BANK OF ENGLAND

Mark Carney
Governor

Mr Mario Draghi
Chair of ESRB General Board
60640 Frankfurt am Main
Germany

6 July 2015

Dear Mario,

UK countercyclical capital buffer rate

In accordance with Article 136 of Directive 2013/36/EU (CRD IV), I am writing to notify the European Systemic Risk Board that the UK countercyclical capital buffer (CCB) rate has been set at 0 per cent, as announced in the *Financial Stability Report* which was published on 1 July. More information on the UK's approach to setting the CCB rate is provided in the annex to this letter.

In addition, the CCB rates of 1.5% set by Sweden and Norway on their banks' domestic exposures will be reciprocated in the United Kingdom from 27 July 2016 and 30 July 2016, respectively.

Yours sincerely,

Annex: Further information on setting of the UK CCB rate

Information required to be published under CRDIV	Latest data*
Applicable countercyclical buffer rate	0%
Credit-to-GDP ratio	145.1%
Deviation of credit-to-GDP from long-term trend	-25.3%
Buffer guide	0%

* As of 19 June 2015.

Justification for the buffer rate on UK exposures (Source: Box 6, July 2015 Financial Stability Report)

In setting the CCB, the Committee considers a range of indicators and analysis that assess the threats to UK financial stability, and the resilience of the UK banking system.

The Committee's judgements on the main risks to UK financial stability are set out in Part A [of the July 2015 Financial Stability Report]. Some risks, particularly around Greece and emerging markets, have increased since December. Some other risks have declined. Notably, the risks associated with low growth in advanced economies have moderated particularly as growth prospects in the euro area have improved following actions by the European Central Bank.

In June 2015, the Committee also considered the Basel 'buffer guide' — a simple metric identified in legislation, based on the size of the gap between the credit to GDP ratio and its long-term trend. Reflecting modest credit growth over the past year, the credit to GDP ratio has fallen by around 5 percentage points over the past twelve months to 145%. As a result, the 'buffer guide' implied that the CCB should be set at 0%.

But the Committee considers there to be a number of drawbacks to this measure and that there should be no simple, mechanistic link between the buffer guide and the CCB rate. For example, while the negative gap partly reflects the weakness in credit growth to the non-financial private sector, it is also driven by a strong upward trend in the credit to GDP ratio prior to the crisis (Chart B); yet this strong growth trend was clearly not sustainable and might not be consistent with the path of credit to GDP in the years ahead.

As set out in Part B, UK banks have continued to strengthen their capital and funding positions, as part of transitioning towards stronger regulatory requirements (see Section B.1). Furthermore, actions taken as a result of the 2014 stress-test exercise will have increased UK banks' resilience. The Committee will examine UK banks' ability to withstand risks that could materialise from developments in emerging market economies and financial markets as part of the 2015 stress-test exercise, as set out in Box 3.

Taking these considerations into its overall assessment of risks, at its June meeting the Committee agreed to set the CCB rate for UK exposures at 0%, unchanged from March 2015.

Reciprocation

The FPC also has responsibility for deciding whether foreign CCB rates should be reciprocated by the UK authorities. While such decisions are made on an individual basis, in most cases reciprocation would enhance UK financial stability and therefore the FPC expects to reciprocate foreign CCB rates. In light of this, the Committee noted that the PRA would reciprocate recent CCB actions by Norway and Sweden.