Financial Stability Report Press Conference

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Mehreen Khan, The Times: The outlook that's in the Financial Stability Report suggests resilience in corporates household banking system and it seems to suggest that a lot of the parts of economy have adjusted to your higher for longer message. Given that this relatively resilient and benign picture, does what is published today embolden the banks other part of its hat which is monetary policy that there is no need to cut interest rates next year because it doesn't look like the picture on debt sustainability and mortgage payments on the corporate sector is going to be particularly apocalyptic next year.

Andrew Bailey: Well, as Katie said we're in the monetary policy quiet period, but I'll do a more general answer Mehreen to the question because it's a good question, without commenting on where we are with monetary policy. So, obviously, just to make the point on monetary policy then, however as the framework, of course the target is the inflation target and that's always the target with monetary policy. Now, obviously, monetary policy and financial stability interact in the sense that it is much easier to pursue a monetary policy course in a stable financial system and it's much easier to have financial stability in a system of price stability. So, I really won't go along with the argument that in some sense we will set monetary policy with financial stability directly in mind and therefore move away from the target, but you're right in the sense, what I think lies behind the question and it's a good point that these are the two core objectives of central banking, and they interact. We don't trade them off in that sense, in our normal decision making. That would be the wrong thing to do, but it is the case that obviously, it is easier to pursue each of them when the other one is stable.

Laura Noonan, Financial Times: Just a quick question around the leverage around, you talk about the risks re billing and leverage lending and in private credit. Is it possible to materially tackle those or do we have to accept that the risk had to go somewhere? It came out of the banks, therefore it goes into the NBFI system and then as a follow onto that, shall we be expecting the next financial crisis to come from NBFIs? Thank you.

Andrew Bailey: Well, I'll get Sarah to come in on the detail, on the point about the next financial crisis, does it come from NBFIs, that's quite a sweeping statement to make. But what I would say is this and to put it into a slightly broader background because I think it's a very important point you raise. I mean, what we have seen since the financial crisis is a switch in the relative importance of intermediation in the financial services from the banking system to the non banking system. So, relatively, the non banking system has increased in importance relative to the banking system. I don't think we should be surprised by that by the way because in one sense, we were tackling a number of perceived critical failings in the banking system in the context of financial stability and I don't think we should be surprised at that change in relative positions because frankly, some of the activities that were taking place in the banking system that exacerbated the financial crisis were not really appropriate for, what I would call, you know, deposit taking institutions in that sense.

But you're right in the broader sense that what that means is that we have to pay much more attention to the non bank world than would've been the case in the past because there has been a relative shift of importance between the two systems. They're now both in a sense important, whereas in the past if you'd gone back in time, you'd have found we'd have been talking about banks almost exclusively in this type of event. So, that's right. I'm not predicting therefore the next financial crisis is going to come from the non bank system. What we are saying, I think and it's common around the world is that the relative importance of the two is now much more balanced.

Sarah Breeden: Let me expand a bit on the private equity, private credit, leverage lending issue. It's risen a lot in the recent past as Andrew said and that of course, is a business model that has grown up in a low interest rate environment and we might expect it to be there for more challenged as we adjust to a higher interest rate environment, and we certainly see some challenges as we look ahead. Private credit in particular, we explore in our-, there's a lovely box in the FSR and we highlight the opacity of that, the slowness in adjusting valuations and the possibility of leverage on leverage. All of which are warning signs in the context of risks building and what we highlight is that banks and others should be particularly alive to the risks in that area.

Andrew Bailey: I think that's right, and I think certainly that private credit sometimes presented as being a universe of its own. I think our analysis would be, it's much more interconnected with the leveraged world and with the private equity world and the leverage lending world than I think that, sort of, slightly atomistic view of the world would suggest, I think to assess the risk properly, you have to understand the interconnections.

Sam Woods: I wonder Andrew if I can just have one point on leveraged lending, which is of course, Laura, some of our banks are engaged in it and banks around the world are engaged in that and you'll have seen that the latest default rate is 5.4% gone up from about 5% in our last report, but the way we have always approached that is to make sure that we're stressing a much higher level of losses up to more than 10% in our regular stress testing.

Phil Aldrick, Bloomberg: Just to pick up on the point about the risk in the private credit, private asset markets. Obviously, the government is pushing the agenda for pension funds to invest more heavily in this area at the moment. Do you think that's a prudent policy right now? And with hedge funds that you do draw attention to the hedge fund risks, the positions, as you were talking about, the derivatives are even on a scale, even greater than at the dash for cash moment. At that point we had to do £200 billion of emergency QE. Are we talking about similar scale interventions, as you were talking about, if things get a bit bumpy?

Andrew Bailey: Well, on the first point I think it's important to be clear on the distinction between encouraging investment in the real economy. The real economy in the sense of supporting businesses in this country. That, I think, is what the government is keen to see more pension fund investment go to. I think that's a very good idea. We talk obviously a lot about the growth prospects in the economy and what to do about it and what to do about the supply side of the economy. Well, encouraging investment in the real economy is obviously a very important part of that. Now, that's a distinct thing from what we were just talking about in the previous question, which was really about the more, sort of, in a sense, leveraged elements of the system, the more into the world of private credit, private equity, leverage lending. That's a very distinct thing. I mean, there may be overlapping sets, but they are quite distinct in that sense. I don't think the government is saying, 'Therefore, you must invest in high leveraged funds and so on.' That's not the point.

On the point about intervention. I will be pushed back about describing the LDI intervention as QE. It wasn't QE. What it was that we-, well, the dash for cash in 2020 is different in the sense that actually, at that point we were facing both a financial stability and a monetary policy needs to intervene. Whereas in the LDI crisis it was very clearly a financial stability rationale. It was, therefore, appropriate we used the term temporary and targeted, and I think that's exactly what we did. We were out by effectively January of this year and that was obviously very important. Now, what I would put it into the context of is and you know, we've said quite a bit about this, Andrew Hauser has made a number of speeches on this subject. Is that we have to have a tool kit that allows us to intervene where we need to for financial stability reasons, and we have to be able to distinguish a financial stability intervention from a monetary policy intervention. What we can't have I think, is a world where we say, 'Oh, well, it's a bit of a pity we've got a financial stability problem because we can't do anything about it because it would look like we were doing monetary policy.' We have to be able to intervene for both of our core objectives. Very, very clear on that.

Now, as Andrew Hauser has said in a number of his speeches, what we are working on very actively is what that tool kit looks like and I would say two things really as headings there, very quickly. One is exactly what counterpart is in the non bank financial world, you know, we would envisage might require that type of intervention and how would we structure any intervention and on the point about the structure of intervention. You know, last year obviously in LDI, we had to structure it after many hours spent with whiteboards, trying to work out what will be the best intervention, we had to structure it as an outright asset purchase. We would like to, as Andrew Hauser has said, open up scope to conduct an alternative operation, such as re-pit operations, for instance, in that world and that's something we're very actively working on.

Sarah Breeden: Andrew, can I add just a couple of points on that. One is to say that, the issue that you highlight, Phil is peculiar to the US treasury market, we don't have that same hedge fund dynamic of a basis trade at that scale in the gilt market, but what we are doing through the System Wide Exploratory Exercise that Andrew described in his opening remarks is trying to understand what dynamics we might see in a UK gilt market context and that will then help inform what, sort of, counterparties we might need to have for the financial stability operations that Andrew outlined. And the second thing of course, is that any central bank intervention should be a last line of defence, not a first line of defence and of course, that leads to the broader agenda about building resilience in the none bank financial sector that we and the FSB are pushing ahead with.

Kalyeena Makortoff, The Guardian: The committees said it's going to look more closely at AI as we head into the new year. Governor, could you please give us a sense of how concerned you are about the financial stability risks posed by AI and machine learning and which financial sub sectors may be most at risk? And in terms of the consultations set to be launched later this month, what regulations could you end up putting in place for AI and machine learning firms if they're deemed to be critical third parties?

Andrew Bailey: Well, obviously, I mean, look, we're all learning about AI at rapid pace. So, I caveat what I say by the fact that I think all of us will learn at speed on this subject and so views can change. I'll make two big points because it's a very good question. One-, and actually, I'll apply this to the economy broadly, if you don't mind, as well as the financial system. I mean, I think we obviously have to go into AI with our eyes open and I'll come back to that in a second point, but you know, it is something that I think we have to embrace. It is a very important development. It has quite profound implications potentially for economic growth, for productivity and how economies are shaped going forwards. So, it's something we have to embrace in that sense, but we have to embrace it with our eyes open, for all, sorts of, reasons. Obviously, you can cast the net much more broadly than the question but for all, sorts of, reasons. But I think on the question on the second point, the point I would highlight is-, and we see this, I mean, Sam may want to come in on this, we see this in frankly the way firms conduct business and have been conducting business for some time. The moral of the story is that if you're a firm using AI, you have to understand the tool you're using. That is a critical thing.

So, I would say the same about something like algorithmic trading, which has been going on for some time. You can't have people using algorithmic trading without understanding how it works because it's a recipe for trouble. Now, that's a big point with AI as I understand it because I think many of the challenges with AI are not because the thing is-, it's not out of control in the sense of 2001 a space odyssey, it's actually that the thing is so complicated in many of its forms that understanding exactly what the black box delivers can be very hard. I mean, all of us have used it, have had the experience of hallucination and it comes up with something and you think, 'How on earth did that come out?' Sort of, thing. Now, if you're going to use it for real as it were in real financial. I suppose you can't have that, sort of, thing happening. You've obviously got to have controls and understanding of how the thing works and there's a lot to do there.

Sam Woods: Maybe I could say a couple of points. First is that machine learning is actually quite commonly in use by many firms that we oversee, but as for generative AI, firms are in the exploring stage. So, we're not quite there yet in a widespread way. You asked about regulations, so maybe I'll just add on that two points. One is to date we've been very clear that we want to be technology agnostic in all of our regulation, and I think that is a good principle to have. So, we I think start from a point of thinking that AI specific financial regulation may not be the right way forward. I say it may not be because as Andrew said, we're all still learning. That's different from the question about what regulation is used for AI as a whole, economy wide or even a global level where there clearly is I would say, a need for something, but we may need to elaborate some things to achieve what Andrew described.

So, where we say a senior manager must be in charge of a model, you know, what are the reasonable steps that a senior manager must take to have assured themselves that what's coming out of the black box is actually reasonable. So, there's things like that where we may need to add a bit and the second point is that we have just been given powers which we will be taking forward some proposals on for critical third parties. So, if it became the case that the financial system became significantly dependent on a provider of AI technology, it might well be that that would be a candidate for the use of those new powers.

John-Paul Ford Rojas, The Daily Mail: I'm just partly following up on that. The report mentions various risks posed by AI, amplifying herding broader pro-cyclical behaviours or increasing cyber risk and interconnectedness. I just wondered if you could expand on what some of those risks are and just further, when you talk about whether AI may or may not need financial legislation or regulation. Does the bank and other regulators have to act as a cautious or temporary influence as against the government who seem to be throwing their arms open to things like AI, crypto and other new developments in technology in financing?

Andrew Bailey: Well, I think, you know, you give two good examples. I mean, herding and cyber. I think it comes back to the point I was making that both of those would be ways of exploiting weaknesses, which would be arguably more capable of being exploited in a world where the user doesn't fully understand the tool that they're using. So, this comes back to this complexity point. Herding because if many people do the same thing with a tool, they don't understand then the risk gets bigger, you know, multiplies. Cyber again, because the whole point about cyber in a way is that it's trying to find out the weaknesses in the system and exploit them. You know, so I come back to this point and look, I don't want to pretend to be an expert on AI because I'm not, palpably not. But when I talk to people who clearly know a lot more about it than I do, one of the things that they do make the point that again, this point about the complexity of-, I mean, literally the complexity of the code that sits behind it and to what extent it is fully understood and to what extent there are quite large areas of it which are probably not as well understood as we would expect in more conventional systems that people use in financial services.

So, that's the point I would make. Now, I don't think there's a particular difference of view with the government on this at all actually. I think I read the Bletchley Park summit, you know, trying to get very much the same questions. What I do think, and I think the government are in the same place on this is that AI has tremendous potential as well. We must not describe it entirely as a bag of risks, if you like. I mean, it actually has tremendous potential and it has tremendous potential to improve productivity which would be a welcome thing.

Tim Wallace, The Daily Telegraph: On mortgages, are you worried about the ways households are responding to higher costs? For instance, as a quite large increase in the share of people borrowing for the 30 years, 35 years or longer, is that storing up any dangers for the future? And is there anything the bank might be able to do about it or be thinking about doing anything?

Sarah Breeden: We have as you know seen quite an increase in the number of long dated mortgages, 35 years and above and perhaps naturally that's been focused on younger, first time buyers. What we have in the FSR is an interesting chart that puts that trend in a longer-term perspective, so that over the last two decades we've seen that lengthening of maturity. The important thing I think is lending into retirement when people might not have an income and the FCA have got rules that explicitly look to cover that. So, for now, we don't think of that as a financial stability risk but it's something we're watching.

Andy Verity, BBC: Can I ask Sam Woods. You and Charlotte Hogg have both highlighted risks associated with funded reinsurance and bulk annuity buy outs. You also touch on that in this report this morning. Can you give me an independent view given the Bank of England isn’t a political institution of the fact that both major political parties are planning to change what assets life insurers are entitled to invest in and whether that effects the security of people's pensions.

Sam Woods: Thanks. A very, very important area which we've been closely engaged in of course at the PRA. To take your first point, what's happening in the background here is partly because of the change in the rate environment. We've got an enormous wall of pension assets and liabilities coming out of the corporate sector and into the insurance sector and that's the so-called BPA business. That is a natural thing to occur at this point in the cycle. We spend a lot of time on that and because of the scale of what is coming across, one new formal, relatively normal form of reinsurance has emerged in the form of funded reinsurance which we mentioned in the report, as you say. And because it's relatively novel and because of the risks that would surround the need to recapture those risks if the insurance company found that the re-insurer to whom had passed to them could no longer meet their commitments, we want to make sure the insurance companies are proceeding very carefully and if you like, not going too far in terms of how much their business-, sorry, say it again?

Andy Verity, BBC: Could you please unpack that a little bit? What it means to recapture?

Sam Woods: So, essentially if the re-insurer stops being able to cover the risk that you had offloaded to it and you therefore had to take ownership of the collateral to match the liabilities that were coming back to you, there are various risks associated with that process. Not least, around whether or not those assets would be eligible for matching adjustment treatment on insurance company balance sheets and if there weren't that could create quite a significant issue. So, it is a very important issue. As to your broader point, look, the government has made some decisions around changes on the insurance side. It's also made some wider decisions on pensions generally. They are motivated by the point that Andrew was touching on earlier, which is about trying to get more investment into effectively UK corporate assets. That is not a bad objective, of course for a government to have. We of course, have to watch on the insurance side, the prudential side of that. It is true that in around the reforms of making the Solvency II between those we're making and those the government is making. They do introduce a bit more risk into the system, but it is not a very large increase and it's something we've debated extensively with the treasury committee before.

David Robinson, Market News: The projections in the report were based on data cut off last month. Recent days we've seen a lot of volatility. A lot of repricing, interest rate expectations, Euro area, US. Didn't say UK for you. You've seen US treasuries sharp moves. At the same time on the message report is businesses, households have been surprisingly resilient or resilient so far. Now, you've got piles coming down further, what is the message you're giving here? Is it they've done well so far, things are actually going to get easier? Is it that the recent events highlight volatility and the risk around volatility? What shall we take away from that?

Andrew Bailey: Well, I think the-, we're looking here through a financial stability lens. So, I would stress a couple of points, one is, of course, we always say this, vigilance. In other words, you know, you've got to somewhat look through the short-term fluctuations in markets to say, 'Is the system resilient? Are borrowers-,' and we emphasise by the way, for both the borrowers and lenders. It's very important, that's what financial stability is about. So, I would strongly say it's important to look through those short-term movements and say, 'Is the system resilient in that sense?' So, I would not put great weight on the fact that we've seen particular movements in markets in the last week or two from a financial stability point of view. I think that's a critical part of the assessment we make. Now, second point I make is and I think we make this at a number of points in the report looking at it through a number of different lenses into both the household sector and the corporate sector in the UK, that there are, I think, encouraging signs that it is not a stretched and not likely to be as stretched as it was at points in the past. That's for a number of reasons. I mean, some of it's to do with borrower behaviour and borrower resilience and some of it's to do with lending resilience and behaviour, but I mean, that's a good thing. That's a good thing. So, overall, I would just not put too much weight on particular movements in rates in the short-term.

Sarah Breeden: If I can underline one point. The process of the household and corporate sector adjusting is only part way through. There's a lot of fixed rate debt out there, 5 million households have had their mortgage repriced so far but there's another 4 million to come and that is really important to remember, and they will see a move from lower rates to these rates. And even though they might be slightly lower now than they were two weeks ago, they are certainly in a different place then they were when the mortgages were first taken out.

Anna Wise, PA Media: It mentions in the report that renters are typically less financially resilient than homeowners and obviously, a high proportion of renters in the UK are facing a rise in costs. I just wondered if you had any concerns about them and certain groups of the population that might be bearing the brunt of higher costs and being more squeezed in this climate?

Andrew Bailey: Well, I think from a point of renters, I think it is important in a much broader sense. Again, we can look through a financial stability lens, but I think there obviously are broader issues here. And by the way, it's why I made the point early on in my opening remarks about the fact that one can look at this as an aggregate but it's very important also to look at the distribution and to look at how the distribution of households and indeed firms as well is affected by it. So, I think we have to be, you know, in a broader sense, very alert to the position of renters.

There has been a decline in home ownership in this country of late, in recent times. That has led, obviously, to an increase in the proportion of the population that's renting. And, although it's not a perfect fit obviously, but the distribution of renters in terms of household incomes is more skewed towards the lower end of the distribution. So, we do have to be very alert to that. And, you know, it's important to look at it through a number of lenses. So there is, obviously, a financial stability lens on that. It comes through things like the buy-to-let market, for instance. But I would just caution against this point, the aggregate is important from a financial stability point of view but the distribution matters in a broader public policy sense.

Kohei Onishi, Nikkei: So, could you explain your outlook for about CRE and residential real estate market price and possible financial risks in the future property market in the UK? So, recently most debts are under 5 years fixed to let, so I think it is different from other countries and the US. So, what do you think the implication is in the UK?

Sarah Breeden: Can I just check, was your question about commercial real estate or residential?

Kohei Onishi, Nikkei: Both. Commercial and residential, both.

Sarah Breeden: Right. Shall I take commercial real estate in the first instance? We have seen here in the UK a sizeable decline in CRE prices down around 20% but they have since stabilised. One of the positive things about the UK CRE market has been that loan-to-value ratios are much lower now than they were in the previous period of stress in CRE and the financial crisis. And so, although prices have fallen, we haven't yet got to the point where there are forced sales in a serious way. So, the refinancing challenges that you mention are real, but they have been able to be absorbed so far. The other thing I mention is that less of the debt is provided by the UK banking system now. More by market based finance. So, again, as Andrew said in his opening remarks, there'll be some stress in the market but we don't see that becoming a financial stability risk. Similarly in the household sector, it goes to the story we've told about the resilience of households generally, given the broader macro-environment. Inflation has come down, income has risen and interest rates, as they refinance, have come down as well. So, less stress there as we look ahead.

Andrew Bailey: I'd add one more point, actually, on the residential sector, which I think, it's an important benefit of financial stability. So, one of the things that, thank goodness, we are seeing a lot less of these days than we did in the past in this country is re-possession of people's homes. Now, that's for a number of reasons. I mean, the law has changed, for one reason. But the second reason is that the financial system is much better placed to support borrowers. And so, obviously, we've got now the Charter, the government agreed with the major banks. And that's important, because it's a benefit of financial stability that the system is able to take these actions to, if you like, counter the impact of the cycle that can happen. And that's a good thing. A very good thing.

Sarah Breeden: And, of course, an important part of that was the measures that the FPC introduced in 2014 to limit risky lending in the mortgage sector too.

Phil Aldrick, Bloomberg: Sam, it's one for you. Just, it's been many months since the SVB blow-up and it exposed shortcomings in the bank resolution framework. I just wondered where we are in terms of fixing that? The FSCS, there's been talk about reforming that. And what's the hold-up at the moment?

Sam Woods: Thanks Phil. So, look, first thing to say is we think, actually, things went pretty well on the resolution of SVB here in the UK. In the sense that, by the time we got to the Sunday evening in question, we had three options all ready to go. And we took one of them. And, by the way, where that option is available, the transfer option, I think that will often be an appealing option for all sorts of reasons which are probably quite obvious. So I think we feel good about that. But we observed that there was a high level of concern from many stakeholders about the possibility of a lack of continuity of access to deposits. So, in the case of SVB, that was mainly about the access of companies to their deposits and ability to make payroll and those sorts of things. So, since then, we have been engaging closely with Treasury colleagues about, effectively, can we add something more to the toolkit. It would just be another option which would allow us to achieve that continuity of access but without increasing the risks to the public's purse, which would be the obvious risk of doing it through a bridge bank, which is an existing option. And I think what I say to is watch this space. Something very soon will emerge, you won't have to wait much longer. The work is pretty well advanced.

John-Paul Ford Rojas, Daily Mail: One follow up and one slightly broader question, if I may. On the four to five million, I'm not quite clear exactly what it is, who face repricing between now and the end of 2026, can you say a bit more about how many of those are because their fixed terms are coming to an end? And how many are simply because the rates link directly to bank rate? The second, broader question is, changes to migration rules that have recently been announced, and the increase in the minimum threshold for skilled workers. I wonder if there's a concern for you, Governor, or for the Bank in general about how that might impact labour supply?

Andrew Bailey: I'll take the second one, I'll get Sarah to come in on the first one, we'll do them in reverse order. The Bank of England is not responsible for migration policy. Frankly, that is a matter for the government. We, as you know, and this is a point most commonly made in the context of monetary policy, we condition our view of policy on announced government policies. So, the government announces policies, we take them into account. It's not for us to judge those policies, I would not wish to do that for a moment. That's for the government. So, we will take government policy as announced and put it through our analytical processes.

Sarah Breeden: And on your question, those that are to reprice include both those that are on a floating rate and those whose fixed rate is due to come to an end.