



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

28 November 2013

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

FUNDING FOR LENDING SCHEME

Thank you for your letter dated 28 November 2013, setting out the objectives and rationale for the changes that the Treasury and the Bank have agreed to the terms of the Funding for Lending Scheme (FLS) extension. Reflecting the success of the FLS, these changes focus the incentives in the scheme towards supporting business lending in 2014, and SME lending in particular.

As your letter sets out, the Funding for Lending Scheme was launched in an environment of unprecedented financial market distress and uncertainty. The continued effects of the global financial crisis and the uncertainty surrounding the euro area crisis combined to drive bank funding costs higher and credit conditions across the economy were expected to deteriorate further.

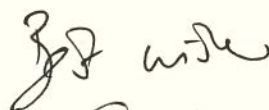
This has fed through to significant improvements in household credit conditions. Although loan volumes remain below pre-crisis levels, there are signs that the UK housing market has started to normalise. Mortgage rates are at their lowest in five years and mortgage products for lower loan-to-value mortgages are widely available. This reflects, in part, the success that the FLS has had on improving household credit conditions, and we have agreed it is an appropriate time to begin withdrawing this broad support for household credit conditions.

Furthermore, because this Government has now set up the Financial Policy Committee as a strong macro-prudential authority within the Bank of England, we have addressed once and for all a key shortcoming of the previous system of financial regulation. In doing so we are making sure that the mistakes of the past – which resulted in the biggest financial crisis in generations – will not be repeated.

However, while household credit conditions and the housing market are recovering, the market for higher loan-to-value mortgages remains very restricted by historical standards. This is a significant barrier to first time buyers and those without access to a large deposit. As you say in your letter, the Help to Buy scheme is a targeted measure designed to address this specific issue, and its ability to perform this vital function will be unaffected by changes to the FLS, which provides more broad based support for household credit.

Credit conditions for smaller businesses have also improved, but to a lesser extent, and lending to businesses overall remains muted. It is therefore very important that the scheme continues to support lending to businesses and provides strong incentives to SME lending in particular, in line with the extension to the scheme announced in April this year. In addition, setting the fee at 25bps, the lowest point on the previous scale will further enhance the incentives for SME lending.

I am confident that these changes will build on the success of the scheme so far and will continue to support further easing of credit conditions to businesses and in particular SME lending. As your letter sets out, the FLS will continue to be overseen by the joint Bank/HMT Oversight Board. I confirm that the scheme is within the remit of the Bank and that I welcome the changes to the scheme.



GEORGE OSBORNE