CHANCELLOR OF THE EXCHEQUER

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

26 November 2013

Dr Mark Carney
Governor of the Bank of England
Bank of England
Threadneedle Street
London, EC2R 8AH

Dear Mark,

FPC LEVERAGE REVIEW

Over recent weeks, you and I have discussed progress in finalising the framework for bank capital adequacy at the national and international level. The completion of CRD4/CRR represents an important milestone, both in setting capital standards for individual banks and for securing a set of critical macro-prudential tools for the FPC to deploy. I am very encouraged by the clarity and focus that you have brought to the Financial Policy Committee's agenda and I strongly support the FPC's decision to concentrate on a few critical priorities over the next 12-18 months.

One of these priorities is to bring much greater certainty on the medium term capital framework for UK banks. That will be very beneficial for the industry and for investors in banks. Most importantly, it will decisively strengthen financial stability in the UK. I am also optimistic that the Financial Stability Board's agenda for the next 12 months will bring to conclusion some of the major outstanding issues on global financial regulation. I strongly endorse the four priorities that the FSB, under your chairmanship, has set out: building resilient financial institutions; ending too-big-to-fail; reducing risks in shadow banking; and making derivative markets safer. Successful completion of the FSB and FPC agendas will make the global and UK financial systems much safer and more resilient. This has been and remains a central goal for this Government and so you have my full support in your efforts to complete this challenging agenda at the national and international level.

Given the strong progress being made at the international level and the clear priorities you have set out for the FPC, I think that the time is now right for the FPC to assess what is the full set of powers that it needs in order to fulfil its statutory objectives.

The FPC will be finalising the capital framework for UK banks over the next 12-18 months and the leverage ratio will be a critical part of the capital framework for banks. As you know, the FPC and the PRA already have considerable powers over the leverage ratio. Although not widely appreciated, the FPC can make recommendations to the PRA in respect of the leverage ratio, and the PRA can set the leverage ratio, both for individual firms and for the system as a whole. You already have these powers and you can exercise them free from any political control. I would not wish to, nor can I, intervene on these decisions of the FPC and PRA. However, the FPC does not yet have a formal power of direction over the leverage ratio, either to set the baseline minimum level or the power to vary this level over time.

Therefore now is an appropriate time for the FPC to consider whether and when it needs any additional powers of direction over the leverage ratio, how it should use these additional powers and how any new powers would fit in with the rest of its macro-prudential "tool-kit". There are also important questions to address about whether and how the leverage ratio should be scaled up for Ring-fenced banks and in other circumstances when the risk-based capital ratios are raised. This review should consider all the outstanding issues relating to the leverage ratio; it is important that we resolve this issue once and for all.

I remain keen, as I know you are, for the UK to be fully compliant with international standards for the leverage ratio, and the UK will of course have to fully comply with any future standards from the EU. My view has been that the international timetable is sensible and that the UK should certainly implement these standards no slower than that. I also think that the UK should apply the international standard for the level of the baseline leverage ratio, in line with the final Basel definition and calibration.

I am open to the review making recommendations that the FPC may need the power to implement a leverage ratio ahead of this timetable or to set a higher baseline ratio in some circumstances for UK banks. However, I would want to see clear evidence how implementation ahead of the international timetable, or at a higher level than the international standard, would contribute to the FPC's primary objective of securing financial stability in the UK. Subject to securing that primary objective, I would also wish to understand the impact of the introduction of the leverage ratio on the ability of the banks to support growth in lending to UK consumers and businesses, which is a critical element of the Government's economic strategy. Therefore I would want to understand how the FPC would phase in the leverage ratio and the review will need to consider carefully the transitional impact of any new leverage requirement.

Subject to the FPC presenting a detailed and evidence-based recommendation, I would expect to be in a position to submit its proposals in this Parliament for approval.

If you agree that the time is now right for the FPC to consider this issue, then I suggest that you finalise the detailed terms of reference for this review once the current Basel process has concluded early in 2014.

I would like the Bank staff to consult with HMT officials in finalising the Terms of Reference. I would hope that you can complete the work within 12 months from the start of the review.

Best wishes,

George.

GEORGE OSBORNE