BANK OF ENGLAND

Financial Stability Report
Executive summary

July 2016

This pull-out contains the Executive summary of the *Report* only.
The full *Report* is available on the Bank's website at
www.bankofengland.co.uk/publications/Pages/fsr/2016/jul.aspx

Executive summary

It is the statutory responsibility of the Financial Policy Committee (FPC) to identify, monitor and take action to remove or reduce systemic risks, with a view to protecting and enhancing the resilience of the UK financial system. By fulfilling this responsibility, the FPC ensures that risks to financial stability are addressed. Transparency about risks is essential to strengthen resilience and for plans to be put in place to manage those risks should they crystallise.

Consistent with its remit, the FPC identified in March the risks around the referendum on the United Kingdom's membership of the European Union as the most significant near-term domestic risks to financial stability.

The Committee had identified the following channels through which the referendum could increase risks to financial stability:

- the financing of the United Kingdom's large current account deficit, which relied on continuing material inflows of portfolio and foreign direct investment;
- the UK commercial real estate (CRE) market, which had experienced particularly strong inflows of capital from overseas and where valuations in some segments of the market had become stretched;
- the high level of UK household indebtedness, the vulnerability to higher unemployment and borrowing costs of the capacity of some households to service debts, and the potential for buy-to-let investors to behave procyclically, amplifying movements in the housing market;
- subdued growth in the global economy, including the euro area, which could be exacerbated by a prolonged period of heightened uncertainty; and
- fragilities in financial market functioning, which could be tested during a period of elevated market activity and volatility.

The FPC has monitored these channels of risk closely. There is evidence that some risks have begun to crystallise. The current outlook for UK financial stability is challenging.

There will be a period of uncertainty and adjustment following the result of the referendum. It will take time for the United Kingdom to establish new relationships with the European Union and the rest of the world. Some market and economic volatility is to be expected as this process unfolds.

The degree of uncertainty and nature of adjustment is evident in financial market prices, which have moved sharply following the referendum. Between 23 June and 1 July, the sterling exchange rate index fell by 9% and short-term volatility of sterling against the dollar rose to its highest level in the post-Bretton Woods era. Equity prices of UK banks have fallen on average by 20%, with UK-focused banks experiencing the largest falls. Equity prices of domestically focused companies have fallen by 10%. The ten-year UK government bond yield fell by 52 basis points. These moves reflect an increase in risk premia on UK assets, a perceived weaker growth outlook, and anticipation of some future deterioration in the United Kingdom's terms of trade and supply capacity.

Rises in funding spreads for investment-grade borrowers and banks have been more than offset by falls in risk-free interest rates. Between 23 June and 1 July, investment-grade corporate bond yields fell by around 25 basis points. Wholesale debt funding costs for the major UK banks fell by a similar amount. Overall bank funding costs — taking into account any increase in the cost of equity and the change in wholesale debt funding costs — are broadly unchanged since the referendum.

During this period of uncertainty and adjustment, the resilience of the UK financial system, upon which financial stability depends, is grounded on:

- substantial capital and liquidity buffers, which have been shown in repeated stress tests to enable banks to absorb extremely severe economic and market shocks without amplifying those shocks;
- the regulatory framework of the United Kingdom that allows capital and liquidity buffers to be drawn on, as needed, to allow the system to cushion shocks and maintain the provision of financial services to the real economy; and
- an institutional framework that promotes co-ordinated, evidence-based responses to risks. This framework was used to develop and implement extensive contingency plans by UK authorities and firms in advance of the referendum. The Bank of England and HM Treasury co-ordinated with international authorities.

The FPC is focused on promoting a financial system that dampens, rather than amplifies, the impact of uncertainty and adjustment on the real economy. This means reducing any pressure on firms to restrict the provision of financial services, including the supply of credit and support for market functioning.

The FPC is monitoring closely the risks of: further deterioration in investor appetite for UK assets; adjustments in CRE markets leading to tighter credit conditions for businesses; increasing numbers of vulnerable households and procyclical behaviour of buy-to-let investors; the outlook for the global economy; and reduced and fragile liquidity in core financial markets.

Having consistently built over recent years the resilience that is necessary for the system to face this challenging outlook, the FPC stands ready to take actions that will ensure that capital and liquidity buffers can be drawn on, as needed, to support the supply of credit and in support of market functioning. At policy meetings on 28 June and 1 July:

- The FPC reduced the UK countercyclical capital buffer rate from 0.5% to 0% of banks' UK exposures with immediate effect (see Box 1). Absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK countercyclical capital buffer rate until at least June 2017. This action reinforces the FPC's expectation that all elements of the substantial capital and liquidity buffers that have been built up by banks are able to be drawn on, as necessary. It will reduce regulatory capital buffers by £5.7 billion, raising banks' capacity for lending to UK households and businesses by up to £150 billion.

- The FPC welcomed the Bank of England's announcement that it will continue to offer indexed long-term repo operations on a weekly basis until end-September 2016. This is a precautionary step to provide additional flexibility in the Bank's provision of liquidity insurance, further reinforcing the ability of firms to draw on their own liquidity buffers.

- The FPC supported the position of the Prudential Regulation Authority (PRA) to allow insurance companies to use the flexibility in Solvency II regulations to recalculate transitional measures. These measures smooth the impact of those regulations. Without them, the regulations, which came into force in January, would tighten regulatory constraints on insurance companies following sharp falls in market interest rates. At the margin, the recalculation of transitional measures is likely to reduce immediate pressure on insurance companies to sell corporate securities and other risky assets.

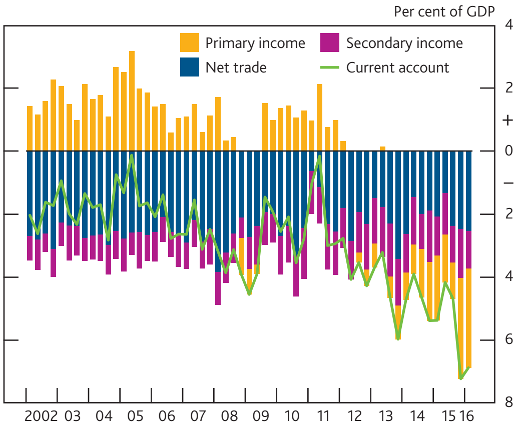
As the outlook evolves, the FPC stands ready to take any further actions deemed appropriate to support financial stability.

Risks around the EU referendum

Consistent with its remit, the FPC identified in March the **risks around the referendum** on the United Kingdom's membership of the European Union as the most significant near-term domestic risks to financial stability. It set out its assessment of those risks in the Statement following, and the Record of, its March meeting.

The financing of the United Kingdom's large current account deficit, which is high by historical and international standards (**Chart A**). The financing of the deficit is reliant on continuing material inflows of portfolio and foreign direct investment, which have been used to finance the public sector deficit and corporate investment, including in commercial real estate. A sudden shift in the supply of foreign capital and in the current account deficit would be associated with a sharp increase in risk premia and adjustment in sterling.

Chart A The UK current account deficit is high by historical and international standards
Decomposition of the UK current account(a)

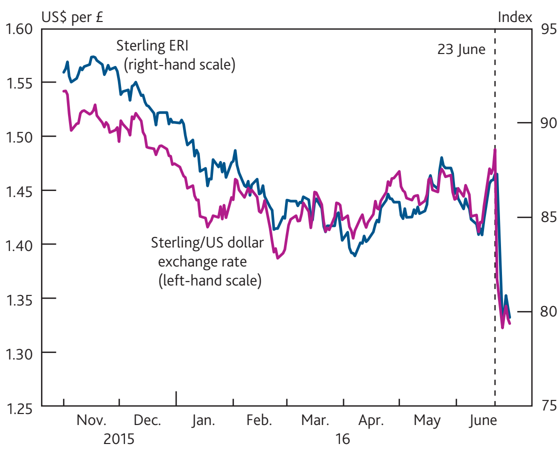


Sources: ONS and Bank calculations.

(a) Primary income mainly consists of compensation of employees and net investment income. Secondary income consists of transfers.

*In the run-up to the referendum, there were signs that foreign portfolio inflows into UK equities had slowed. Following the referendum, sterling experienced its largest two-day fall against the dollar in the post-Bretton Woods era (**Chart B**). Risk premia on UK assets increased.*

Chart B Sterling fell sharply as the referendum result became clear
Sterling exchange rates



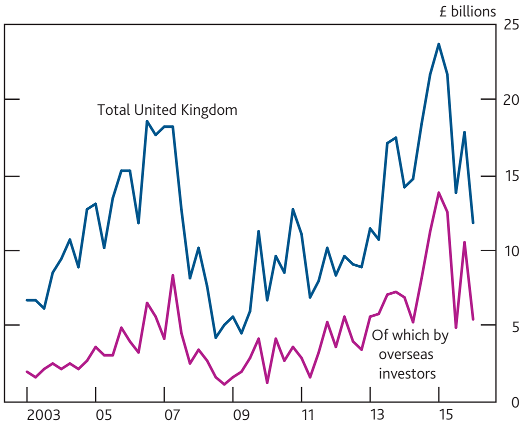
Source: Bloomberg.

The UK commercial real estate market, which had experienced particularly strong inflows of capital from overseas over recent years. Foreign investors accounted for around 45% of the value of total transactions since 2009. Valuations in some segments of the market, notably the prime London market, had become stretched.

*Foreign inflows of capital to the UK CRE market fell by almost 50% in the first quarter of 2016 (**Chart C**). More recently, share prices of real estate investment trusts have fallen sharply, reflecting the risk of future marked adjustments in commercial real estate prices.*

Chart C CRE transactions fell in early 2016

UK CRE transactions (gross quarterly flows)

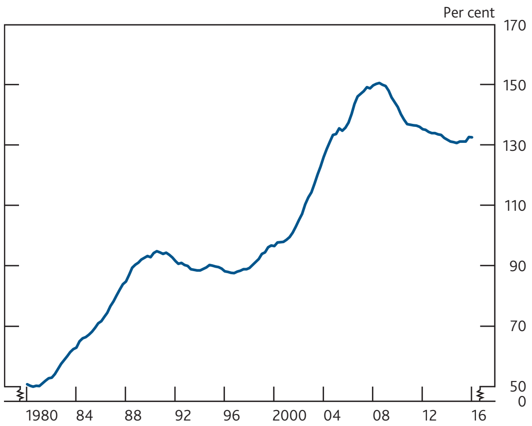


Sources: The Property Archive and Bank calculations.

The high level of UK household indebtedness (**Chart D**), the vulnerability to higher unemployment and borrowing costs of the capacity of some households to service debts, and the potential for buy-to-let investors to behave procyclically, amplifying movements in the housing market.

Chart D Household indebtedness is elevated

UK household debt to income ratio(a)



Sources: ONS and Bank calculations.

(a) Gross debt as a percentage of a four-quarter moving sum of disposable income. Includes all liabilities of the household sector except for the unfunded pension liabilities and financial derivatives of the non-profit sector. The household disposable income series is adjusted for financial intermediation services indirectly measured (FISIM).

Given that the outlook for economic activity and employment has deteriorated, credit conditions may tighten. At its June meeting, the Monetary Policy Committee reported growing evidence that uncertainty about the referendum had led to delays to major economic decisions, which past evidence suggested could increase unemployment. There are early signs that these effects have continued since the referendum.

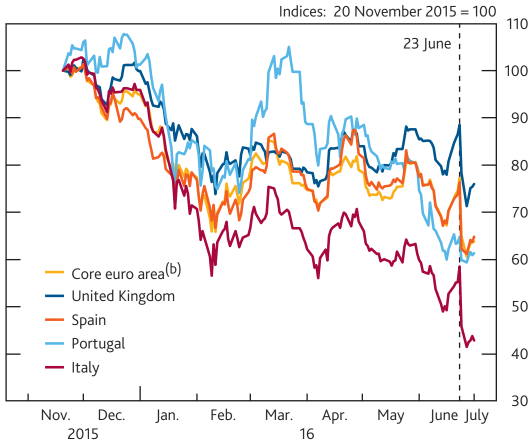
Survey evidence on the housing market has been difficult to interpret in recent months because of the impact of the pre-announced increase in stamp duty on additional properties, which took effect in April. Nevertheless, the RICS survey showed that expectations of housing market activity and price growth slowed sharply in May. New buyer enquiries in May were at the lowest level since 2008.

Subdued growth in the global economy, including the euro area, which could be exacerbated by a prolonged period of heightened uncertainty. This comes at a time when banks in some vulnerable euro-area countries are still working through legacy issues from the financial crisis and are facing challenges from operating in a low nominal interest rate environment.

*Since the referendum, long-term interest rates in the euro area have fallen further. Between 23 June and 1 July, the equity prices of banks in Italy and Spain fell by 27% and 15% respectively (**Chart E**). And the cost of default protection on banks associated with some vulnerable euro-area economies has risen.*

Chart E UK and euro-area banks equity prices have come under particular pressure

UK and euro-area bank equity indices(a)



Sources: SNL Financial, Thomson Reuters Datastream and Bank calculations.

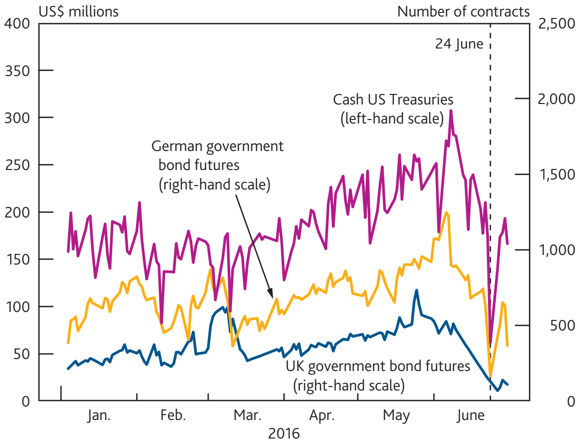
(a) Weighted by 2015 assets.
(b) Ten largest banks based on 2015 total assets in Austria, Belgium, France, Germany and the Netherlands.

Fragilities in financial market functioning, including reductions in the provision of market liquidity services in a number of core financial markets, such as government and corporate bond markets. These fragilities could be tested during a period of elevated market activity and volatility.

*Following the referendum, the foreign exchange market experienced particularly high volumes of transactions relative to normal levels with no apparent impairment of price discovery. Activity in some fixed-income markets has been subdued but largely orderly (**Chart F**). This means that the capacity of these markets has not to date been tested materially by market adjustments.*

Chart F Depth in government bond markets fell in the run-up to, and following, the referendum

Market depth in ten-year government bond markets[(a)]



Sources: Brokertec, Eurex, ICEU and JPMorgan Chase & Co.

(a) Measured as the volume available to transact at the three best bid and ask prices, averaged daily. US series refers to the benchmark ten-year government bond in the cash market. UK and German series refer to the benchmark ten-year government bond in the respective futures markets.

Resilience of the UK financial system

The resilience of the financial system, upon which financial stability depends, is its ability to withstand economic and financial shocks without amplifying their effect on the real economy by restricting the provision of financial services, including the supply of credit and support for market functioning.

The resilience of the UK financial system is grounded on:

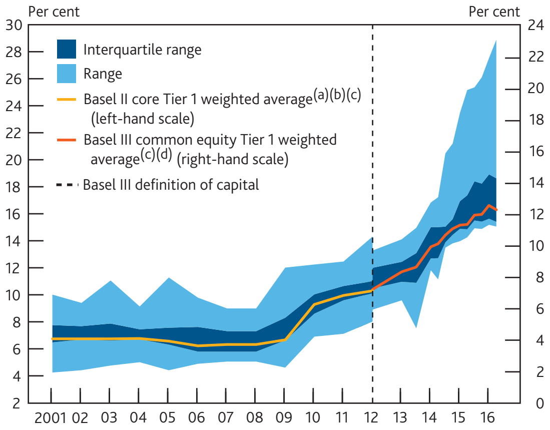
Capital and liquidity buffers

Over the past eight years, major UK banks have raised more than £130 billion of capital. The major UK banks' aggregate Tier 1 capital amounts to 13.5% of risk-weighted assets and 4.9% of aggregate exposures. They hold more than £600 billion of high-quality liquid assets, which is around four times the level they held before the financial crisis. Together, these **capital and liquidity buffers** give UK banks the flexibility they need to continue to lend to UK households and businesses, even during challenging times (**Chart G**).

The Bank of England has stress tested banks against extremely severe economic scenarios. In 2014, the scenario used to stress test the major UK banks included an abrupt slowing in capital flows, a fall in the sterling exchange rate index of 30%, falls in residential and commercial property prices of around 35% and 30% respectively, around a 3.75 percentage point increase in Bank Rate to anchor inflation expectations, a severe recession and around a 4.5 percentage point increase in unemployment. The 2015 stress-test scenario was based around a severe downturn in emerging market economies, Europe and the global economy, and a squeeze on net interest income as Bank Rate was cut to zero. That test led to losses twice as large as those incurred in the global financial crisis.

Chart G Capital positions have improved

Major UK banks' capital ratios



Sources: PRA regulatory returns, published accounts and Bank calculations.

(a) Major UK banks' core Tier 1 capital as a percentage of their risk-weighted assets. Major UK banks are Banco Santander, Bank of Ireland, Barclays, Co-operative Banking Group, HSBC, Lloyds Banking Group, National Australia Bank, Nationwide, RBS and Virgin Money. Data exclude Northern Rock/Virgin Money from 2008.
(b) Between 2008 and 2011, the chart shows core Tier 1 ratios as published by banks, excluding hybrid capital instruments and making deductions from capital based on FSA definitions. Prior to 2008 that measure was not typically disclosed; the chart shows Bank calculations approximating it as previously published in the *Report*.
(c) Weighted by risk-weighted assets.
(d) From 2012, the 'Basel III common equity Tier 1 capital ratio' is calculated as common equity Tier 1 capital over risk-weighted assets, according to the CRD IV definition as implemented in the United Kingdom. The Basel III peer group includes Barclays, Co-operative Banking Group, HSBC, Lloyds Banking Group, Nationwide, RBS and Santander UK.

By the end of each test, it was confirmed that the UK banking system would have the capacity to continue lending to the real economy under such stresses.

This resilience is demonstrated by market moves since the referendum. Although bank equity prices have fallen sharply, reflecting new perceptions of the economic outlook and prospects for bank profitability, bank funding costs remain significantly lower than during previous episodes in which bank equity prices have fallen sharply (**Table 1**). This should reduce the pressure on banks to tighten credit conditions.

Table 1 Market indicators are not as pronounced as in previous episodes of stress

Market indicators[(a)(b)]

	Global financial crisis	Euro sovereign debt crisis	Previous *Report*	23 June 2016	1 July 2016
Price to book ratio[(c)]	0.35	0.43	0.83	0.72	0.58
Additional Tier 1	–	–	451	627	719
Senior CDS	222	319	59	99	123
Senior unsecured bond	368	322	50	76	96
Covered bond	218	127	5	8	12

Sources: Bank of England, Bloomberg, Markit Group Limited and Bank calculations.

(a) The footnotes to **Chart B.3** on page 18 also apply here.
(b) Funding spreads are measured in basis points.
(c) Relates the share price with the book, or accounting, value of shareholders' equity per share.

The regulatory framework

The outlook for financial stability is also supported by the **United Kingdom's regulatory framework for financial services, which allows the system to draw upon its capital and liquidity buffers**, as needed, to maintain the provision of financial services. This means that shocks to the economic and financial environment can be cushioned, rather than amplified, by the system.

Nothing in financial regulation has changed as a result of the referendum. It will not change until the process of the United Kingdom's withdrawal from the European Union is complete, and until EU law ceases to have effect in the United Kingdom. The Bank is continuing to implement the current regulatory framework until any new arrangements with the European Union take effect. That framework implements internationally agreed standards.

The framework provides that around half the level of capital that the largest banks are expected to hold in normal conditions should take the form of capital buffers that can absorb shocks in times of stress. The framework also provides for liquidity buffers that must, as with capital buffers, be maintained in normal conditions. These are supplemented by liquidity facilities from the Bank of England and other central banks. For commercial banks, the ability to draw down these buffers, if needed, allows them to continue to lend to UK households and businesses; for firms with investment banking functions, it allows them to continue to provide services that support the liquidity and functioning of core financial markets.

The FPC strongly expects that banks will continue to support the real economy, by drawing on buffers as necessary. This includes the countercyclical capital buffer, which for UK exposures is set by the FPC.

Extensive contingency planning

The resilience of the UK financial system has been further enhanced by the actions of the Bank of England, alongside other domestic authorities and international authorities, and financial companies themselves, to put **extensive contingency plans** in place, including through supervision by the PRA. The measures will continue to support institutional resilience and market functioning during the period of heightened uncertainty. The FPC was briefed on, and reviewed, these plans in advance of the referendum.

In March, the Bank of England announced measures to provide additional sterling liquidity to banks, building societies and broker-dealers around the referendum, through three additional indexed long-term repo operations.

Eligible counterparties have positioned collateral with the Bank of England that creates the capacity to access more than £250 billion of additional funds through the Bank's normal operations and facilities. On 30 June, the Bank announced that it will continue to offer indexed long-term repo operations on a weekly basis until end-September 2016. The Bank is also able to provide substantial liquidity in foreign currency, if required, using existing swap lines in place with the Federal Reserve, the European Central Bank and other central banks.

Market functioning was also supported by the operational resilience of central counterparties and their management of financial risks using collateral calls from clearing members. Clearing of trades has not been disrupted and has been resilient to the record volumes of trading seen following the referendum. The ability of banks to meet margin calls through buffers of liquid assets has been assessed.

Challenges to the outlook for financial stability

The FPC judges that the current outlook for financial stability is challenging. It is monitoring closely the risks of:

Further deterioration in investor appetite for UK assets. During a prolonged period of heightened uncertainty, the risk premium on UK assets could rise further and overseas investors could continue to be deterred from investing in the United Kingdom. Persistent falls in capital inflows would be associated with further downward pressure on the exchange rate and tighter funding conditions for UK borrowers.

Adjustments in commercial real estate markets tightening credit conditions. Any adjustment in CRE markets could potentially be amplified by the behaviour of leveraged investors and investors in open-ended commercial property funds. Although they have a range of measures to manage stressed levels of redemptions, these open-ended funds could be forced to sell illiquid assets to meet redemptions if conditions persist beyond funds' notice periods. Any such amplification of market adjustments could affect economic activity by reducing the ability of companies that use commercial real estate as collateral to access finance.

Increasing numbers of vulnerable households and procyclical behaviour of buy-to-let investors. Since their implementation in 2014, the FPC's Recommendations on owner-occupier mortgage underwriting standards have guarded against a sharp increase in the proportion of households that are very highly indebted. However, the ability of some households to service their debts would be challenged by a period of weaker employment and income growth. These vulnerable households could affect broader economic activity by cutting back sharply on expenditure in order to continue to service debts. In March, the FPC welcomed the PRA's Supervisory Statement on underwriting standards in the buy-to-let market. The Committee is monitoring the behaviour of buy-to-let investors, which has the potential to amplify movements in the housing market.

The outlook for the global economy. The FPC has previously highlighted the risks from rapid credit growth in China. Though policy stimulus measures look to have stabilised the economy in the near term, that has been associated with even more rapid growth of credit, increasing financial fragility over the medium term. This could have potentially significant spillovers to emerging market economies (EMEs) and the global economy more broadly. Diminished global risk appetite and a further appreciation of the US dollar could also bring vulnerabilities associated with high, and growing, levels of debt in a number of EMEs into sharper relief. Although spillovers to date have not been widespread, a prolonged period of uncertainty associated with the referendum could affect the global economy, particularly the euro area. The euro area accounts for around two fifths of the United Kingdom's trade and around one third of UK foreign direct investment. Major UK banks' exposure to the euro area amount to around 200% of their core equity capital.

Reduced and fragile liquidity in core financial markets. Further adjustment of market prices is possible, with the potential for a material rebalancing of investor portfolios. This could test the liquidity of core financial markets. In such an environment, prices could tend to move discontinuously and overshoot in response to shocks. An abrupt rise in liquidity premia would amplify adjustments in market prices and tighten credit conditions for UK corporate borrowers. The FPC has reviewed developments in market liquidity, including in the context of its review of the FPC Direction on a leverage ratio requirement and buffers (see Box 2).

Actions by the Financial Policy Committee

Having consistently built the resilience that is necessary for the system to face this challenging outlook, the FPC stands ready to take actions that will ensure that capital and liquidity buffers can be drawn on as necessary to support the supply of credit and market functioning, and thereby promote financial stability. At policy meetings on 28 June and 1 July:

- The FPC reduced the UK countercyclical capital buffer rate from 0.5% to 0% of banks' UK exposures with immediate effect. Absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK countercyclical capital buffer rate until at least June 2017. This action reinforces the FPC's view that all elements of the substantial capital and liquidity buffers that have been built up by banks are able to be drawn on, as necessary. It will reduce regulatory capital buffers by £5.7 billion, raising banks' capacity for lending to UK households and businesses by up to £150 billion.

- The FPC welcomed the Bank of England's announcement that it will continue to offer indexed long-term repo operations on a weekly basis until end-September 2016. This is a precautionary step to provide additional flexibility in the Bank's provision of liquidity insurance, further reinforcing the ability of firms to draw on their own liquidity buffers.

- The FPC supported the position of the PRA to allow insurance companies to use the flexibility in Solvency II regulations to recalculate transitional measures. These measures smooth the impact of those regulations. Without them, the regulations, which came into force in January, would tighten regulatory constraints on insurance companies following sharp falls in market interest rates. At the margin, the recalculation of transitional measures is likely to reduce immediate pressure on insurance companies to sell corporate securities and other risky assets.

Part A of this *Report* sets out in detail the Committee's analysis of the major risks and action it is taking in the light of those risks. Part B summarises the Committee's analysis of the resilience of the financial system.

Box 1
Countercyclical capital buffer

The FPC is reducing the UK countercyclical capital buffer rate from 0.5% to 0% of banks' UK exposures with immediate effect. Absent any material change in the outlook, and given the need to give banks the clarity necessary to facilitate their capital planning, the FPC expects to maintain a 0% UK countercyclical capital buffer rate until at least June 2017.

This action reinforces the FPC's view that all elements of the substantial capital and liquidity buffers that have been built up by banks are able to be drawn on, as necessary, to allow them to cushion shocks and maintain the provision of financial services to the real economy, including the supply of credit and support for market functioning.

It will reduce regulatory capital buffers by £5.7 billion. For a banking sector that, in aggregate, targets a leverage ratio of 4%, this raises their capacity for lending to UK households and businesses by up to £150 billion.

In March, the FPC had begun to supplement regulatory capital buffers with the UK countercyclical capital buffer. This reflected its assessment that the risks the system could face were growing and additional capital was needed that could be released quickly in the event of an adverse shock.

At that time, the FPC judged that risks associated with domestic credit were no longer subdued, as they had been in the period following the financial crisis, and global risks were heightened. The Committee raised the UK countercyclical capital buffer rate to 0.5% and signalled its expectation that it would increase it further, to 1%, if the risk level remained unchanged.

As set out in this *Report*, a number of economic and financial risks are materialising. The FPC strongly expects that banks will continue to support the real economy, by drawing on buffers as necessary.

Consistent with the FPC's leverage ratio framework, the countercyclical leverage ratio buffer rate will also fall.

The Committee's decision in March to raise the UK countercyclical capital buffer rate to 0.5% was due to take effect formally from 29 March 2017. However, as the Committee explained in March, there is an overlap between the risks captured by existing PRA supervisory capital buffers and a positive UK countercyclical capital buffer rate of 0.5%.

The PRA Board concluded in March 2016 that, to ensure there is no duplication in capital required to cover the same risks, existing PRA supervisory buffers of PRA-regulated firms should be reduced, as far as possible, to reflect a UK countercyclical capital buffer rate of 0.5%, when such a rate came into effect.

The FPC has therefore accompanied its decision to reduce the UK countercyclical capital buffer rate with a Recommendation to the PRA that it bring forward this planned reduction in PRA supervisory capital buffers.

Recommendation: **The FPC recommends to the PRA that, where existing PRA supervisory buffers of PRA-regulated firms reflect risks that would be captured by a UK countercyclical capital buffer rate, it reduce those buffers, as far as possible and as soon as practicable, by an amount of capital which is equivalent to the effect of a UK countercyclical capital buffer rate of 0.5%.**

The PRA Board has agreed to implement this Recommendation. This means that three quarters of banks, accounting for 90% of the stock of UK economy lending, will, with immediate effect, have greater flexibility to maintain their supply of credit to the real economy. Other banks will no longer see their regulatory capital buffers increase over the next nine months, increasing their capacity to lend to UK households and businesses too.

Consistent with this, the FPC supports the expectation of the PRA Board that firms do not increase dividends and other distributions as a result of this action.

Box 2
Market liquidity and review of leverage Direction

In advance of the referendum the FPC had reviewed developments in market liquidity (see Developments in market liquidity chapter). Over the past year, government and corporate bond markets, including in the United Kingdom, have shown signs of reduced liquidity, and activity in repo markets has fallen materially. Some measures of the compensation investors require for liquidity risk have picked up. These reductions in market liquidity probably, in part, reflect post-crisis regulations as firms adjust their risk management and business models. The FPC judges that these regulations remain materially beneficial because of their contribution to the resilience of these markets and to financial stability more broadly.

However, the FPC judged that some market developments motivated careful review and consideration of whether there are possible refinements that would promote market effectiveness without compromising the resilience of the core system. In that context, the FPC has completed the annual review of its Direction to the PRA regarding leverage requirements for major banks and building societies (see the FPC Direction on a leverage ratio requirement and buffers chapter).

The Committee is reminding banks that the requirements are intended to be applied only at consolidated level. It is also responding to the Basel Committee's consultation on international leverage ratio standards. The FPC judges that there would be merit in these standards amending the current definition of total exposures in two respects: netting of cash receivables and cash payables from unsettled sales of securities; and allowing initial margin posted by clients to reduce dealers' potential future exposures to a default of those clients in centrally cleared derivatives transactions.

The Committee is further calling on the Basel Committee to review carefully the possible unintended effects of forthcoming international leverage ratio standards on the ability of the banking system to cushion shocks and to draw on central bank liquidity facilities as necessary. The FPC intends to keep under review the possible effects of including holdings of central bank reserves in measures of exposures used to calculate banks' leverage ratios.