Financial Stability Report Press Conference

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Ashley Armstrong, The Sun: I just wanted to ask about the level of arrears, you say we're going to have a shoot up but it's not going to be as bad as 2007. Given that in 2007 we had a slightly different situation, now we've got inflation much higher that's eroding basic income. Do you think that there's going to be a greater drift between the inequality of sociodemographic groups than it was in 2007? It feels like the poorest are already being hit by inflation at this level and actually those that are facing arrears will probably face even more difficulty?

Jon Cunliffe: So there are some big differences between now and 2007 as you say, 2007 inflation was not rising and interest rates were going down, whereas at the moment we're seeing the opposite. I think the big difference is the amount of household debt that's being carried is much lower now than it was at the time of the financial crisis so households aren't really over-levered as they were before and that's one of the reasons why we think that households in distress are whose debt service ratios adjusted for inflation will reach levels where in the past you've seen distress. That proportion of households will be smaller than we saw in the financial crisis, considerably smaller. I think it's clear that inflation hits the poorest off in society worse I think that's well known. And that's one of the key reasons why one needs to get it under control. But if we're thinking about mortgage arrears and the ability of households to pay, then I think the fact that households are carrying less debt than they were. And that's in part because of the action that the Bank of England and the Financial Policy Committee took to put constraints on mortgage borrowing, that, I think, will leave us in a stronger position in terms of distress.

Andrew Bailey: I absolutely agree with Jon on this. I'll just reinforce the two points that I made in the beginning. We have a set of borrowers that, who as Jon as said, are less exposed and particularly less exposed at the extreme tail. Secondly, we also have a banking system that is more able to support its customers. A resilient banking system is more able to support its customers and that is a critical point as well. That's another critical point of macroprudential policy. The banks can support their customers and support the economy rather than the other way round.

Ed Conway, Sky News: How can you reconcile the fact that for a lot of people around the country this feels really tough with the fact that you have charts now saying that in many dimensions it's not going to be as bad as in 2008. Is that just about the distribution of the way that the pain is being felt or is it something else? And just a tiny micro second question. Do you regret withdrawing the mortgage affordability tests in 2022? Would things have been different? I know they've probably improved, the nature of those charts right now but would they have been even more resilient had you actually left it in place for a little bit longer?

Andrew Bailey: Two points on the first part, I'll come on to the test withdrawal point. The first part is what Jon just made. Which is, what macroprudential policy and particularly the mortgage policies that adopted back nearly 10 years ago actually have done is that they have limited the number of people that will face the extreme pain and stress of this as a consequence. The second point I will make is a macroeconomic point. We do have much lower unemployment in this country. We have a much stronger labour market. We're

having to deal with that on another front but on this front of course it is helping a lot in terms of the stress that households are seeing.

On the withdrawal of the test. The answers no actually. The reason we withdrew the test is, we had three tests essentially applying at that time, so there was the LTI flow limit as we call it which is an FPC measure which is still there. Then we had two affordability tests, one was the FPCs and the other was the FCAs. The consequence of all the work that our staff did in assessing that is that the two affordability tests and actually also the sum of the three tests, if you like meant, that we didn't need two affordability tests. One was doing that job and that's why we withdrew the FPC one because we felt that actually the combination of the FCA one which has to be there under rules and the LTI flow limit test did the job, so we do obviously have a keen eye on regulatory efficiency and we felt that did it.

Kalyeena Makortoff, The Guardian: You are predicting some households, around a million I think by Q4 2026 are going to see their mortgages rise by about £500. What impact do you think that's going to have and do you think that they can actually keep up with those payments?

Andrew Bailey: Well it is going to have an impact clearly. I have to put my monetary policy hat on for a moment of course that is part of the transmission of monetary policy, no question about that. I'll just come back to the point we've made a number of times. What we're seeking to do here, and this is why the Bank of England has responsibility for both monetary policy and financial stability, we are trying to balance having the transmission of monetary policy with the two things I would emphasise. 1 is the resilience of the banking system and 2 is the ability to support customers and therefore manage the consequences of this. But there will still be consequences from increased interest rates I'm afraid because that's from a monetary policy perspective why we have to do it.

Laura Noonan, Financial Times: Just a quick question about the efforts that are ongoing to try to encourage banks to increase their savings rates and reduce their mortgage rates. Do you have any concerns from a financial stability perspective about those efforts, is it a dangerous game to get into telling banks to offer higher savings rates, telling banks to control their mortgage rate increases in this environment?

Andrew Bailey: Let me start off with one big message from what we have released this morning, which is that the resilience of the banking system is not a constraint on banks managing their net interest margins and therefore managing the rates they pay to saver and the rates they charge on mortgages. That's important. It wasn't always the case in the past as you know. It's very important that financial stability is not a constraint in that sense so banks can take the decisions that they need to take on that front, without having to, in a sense restrict for financial stability reasons and I think that's a very important thing.

Now in terms of saving rates. I'll make three points, I think all of which I've made before, but they're important. 1 is the case, and we do draw this point out, that we've seen more pass through in fixed deposits than we have in sight deposits. I'm not saying that banks can have no regard for sight deposits but there is a reason for that which is that particularly from the point of view of liquidity management for banks. Fixed term deposits have a value in that sense. We come back to the point about exposure to runs actually at that point so there is a value to that. Now it's not surprising that we're therefore seeing customers switch deposits from sight deposits to fixed deposits, that's happening and that's not surprising at all. I think that's an important point to bear in mind. A 2nd important point to bear in mind is that there is what I might call a

more structural rebalancing of rates going on as we move away from zero interest rates. Obviously when we went to effectively zero interest rates, if you go back to before the financial crisis, back to the time where we had rates more in the run that we have them today, it was pretty typical for the average rate that banks paid on savings to be just below our official rate. When our official rate went down to nearly zero that relationship reversed and what we're now seeing is it re-establishing the old order if you like, and I don't think that's a surprising thing to see.

Those two points I think are important as part of the understanding the transmission. I'll finish with a 3rd point. It is important that obviously rates get passed through. I think it's important that we have competition in the banking system which encourages banks to compete, and compete on saving rates. And again, just to re-emphasise, a more resilient banking system will be able to compete. They haven't got one arm tied behind their back by the need to achieve financial stability. They can compete on that basis and that's a good thing.

Sam Woods: Just to add one very brief point Laura. We have also explored that in the stress test. So in the stress test we've done two things. One is that we've made the proportion of non-interest bearing household deposits drop by 15 percentage points. People are migrating more into term. That's more than the banks put into us and more than we've experienced so far. And the other thing we've done to illustrate Andrew's point is we've required the level of pass through to be such in the stress test, that the spread between sight household interest bearing deposits and Bank Rate goes back down to the sort of level it was at in the 2000s which is about 220 basis points versus more like the 285 that we see recently. We've made sure as Andrew was saying that the system is kind of capitalised and tested against a high level of pass through.

Jon Cunliffe: Just a macro point. I think the structure of banks liabilities deposit accounts will change and they changed after the financial crisis. I think a period of very low interest rates meant the number, the proportion of bank liabilities accounts did fall by non-interest bearing deposit accounts grew and the proportion of remunerated fixed-term deposits shrank. And what you're seeing now, I think that's what you would expect to see as interest rates go up, is those proportions moving and we're getting a greater move into more fixed-term remunerated deposits. And from a financial stability point of view, re-dressing that balance, that's a good thing because as Andrew said, that's more stable funding for the banks and you would expect them to want to pay more for that, and actually to bring us back to the pre-financial crisis levels.

Andrew Bailey: They also I mean get a benefit in our liquidity regime that Sam operates if they have more stable funding.

John-Paul Ford Rojas, Daily Mail: I just wanted to ask, please, about the debt servicing ratio. So the proportion of post-tax income being paid in mortgages expected to rise to 8% by mid-2026. That's going to be lower than it was in the 2007 crisis. Does that comparison in one sense or those kind of comparisons give the MPC in a sense a green light for interest rate rises? But also, what is that rate going to be when it's just as a proportion of people who have mortgages. I've seen it said it's more like 25% of their income is going to be spent on debt servicing, and how does that compare to the crisis levels? I'm not sure if you've done that in the report.

Andrew Bailey: I'm not going to use the green light analogy because obviously we're not giving any messages about what will happen to interest rates here. But what I would say is this. Obviously monetary

policy and financial stability sort of closely interact here. So of course the MPC has to have regard for the stability of the financial system and the stability of the environment one thinks about its actions actually written into the operating rules. And we do that so again, a more stable environment is one in which monetary policy can do its job. It's easier for monetary policy to do its job when it's operating against the backdrop of a stable financial system. I just emphasise, I think that's a very important point.

Jon Cunliffe: I don't have a number, but just as a proportion of that.

Andrew Bailey: We will come back to that.

Phil Aldrick, Bloomberg: Jon, I think a year ago you suggested that interest rates at about 5% would start to cause problems for corporates and also put more dangerously high levels of households in debt distress. It seems in this report today that 5% isn't causing undue distress among corporates or households so what is the level at which we will start to see problems? I just wondered if you could also explain what is happening on the LDI front, I understand that there were further recapitalisations. Were there billions more and what's been happening on that front?

Jon Cunliffe: I think what I said is there is a range. I think it was between 200-500 basis points so quite a big range. So that would take an interest rate considerably higher than where we are now. One of the things that we've seen though over the last year is actually through basically the support the banks are offering. Through the ability to extend term. Through the ability to change mortgage terms. Or move onto interest-only which I think is part of the Chancellor's package. That actually there are more options there for people to soften that. But the number we give in this report, and there's been some changes because we were talking also about not just mortgage payments, but cost of living. Trying to take account for both impact of inflation and higher mortgage repayments. And we've tweaked the inflation numbers to add more elements of inflation in, which has made the inflation pressure go up a bit. But the number we're giving now is about 300 basis points for interest rates to increase before you reached those debt levels which are the levels we just talked about that we had in the financial crisis. So we've seen that highly indebted number move from 1.6% of households to about 2%. But it would need to move up to about 3.5% to get to where we were in the Financial Crisis and the number we give there is about 300 basis points to get there. We gave a range last time and you gave me the bottom end of the range and I've just given you something close to the top end of the range.

Andrew Bailey: On LDI, what we've done, is we've essentially set what we think is a sensible buffer level for them to hold as a buffer against stress. What that meant was that when interest rates went up there was no disorderly need to in a sense try to cool down assets to re-capitalise the LDI funds. There was a movement of assets but that happened in a very orderly fashion. Which is what we want.

The other point I'd make about that movement is of course, it's actually that case that when interest rates rise the underlying position of pension funds actually strengthens, the net asset value of pension funds strengthens. So it's not a question of the underlying solvency of pension funds. It was the problem of the need to do this sudden and quite disorderly transfer of funds. Which couldn't happen in the time available. So with the buffer in place that problem is mitigated.

Phil Aldrick, Bloomberg: There will be further recapitalisations?

Andrew Bailey: Well there will be some re-building of the buffer but it wasn't that large actually.

Jon Cunliffe: Immediately after the LDI crisis, until we'd work out a more longer-term solution, We asked the funds to be holding about 300 basis points to be able to accommodate a 300 basis point shift in long-dated gilt yields. And they put that in place immediately after the LDI incident. We've since formalised that and in the last FPC round we set our requirements for them to hold a standing buffer of about 200-250 basis points and then enough to deal with market moves. And that is pretty much kind of where they were at the time. With the extra resilience that we put in immediately after the crisis so some of that buffer has been used up as yields have moved, but as Andrew says, what the buffer is trying to do is to give them time to actually re-capitalise, to get contributions from the sponsor pension funds and the sponsor pension funds can do that because their liabilities are going down in value faster or by more than their assets are going down in value. So this is really a question of how do you deal with an acute liquidity crisis.

2nd point of course, we have seen the movement up in yields but I think during the LDI crisis yields went up by I think 150 basis points in three days. Which is an unprecedented speed and that was being driven by other events. Whereas now we're seeing yields go up as the market works out or re-estimates where Bank Rate will need to go to bring inflation back to target. So that's a more gradual adjustment process to the combination of the fact that this is happening over a more gradual period and the fact they have the buffer to absorb it, means that they will be able to absorb those increases in gilt yields without the financial stability stress we saw back in September.

William Schomberg, Thomson Reuters: Just coming back to the report, I think you referred to how the stress that we saw in parts of the banking sector recently underscored the importance of international authorities and their commitment to making sure that the resolution framework remains credible. Can I just ask, the way that Credit Suisse was taken over, did that affect the credibility of the global financial resolution rules on an international level. And secondly, seeing as you have put your monetary policy hat on a couple of times already today, and you talked about the labour market, what was your take away from yesterday's jobs report? Was it more of the signs of accelerating pay growth or were you more taken with the signs of perhaps some weakness or some looseness coming into the labour market?

Andrew Bailey: Let's start with Credit Suisse. There was a resolution on Credit Suisse let's be clear on that. It wasn't a resolution that followed the sort of playbook exactly. I should say there is always some flexibility within the playbook, and you have to have that because we can't prescribe every situation that's going to occur. So I don't think that's the issue and I'm not going to get into the question of what happened and what didn't happen around the route that was chosen. What I think is important, and I've said this before is there were comments made that were, there were doubt cast on the globally significant bank resolution plans more broadly. By virtue of not using the playbook and deciding that the playbook couldn't be used. Now that's a very serious issue. Two points I will make here is. One, we can't ignore that, we can't live with a world where there is ambiguity, that's just not of course acceptable, the risk is much too great. Secondly, we have to get to the bottom of the question. Is this or is this not accurate in terms of the description of resolution plans which of course come out of the work done in the global Financial Stability Board and then implemented by all of us as national authorities. And that work is going on. The Resolution Committee of the Global Financial Stability board led by Martin Gruenberg is very focused on that.

I think I've said this before in public. I will give a starting point on this. I'm afraid I do remain to be convinced that that assertion that this casts doubt on plans more generally. I'm afraid I am not convinced by that assertion. But I am very convinced that we have to obviously kick it's tyres and test it thoroughly to decide whether these plans are still fit for purpose or whether we need to go back to them and change things. You just cannot. This is far too important to sweep that under the carpet. So that's my view of the position.

Jon Cunliffe: Just to say, some of that work is at the international level, the Financial Stability Board looking at resolution in the light of Credit Suisse and in the light of the three US banks that need to be resolved. At the last meeting of the FSB plenary, there was a press notice that just gave some of the conclusions, initial conclusions which was there was a viable and credible resolution option so I think the better way to think about it is that the Swiss authorities had a number of choices. They happened to have a private sector buyer although they came with other things as well. And they chose one route rather than the other route and the fact they chose one route doesn't mean the other wasn't a viable and credible alternative and I think there was some of the kind of noise surrounding that. As Andrew said, perception may have grown that there wasn't a credible alternative. I think the work the FSB is showing is that there are lessons to learn from Credit Suisse as there are from Silicon Valley etc. and the regime always needs to take account of actual incidences that credible resolution options under the international framework are there and can be used. There wont always be a private sector buyer.

Andrew Bailey: On the labour market, obviously this isn't a monetary policy press conference this morning but good try. The Monetary Policy Committee will be starting our round next week actually. So what I would say. I'll just say I think a number of commentators have said this about yesterday's data. There are two parts to it and you can see that. I will repeat what I said at Mansion House, and not for the first time, on Monday evening. Which is that the current level of pay increases is not consistent with the inflation target. I'm afraid that's a fact of life and we have to deal with that.

On the other side, I think you were referring to this when you look at the quantities side of yesterday's report. I think there are some interesting pieces of evidence and not actually that new evidence. It's a continuation in some cases if you look at the vacancies to unemployment ratio for instance, of some signs of the labour market cooling. I pick this up, we pick this up, when we go round the country actually. You are hearing more stories so what I will say is that is the job of the MPC. We're going to have to put all of this information together again and see what we make of it.

Tim Wallace, The Daily Telegraph: Can you expand a bit more on the plight of small landlords? Are they facing a bit of a wipeout given the sharp rise in interest rates and can you talk about the implications of this for house prices and for rents as well? Also, are we still seeing any help for households coming through from the pandemic savings that they built up, are they helping people through the shock they're facing at the moment?

Sam Woods: On the smaller landlords point, we're not very concerned by that from a financial stability point of view. We do include in today's publications an assessment of what we think the average increase in a monthly payment for a buy-to-let landlord would be likely to be over the course of the next couple of years and we put an estimate there of £275 a month. Now it is true that if everything else was held static and landlords had no ability to adjust any of there other incomings and outgoings that that would push a considerably higher portion of buy-to-let mortgages below a key threshold that we use in supervision which

is an interest rate coverage ratio of 125% and it would actually increase that number from about 3% to just over 40%. But of course, in the real world other things are not held fixed and we have actually seen over the last year around a 5% increase in rents and that is a product of the pressures that landlords are facing. At least in part, partly from of course, change in financing additions, but also other pressures that they have. So we expect the situation to continue to evolve in that way. We've included a number also of the net sales coming out of that part of the market in terms of properties which is actually a relatively small number of 100,000 on context to the overall housing market.

The only other point I'd make is that we do of course stress test all that in our stress test and we do stress buy-to-let mortgages. We think they have a higher impairment rate in our stress test than others but overall if you look at mortgages. It actually goes back to the earlier question as well, we think that the impairment rate that we'd see in mortgages in our stress test which is a much worse version of the world than the one we are actually in at the moment. It would only be 0.9% and that's actually down from 1.6% last time we did that and that's because the quality of assets has improved in the meantime. Not least because house prices have gone up, and therefore the portion of these mortgages as a high LTV is pretty low. I'll finish on one point to illustrate that which is that the stock of buy to let mortgages, 94% of them have an LTV of less than 75%.

Jon Cunliffe: Can I just make a general point on that. Two general points. One, there are a lot of other things going on in the buy-to-let market, they're have been taxation changes, new environmental standards. There are changes to the structure of tenancies and how you can end tenancies. So there's a lot of other things apart from interest rates. But the more general point is we've come out of a period of very low interest rates and the percentage, the proportion of small private sector landlords grew during that period. And now we're in a period of higher interest rates where there are other returns in other parts of other sorts of investments. And you would expect that there will be some re-balancing as we move and it's the same point as the re-balancing of deposit accounts. One would expect those flows from a financial stability point of view, the question is, does that happen in a way that can be accommodated? What's the impact on the banking sector? And as Sam said, the net outflow when you look at the larger landlords coming into the market is not particularly large at the moment. But I think we should expect, as we go through this period that people will change their investment preferences because the relative value of different investments changes.

Andrew Bailey: I think that re-balancing was already happening just consistent with Jon's point about other factors before interest rates started to rise actually.

Tim Wallace, The Daily Telegraph: And on the pandemic savings. are we still seeing help coming through from the pandemic savings people built up? Are they helping with shock people are facing at the moment?

Andrew Bailey: No. I think you're right. I think that the build up of savings, especially the build-,up of unexpected savings beyond what you would expect during the pandemic does provide some buffer for it in that sense yes. The real value of that saving has come down but it does provide some buffer yes.

David Robinson, Market News: Following the footsteps of the New York Fed, do you place any weight on the idea of double R-star, there is a policy rate at which you create financial instability. I notice that Catherine L Mann referred to it recently. And if you do attach weight to that, are we above it or below it?

Andrew Bailey: I think you'd have to ask the question, what is the underlying reason why you take rates to whatever level it is. I would caution against merely running a simulation and a model in saying 'what if we put rates to' pick your number, what would happen because you would have to look at the underlying reason. This is the point where things come through in a number of answers to a number of questions. We've got a higher interest rate today than in a very different context to the one we see in the stress test so you have to, in terms of what breaks it, you really do have to take that into consideration. So you've got to specify the scenario very carefully to do that type of analysis because you'll get different answers for different scenarios.

Jon Cunliffe: Maybe just a general point stepping back. The economy will go through different cycles over time. There will be an interest rate cycle. This one has been fast by historical standards, but in terms of the amplitude to the cycle, actually not so very different. The job of financial stability is to make sure that when that happens the financial sector has the resilience to deal with it. First of all, to make sure the financial sector doesn't cause it, which is what happened in 2008. But even if it doesn't cause it, that it has the resilience to deal with that, so monetary policy has the freedom to operate. And that in a way is what the stress test is all about so deposits, unemployment at 8.5, 5% recession etc and says can the banking system deal with that so that monetary policy does have the freedom to operate, to do what is necessary to bring inflation back to target? I think that's a more helpful way of looking at it than saying in a model somewhere is there a rate that breaks this. Do people lose money when economic circumstances change? They do. Actually, it's a function of markets and the system that that should be a part of it. The question is, can the financial system adjust to that change without falling over in the way that we saw happen 15 years ago. That's in the stress test and the judgement that's in this FSR.

Andrew Bailey: I just emphasise this point that I think historically, slightly at the risk of what I said on Monday evening about we always understand life backwards. Unemployment is one of the best guides to impairment in the banking system. That's been the case in the past, obviously we have had very big spikes in our employment in the past during recessions. And that's why you see a very different situation today. But then again as Jon just said, a stress test which we've tested with a level of unemployment has just over double what we've got today and the system is resilient to that.

Kohei Onishi, Nikkei: As Governor Bailey said in March, the BoE took a decision where HSBC bought Silicon Valley Bank UK for £1. What lessons can you restore from this exact event or processes for future a financial crisis? And do you think that the Banking Act 2009 is effective through this exact experience?

Andrew Bailey: I think there are a number of lessons I take from that but we're all closely involved in out so we will have our perspectives.

Let me draw out three things about that weekend in the context of Silicon Valley UK. 1 is that in the UK system we have, for a long time now, actually required as part of what we call Pillar 2 of the capital system. Slightly the intricacies of Basel. Basel globally is Pillar 1 and then Pillar 2 is things you choose to implement nationally. We've implemented what we call interest rate risk in the banking book capital requirement. That's important because that covers whatever risk banks are taking through. As we saw with SVB globally this capacity to have an interest rate mismatch in the banking book. We've always for a long time required banks to hold capital against that risk and there's a stress test used to, in a sense to calibrate that interest rate risk. That's the first thing. I think that's important.

The second thing is, I'm going to be quite careful what I say here, because it's been covered. It is the case that Silicon Valley Bank UK subsidiarised last year about a year ago actually wasn't it Sam I think. And that's because it was approaching the policy that we already have in place, at what point we think it makes sense for a bank to subsidiarise. In the context of how many effectively insured FSCS eligible deposits it's holding.

Now, I just want to be careful here because things have been written about this. Of course we're doing the lessons learned. It doesn't mean we're about to enact some radical change to the subsidisation policy. I think it was a particular benefit to us in this case because frankly if we hadn't of had it we couldn't have done a resolution. The FDIC would have been doing it. We always review these things but I just want to be very careful that we're not cooking up some radical change, we're just looking at it and saying how it will work.

I think the third thing I take from it, and here I will be quite open about it. I think the first two things I've set out meant that we had a resolvable entity. We had something that we could resolve. In the UK it looked to me, certainly to be basically solvent and resolvable. You've got to have that to get into the process. Here I'm talking about resolution in terms of transfer and sale to another party. The third thing you have to have is a party that wants it and we had it in this case. You can't always rely on that, I've done quite a few resolutions in my time and they don't always work like that. But put those three things together and it came together. What we're doing is saying 'ok, that was very good and helpful' but we have to look very carefully then and say what do we learn from that in terms of messages we can make and that's what we're doing.

Sam Woods: Maybe I can just add two brief points, one is I think the events that have taken place in the US banking system are a useful reminder in the way that contagion can happen within a banking system. We had very limited contagion into our own system, only really through wholesale funding costs and banks share prices. But it's reminder of that and something to be aware of and secondly, just to go back to a point Andrew had mentioned earlier, we feel we had a very successful resolution of Silicon Valley Bank UK. And from a standing start on a Friday morning to Sunday afternoon we had three different options that we could have taken. That's a good place to be, much better than where we were say 10 years ago, so that reinforces the confidence that I have in that part of our toolkit. But as Andrew was saying, you need to learn from these things and there is a question, do we want to broaden our toolkit to have some more options for depositor continuity in smaller firms and that's something we're working on.

Christopher Dorrell, City AM: Generally it seems that risks emerge in unexpected places in quite concentrated ways and I take all the points that this scenario is testing, high unemployment, inflation, global downturn. What can it tell us about risks that emerge in very specific markets, say in commodities and where the changes that take place, take place very quickly and how can banks prepare for that?

Andrew Bailey: Two things I'll say, one in constructing the scenario for the bank stress test, we do look more broadly than just the core UK markets. So you'll see from looking at it for instance that we've obviously once again had to think quite carefully for instance about risks in China and Hong Kong because obviously our major banks are very active in those markets. Much more so than other major banking sectors elsewhere. So that's an example of something we always look at carefully because we have the exposures in that respect and so have to look at them very carefully. We also look very carefully at areas like for instance, leverage lending because its another, we've highlighted again in this report and have in quite a few previous

ones it's an area where we do think there's more risk. Commercial real estate would be another one so those things we do.

The second thing I'd say is, I will just move on to the market-based finance tests, the exercise we're launching. Your question is really very relevant to this actually which is, I've said before, one of the big challenges with the non-bank world is that it's a very big landscape, quite diverse as you said and also we've found by experience that sometimes the problems can emerge in quite opaque and slightly obscure parts of that world. And so the challenge that we have to set ourselves, here and globally, how can we sort of in a sense get our arms around that efficiently. The exercise we're launching is very much, as I see it, as a learning experience to say you know how can we take this forward now and actually put this into practice. Because it is a challenge, you mentioned commodity markets. In a sense LDI, which I've said before, it wasn't the major part of the LDI industry where the particular problem arose. It was in the so-called pooled funds which is only about 15% of the LDI market. These are substantial challenges and ones we know we've got to get our arms round and so the exercise is again in the market-based finance world is a big step forward in how we can actually do that effectively.

Jon Cunliffe: The dash for cash that we saw in March 2020 is actually quite illustrative of that. We know that there is what I will call fragility in market liquidity under stress so we've seen jumps to illiquidity over the last few years in a number of instances. And some of that is to do with the way in which the system interacts. As Andrew said, market-based finance, much more diverse and I don't think the FPC has a regular horizon scanning exercise where it looks at all that. We're trying to improve that. We have the system-wide exploratory test which is essentially a test of how the market works together coming up. But we know that there are some areas where if you like, liquidity stress gets amplified and transmitted across the system. Money market funds, open-ended funds, impact of margin call in stress. Some of the hedge fund strategies, these things have been well identified over the last few years. It's an international issue because these markets are kind of international, you can't really solve much of it domestically. But there is work going on in the FSB. They've just brought out something on open-ended funds. We've got improvements on money market funds where in the UK we will be putting out our proposals later on. There will be proposals coming, I hope on margin. So there are things we can do but we really have to act internationally to try and reduce that liquidity fragility because we've seen when the system works together you can just amplify liquidity stress. But will we always know everything that's happening in those markets globally, I think that's going to be very difficult.

Andrew Bailey: As Jon said, if you go back to March. One of the particular things in the US you saw was a flow out of banks into money market funds, now that emphasizes the fact that money market funds are an important part of the system and we've got FSB proposals out there but they've got to be put into effect.

Sam Woods: When we talk about the stress test we tend to focus mainly on the real economy variables but we also have a very significant trader risk stress, the banks taking £30 billion loss and in amongst that the banks are required to default five of their uncollateralised counterparties and two of their largest collateralized counterparties so I think that gets to the kind of risk you're asking about.

Ed Conway, Sky News: Correct me if I'm wrong on this. Looking at the stress test it does look like some of the ringfenced banks did particularly well. I just wonder whether there is a lesson from that given the talk

about the Edinburgh Reforms, given people are looking at this right now. Is it a warning of the resilience of the current system, a warning about messing with that system?

Sam Woods: I think by far the most striking thing about the stress test, is in fact that the capital draw down, in other words the capital hit is really quite a lot smaller than the last time we ran a test of similar severity. So it's a 3.5 point draw down versus 5.2 last time that we did this and within that you're quite right to observe that the ringfence banks even have a lower draw down. That is good news. That is a product of the changes we were talking about earlier in terms of asset quality. It's also things like some of the legacy books that are actually still with us from before the financial crisis having got smaller and rolling off since then and some changes in lending standards. So I think that is good news. What you do see though of course in the ringfence bank results is sort of what you'd expect, that the effect of the scenario on the ringfence banks is a bit more homogeneous than the effect on the banks overall and you would expect that. But that is obviously something we have to have an idea, it is of course very important that we are stressing those banks to things that could really happen because there more of a possibility naturally by design if you like that the ringfence banks results can be more similar through time.

Phil Aldrick, Bloomberg: Just on uninsured deposits, I think you sort of touched on the fact that resolution regimes are being looked at. There's been talk about turning the FSCS into a re-capitalisation fund, there's been talk about pre-funding the FSCS as part of these reforms. I just wondered where we are on that and current thinking?

Andrew Bailey: I'm not going to pre-judge where all of that is going to end up. You're right, we're looking quite broadly at it. I don't by the way think the answer is just to raise the limit, the £85,000. There may be a case for doing something with £85,000, I'm not going to pre-judge that for a moment. But the answer is not to raise the £85,000 in this case. In a way that was one of the lessons I think, one of the messages from Silicon Valley UK which was that actually what it had was some very lumpy corporate deposits which were the working capital of companies. It was the lifeblood of these companies and we were very aware of that from the messages we got over the weekend. So I don't think just saying if we put it up from £85,000 to you know some other number that's larger than £85,000, that doesn't really do it. So, we are looking as we've said more broadly at the resolution toolkit if you like as Sam was saying earlier to say how can we address that question because I think the point that did come across that weekend, to be clear was, that in the corporate deposit world these accounts are of course you know very much the lifeblood of how these companies operate. It does make it clear that we have to look at that fresh and say what can we do but I think the answer if it probably lies in the resolution toolkit rather than the FSCS limit world.

William Schomberg, Thomson Reuters: The Treasury has spoken to and reached agreements with banks about ways to minimise forbearance in the mortgage market, also other ways to help people who are struggling perhaps with their mortgage costs. On the other hand, the Bank of England is using interest rates to execute monetary policy. How close are we to a point where these two institutions are almost working at loggerheads and is this something you've discussed with the Treasury around the time that they were talking to the banks about what they could do to make mortgage costs more bearable for people?

Andrew Bailey: Well, we're not at loggerheads at all actually. One of the things that the monetary policy committee has to do is understand that obviously the transmission mechanism of monetary policy is an important part of monetary policy setting. And so understanding that and understanding how it's changing

and of course the mortgage area has changed a lot. It's 20 years really since we last had a rate rise cycle so the shift to a predominantly fixed rate market and then the question of how the process of recessing rates actually works is an important consideration for the MPC. But we're not at loggerheads, and I will just come back to a point I think I made very early on, on that just from a financial stability point of view. It is, I think, very helpful to have a banking system that can support its customers. I don't think any of us want to go back to a world where the rate of repossessions of houses. If you go back to the early 90s for instance, the recession in the early 90s, the rate of repossessions that was then and the effect that has on people and on families, we don't want to go back to that world and I think we're in a much better place with the banking system that can support its customers. We're not at loggerheads. It's a matter of understanding the impact of these measures.