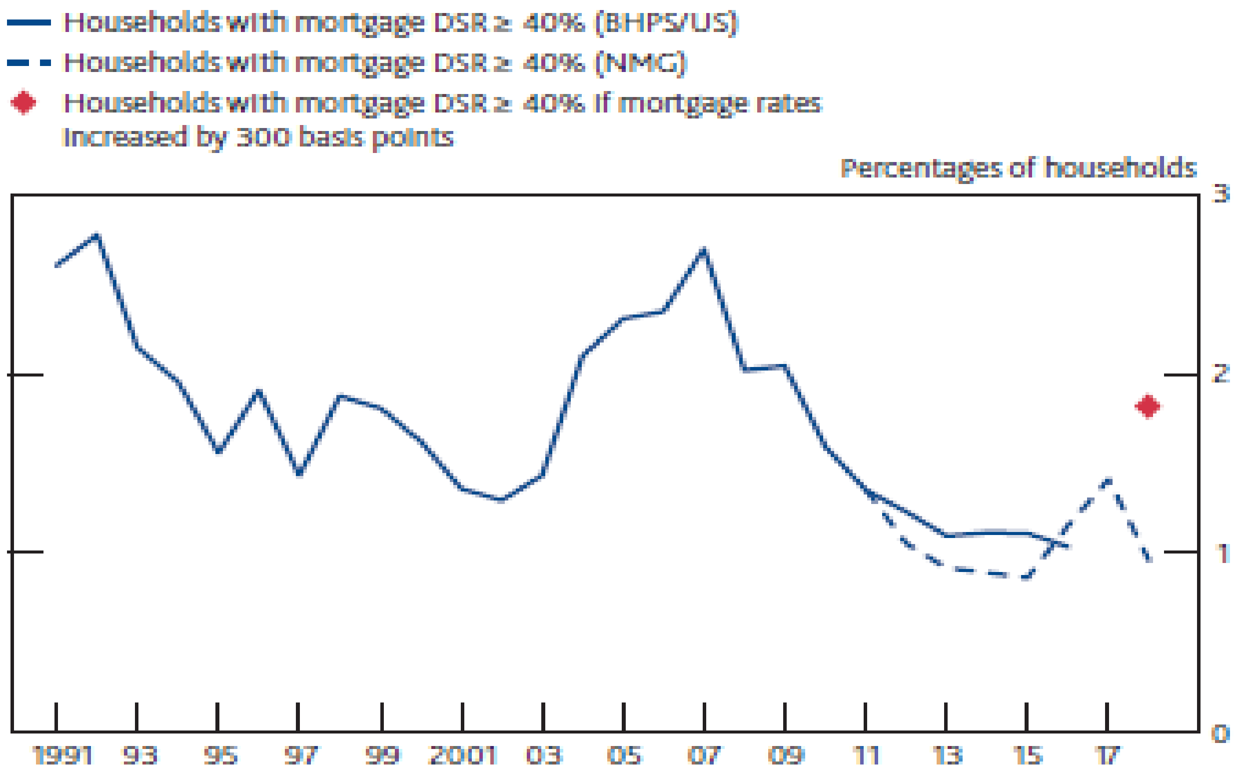
Prominent Examples of FPC Tools and Decisions

Tool type	Date	Description
Borrower Resilience	June 2014	15% LTI flow limit for owner-occupier mortgages
Borrower Resilience	June 2014	Affordability tests for mortgages
Borrower Resilience	June 2017	Update affordability tests for mortgages
Bank Resilience	Annual since 2014	Stress test scenario design
Bank Resilience	Quarterly	Set CCyB
Bank Resilience	June 2015	Introduction of a UK leverage ratio framework
Market Resilience	June 2013	Contingency planning for LIBOR and other benchmark rates disappearing
Market Resilience	March 2015	Asked the Bank and FCA address data gaps and build a common understanding of vulnerabilities in capital markets and asset management activities; report back by September
Market Resilience	June 2015	Asked the Bank, PRA and FCA to ensure firms at the core of the UK financial system, including financial market infrastructure, completed their cyber vulnerability tests and adopted resilience action plans.
Market Resilience	Semi-Annual	Financial stability report risk identification chapters
Brexit mitigants	Quarterly since 2017	Checklist laying out risks to banks, borrowers and markets

Proportion of new mortgage lending by LTI



Tail of the Debt Service Ratio as a “State Variable” for Borrower Resilience



Sources: British Household Panel Survey/Understanding Society (BHPS/US), NMG Consulting survey and Bank calculations.

(a) Mortgage DSR calculated as total mortgage payments as a percentage of pre-tax income.
(b) The percentage of households with mortgage DSRs of 40% or greater is calculated using the NMG Consulting survey from 2011 onwards. BHPS/US are used from 1991–2011, and are provided as a comparison to the NMG Consulting survey from 2011–16.
(c) A new household income question was introduced in the NMG survey in 2015. Data from 2011 to 2014 surveys have been adjusted based on 2015 data to produce a consistent time series.

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Principles guiding tool usage

- Try to identify an externality that a tool must fix
  - Aggregate demand in the case of housing
- Use cost-benefit when possible
  - Tradeoff gains from allowing some high DSR borrowing against risks
- Pick a tool that is fit for purpose
  - Big question: structural or time-varying, housing tools have elements of both

Lessons so far

- Be humble: the post GFC period is probably not indicative, should not be declaring victory
- Strive for predictability and transparency, but you must be forward-looking
- Committee needs a portfolio of skills
- Dogs that did not bark
  - No inter-committee warfare, limited public pushback

Challenges

- Communicating -- talking about tail risk is hard

- Defining success -- is moving a crisis probability from 1 in 20 years to 1 in 50 appropriate?

- Finding a summary measure for financial stability -- is GDP at risk a way to start?