HM Treasury

The Financial Policy Committee's housing market tools

October 2014

HM Treasury

The Financial Policy Committee's housing market tools

October 2014

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gsi.gov.uk

ISBN 978-1-910337-36-3
PU1710

Preface

Scope of this consultation:

On 2 October 2014, the Financial Policy Committee (FPC) published its recommendations to the Government. Specifically, the FPC recommended that it be granted powers of direction over the following housing tools for the owner-occupied and buy-to-let residential mortgage markets:

- Loan-to-Value (LTV) Ratios; and
- Debt-to-Income (DTI) Ratios, including Interest Coverage Ratios (ICR) in respect of buy-to-let lending.

The Government is now responding to the FPC's recommendations with a proposal for draft legislation. This consultation seeks to gather the opinions of stakeholders and other interested parties concerning the housing market tools that the FPC has recommended it be granted powers of direction over.

Who should read this:

Institutions that would be affected by the FPC's powers of direction (i.e. PRA- and FCA-authorised firms) and associated bodies. We would also welcome responses from all parties interested in housing market policies.

Duration:

The consultation will run from 30 October 2014 to 28 November 2014.

Lead official:

Ali Uppal, HM Treasury.

How to respond or enquire about this consultation:

Responses are requested by 28 November 2014. Please send responses to:

FPC housing consultation
Financial Stability Group
Room 1/34, HM Treasury
1 Horse Guards Road
London, SW1A 2HQ
Email: FPChousingconsultation@hmtreasury.gsi.gov.uk

After the consultation:

The Government is committed to ensuring that both the public and Parliament are given ample opportunity to scrutinise and examine the proposals in this document. We will use the responses to the consultation to inform the final legislation.

We intend to lay the final legislation before Parliament in early 2015. The order containing the direction tools will then need to be approved by resolution of both Houses of Parliament, via the affirmative procedure. We also intend to publish a consultation response document and impact assessment alongside the legislation.

Getting to this stage:

On 12 June 2014, the Chancellor announced, in his annual Mansion House speech, that the FPC would be granted powers of direction over housing market tools, specifically over LTI and LTV, and that HM Treasury would consult on them.

On 2 October 2014, the FPC published its statement which includes its recommendations to the Government on the specific tools the FPC believes it would need powers of direction over to tackle financial stability risks in the housing market. The FPC's statement also includes a qualitative cost-benefit analysis.

Contents

1 Introduction

Background

1.1 The global financial crisis exposed deep flaws in the financial regulatory architecture. Since then, the Government has embarked on an ambitious programme of reform to deal with the legacy of the crisis.

1.2 In June 2010, the Chancellor, at his annual Mansion House speech, explained that a key weakness of the system of financial regulation was the lack of focus on broader risks across the economy, in areas like housing.

1.3 As a result, the Government created the Financial Policy Committee (FPC) within the Bank of England. The FPC's role includes identifying, monitoring and taking action to address emerging risks and vulnerabilities across the financial system as a whole.

1.4 In his Mansion House speech on 12 June 2014 the Chancellor committed to ensuring that the FPC has "all the weapons it needs to guard against risks in the housing market". He announced his intention to give the FPC "new powers over mortgages, including over the size of mortgage loans as a share of family incomes or the value of the house". He said that the Treasury would consult on the tools, and that they would be in place before the end of this Parliament.[1]

1.5 The FPC is empowered to make recommendations to the Government that it be given powers of direction over specified tools.[2] In response to the Chancellor's announcement, on 2 October 2014, the FPC recommended that it be granted powers of direction over housing market tools in relation to owner-occupied mortgages and buy-to-let residential mortgages.[3] Specifically, the FPC recommended that it be granted the power to direct, if necessary to protect and enhance financial stability, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) to require regulated lenders to place limits on mortgage lending, both owner-occupied and buy-to-let, by reference to:

- Loan-to-Value (LTV) Ratios; and
- Debt-to-Income (DTI) Ratios, including Interest Coverage Ratios (ICR) in respect of buy-to-let lending.

1.6 In response to this recommendation, the Government is proposing that powers of direction are granted for LTV limits and DTI limits in respect of owner-occupied mortgages. The Government would particularly welcome respondents' views on the appropriate definition of debt for the purposes of the FPC's power of direction.

[1] See *Mansion House 2014: Speech by the Chancellor of the Exchequer*, available at https://www.gov.uk/Government/speeches/mansion-house-2014-speech-by-the-chancellor-of-the-exchequer.

[2] As set out in section 9P of the Bank of England Act 1998 (as amended by the Financial Services Act 2012)

[3] *Financial Policy Committee statement from its policy* meeting, 26 September 2014, available at http://www.bankofengland.co.uk/publications/Pages/news/2014/080.aspx

1.7 The FPC also recommended that it be granted powers of direction over LTV limits and ICRs in respect of the buy-to-let mortgage market. The FPC argued that buy-to-let mortgages can pose risks to financial stability through similar channels to the owner-occupied sector. The Government intends to consult separately on these recommendations in 2015 with a view to building an in-depth evidence base on how the operation of the UK buy-to-let housing market may carry risks to financial stability.

Aims of the consultation

1.8 This consultation aims to gather views on whether the powers of direction over owner-occupied mortgages that the Government is proposing to grant the FPC are necessary and should be sufficient, subject to the separate consultation on buy-to-let, to ensure that the FPC is able to address risks in the housing market, and that the benefits in terms of enhanced financial stability outweigh any costs. This will ensure that the final approach taken will result in domestic legislation that meets the aims of the FPC recommendations in a proportionate way.

1.9 The consultation also seeks specific comments on the draft legislation granting the FPC these powers.

Structure of the document

1.10 The background above outlines the FPC's recommendations. The remainder of the document is set out as follows:

- Chapter 2 provides an overview of the FPC and its powers;
- Chapter 3 explores the financial stability risks from the housing market;
- Chapter 4 sets out the Government's proposals;
- Chapter 5 provides a copy of the draft legislation; and,
- Chapter 6 sets out a summary of the consultation questions.

Implementation

1.11 Section 9L of the Bank of England Act 1998 (as amended by the Financial Services Act 2012) allows HM Treasury to make secondary legislation prescribing macroprudential measures for the purposes of section 9H.

2 The Financial Policy Committee

Macroprudential Policy and the Financial Policy Committee

2.1 There has been increasing recognition that traditional microprudential policies allowed financial vulnerabilities to grow unchecked, contributing to the global financial crisis. A key lesson of the crisis has been that the safety and soundness of individual institutions focused primarily on financial resources and idiosyncratic risks (i.e. microprudential regulation) is not enough to maintain financial stability.

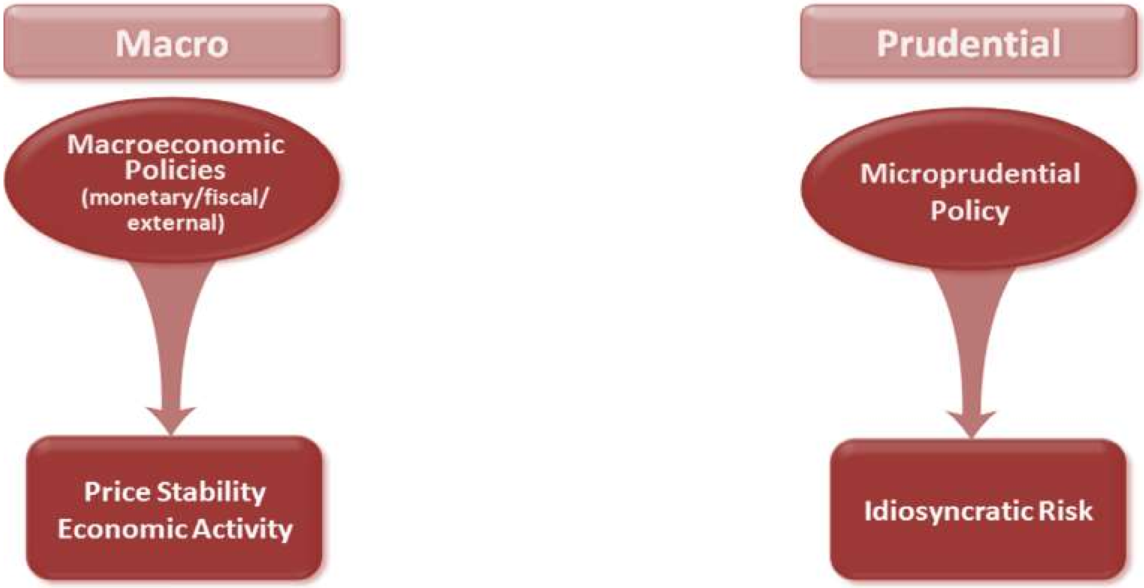
2.2 As a result, authorities across the world have sought a more systemic approach to financial stability. This holistic approach is called macroprudential policy.

2.3 However, macroprudential policy is not intended to displace microprudential policy but rather to complement both microprudential policy and macroeconomic policy (see Chart 2.A and Chart 2.B).

2.4 Macroprudential policy can deploy traditional regulatory tools (relying on the regulators for implementation and enforcement). However, it adapts the use of these tools to counteract growing vulnerabilities in the financial system by assessing two key dimensions of risk:

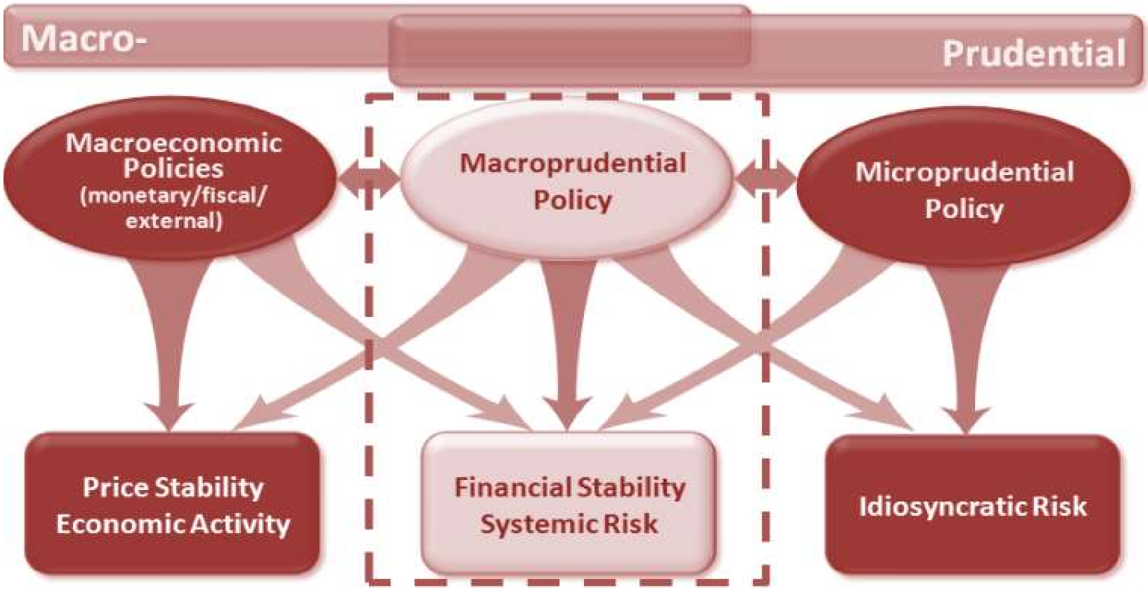
- Cross-sectional dimension of risk: the contributions of individual institutions to systemic risk. This is related to connections between institutions, the distribution of risk within the sector and structural factors such as information asymmetries.
- Time-series dimension of risk: the evolution of systemic risk through time. This is related to over-exuberance in the upturn of the financial cycle being exacerbated by systematic under-pricing of risk, leading to asset bubbles, stretched balance sheets and other unsustainable expansionary trends. This can be monitored by tracking a wide set of macroeconomic and financial variables such as the ratio of credit to GDP.

Chart 2.A: How we saw the world before the financial crisis



Source: *The Interaction of monetary and macroprudential policies,* IMF, January 2013.

Chart 2.B: How we see the world now



Source: *The Interaction of monetary and macroprudential policies,* IMF, January 2013.

2.5 The UK has embraced macroprudential policy and is not alone in moving to incorporate macroprudential policy into its regulation of the financial system. The European Systemic Risk Board in the European Union and the Financial Stability Oversight Council in the United States are just two prominent examples of this international shift.

2.6 The UK Government created the independent Financial Policy Committee (FPC) within the Bank of England with statutory responsibility for maintaining financial stability.[1]

2.7 The FPC's primary objective is 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. However, given there are interactions between macroprudential policy and economic activity (see Chart 2.B), the Government provided the FPC with a secondary objective to support the economic policy of the Government.

2.8 The FPC has eleven members, of which ten are voting members. Its members are the Governor of the Bank of England, three of the Deputy Governors, the Chief Executive of the FCA, the Bank's Executive Director for Financial Stability Strategy and Risk, four external members appointed by the Chancellor, and a non-voting Treasury member.

2.9 The FPC meets on a quarterly basis, and it publishes a Financial Stability Report (FSR) every 6 months. The aim of the FSR is to set out the FPC's assessment of the outlook for the stability and resilience of the financial sector, and to make recommendations based on this assessment.

Powers of the FPC

2.10 The FPC has two main sets of powers at its disposal. These are its powers of recommendation and powers of direction. Reflecting its macroprudential role, the FPC is not responsible for making decisions in respect of individual firms; it can only make recommendations or issue directions that relate to all regulated institutions or to all institutions that meet a specified description. The role of the FPC is therefore a crucial complement to, but distinct from, those of the firm level regulators – the PRA and the FCA.

Powers of recommendation

2.11 The FPC has a power to make recommendations to the regulators – the PRA and the FCA – about the exercise of their functions, such as to adjust the rules facing banks and other regulated financial institutions. The FPC can issue these recommendations on a 'comply or explain' basis. Should the regulators decide not to implement these 'comply or explain' recommendations, they would be required to explain their reasons for not doing so.[2]

2.12 The FPC is also able to make recommendations to HM Treasury, including on additional macroprudential tools that the Committee considers that it may need, and on the 'regulatory perimeter' – that is, both the boundary between regulated and non-regulated activities within the UK financial system, and the boundaries of different regulators within the regulated sector.[3]

2.13 The FPC also has a broader power to make recommendations to any other persons. For example, this power allows the FPC to make recommendations directly to the industry or to independent bodies such as the Financial Reporting Council.

Powers of direction

2.14 The second set of powers is to give directions to the regulators (i.e. the PRA and FCA) to implement specific macroprudential tools.

2.15 The Capital Requirements Regulation and the Capital Requirements Directive 4 establish rules concerning the prudential supervision of banks and certain investment firms. These rules contain a formalised framework for macroprudential measures where they operate directly on

[1] The structure of the FPC and its objectives are set out in Part 1A of the Bank of England Act 1998 (as amended by the Financial Services Act 2012).

[2] As set out in section 9Q of the Bank of England Act 1998 (as amended by the Financial Services Act 2012)

[3] As set out in section 9P of the Bank of England Act 1998 (as amended by the Financial Services Act 2012)

risk weights, levels of own funds, large exposures, liquidity or microprudential buffers. Moreover, the framework established rules for setting the countercyclical capital buffer (CCB).

2.16 Currently, the FPC has the power to apply two macroprudential tools that operate within the EU framework for macroprudential measures:

- It is responsible for policy decisions on the CCB: the FPC can require banks and large investment firms to build up capital when it judges it to be the best approach to head off threats to financial stability. The CCB would be released either when threats to stability are judged to have receded, or when the size of banks' capital buffers is judged to be more than sufficient to absorb future unexpected losses and credit conditions and other relevant indicators are weak. The FPC's decisions on the CCB apply to those firms' UK exposures.
- It has a power of direction over sectoral capital requirements (SCRs): this allows the FPC temporarily to increase banks' capital requirements on exposures to specific sectors. The FPC is able to adjust SCRs for exposures to three broad sectors: residential property, including mortgages; commercial property; and, other parts of the financial sector.

2.17 These tools apply to all banks, building societies, and large investment firms incorporated in the UK (investment firms which are not authorised by the PRA have been carved out from the scope of the FPC's SCR powers by the Government and smaller investment firms which are authorised by the FCA have been exempted from the CCB).

2.18 Use of the CCB and SCR tools can enhance the resilience of the financial system in two ways: first, directly by increasing the loss-absorbing capacity of firms, increasing the resilience of the system to periods of stress; and second, via indirect effects on the amount of financial services supplied by the financial system through the cycle (either through the distribution or overall level of these services), reducing the severity of periods of instability.

2.19 Although the measures contained in this consultation paper will concern the prudential supervision of banks and investment firms, they will not operate within the current formalised EU framework for macroprudential measures. Therefore it will be important for the FPC to be cognisant of developments in the EU relating to macroprudential policy, where these impact on the measures contained in this consultation paper.

Accountability

2.20 There are a number of ways by which the FPC is held accountable for the exercise of its powers.

2.21 FPC policy decisions, including any new directions and/or recommendations, are communicated to those to whom the action falls (e.g. the PRA or FCA). The policy decision is also communicated to the public, either via a short statement in the first and third quarters of the year or via the FSR in the second and fourth quarters.

2.22 For each of its powers of direction, the FPC must prepare, publish and maintain a written statement of the general policy that it proposes to follow in relation to the exercise of its power including maintaining core indicators. Furthermore, when making recommendations or directions the FPC must provide an estimate of the benefits and costs, unless it is not practicable to do so.

2.23 A formal record of the FPC's policy meetings is published around a fortnight after the relevant meeting. It must specify any decisions taken at the meeting and must set out, in relation to each decision, a summary of the FPC's deliberations.

2.24 FPC members also appear regularly before Members of Parliament at Treasury Select Committee (TSC) hearings, where they are required to explain their assessment of risks and policy actions. The TSC has also held confirmation hearings for members.

2.25 Furthermore, the Bank of England Act 1998 (as amended by the Financial Services Act 2012) requires that statutory instruments that set out the FPC's tools in secondary legislation must go through an affirmative legislative procedure. Therefore, both Houses of Parliament must expressly approve any draft macroprudential tools orders before they can become law.

3 The mortgage market and financial stability

Description of the UK mortgage market

3.1 The UK mortgage market fulfils a critical role in supporting the UK housing market. Property expenditure is the largest item of discrete spending for households, with homes typically financed by long term variable rate mortgages. Housing wealth in the UK is estimated at £4.4 trillion or 62% of total household wealth[1] and the value of outstanding mortgages is £1.24 trillion, or 50% of all domestic lending by UK banks.[2]

3.2 The UK mortgage market is dominated by two types of participant: owner-occupiers and buy-to-let investors. Buy-to-let lending accounted for 12% of total mortgage lending in 2013, down from the peak of buy-to-let lending in 2007, when it accounted for 15% of lending.[3]

Financial stability risks from the housing market

3.3 The mortgage market can pose threats to financial stability via two channels, as set out by the FPC:

- Mortgages are the single largest asset class on UK banks' balance sheets. An increase in defaults on mortgage loans, especially when accompanied by large declines in the value of housing assets used as collateral can significantly impair banks' capital positions and access to finance.
- Mortgages are also the single largest liability on the UK household sector's balance sheet. A fall in perceived housing wealth could therefore cause households to cut back on spending. In turn, this can weigh on economic activity, and may lead to losses on a wider set of assets on lenders' balance sheets.

3.4 There is also often a self-reinforcing loop linking credit and asset prices at the heart of financial cycles which can further amplify threats to financial stability.[4] Whilst the equilibrium or sustainable level of asset prices is difficult to establish, in general the faster the growth in prices, the greater the potential for a large fall and hence the larger the risk to financial stability for a given level of bank capital or household debt.

3.5 This loop is particularly pronounced in the housing market as housing is the main source of collateral in the economy and collateral is at the centre of price-credit amplification mechanisms. As house prices rise, households experience rising wealth and lenders see their collateral value grow. This can result in an increase in both the demand and supply of credit which feeds back into higher house prices. In a downturn, this amplification mechanism works in reverse.

[1] Office for National Statistics data

[2] Bank of England data

[3] Council of Mortgage Lenders data

[4] See *The Financial Policy Committee's powers to supplement capital requirements, January 2014*, available at http://www.bankofengland.co.uk/financialstability/Documents/fpc/policystatement140113.pdf.

3.6 While house building has a fundamental link to housing market conditions there are also other sectors, such as estate agents, furniture stores and removal companies, which see their activity closely related to that of the housing market.

Recent events

3.7 In June, the FPC published its FSR.[5] The FSR noted that house prices had continued to rise strongly since the last FSR in November 2013, with the average of Halifax and Nationwide house price indices rising by 9% over the year to 2014 Q1. House price inflation had spread out across the UK, with higher than average rates of inflation in London (4.5% in 2014 Q1). House prices had risen faster than average earnings, meaning that some measures of house price affordability had begun to deteriorate, with significant new mortgage lending to borrowers with higher loan to income multiples.

3.8 The FSR noted that the FPC did not think that household indebtedness posed an immediate risk to financial stability. However, the Committee did recommend that regulators should ensure that mortgage lenders do not extend more than 15 per cent of new mortgages at loan to income (LTI) multiples at or greater than 4.5. An LTI limit applies to the ratio of the mortgage loan to the applicant's gross income at the point of origination. The FPC also recommended that, 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.

3.9 The FPC was clear that these actions were calibrated to insure against the risk of a marked loosening in underwriting standards and a further significant rise in the number of highly indebted households. It also noted that its guidance appeared to be broadly in line with current practice by most major lenders, so it expected the incremental impact of its guidance on mortgage lending to be relatively small.

3.10 In its statement from its meeting on 26 September 2014, the FPC noted that: "While the housing market remains a source of risk to financial stability, activity appears to have eased slightly and the MPC's latest projections are consistent with the rate of increase in house prices moderating earlier than previously expected".[6]

[5] See *Financial Stability Report, June 2014, Issue No. 35*, available at http://www.bankofengland.co.uk/publications/Documents/fsr/2014/fsrfull1406.pdf.

[6] *Financial Policy Committee statement from its policy meeting, 26 September 2014*, available at http://www.bankofengland.co.uk/publications/Pages/news/2014/080.aspx

4 The Government's proposals

Rationale for giving the FPC new powers of direction

4.1 In 2012, the interim FPC made recommendations to the Government on the powers of direction that it judged it needed.[1] It chose not to recommend that it be given powers of direction over LTI or LTV restrictions. One of the reasons the interim FPC gave for this decision was that it did not judge that the public debate necessary to achieve acceptability for such instruments was sufficiently advanced at that time. However, the interim FPC agreed that these tools may be appropriate after further analysis, reflection and public debate.

4.2 Since then, there has been considerable further debate, both in the UK and internationally, about how developments in the housing market may pose risks to stability and how best to address these risks.

4.3 In his Mansion House speech on 12 June 2014, the Chancellor announced his intention, subject to consultation, to grant the FPC new powers of direction, including over LTI and LTV ratios, and committed to ensuring that the "Bank of England has all the weapons it needs to guard against risks in the housing market".[2]

4.4 In response to the Chancellor's announcement, the FPC has carried out a review into the tools it judges that it might require to tackle housing market risks in future. At its policy meeting on 26 September, the FPC decided to recommended that, "HM Treasury exercise its statutory power to enable the FPC to direct, if necessary to protect and enhance financial stability, the PRA and FCA to place limits on residential mortgage lending, both owner-occupied and buy-to-let, by reference to:

- Loan-to-Value (LTV) Ratios; and
- Debt-to-Income (DTI) Ratios, including Interest Coverage Ratios (ICR) in respect of buy-to-let lending".[3]

4.5 In taking this decision, the FPC concluded that "…taken together, these instruments were necessary, and should be sufficient, to tackle risks to financial stability that could emerge from the housing market in future, rather than indicating likely FPC policy decisions in the short term". As such, "The Recommendation does not reflect any FPC decision about the current state of the housing market".[4]

4.6 In the record of its 26 September meeting the FPC noted that its existing powers of recommendation and direction provide some scope to address risks to financial stability arising

[1] See *Financial Policy Committee statement from its policy meeting, 16 March 2012'*, available at http://www.bankofengland.co.uk/financialstability/Documents/fpc/statement120323.pdf.

[2] See *Mansion House 2014: Speech by the Chancellor of the Exchequer*, available at https://www.gov.uk/Government/speeches/mansion-house-2014-speech-by-the-chancellor-of-the-exchequer.

[3] *Financial Policy Committee statement from its policy meeting, 26 September 2014*, available at http://www.bankofengland.co.uk/publications/Pages/news/2014/080.aspx

[4] See *Financial Policy Committee statement on housing market powers of Direction from its policy meeting, 26 September 2014*, available at http://www.bankofengland.co.uk/financialstability/Documents/fpc/statement021014.pdf.

from the housing market.[5] However, as the Committee also noted in deciding to make its recommendations, powers of direction have several benefits over powers of recommendation.

4.7 Firstly, powers of direction provide for greater certainty to the FPC as, unlike a recommendation, the regulator is compelled, within the scope of its powers, to comply with the direction.[6] Moreover, as the FPC notes, there may be circumstances where tensions arise between the preferred policy actions of microprudential and macroprudential regulators. For example, in a downturn the macroprudential authority might judge that loosening regulatory requirements could help to protect and enhance the resilience of the financial system as a whole, whereas the microprudential regulator may place more weight on maintaining standards to protect individual firms.

4.8 Furthermore, powers of direction allow for greater accountability and policy predictability than recommendations. In addition to the duty to explain how a policy action will help the FPC meet both its objectives, which applies to recommendations and directions, the FPC is required to produce and maintain a statement of policy for each of its direction powers. These statements set out how the tools are defined, the likely impact the tools are expected to have on lenders' resilience and the wider economy, and in what situations the FPC would expect to use the power. The FPC is also expected to provide as part of the statement a list of key indicators that it will consider when judging if policy action using the tool in question is appropriate. Ex-ante explanations of this depth are not possible or practical for the FPC's recommendation power because of its breadth. The information contained within the policy statement will help market participants discern the FPC's policy reaction function and serve as useful context when the FPC is held to account for its actions after the fact.

4.9 However, there are also potential benefits from prescribing a set of tools which is proportionate to the threat being posed. This means a set of tools whose role and effects can be more clearly defined which avoids undue complexity, and helps to ensure public accountability and communication. By maintaining simplicity and clarity of the macroprudential framework, the FPC would be more likely to convey a clear reaction function (i.e. improve predictability of its actions) which would help shape expectations of future FPC actions.

Tools over the owner-occupied mortgage market

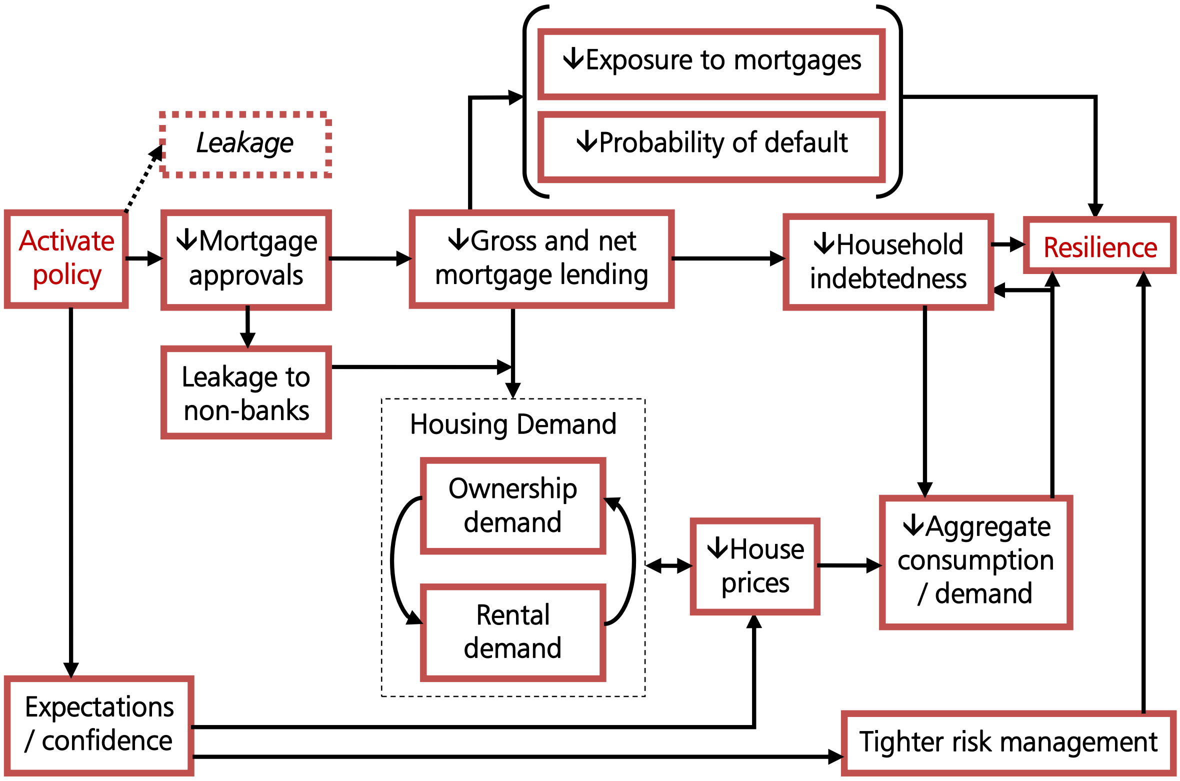
4.10 In relation to the owner-occupied mortgage market, the FPC has recommended to HM Treasury that it be granted powers of direction over the DTI ratio and the LTV ratio. Specifically, it is seeking portfolio limits over both these tools.

4.11 Limits on DTI and LTV ratios work through broadly similar channels. Chart 4.A below describes a high-level transmission mechanism of the activation of these tools.

[5] See *Record of the Financial Policy Committee meeting, 26 September 2014*, available at http://www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2014/record1410.pdf.

[6] Section 9H(8) of the Bank of England Act 1998 (as amended by the Financial Services Act 2012) provides that directions cannot require the regulators to do anything outside their legal power.

Chart 4.A: High-level transmission mechanism of LTV, LTI or DTI tools



Source: HM Treasury.

4.12 The activation of DTI or LTV tools is likely to result in lower mortgage approvals and/or a reduction in the size of individual mortgages advanced than would have been the case had policy action not been taken. In turn, this would likely result in relatively lower levels of household indebtedness, and relatively less, and lower risk, mortgage lending. All else equal, these impacts should improve the resilience of both lenders' and the household sector's balance sheets.

4.13 A fall in mortgage lending, aside from directly reducing household indebtedness, could also impact house prices. Households affected by the policies (i.e. constrained households) will have a reduced ability to purchase housing. The tools could also have a role in shaping expectations, which could in turn influence house prices and activity. However, the impact of the policy on house prices will also depend on the behaviour of unconstrained households, including cash buyers and overseas investors. We would, however, expect this offsetting effect to be smaller than the direct effect on house prices, implying likely overall downward pressure on house price growth following the activation of housing tools.

4.14 It is also important to consider the potential for 'leakage', whereby lending activity can become displaced into other forms of debt outside the scope of the macroprudential measure, or to other types of lender that are not subject to the macroprudential measure. This could dampen the effectiveness of the macroprudential policy.

4.15 Whilst there are several effects at work, including in opposite directions, the Government would expect the net impact on bank resilience and financial stability to be positive as the second-order effects are likely to be smaller than the direct effect.

4.16 Finally, it is important to note that the FPC has made clear that its aim in using these tools is not to control house prices, rather it is to mitigate the risks that a cycle of rising house prices and overextension of credit can pose to financial and macroeconomic stability.

Portfolio limit on debt-to-income (DTI)

4.17 As explained in paragraph 3.8 above, an LTI limit applies to the ratio of the mortgage loan to the applicant's gross income taken into account for the purposes of the decision to advance the credit. The FPC has recommended that it be given a power of direction over DTI limits. This operates in the same way as an LTI constraint, but the limit takes into account some of a borrower's stock of existing mortgage and non-mortgage debt (e.g. unsecured lending). As such, an LTI limit can be seen as a subset of the broader DTI tool.

4.18 A DTI portfolio limit sets two parameters and specifies that, over a given period of time, no more than a specified proportion of new mortgages originated by a lender can have DTI ratios above a certain level. The proportion of new mortgages is calculated on either a values or volumes basis. If the specified proportion is set to zero then the tool operates as a hard cap, where all mortgages with DTI ratios above a certain level at origination are prohibited. If the specified proportion is set at above zero this allows for some lending above the threshold to be extended.

4.19 An LTI or DTI tool works by limiting the value of the loan that a mortgage lender can extend, relative to the borrower's income. In doing so, it can, all else equal, lower the probability of default of borrowers. An increase in highly indebted households can pose risks to the financial system directly (if borrowers eventually prove unable to service their debts and default on their mortgage) or indirectly (if, in struggling to service their debts, households reduce consumption and therefore put downward pressure on wider economic activity). Imposing limits on lending at higher LTI or DTI ratios will indirectly limit increases in aggregate household indebtedness.

4.20 The FPC, in its statement on housing market powers published on 2 October 2014, identified two key benefits of having the scope to apply a broader DTI power as well as an LTI power:

- a DTI power would give the FPC additional scope to mitigate financial stability risks arising not only from mortgage indebtedness but also from household indebtedness more broadly; and
- international experience has shown that the imposition of an LTI limit can result in activity being displaced to other forms of debt, undermining the effectiveness of the intervention.

4.21 The FPC therefore recommended that it be granted a power of direction over a DTI tool.

4.22 The Government agrees with the FPC's recommendation and proposes to legislate to give the FPC the power to:

- impose portfolio limits on the flow of new owner-occupied mortgage lending, limiting the value of the loan that a mortgage lender can extend relative to the borrower's income; and
- to require lenders, in applying that limit, to take into account a borrower's stock of existing first and subsequent charge mortgage debt as well as some forms of non-mortgage debt.

4.23 It is worth noting in this context that the FCA's new mortgage affordability rules, which were strengthened through the Mortgage Market Review already require lenders providing FCA regulated mortgage contracts (i.e. lending to owner-occupiers) to take into account the borrower's other credit commitments (including unsecured loans and credit cards) in the context of the affordability assessment. Any DTI limit imposed by the FPC would act in addition to this affordability assessment.

Question 1: Do respondents agree that the FPC should be granted a power of direction over DTI?

Portfolio limit on loan-to-value (LTV)

4.24 The LTV ratio for a new mortgage is calculated as the ratio of mortgage value to property value at origination. The LTV portfolio limit would set two parameters and specify that, over a given period of time, no more than a specified proportion of the flow of new mortgage originations by a given lender can have an LTV at origination above a certain level. The proportion of new mortgages is calculated on either a values or volumes basis. If the specified proportion is set to zero then the tool operates as a hard cap, where all mortgages with LTV ratios above a certain level at origination are prohibited. If the specified proportion is set at above zero this allows for some lending above the threshold to be extended.

4.25 An LTV limit acts by setting the minimum size of deposit that a borrower needs to buy a property (or equity in the property to obtain a further advance or a re-mortgage with an increase in the loan). For example, a 90% LTV limit would require the borrower to a have 10% deposit. It reduces the loss to the lender in the event of default. By extending an increasing share of higher LTV mortgages, lenders become more vulnerable to losses on collateral if house prices subsequently decline. There is also empirical evidence of a positive correlation between LTV rates at origination and subsequent mortgage default.[7] Imposing limits on lending at higher LTV ratios should act directly to limit the exposure of individual lenders as well as the system as a whole to this risk.

4.26 LTV limits have been used extensively across a number of countries and international evidence suggests that they have been effective in calming housing and credit cycles.[8]

4.27 In its statement, the FPC also explained the benefits from being able to set limits on LTV ratios and therefore recommended that it be granted a power of direction over this tool. The Government intends to grant the FPC this power.

Question 2: Do respondents agree that the FPC should be granted a power of direction over LTV?

Mortgages to which the DTI and LTV limits could be applied

4.28 The Government proposes that the FPC should be able to apply the DTI and LTV limits to the flow of new first and subsequent charge owner-occupied mortgage lending extended by PRA- and FCA-authorised firms. Consistent with the approach taken by the PRA in implementing the LTI limit discussed in paragraph 3.8, these limits would not apply to re-mortgages with no increase in principal (see paragraphs 4.45 and 4.46 for further detail on the treatment of re-mortgages).

[7] See, for example, *Mortgage Market Review*, Discussion Paper No. 09/3, Financial Services Authority,

[8] Wong et al, *Loan-to-Value Ratio as a Macro-Prudential Tool – Hong Kong's Experience and Cross-Country Evidence*, Hong Kong Monetary Authority, February 2011.

4.29 As discussed further below, tools such as DTI and LTV limits can have distributional consequences as they are likely to constrain some households' access to mortgages. Those most likely to be affected would be more indebted households, or borrowers seeking to access high LTV mortgages. The Government therefore intends to exclude from the scope of the LTV and DTI limits secured lending to consumers by the Government (including local Government and housing associations) provided that the loan is free of interest or at lower borrowing rates than those available on the market, or on other terms more favourable to the consumer than the market would be able to provide, and there are eligibility criteria to access the loan.[9] This will ensure that the Government retains the ability to intervene in a targeted way, through schemes such as the Help to Buy: Equity Loan, to promote a better functioning housing market and make home ownership more accessible.

4.30 The Government would welcome views from respondents on whether the definition of mortgages should include business loans to individuals that are secured on the borrower's home and therefore be within the scope of the FPC's LTV and DTI powers. There is a risk that including these types of loans could have a negative impact on small business lending. On the other hand, excluding them could create scope for leakage that could reduce the effectiveness of the FPC's tools, and lenders may find that their exclusion adds unhelpful complexity.

Question 3: **Do respondents agree with the proposed scope of mortgages to which the DTI and LTV limits could be applied? If not, please explain your reasoning.**

Question 4: **What are respondents' views on the appropriate treatment of business loans to individuals secured on the borrower's home?**

Definition of 'debt'

4.31 The outer boundaries of the definition of 'debt' for the purposes of the DTI power will be defined in the secondary legislation granting the FPC the power. Subject to this, the FPC has indicated that, in using the power of direction, it will use its judgement to determine whether any direction should specify a narrower category of types of debt that will be included, basing this judgement on what is appropriate and proportionate to managing risks at that particular time.

4.32 The FPC recommended that it should have the scope to apply the power of direction so as to take account of households' contractual, commercially extended debt (including for example first-charge mortgage debt, other mortgage debt e.g. second-charge loans), and other commercially extended secured and unsecured loans.

4.33 The Government proposes to adopt a definition of 'debt' for the purposes of this legislation that includes the following:

- the borrower's outstanding debt on owner-occupied mortgages (see paragraphs 4.28 to 4.30 above) plus the amount of credit extended under the new mortgage to which the flow limit applies; and
- amounts outstanding on personal loans, overdraft facilities, credit cards and other types of secured and unsecured borrowing, excluding loans from family members and student loans.

4.34 Consistent with the FPC's recommendation, the Government proposes that non-contractual personal debts should be outside the scope of the limit, as should regular payment

[9] This mirrors an exemption from the definition of regulated mortgage contract in the draft Government legislation implementing the EU Mortgage Credit Directive (MCD) in the UK, which the Government is currently consulting on.

arrears such as utility bills. The Government also intends that student loans supplied by the Government-owned student loans company should not be included in the definition of 'debt' for these purposes.[10] These loans do not constitute a fixed debt because repayment is determined by the income of the borrower.

4.35 The amount of debt would be calculated, and the DTI limit applied, for the purposes of the decision to advance the mortgage credit. So, for example, lenders would calculate debt on credit cards or overdrafts on a particular date on the basis of the amounts outstanding at that point and feed those amounts into their decision on the amount of mortgage credit to grant.

4.36 If the FPC were to identify evidence that lending was being displaced into other forms of debt outside the scope of this definition, the FPC would be able to use its existing powers of recommendation to address these types of leakage.

Question 5: What are respondents' views on the proposed definition of 'debt' for the purposes of the DTI tool?

Savings and other assets held by borrowers

4.37 The Government would welcome views from respondents as to the extent to which (if at all) a borrower's savings and other assets should be permitted to be offset against the borrower's debts when calculating DTI (in a similar way to offset mortgages).[11]

4.38 If a borrower's assets are not taken into account in the DTI calculation, this could have a prejudicial impact on individuals who have simultaneously accumulated assets and debt. On the other hand, not all assets are equivalently liquid, with cash savings, for example, being far easier to use to pay off debts as they fall due than other assets like pension savings. Defining categories of liquidity between these extreme examples could be difficult to codify into legislation, and could impose additional burdens on lenders to assess and categorise a customer's assets. In addition, some assets may arise from forms of debt that are not captured in the Government's proposed definition, including informal loans from friends and family. This could create a source of leakage if individuals were able to extend informal loans which would temporarily net off their debts, without contributing to their overall indebtedness.

Question 6: What are respondents' views on how (if at all) a borrower's assets should be taken into account in calculating that borrower's DTI ratio?

Definition of 'income'

4.39 The Government proposes that income should be defined for the purposes of the DTI limit with reference to the total gross annual incomes (before tax or other deductions) taken into account when the lender made the lending decision. For these purposes, each borrower's gross income is the sum of that person's main income and any other reckonable income (e.g. overtime and/or income from other sources). As with the definition of debt, this would set the outer scope of income that the FPC could choose to include in a DTI direction. The FPC will use its judgement to determine whether any direction should specify more precisely what types of income should be included, basing this judgement on what is appropriate and proportionate to managing risks at that particular time.

[10] Other contractual, commercially extended loans to students would, however, be within scope.

[11] FCA mortgage affordability rules allow a mortgage lender to consider assets when assessing affordability only for a 'high net worth mortgage customer'. The FCA defines a 'high net worth mortgage customer' as a customer with an annual net income of no less than £300,000 or net assets of no less than £3,000,000, or whose obligations are guaranteed by a person with an income or assets of such amount.

Question 7: Do respondents agree with the proposed definition of 'income' for the purposes of DTI? If not, please explain your reasoning and provide an alternative definition if possible.

Buy-to-let income and debt

4.40 As explained elsewhere in this document, the Government will consult separately on the FPC's recommendations concerning the buy-to-let sector. As part of that consultation, the Government will consider how, if at all, a borrower's existing buy-to-let mortgage debts, and their income from their buy-to-let mortgage portfolio, should be taken into account in applying a DTI limit on owner-occupied mortgages.

4.41 The Government's preliminary view is that the definition of debt for the purposes of calculating the owner-occupied DTI limit should exclude existing buy-to-let mortgage debt held by the customer. In relation to any rental income received by the borrower from buy-to-let properties, prudent lenders are likely only to consider this as income when calculating affordability where they have evidence that it represents income after costs (e.g. after buy-to-let mortgage payments have been made).

Question 8: What are respondents' views on the appropriate treatment of existing buy-to-let mortgage debt, and income derived from rental yields (after costs) on buy-to-let properties?

Scope and application

4.42 The FPC will have the flexibility to give directions to either or both the PRA and FCA, and specify any thresholds above or below which the direction will apply. Therefore, the draft legislation does not set an ex-ante *de minimis* level, given that this will depend on the specific circumstances in which the FPC issues a direction. There is scope for this to be set by the FPC in its directions or for the FPC to give discretion to the PRA and the FCA to fine-tune the level. For example, the PRA and FCA have put in place *de minimis* thresholds in implementing the LTI limit recommended by the FPC in June (see paragraph 3.8). It will be important that the FPC, when issuing a direction, considers what exemptions may be appropriate to take account of any proportionality implications as per its legal obligations.

4.43 The direction can only apply in respect of PRA- and FCA-authorised firms. PRA and FCA rules can also extend to unregulated activities of authorised firms.

4.44 The FPC will be able to apply either tool to a proportion of new mortgages calculated on either a values or volumes basis. Depending on the nature of the risk to financial stability that the FPC seeks to address, a values or volumes limit on new lending may be more appropriate. For example, if there is a financial stability concern over the risk to lenders' balance sheets of high LTV or DTI lending, a values measure may be used. However, if the FPC is concerned about the number of households with high LTV mortgages, or the number that are highly indebted, they may exercise the tools on a volumes basis.

4.45 Re-mortgages would only be in scope of the FPC's tools if there is an increase in principal. The LTV and DTI limits would not apply in respect of new lending where there is no increase in principal and where reasonable fees/costs are rolled into the re-mortgage.

4.46 However, the Government believes that re-mortgages with an increase in principal should be in scope of LTV and DTI limits given that this would constitute an increase in household indebtedness. Further advances on existing mortgages would also be in scope.

Question 9: Do respondents agree that the FPC should be able to apply DTI and LTV limits to a proportion of new mortgages calculated on either a value or volumes basis? If not, please explain on which basis the tools should apply and why.

Question 10: Do respondents agree with the Government's proposed approach in relation to re-mortgages and further advances on existing mortgages? If not, please describe an approach that you believe would be more suitable.

Tools over the buy-to-let mortgage market

4.47 The FPC also recommended that it be granted powers of direction over LTV limits and interest coverage ratios in respect of the buy-to-let mortgage market. The FPC argued that buy-to-let mortgages can pose risks to financial stability through similar channels to the owner-occupied sector. The Government intends to consult separately on these recommendations in 2015 with a view to building an in-depth evidence base on how the operation of the UK buy-to-let housing market may carry risks to financial stability.

Implications of powers over the housing market

4.48 As explained elsewhere in this consultation, the Government judges that powers of direction over DTI and LTV are necessary to ensure that the FPC is equipped to guard against risks in the housing market. International evidence demonstrates the risks that developments in the housing market can pose to financial stability – more than two thirds of systemic banking crises were preceded by boom-bust cycles in the housing market, while recessions that followed property booms have on average been two to three times deeper than those without.[12]

4.49 Moreover, macroprudential tools such as DTI or LTV restrictions can be far more targeted than interest rate rises in addressing risks to financial stability. Both the Government and the Bank of England see macroprudential tools as the first line of defence against risks to financial stability, including from developments in the housing market. In the absence of macroprudential tools, raising interest rates to tackle specific macroprudential concerns would have more unintended implications for growth and employment.

4.50 That said, the Government recognises that the use by the FPC of these tools could have wide-ranging impacts as well as specific distributional consequences. The tools could constrain some households' access to credit, and indeed may be specifically designed to do so. Those most likely to be affected would be highly indebted households, or borrowers seeking to access high LTV mortgages. The tools could also result in costs to lenders, including operational overheads in ensuring compliance with the FPC's directions and reduced profitability from restricting the range and availability of lending that would otherwise have been offered.

4.51 The impact of these tools will depend primarily on the calibration that the FPC decides and the prevailing market conditions at the time the tools are used. The FPC is only permitted to take action if it judges it to be necessary to address financial stability risks. Moreover, the FPC has a statutory obligation to exercise its functions with regard to the principle of proportionality, and is required to publish a cost-benefit analysis whenever it exercises its powers, including its powers of direction (unless it judges that it is not reasonably practicable to do so). Both the costs and benefits will therefore be carefully considered by the FPC whenever it considers deploying these tools.

4.52 On 2 October 2014, the FPC published a cost-benefit analysis as an annex to its statement on housing market powers of direction. This consisted of a qualitative assessment of the impact and effectiveness of the powers of direction that the FPC recommended it be granted. The FPC and PRA have also published cost-benefit analyses in relation to the FPC recommendation in its

[12] See *Financial Policy Committee statement on housing market powers of Direction from its policy meeting, 26 September 2014* available at http://www.bankofengland.co.uk/financialstability/Documents/fpc/statement021014.pdf.

June FSR regarding a limit on LTI.[13] The Government is not therefore publishing a separate impact assessment to accompany this consultation, but it will publish one when the legislation is finalised and laid in Parliament, alongside a consultation response document.

Question 11: What views do respondents have regarding the potential impact of the Government's proposals?

Procedural requirements when implementing directions

4.53 When the PRA or FCA take action to implement a direction from the FPC, any procedural requirements that are applicable under the Financial Services and Markets Act (FSMA) 2000 would normally apply. For example, if the regulator makes rules to implement an FPC direction, it would be required to undertake consultation on those rules, including a cost-benefit analysis.

4.54 In some cases, the FPC's actions will need to be implemented quickly in order to be fully effective. Any delay by the regulator, for example, in order to undertake consultation, could prove damaging to stability. In urgent cases, both the PRA and FCA have the ability to waive consultation requirements in order to take action quickly.[14] In the case of the PRA, consultation requirements can be waived where a delay would be prejudicial to the safety and soundness of the firms it regulates and in the case of the FCA, the test is that a delay would be prejudicial to consumers. It is clear that where a delay in implementing an FPC direction could provoke severe financial instability, this might negatively impact both firms and consumers.

4.55 In addition, as the FPC noted in its 2 October statement on housing tools, when creating macroprudential tools in secondary legislation the Government is able to modify or exclude any procedural requirements that would otherwise apply under FSMA 2000 on a tool-by-tool basis.[15] The FPC noted in this context the risk that lenders and borrowers might bring forward transactions to avoid incoming requirements.

4.56 The Government agrees that the FPC and the regulators may need to act quickly to respond to risks to financial stability arising from the housing market. On the other hand, the use of such powers can have a significant impact on the availability of credit for borrowers and the distribution of credit across different sections of society. In addition, there may be other operational considerations for lenders or regulators. The Government believes that the potential impact of the tools justifies the retention of requirements for the regulators to consider the impact of their actions, and consult on them.

4.57 The Government therefore proposes to take the following approach to procedural requirements in the legislation granting the FPC a power of direction over housing tools:

- On the first application of any PRA/FCA rules following an FPC direction, the PRA/FCA must carry out all procedural requirements (e.g. consultation and cost-benefit analysis).
- Where the FPC subsequently revokes and replaces a direction by changing the calibration, HM Treasury proposes to waive the requirement on the PRA and FCA to consult, but to retain the requirement to carry out a cost-benefit analysis. The Government judges this to be necessary because changes to the calibration of housing tools could have wide-ranging impacts as well as specific distributional consequences.

[13] *Implementing the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending*, Prudential Regulation Authority, June 2014.
[14] Section 138L(1) and (2) Financial Services and Markets Act 2000 (as amended by the Financial Services Act 2012)
[15] Section 9I(2) Bank of England Act 1998 (as amended by the Financial Services Act 2012)

4.58 The Government believes this strikes the right balance between responsiveness and public accountability.

Question 12: Do respondents agree with the Government's proposed approach in relation to procedural requirements? If not, please explain an approach that you consider would be appropriate.

5 Draft statutory instrument

5.1 This chapter contains a draft of the order granting the FPC powers of direction over DTI limits and LTV limits in respect of owner-occupied mortgages.

Question 13: Do respondents have any comments regarding the Statutory Instrument.

2015 No.

FINANCIAL SERVICES AND MARKETS

The Bank of England Act 1998 (Macro-prudential Measures) Order [2015]

Made - - - -	***
Laid before Parliament	***
Coming into force - -	

In accordance with section 9N of the Bank of England Act 1998(**a**), a draft of this Order has been laid before Parliament and approved by a resolution of each House.

The Treasury make the following Order in exercise of the powers conferred by section 9I(2) and 9L of the Bank of England Act 1998(**b**):

Citation and Commencement

1. This Order may be cited as the Bank of England Act 1998 (Macro-prudential Measures) Order 2015 and comes into force on [].

Interpretation

2.—(1) In this Order—

"annual income" means the amount of the annual income (before tax or other deductions) taken into account by the lender when deciding to provide credit to the borrower;

'borrower' means an individual, individuals jointly or trustees receiving credit;

"cost benefit analysis" means an analysis of the costs together with an analysis of the benefits that will arise from the rules that have been made and, where the costs and benefits can reasonably be estimated, an estimate of those costs and of those benefits;

"credit" has the meaning given in article 61(3)(c) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**c**);

"debt-to-income ratio" means the ratio of the borrower's total relevant debt to the borrower's annual income calculated by the lender when deciding to enter into a relevant mortgage contract;

"excluded mortgage contracts" means a mortgage contract which —

(a) is offered to a particular class of borrower and not offered to the public generally;

(b) is offered under an enactment with a general interest purpose; and

(c) the terms on which the credit is provided are more favourable to the borrower than those prevailing on the market, because it meets one of the following conditions-

(a) 1998 c.11. Inserted by section 4 of the Financial Services Act 2012 (c.21).
(b) Inserted by section 4 of the Financial Services Act 2012.
(c) SI 2001/544, Article 61 was amended by statutory instruments 2001/3544, 2005/2114, 2006/2383 and 2010/2960.

(i) it is interest free;

(ii) the rate of interest is lower than that prevailing on the market; or

(iii) the rate of interest is no higher than that prevailing on the market but the other terms on which credit is provided are more favourable to the borrower;

"Financial Policy Committee" has the meaning given by section 9B of the Bank of England Act 1998(**d**);

"further advance" means an amount of credit provided by a lender to a borrower in addition to credit already provided by that lender to that borrower which is secured by a mortgage on land pursuant to the terms of an existing relevant mortgage contract;

"lender" means a person providing credit by way of business;

"loan-to-value percentage" means, in relation to a particular extension of credit by a lender to a borrower, the aggregate amount of outstanding credit provided under all relevant mortgage contracts relating to the same land immediately after the last amount of credit is provided, as a percentage of the total value of the land as assessed by the lender for the purposes of deciding to provide credit to the borrower;

"mortgage" includes a charge and (in Scotland) a heritable security;

"mortgage contract " means a contract under which—

(a) the lender provides credit, including a further advance, to the borrower; and

(b) the obligation of the borrower to repay is secured by a mortgage on land whether or not in the United Kingdom; and

(c) at least 40% of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person in;

"regulated persons" has the meaning given by section 9H(2) of the Bank of England Act 1998(**e**);

"related person" means, in relation to a borrower, or (in the case of credit provided to trustees) a beneficiary of the trust —

(d) that person's spouse or civil partner;

(e) a person (whether or not of the opposite sex) whose relationship with that person has the characteristics of the relationship between husband and wife; or

(f) that person's parent, brother, sister, child, grandparent or grandchild;

"relevant credit agreement" means:-

(a) a credit agreement as that term is defined in article 60B(3) of the Regulated Activities Order(**f**), but excluding a relevant mortgage contract and the types of agreement described in articles 60D(**g**), 60F(5)(**h**) and 60F(6)(**i**), 60G(3)(**j**) and 60G(4)(**k**) of that Order; and

(b) a consumer hire agreement as that term is defined in article 60N(3)(**l**) of the Regulated Activities Order, but excluding the type of agreement described in article 60P(**m**) of that Order;

"relevant mortgage contract" means a mortgage contract other than an excluded mortgage contract or a remortgage;

"remortgage" means a mortgage contract under which the amount of credit provided by the lender to the borrower does not exceed that outstanding to the lender, or to a different lender, under:

(a) a previous mortgage contract, or

(d) Inserted by section 4 of the Financial Services Act 2012 (c.21).
(e) Inserted by section 4 of the Financial Services Act 2012 (c.21).
(f) Inserted by SI 2013/1881, articles 2 and 6.
(g) Inserted by SI 2013/1881, articles 2 and 6.
(h) Inserted by SI 2013/1881, articles 2 and 6, amended by SI 2014/366, articles 2(1) and 27(b).
(i) Inserted by SI 2013/1881, articles 2 and 6, amended by SI 2014/366, articles 2(10 and 27(b).
(j) Inserted by SI 2013/1881, articles 2 and 6.
(k) Inserted by SI 2013/1881, articles 2 and 6.
(l) Inserted by SI 2013/1881, articles 2 and 6, amended by SI 2014/366, article 2(1) and (34).
(m) Inserted by SI 2013/1881, articles 2 and 6.

(b) any other type of contract under which the obligation to repay the credit is secured by a legal mortgage

which relates to the same land;

"total relevant debt" means the total amount of outstanding credit provided to a borrower pursuant to either or both of the following:

a) a relevant credit agreement; and

b) a relevant mortgage contract.

(2) For the purposes of calculating the amount of credit provided in relation to a remortgage, if any reasonable amount of the fees or costs listed in (a) to (c) of this clause have been included in the amount of credit provided then it shall be deducted from the amount of credit for the purposes of assessing whether the amount of credit provided exceeds that outstanding to the lender, or to a different lender, under a previous relevant mortgage contract, or any other type of contract under which the obligation to repay the credit is secured by a legal mortgage on land—

(a) arrangement fees;

(b) professional fees and costs;

(c) [redemption fees in relation to redeeming a previous mortgage contract which relates to the same land; or]

(d) administration costs.

(3) Any reference to 'specified' in article 3 of this Order means specified by the Financial Policy Committee in a direction made pursuant to section 9H of the Bank of England Act 1998 by reference to this Order.

Macro-prudential measures

3. The measures listed in the first column of the table (and any measures falling within a listed measure) are prescribed in relation to the regulator specified in the second column of the table.

Macro-prudential measures

Macro-prudential measure	*Regulator*
To require regulated persons who enter into relevant mortgage contracts to ensure that no more than a specified proportion of new relevant mortgage contracts have a loan-to-value percentage greater than the specified maximum loan-to-value percentage.	PRA and FCA
To require regulated persons who enter into relevant mortgage contracts to ensure that no more than a specified proportion of borrowers under new relevant mortgage contracts have a debt-to-income ratio greater than the specified maximum debt-to-income ratio.	PRA and FCA

Disapplication of procedural requirements

4.—(1) Paragraph (2) applies if—

(a) The Financial Policy Committee has given a direction to the PRA or the FCA under section 9H or the Bank of England Act 1998 which specifies a loan-to-value percentage or a debt-to-income ratio ("the first direction");

(b) The Financial Policy Committee subsequently revokes the first direction; and

(c) Immediately after that revocation the Financial Policy Committee gives another direction to the PRA or the FCA under section 9H of the Bank of England Act 1998 ("the subsequent direction") which is in substance identical to the first direction except in relation to the values specified in the direction.

(2) To the extent that the subsequent direction is implemented by—

(a) the FCA, section 138I of the Financial Services and Markets Act 2000 does not apply, but the FCA must undertake and publish, at the same time as the subsequent direction is implemented, a cost benefit analysis relating to changes incorporated in the subsequent direction; and

(b) the PRA, section 138J of the Financial Services and markets Act 2000 does not apply, but the PRA must undertake and publish, at the same time as the subsequent direction is implemented, a cost benefit analysis relating to changes incorporated in the subsequent direction.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order prescribes macro-prudential measures for the purposes of section 9H of the Bank of England At 1998 (c.11) ("the 1998 Act") (power of the Financial Policy Committee of the Bank of England to direct the Financial Conduct Authority and the Prudential Regulation Authority).

The Order specifies two macro-prudential measures which are designed to limit the provision of new residential mortgages by reference to the loan-to-value or to debt-to-income ratios applicable at the time when the lender makes the decision to lend to the borrower. Where a remortgage does not involve an increase in the amount of the credit provided then it is excluded.

For the purposes of the debt-to-income ratio, debt is widely defined, but does not include various government support schemes, such as student loans and Equity Loans provided under the Help to buy scheme. The Financial Policy Committee may specify any sub-category of debt as the relevant measure for the calculation of this ratio.

The Financial Policy Committee will, under section 9H of the 1998 Act, be able to direct the Prudential Regulation Authority and the Financial Conduct Authority to implement the measures prescribed in the Order in relation to regulated persons (as defined in the Financial Services and Markets Act 2000 (c.8)).

When a ratio has been previously prescribed and a subsequent direction does not change the substance of the previous direction, but recalibrates the ratio then the FCA and PRA will, when they publish their amended rules, publish a cost-benefit-analysis of the changes, but will not have to consult on the draft rules.

6 Summary of consultation questions

Question 1: Do respondents agree that the FPC should be granted a power of direction over DTI?

Question 2: Do respondents agree that the FPC should be granted a power of direction over LTV?

Question 3: Do respondents agree with the proposed scope of mortgages to which the DTI and LTV limits could be applied? If not, please explain your reasoning.

Question 4: What are respondents' views on the appropriate treatment of business loans to individuals secured on the borrower's home?

Question 5: What are respondents' views on the proposed definition of 'debt' for the purposes of the DTI tool?

Question 6: What are respondents' views on how (if at all) a borrower's assets should be taken into account in calculating that borrower's DTI ratio?

Question 7: Do respondents agree with the proposed definition of 'income' for the purposes of DTI? If not, please explain your reasoning and provide an alternative definition if possible.

Question 8: What are respondents' views on the appropriate treatment of existing buy-to-let mortgage debt, and income derived from rental yields (after costs) on buy-to-let properties?

Question 9: Do respondents agree that the FPC should be able to apply DTI and LTV limits to a proportion of new mortgages calculated on either a value or volumes basis? If not, please explain on which basis the tools should apply and why.

Question 10: Do respondents agree with the Government's proposed approach in relation to re-mortgages and further advances on existing mortgages? If not, please describe an approach that you believe would be more suitable.

Question 11: What views do respondents have regarding the potential impact of the Government's proposals?

Question 12: Do respondents agree with the Government's proposed approach in relation to procedural requirements? If not, please explain an approach that you consider would be appropriate.

Question 13: Do respondents have any comments regarding the Statutory Instrument.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gsi.gov.uk