HOUSE OF COMMONS

Treasury Committee

Oral evidence: Bank of England Financial Stability Reports, HC 208

Wednesday 10 January 2024

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Watch the meeting

Members present: Harriett Baldwin (Chair); Dr Thérèse Coffey; Dame Angela Eagle; Stephen Hammond; Danny Kruger; Keir Mather; Dame Siobhain McDonagh.

Questions 340 - 397

Witnesses

I: Andrew Bailey, Governor, Bank of England; Sarah Breeden, Deputy Governor for Financial Stability, Bank of England; Jonathan Hall, External Member, Financial Policy Committee; Carolyn A. Wilkins, External Member, Financial Policy Committee.

Examination of Witnesses

Witnesses: Andrew Bailey, Sarah Breeden, Jonathan Hall and Carolyn A. Wilkins.

Q340 **Chair:** Good afternoon, everybody, and happy new year to you all. This afternoon, we are going to cover the Bank of England's financial stability reports. For those members of the public who are watching and who think that we are going to cover monetary policy, we are saving that up until after your next monetary policy meeting, which you are coming in to talk about on 20 February. Just to clarify, today's session is on financial stability. Can I invite our witnesses to introduce themselves, starting with you, Governor?

Andrew Bailey: Andrew Bailey, Governor of the Bank of England.

Jonathan Hall: Jonathan Hall, external member of the FPC.

Sarah Breeden: Sarah Breeden, Deputy Governor, financial stability.

Carolyn A. Wilkins: Carolyn Wilkins, external member of the FPC.

Q341 **Chair:** Thank you all very much. I should also say that there is a small risk that we may be interrupted by votes. We are not expecting it, but it will depend on how long the business runs.

I want to start with the macroprudential impact of higher interest rates and the inflationary period that we have gone through as a country. Governor, what overall impact has that had on the financial stability of the UK system?

Andrew Bailey: First of all, I would stress that price stability and inflation being a target is consistent with and supportive of financial stability, so it is important from a financial stability point of view that we return inflation to target. We have had to watch very closely the impact of higher interest rates.

The other thing about higher interest rates and financial stability is that I would draw an important distinction between what I call unanticipated and anticipated increases in interest rates. Ones that are anticipated and well telegraphed by the financial system have less impact, because there is time to adjust to them. I draw that distinction because the particular feature of the LDI problem that we had in autumn 2022 was not the level of interest rates, but the sudden and very pronounced increase in rates. It was the unanticipated, sudden increase that caused the clear risk to financial stability that we had to step in and deal with.

The final point that I would make is one that we drew out in the report. There are a number of mitigating factors that we have seen in this particular context which we have not always seen in the past in terms of the economy. I would draw out two particularly. One is that we have not seen a pronounced increase in unemployment. In fact, we have seen very little increase in unemployment. That is relevant because, historically, if you analyse it statistically, one of the drivers of loan losses, particularly in the mortgage market, is unemployment. The second one is associated with that. Last year, we saw around a 2% increase in household real incomes. Both of those things support overall conditions and financial stability.

Q342 **Chair:** A year ago, you were talking about anticipated and unanticipated increases in interest rates. This time last year, no one thought that the base rate would get as high as 5.25%. That was not priced into the market. I just wondered whether there are other things that have surprised you about the performance of the UK economy. You mentioned the fact that employment has been stronger than you would have thought, and the impact on financial stability has, therefore, presumably, been more modest. Is that your assessment, Governor?

Andrew Bailey: Yes, it is. I would draw out two things there. I am going to caveat this, particularly when I talk about households. We have to talk about aggregates and averages, and I want to be very clear that there are people who are experiencing very difficult times in this country, so let me preface that with that very important comment. We recognise that there are individual circumstances.

Overall, particularly in relation to household borrowing in the mortgage market, the situation is that there is less stress in that market at the moment. We draw this out in the report. We use this thing called the cost of living adjusted debt service ratio, which is, basically, taking household income, deducting the cost of essential household spending, and then seeing what proportion of the residual income is servicing housing debt costs.

It is interesting to look at that. It is nowhere near as stretched as it was, for instance, during the global financial crisis period, so there is, as you said, some mitigation in there. The same thing is true with small firms. Again, the average small firm debt servicing ratio last year relative to earnings was not as stretched as we have seen in previous events.

Q343 **Chair:** I am going to ask about small firms in a minute, and I just wondered whether each of the witnesses could tell us what they think is the biggest threat to financial stability for the year ahead. Just choose one, starting with you, Jonathan.

Jonathan Hall: If I can start by adding to what Andrew said in terms of the markets, the unanticipated and the level of interest rates is important for households and businesses but also for the markets. Volatility and a sharp rise in interest rates are more of a risk for stability, and they have stabilised. Although interest rates are expected to remain high, the expected volatility has come down, so we should expect to see less risk of financial instability in the markets, unless that changes. That could then mean, if conditions seem calm and if volatility is low, that you could get a risk of exuberance, with people taking on more risk because they think that the market is more benign.

Q344 **Chair:** So the No. 1 risk for you is the risk of exuberance in 2024.

Jonathan Hall: As the risk from historical volatility declines, the risk of exuberance increases. We have seen examples of that. Credit spreads are very tight and equity markets, particularly in the US, are very strong, so that is something that we have to monitor.

Q345 **Chair:** That is your No. 1 risk. I am asking the witnesses to choose their No. 1 risk. What would your No. 1 risk be for the year ahead, Governor?

Andrew Bailey: Unfortunately, the world is still a pretty uncertain place. The potential for further global shocks is clearly there. The events in the Middle East are tragic from an individual point of view, but interesting from an economic point of view. If you take the oil price, which is an obvious place to look, it has not had the effect that I feared it might, but it remains a very uncertain place.

Q346 **Chair:** So there are macroprudential risks from the potential for energy prices to spike higher again.

Andrew Bailey: Yes, and further global shocks.

Q347 **Chair:** That would be the No. 1 that you would pick.

Andrew Bailey: Yes.

Q348 **Chair:** Sarah, what would you pick as your No. 1?

Sarah Breeden: I have something that speaks perhaps to both of the issues that John and Andrew mentioned, which is about uncertainty not being priced properly in markets. That goes back to, "What are people expecting to happen?" and, therefore, the risk of an adjustment. It is uncertainty about the macroeconomic environment, geopolitics, credit risk and unemployment.

Q349 **Chair:** That is a constant feature of the world, though. How can you say that that is a particular stress point for you in 2024?

Sarah Breeden: The way that we phrased it, and I would underline this, is that the risk environment at the moment feels particularly challenging. It is a trite thing to say that the world is always uncertain, but I do think that the set of circumstances that we currently face are extraordinary.

Q350 **Chair:** So "the unknown unknowns" is what I am hearing.

Carolyn A. Wilkins: The thing that worries me the most is that, in the Bank of England's base case outlook, there is a slowing in growth, but it is not a dramatic one. It is a reasonable outlook to have that there are a lot of risks out there, as we have just heard about, coming from the global economy and from geopolitical risks, which could create an uptick in inflation and therefore a need for higher interest rates, but also a slowdown in economic activity. That combination, given the vulnerabilities that are out there, would be stressful from a financial stability point of view. That is exactly why we do the stress test on financial institutions, to see whether they can withstand that kind of shock.

Q351 **Chair:** I want to go back to small and medium-sized enterprises, because we have an ongoing inquiry into their access to finance. You say in your financial stability report that the pressures on small and medium-sized businesses could pose one of these risks that you are concerned about, because about 60% of UK employment is in those businesses. Given the Basel 3.1 changes, is there not a risk that the changes you make will make it more challenging for those businesses in 2024, Governor?

Andrew Bailey: That is why we are looking very carefully at those changes. We put the consultation paper out, we have had the responses, and we are reviewing them very carefully. We started with a position where the current Basel regime in this country was implemented when we were a member of the European Union, and so, essentially, it was harmonised European Union rules. The European Union decided to implement something that was not in the Basel framework, for which it received from the Basel Committee a "non-compliant" judgment afterwards. That is the so-called small firm factor, which lowered the risk weight for small firms relative to larger ones.

I have to say that, on a risk basis, there is not a lot of justification for that, but there are other justifications for it from the point of view of our secondary objectives, the have-regards and the PRA's functions. What we proposed originally lowered the proposal from Basel, but did not continue the support factor.

We have had feedback. We are looking at it. What I can say to you is that we are going to try to come out with something that works all round, taking into account our secondary as well as our primary objectives. We are giving it a lot of consideration. We will come out with something that I hope people will feel is an acceptable balance, so we are cognisant of the point.

Q352 **Chair:** Are you confident enough to state that, whatever you decide, it will not make financial stability more of a challenge for that sector of the UK economy?

Andrew Bailey: The interesting thing is, I have to say, that the analysis that has been done over recent times on the relationship between those risk weights and lending does not suggest that there was much effect from the concession that the European Union gave in the first place. There is not a lot of evidence to suggest that it stimulated lending relative to a higher risk weight. I just want to emphasise that we are cognisant of the point. We understand that small firms are important. Your point about employment is one that I share, so we will try to come out with something that works. We do understand the point.

Q353 **Chair:** I want to turn to another thing the Bank is doing that could have an impact on financial stability. Sarah, something that you and I have talked about in the past is the quantitative tightening programme and the impact that it has in terms of real world financial stability. Although you have been absolutely clear that you are going to be selling £100 billion of gilts this year, that had to be paused when the unanticipated changes that have been alluded to in September 2022 happened. I would like to ask you again whether there is a risk that the Bank being a seller of £100 billion, on top of the issuance coming from the Government, could have an impact on financial stability in 2024.

Sarah Breeden: I would differentiate here between the impact on markets and the impact on banks, financial conditions and reserves. In terms of the impact on markets, sales of gilts could affect yields. We have given some estimates of that. They are relatively small. We have been really clear that bank rate is our main tool through which we will ensure that the right financial and monetary conditions exist in the economy.

The MPC has also been really clear that market functioning is important to how it goes about that programme. We transparently and clearly indicate what our expected programme of sales is and, so far, all of the evidence suggests that there has not been an impact on market functioning, never mind financial stability, with the exception of the one event that you mentioned.

We have also started to look at the impact on banks, because the quantity of reserves, which are a key liquid asset for banks, will reduce as a result of quantitative tightening. In addition, there will be fewer deposits in the economy, which the banks will need to adjust to as well. We have emphasised how important it is for banks to take into account these system-wide trends as they think about how they manage their liquidity and funding. Of course, we remain open for business through our other facilities to ensure that they get the liquidity they need.

There are a number of channels through which quantitative tightening might matter for market stability and for banks. So far, there is no evidence that that has been a problem.

Q354 **Chair:** You have previously told us that it is probably raising gilt rates by about 10 to 15 basis points and, therefore, feeding through into corporate lending rates and mortgage rates. Is that still your assessment?

Sarah Breeden: It is. There has been no update. That then feeds into our assessment of what the appropriate level for bank rate is. We take the whole curve into account when determining that.

Q355 **Chair:** Thank you. Carolyn or Jonathan, did you want to add anything on quantitative tightening or small and medium-sized business lending?

Jonathan Hall: On Sarah's point, one of the reasons why we are talking about this very early in terms of the liquidity needs for banks is that they have long-term planning and we just want to make sure that they are taking it very seriously. This is a reversal of some of the extraordinary measures that happened as a function of, first, the financial crisis and then Covid. The level of deposits and reserves was extraordinary through that period. As that unwinds, they should return to business as usual, as it were. It is supposed to remove the chance of unexpected surprises in the future by being well ahead of it at this point.

Q356 **Stephen Hammond:** Governor, good afternoon.

Andrew Bailey: Good afternoon. Welcome back.

Stephen Hammond: Thank you. The countercyclical buffer was reduced to 0% in the light of the pandemic and, last July, went back to 2%. I am assuming two things. The first is that we should now look at 2% as the neutral level in a standard risk environment. The Committee got a letter from Sam Woods yesterday, which you will have seen, which says, "The Bank does not consider that the increase in the CCyB has had a material effect on banks' net lending, including to SMEs". I just wondered whether you could give some flavour as to the rationale for the Bank believing that this has not had any constraint.

Andrew Bailey: What happened during the Covid period is interesting. We reduced it very quickly as the Covid period started, and the reason for doing that was that we wanted to guard against the very big economic downturn that we had feeding through very quickly into credit conditions, creating credit losses and causing the banks to have a constraint on the supply of lending. We do distinguish between what I call the demand for lending, which is driven by borrowers' conditions, and the supply of lending, which is driven by banks' conditions. The CCyB is about the latter, in the sense that we do not want lending to be constrained by the situation of the banks themselves.

It was a proactive thing to do to say, "We will release this constraint to enable the banks to continue to lend, even if they suffer losses on their existing loan books." The interesting thing is that they did not suffer losses, so those losses did not materialise during that period. What we found was that the banks had that capital buffer, which just stayed there. In our view, lending really followed a path that was determined by the demand for lending, not by the capacity to supply it. We reached a point, as the economic effects from the Covid period were unwinding, where the capital was still there, so we said, "We will put it back into the buffer."

Q357 **Stephen Hammond:** When the buffer was reduced to zero, the Bank said that this would be to support lending of up to £190 billion. The evidence from Sam Wood's letter to us yesterday was that increased net lending during that period was £23 billion, not £190 billion. Why was there such a difference between £190 billion and £23 billion?

Andrew Bailey: We thought £23 billion was a plausible level of demand for lending. The £190 billion was, to use your words, "up to". That was the maximum arithmetic capacity of that. It did not mean to say that we expected £190 billion to happen. We made what I might call a big move at the start to signal to the banks, "You can make loans and not feel constrained." The "up to £190 billion" was not necessarily because we thought that there would be £190 billion, but we wanted to make it very clear to the system, "You are not constrained."

Sarah Breeden: Larger corporations, but not SMEs, can source finance from markets as well as from the banking system. In taking that decision about releasing the CCyB, we had an eye to perhaps markets not being able to function and, therefore, the banks needing to step in at scale.

Q358 **Stephen Hammond:** On the basis of the previous decade, you had had interest rates that facilitated easy access to market-based finance.

Andrew Bailey: If you go back to February and early March 2020, just as the Covid crisis was breaking, there were very big drawdowns, here and internationally, by large firms on their credit facilities. That was another thing that prompted us to move, because these numbers were very big.

Those were precautionary draws by firms saying, "We have to pile up liquidity, because this looks really bad," as you can remember. In the end, that credit was not needed on the whole. We observed that that credit sat in accounts that came back into the banking system, and so the pressure was relieved. At the point when we took that decision, which was mid or late March, had that gone on, those numbers were so big that they would have created quite a big draw on the system.

Q359 **Stephen Hammond:** In the light of the last three years, where the buffer has gone from the standard neutral down to zero, and now back to the standard, have you drawn any lessons as to where it is more efficacious? Is it more powerful when it is being lowered with regard to the action that you wanted to take in terms of macroprudential policy, or more effective when it is being raised, or can we not learn anything from what we have experienced?

Andrew Bailey: Our philosophy towards it is that we use it proactively. There is another reason for this. There are two sorts of buffers that the system has in it. The CCyB is an example of a buffer where we "release" it, in the sense that we reduce the capital requirement. We say, "Your capital requirement is now this much lower." There is another form of buffer where we do not release it. We say to the banks, "It is okay for you to go into the buffers." I would say that, on the second sort of buffer—and this is a question that we have to come back to—the banks are a bit suspicious about, "Is it really okay?" because we have not lowered the capital requirement. The CCyB is a more powerful buffer and we use it proactively for that reason.

Sarah Breeden: The Basel Committee has pulled together some international evidence, which underlines the point that the Governor has just made that banks are prepared to use buffers that are released in a way that they do not use buffers that we say are okay to use. That supports a steady-state neutral setting of a meaningful number, so that, when stress hits, you can release that rainy day capital in case it is needed.

Q360 **Stephen Hammond:** We can take it from that that you think that the countercyclical buffer is a fairly major tool of macroprudential policy.

In your minutes or record of the November committee meeting, you said that you stood ready "to vary the UK CCyB rate, in either direction, in line with the evolution of economic and financial conditions" this year. Can I just ask everybody what case they would argue for a change in the buffer this year? Are there things that you are concerned about that lead you to think that we should be watching for an argument for that change?

Carolyn A. Wilkins: We view 2% as being a neutral setting. The kinds of situations where we would consider raising it above 2% would be ones where the risk to the banking system had increased to such an extent that more of a buffer was needed to provide that certainty, or at least try to ensure that the banks could withstand a shock without having to really tighten credit in a way that would be bad from a macroprudential point of view. In November, we did not see that situation, which is why we left the buffer where it was.

The contrary—this is something that we have done in the past—is that, if we see conditions deteriorating to an extent where banks might be in a position to restrict credit over and above what they would normally do because of deteriorating credit conditions, but to rather protect their capital positions, we would consider lowering it. Again, that was not a situation that we saw at the time. It is important that, every time, we look at the outlook and make that judgment based on what we see in terms of bank behaviour and bank financial situation, as well as general financial market conditions.

Sarah Breeden: I would take very much the same approach. If financial vulnerabilities are increasing in the system—if we are seeing looser lending standards and if aggregate debt levels are rising—that would be a situation that implies that there is greater financial risk in the system that needs bigger buffers. However, if banks are focusing on their balance sheet and are worried about losses because of the economic environment and restricting credit supply, that would be the case for reducing it.

Jonathan Hall: I agree with what has been said before, but one thing to make very clear again is that the word "countercyclical" within "countercyclical buffer" is countercyclical not to the economic cycle but to the financial or credit cycle. That then feeds into this answer, which is, "When is it most powerful?" At the point when the credit cycle is a credit boom, you raise the capital, not primarily to restrain the boom but because you know that the consequences of a bust ending that boom could be quite adverse, and so you are building up rainy day capital at that point.

It is slightly asymmetric. On the downside, you are lowering capital in order to facilitate lending that would otherwise be restricted for unwarranted reasons. There is this asymmetry. On the one hand, it is just building a rainy day buffer and, on the downside, it is supposed to support lending to the real economy and, therefore, absorb some of the economic shocks as opposed to amplify them.

Q361 **Keir Mather:** Happy new year, Governor. I would like to turn to the issue of mortgage rates and household debt, if I may. Thank you for your comments earlier about the individual impact on mortgages. In my own constituency, I know just how difficult people are finding it. Your average owner-occupier mortgager, if they took it out from Q2 2023 through to 2026, is likely to face increases of £240 a month. I question how sustainable that can be alongside cost of living pressures too, so thank you for those remarks.

In that context, how confident are you that there will not be any serious repercussions for financial stability in the context of increases in household interest payments over the course of this year?

Andrew Bailey: It is a very good question. I would put a couple of things back. Here, I do want to apply the caveat again about individual circumstances, because, as I said before, it is very easy now to talk about averages, which we have to do, but that ignores individual circumstances, which is not the right thing to do.

That said, debt servicing ratios for households are by no means as extended as they were, for instance, during the global financial crisis period. We have this thing that we set out in the report called the cost of living adjusted debt service ratio. It is about 1.4% to 1.6% at the moment, whereas, during the global financial crisis, it was around 3%, so you have a sense.

If you translate that into unemployment, which we mentioned earlier, it is quite a good thing to ask what it would take to get it to that level. On the back of our envelope, it is about an 8% unemployment rate. Currently, it is 4.2%. The November monetary policy forecast takes it to about 5%. You can see that, in that sense, we have a degree of margin in there that we have not had in past crises.

You see that, by the way, also in the arrears rates, which are lower. One of the things that are most important is also that, due to changes in the rules as well as in the resilience of the banks, repossessions are now rare. One of the worst things that we had in the past was a big upturn in repossessions and the suffering that that caused for people. You see it through that lens, but it is important to watch it.

The second thing that I would say is that we have now had quite a big change in market interest rates over the last few months, so the cost of mortgages is coming down. I am going to abide by the Chair's comment at the beginning that we are going to come back to monetary policy later, but let us just take the market for a moment. That is feeding through into mortgage costs, and I hope that that is something that continues.

Q362 **Keir Mather:** Given what you have said about the labour market and the sustainability of household debt overall, are there particular sorts of households that you feel will have a worse 2024 in relation to their mortgage rates as opposed to others?

Andrew Bailey: As I may have said at a previous hearing to a question that Dame Siobhain asked me, the rental market is more stretched, because you have a higher proportion of low-income households in the rental market. Rental inflation is currently, on the stock, around 6%. Again, I really hope that that will come down, and lower interest rates help that as well. That is an important area, because that is where you have a greater preponderance of low-income households.

Q363 **Keir Mather:** Turning to the rental market specifically, the Bank concluded, "However, banks are unlikely to be severely affected if renters come under further stress. Banks do not have outsized exposure to renters". What are the areas of the financial sector that you feel are particularly exposed to it, and especially to buy-to-let renting as a specific market phenomenon?

Andrew Bailey: The reason why the banking system is not critically exposed to buy-to-let is that the loan to value ratios in buy-to-let are typically quite cautious, so 75% is quite often the upper margin on that. We are also seeing quite a structural change going on in the buy-to-let market. There has been a continuing shift in the market from the smaller buy-to-let owners to the more commercial, larger ones. I do not think that the banking system is heavily exposed towards the buy-to-let market in a credit condition sense.

Q364 **Keir Mather:** Are credit card defaults also a phenomenon that we will have to keep a close focus on this year?

Andrew Bailey: We watch all those numbers very carefully for arrears, but we are not seeing substantial upturns in arrears at the moment.

Sarah Breeden: Those sorts of issues are the ones that we do stress the banks for in our regular stress tests. You see chunky falls of 36% in house prices in our stress test, which means that there can be losses on buy-to-let mortgages. We stress consumer credit very heavily through that as well, and the banks are resilient through that, so they should have capacity to support households, even if economic conditions are much worse than we were expecting.

Andrew Bailey: If you take the charter that the banks have agreed and that the Chancellor was very involved in creating, that is important. It is more possible to do that with resilient banks.

Q365 **Keir Mather:** Just finally, the Bank withdrew the affordability test in August 2022. Does it have the potential over the course of this year to expose us to financial risk in allowing borrowers to take on mortgages that they, in effect, should not be?

Sarah Breeden: Our analysis is that we do not need the affordability test that we withdrew as well as the FCA's affordability test and our macroprudential loan-to-income limit. We brought all of those three in at the same time back in 2014. What we learned through the process of seeing how those tools operated was that we could get resilience in the household sector just by having the FCA's affordability test and the FPC's loan-to-income test. We have checked our analysis, and that shows that we are getting the resilience we need through those two tools and that we do not need the FPC's affordability test as well.

Andrew Bailey: It is quite interesting if you look at the flow of new mortgage lending against the loan-to-income test. The point on the loan-to-income test is 4.5 times loan to income, is it not?

Sarah Breeden: That is right.

Andrew Bailey: In the low-income period, we saw it sitting just a bit but not much under that, so the flow of new lending has come down quite a bit. That is happening naturally, which is a sign that the market is working as interest rates go up.

Q366 **Keir Mather:** So, from your perspective, as we look toward 2024, there are no circumstances in which it would be necessary to reinstate the affordability test.

Andrew Bailey: We do not see that. We committed to reviewing the removal of it and, as we concluded, we do not see that.

Jonathan Hall: It is fair to say that the loan-to-income test is most binding in very low interest rate environments. If you were to see a structural shift where the natural interest rate was much higher on a long-term, sustainable basis, a loan to income of 4.5 times would be less sustainable. We will continue to review the tools in general, but you could imagine, for example, that that LTI limit could be moved from 4.5 times to four times. Given that you also have this MCOB affordability test, those two tools together should be appropriate. You do not need a third tool, but that does not mean that we might not want to adjust one of the tools, such as the affordability test.

Andrew Bailey: Why we review these rules more frequently than almost all of our others is because they have such a direct effect on people.

Carolyn A. Wilkins: Especially coming from outside the UK, it is really a moment to look at the rules that are there. We make a point of keeping only the rules that we think are necessary, but this is the point to say that the increases in interest rates are really hard for people, especially for some households. At the same time, the fact that we can see a resilient system in the face of such large increases in interest rates is testament to the wisdom of having had these rules in the first place, and we should keep sight of that.

Q367 **Dame Angela Eagle:** I want to ask about highly leveraged corporates and the extent to which you are worried about what is going on in this particular sector. In your stability report, you talk about the three ways that highly leveraged corporates are likely to borrow: in leveraged loans, in private credit and in high yield bonds. You also point out the fact that, in respect to private credit, non-bank financial institutions are those that normally lend and that there has been a large increase in that sector compared to the more regulated sectors, which might have some rather obvious connotations for financial stability globally. How do you feel that that is going? Are you worried by that? What should you, as a committee, be keeping an eye on to try to mitigate those risks?

Andrew Bailey: It is a good point. It is very high on our list of issues to work on and watch carefully. We do see developments in the market that cause us to want to understand more about them. Private credit is a good example of that. It is not as big as leveraged lending but it is growing. Also, in the early days of private credit, I heard people say, "Don't worry. It is not leveraged." While it is not leveraged, it is lending to people who are leveraged. That is the point, so the risk is there, clearly.

It is relatively opaque. The name "private" probably gives it away. It is not done on markets in that sense. To your question, one of the things that we in the Financial Stability Board are looking at internationally is that we have to improve the access to information. It is right that we do that internationally, because this is very much an international thing. There is more of it in dollars than there is in other currencies, but our banks are in those activities, as well as our firms more generally.

It is not something that currently, in our view, is a big risk waiting to happen, but it is very much at the top end of our range of issues that we want to know more about, get to grips with and understand whether we know what all the risks are in this activity.

Q368 **Dame Angela Eagle:** Which sectors are these highly leveraged corporates in? Is there some gathering together in particular sectors that might set off alarm bells, is it spread fairly widely over the corporate sector more generally, or do we not know?

Andrew Bailey: There are some sectors where it is more prevalent than others. I do not think that you can point to them.

Q369 **Dame Angela Eagle:** What are they? Are they sectors that we should worry about particularly? Are they volatile?

Andrew Bailey: If you look at leveraged lending in this country, you can see transport and utilities.

Dr Coffey: Some of the water companies.

Andrew Bailey: I have to declare an interest. I am a consumer of their water.

Dr Coffey: But Ofwat is supposed to be handling that, is it not?

Q370 **Dame Angela Eagle:** That is all fine then. In utilities and potential monopolies where there are going to be customer cash flows that, hopefully, help this, is that the kind of area that they have accumulated in?

Andrew Bailey: We are interested in the sectoral distribution of it, but we are more interested in the nature of the activity and what risks it gives rise to generically rather than particular sectors at this point.

Q371 **Dame Angela Eagle:** It always struck me that, if one thinks of a private equity-financed, highly leveraged sector, one would think of something like social care and nursing homes. We remember what happened with Blue Circle. If there is a failure in an area like that, there is quite a big risk that the state has to come in and deal with it, because one cannot simply leave older people who are in nursing homes that have gone bust in empty buildings. As policymakers, we are worried about that, but to what extent does that leverage—with an idea that, even if you fail, you are going to leave costs on the public purse—impinge on the work that you do or are you looking more systemically?

Andrew Bailey: It is not quite classic financial stability, but you are right to point to it, because what you are saying is that it is areas where, if the problem arises, there is not a natural resolution mechanism that not only addresses the financial stability issue but also recognises that those sorts of sectors are ones where the service is essential. It has to have continuity of service.

Q372 **Dame Angela Eagle:** Water would be another example.

Andrew Bailey: We are not the water regulator, so I will draw the line there.

Q373 **Dame Angela Eagle:** I understand that—fair enough. Again, reading your report, my attention was attracted when I saw that 24% of global leveraged loans and 29% of high yield bonds are due for refinancing before the end of 2025. As you point out in your report, for people watching, the refinancing has to be of the total loan, so it is not a small percentage. That implies rather a large potential risk, does it not? What can people like you do about that?

Andrew Bailey: That is why I think we can come in, because it is one of the risks that you see in that lending. It is what we tend to think of as cliff edges, where, if there is a very big refinancing cliff and that refinancing goes wrong for whatever reason, the outcome is difficult. Where we can come in is not so much in the borrower case but in terms of getting the lending industry to understand how it manages those cliff edges. Not having a means to manage them is not, in my view, an acceptable state of affairs.

Sarah Breeden: By coming in and highlighting the issue, and pointing out the vulnerabilities and the risks, we are aiming to ensure that the investors who will be asked whether they want to refinance these loans come 2025 are thinking about the risks before they crystallise at the time of the refinancing.

Andrew Bailey: In reality, if the cliff happens, the investors are not going to get their money out. That is the other reality of it.

Q374 **Dame Angela Eagle:** Thinking about the LDI experience, are there other things like that that hove into view and crystallised a problem that nobody quite knew was going to crystallise in that way? How do you, as a committee, spot things like that—things that have never happened before but may happen in the unusual circumstances, where we are going from a very low interest era to one that is, in theory, more normalised in terms of the cost of borrowing and interest rates? Volatility and unusual things are going to happen when moving from an odd phase of economic reality into a more normalised one. How do you try to spot the lurking things in the markets?

Andrew Bailey: It is a big challenge because, domestically and globally, we are having to spend a lot more time on the non-bank world, as LDI illustrates. The non-bank world is a very large landscape.

Q375 **Dame Angela Eagle:** It is opaque, as you were saying.

Andrew Bailey: Parts of it are opaque. It is very disparate. Both domestically and internationally, through the global Financial Stability Board, we are having to spend a lot of time on what I call, "How do you survey a landscape like this?"

I can give you a few examples, because it is recently areas that are relatively opaque that have caused the issue. Going back into the earlier part of the Covid period, there was quite extreme volatility in commodity prices that caused concerns about commodity financing, which is another opaque part of the landscape. On LDI, I mentioned the point about volatility earlier. The other thing is that the LDI industry is split between 85% in single funds and 15% in pooled funds. It was the 15% that was the problem, because of the co-ordination problem in it.

Coming to your question about how you scan for those things, you are facing quite a challenge at that point and, both domestically and internationally, we are having to come to terms with how we deal with this.

Q376 **Dame Angela Eagle:** Given the relative increase in the size of non-bank financial institutions in terms of this lending—it is growing rapidly—is there a case for some form of regulation? I do not mean the same as banking regulation, but maybe a senior executives registration or something that would give you a handle on what is an increasingly unregulated and opaque but rapidly growing sector.

Andrew Bailey: There are a number of ways that you can come at this. Jonathan referred early on to something that I think is important. If you come at it from a different angle and say not so much, "What are the institutions and the markets?" but, "What are the functions?" there is often commonality in the functions.

One thing that is often common across these abrupt changes in market conditions is margin calls and collateral requirements. You referred to it early on in your point about volatility. Domestically, but particularly internationally, we have to get to grips with this question about appropriate margining practices. That is a way to come at quite a few of these areas together to say, "Your margining practices and your collateral call practices are not robust." Why we put greater resilience into the LDI market is because they have to be able to meet these requirements.

It is why we have concerns. Going back to the dash for cash in March 2020, people asked, "Why is the US treasury market a problem? It is the deepest market in the world." The problem is when you get these abrupt changes in the market, the margin calls are so big that they cause stress in the market and people then start dumping positions in a disorderly fashion, which causes financial stability problems. You can come at it through these functionally generic approaches.

Dame Angela Eagle: I am conscious that I interrupted you. I wondered whether you wanted to come back on that.

Sarah Breeden: A really important thing that we are doing is our system-wide exploratory stress test. We have talked a number of times about how we stress test the banks to see how they are going to behave in bad economic states of the world, what that means for businesses and households, and what they need to do in advance in order that they absorb rather than amplify that shock.

Through our novel systemwide stress test, never done anywhere in the world before, we are trying to apply those same techniques to this whole system of market-based finance, which should give us a much better sense both of how these things might matter for businesses, households and the real economy, and, therefore, what an appropriate regulatory response might be.

Q377 **Dr Coffey:** Thinking about global risks and climate change, there are geopolitical risks right now arising from events in the Middle East. To what degree are you anticipating any volatility in commodity markets? In particular, I am thinking of the shipping routes and Houthi rebels. It would be useful to get a sense of that.

Andrew Bailey: It is a good point. As best as we can tell from the monitoring, we have seen that shipping traffic is being affected and rerouted. That will increase shipping prices and costs. Initially, that will be an issue in the monetary policy world and then may feed through into the financial stability world.

As I said earlier on, fortunately, we have not had a prolonged spike in oil prices; we had a bit of an initial spike. At the moment, if anything, the oil price is coming down a bit and there seems to be some price management to keep it there. That is very helpful, because quite a bit of the shipping traffic that goes through those straits and through the Suez Canal is oil and liquefied natural gas. We have to watch it very carefully, though, because it is having an effect. Fortunately, on the energy side, it seems to have been managed so far.

Q378 **Dr Coffey:** If there were a supply side shock, is the financial sector resilient enough to withstand that?

Andrew Bailey: We have seen this in recent years, so in a sense we have been through that one. As I said earlier, one of the interesting things that came up a couple of years or so ago in the non-bank world is that the commodity finance world is quite opaque. It is quite a separate section of the financial world. We saw signs of dislocation in that market. It did not come to a financial stability problem in the end, but it has caused us globally to have a much greater focus on it and is something that we have to continue to watch.

Q379 **Dr Coffey:** We have a pretty sophisticated business model more generally of supply chain management around the world, which is encouraging.

The UK is one of the leading global financial centres and we need to make sure that that financial stability agenda continues to be a global effort. It would be really interesting to hear what your intention is at some of the G7 and G20 meetings this year to make sure that there is that financial stability progress.

Andrew Bailey: I have the joy of chairing the global supervision and regulation committee at the Financial Stability Board, so I get this directly. It will be a big focus of attention, and the potential implications of the Middle East developments for that world will be a focus. As the G7, we had a call just before Christmas and that point came up, so the answer is yes to that one.

Q380 **Dr Coffey:** I know that we spent some time discussing this yesterday with Mr Benjamin, but in terms of risks arising from China, particularly thinking of the real estate sector, are there any signs that banks are taking steps to mitigate those potential losses?

Sarah Breeden: It is clear that vulnerabilities in the property market in particular in China are crystallising and have been probably since mid-2021. What we have seen so far is a fall in activity. Some property developers have defaulted, and some of our banks that are especially active in China have been taking impairment charges and losses on the back of that. Those have been quite contained so far.

From a financial stability perspective, we have been focused on whether problems in the Chinese property market might spill into the Chinese economy more broadly or, indeed, into the Hong Kong property market, where UK banks are more active. We have not seen that happen yet. The Chinese authorities are being very active in supporting their economy. We stress test the banks regularly for that and we expect it to be contained, but we are confident that, if it gets worse, UK banks are resilient to it.

Andrew Bailey: In the last stress tests, we had a 36% fall in Chinese residential property prices, which is a lot more than has happened.

Carolyn A. Wilkins: And big slowdown in growth.

Sarah Breeden: Hong Kong CRE down 50% and Hong Kong residential down 46%, so the kinds of stress tests that we apply to our banks are well beyond what we have seen so far.

Q381 **Dr Coffey:** As an aside, that is the second time that you have mentioned a 36% fall as being a stress test. Is that something that you just always do, as opposed to 40%?

Sarah Breeden: It is a coincidence. We calibrate it on the basis of historical experience and think about one-in-100 events. It looks like that calculation led to the same number in two different contexts.

Q382 **Dr Coffey:** That is useful. Turning to hedge funds, you noted in your report that, since the July report, net short positioning in US treasury futures had increased significantly, from about $650 billion to around $800 billion, so something like a 23% uplift. To what extent is that a source of concern? Do you anticipate that it could have an impact in the UK?

Jonathan Hall: Maybe the most important point is the last one, which is that this is a US issue. We do not really see this in gilt basis trading, but of course if the US sneezes, the rest of the world gets a cold, and so we are focused on it, as is the Fed. There are two ways of looking at the US basis trade. One is that it is just the natural other side of real money buying of futures. When they do that, a gap builds up between the fair price of the future, as calculated by owning a bond and repoing it, and the actual price.

As this widens, hedge funds say, "That is an opportunity. We will take the other side of that free money," as it were. It is free money when it expires, but there is this period until expiry when you have to manage, effectively, a leveraged position and roll over the repo, et cetera. On the one hand, it is just a natural thing that arises and, as you saw in the charts, the size is exactly equal and opposite to the real money growth, so there is real money growth and hedge funds take the other side.

On the other hand, it is quite concerning, as we saw in 2020, because hedge funds are prone to what I have called in the past a jump to illiquidity. They provide liquidity for the market in good times. When things are going well, they help efficiency, but if they have losses elsewhere, are not able to fund their positions or, for some other reason, want to pull back and start unwinding, they cause inefficiency and lead to an increased chance of instability. The question is, "What could trigger that?" In 2020, Covid was a huge trigger. We now have a larger position but, as yet, no trigger for this flip from providing to demanding liquidity.

There is one other slight mitigating factor, which is that the margin requirement on those trades is now more than twice as large as it was in 2020, so the buffer, as it were, is greater. That is why we highlight it. It is a worry. The Fed is also looking at it. It is more in the Fed's wheelhouse than ours, but it is certainly something that we are keeping a close eye on. If there were to be a shock, that is one area where it could be amplified. It is a vulnerability.

Q383 **Dr Coffey:** Something that we know is increasing is climate change risk, and there is a lot of mitigation work going on to try to either adapt to or prevent it. Financial risks arising from climate change are not referred to in the financial stability report. Could you tell us why that is and what action financial businesses are taking?

Sarah Breeden: The biggest piece of work that we have done on climate change is our climate stress test. We did a climate exploratory scenario analysis in 2022[1], which gave us the best possible sense of what these future risks might be. Although it is not mentioned in this FSR, we have done a considerable amount of work on it.

That scenario analysis showed that a world with climate change is riskier than a world without it, because of the physical and transition risks that you mentioned. Those risks are building through time and are lowest with early action. We are seeing evidence of that now: flooding in the UK, wildfires in North America, and CRE and buy-to-let having requirements for energy efficiency, so the risks are there.

What are we doing about that? Since 2019, we have been ensuring that the financial institutions we regulate, banks and insurers, are embedding climate-related risks in how they go about doing their business. Through the scenario analysis exercise and our normal supervision, we have a sense of how far they have got with doing that. I would summarise it like this: they have done a lot, but there is still a huge amount to do.

The firms, which are our window on these risks, are being asked, through our supervisory expectations, to build their capabilities and to help us see the risks. They arise in the real economy, but in so doing they create financial risks for the firms that we regulate.

Q384 **Dr Coffey:** This is something I might follow up on separately, but I am thinking about my time in DWP. We brought TCFD into the pension funds and different elements like that because we were—

Chair: I am getting a bit confused. There was CRE—is that corporate real estate?

Sarah Breeden: It is commercial real estate.

Chair: What is TCFD?

Dr Coffey: It is the Task Force on Climate-related Financial Disclosures. TNFD is about nature; that is the new one. It is the Task Force on Nature-related Financial Disclosures. It is about nature-related risks to finance.

Chair: That was just for the listening public.

Dr Coffey: They are to encourage people who are investing money to think about the long-term impact on climate change. That is why I am surprised it was not in your financial stability report, but I have heard what you have said.

Andrew Bailey: One of the important things that you may remember is that we have been working internationally to turn the climate financial disclosure agreement into a set of international standards.

Dr Coffey: Yes, the accounting standards.

[1] The Bank later clarified that the climate exploratory scenario analysis took place in 2021

Andrew Bailey: The key challenge now is the adoption of that. The world is not great at adopting the same accounting standards on anything. That work went well last year. There is now a standard. It is now a question of getting it adopted.

Sarah Breeden: In the UK context, we work very closely with the FCA, which is the lead authority on the ISSB—International Sustainability Standards Board—work on disclosure, which is what TCFD has turned into.

Dr Coffey: I have strayed a little bit from where perhaps the Chair wanted me to, but thank you.

Q385 **Dame Siobhain McDonagh:** UK banks made £41 billion in pre-tax profits between January and September 2023, which is double what they made in the same period the year before. Why is that?

Andrew Bailey: It is a number of things. As I was saying earlier, we have certainly had much more benign credit conditions than were anticipated. If you go back into the year before, banks were still provisioning quite heavily on the anticipation of Covid-related losses. That credit cycle has been much more benign than expected, and so they have now come to a much better place in terms of their provisioning, certainly. We are seeing some of that.

We have seen—we have discussed this in previous hearings—some adjustment in net interest margins, which has now pretty much run its course. It looks as if it has stabilised. We have been through a period, since the financial crisis, where our interest rate was near zero. That caused the compression of net interest margins relative to the pre-global financial crisis position.

One reason for that was that traditionally, in the pre-financial crisis world, the banks would typically set their average deposit interest rates a bit below our rate. When our rate went to nearly zero, the effective rate on bank interest stayed above our rate. As we have raised rates, we have seen that we have gone back towards that traditional relationship.

That has led to some widening of net interest margins. We have a chart on this in the report. They are now back towards where they were in the immediate pre-financial crisis period. If we go back a bit further, they were higher, but they are certainly now back to where they were before the financial crisis. They look like they are back to a normal place, at least compared to the pre-financial crisis period. That has contributed to it as well.

Q386 **Dame Siobhain McDonagh:** In July, this Committee wrote to the UK's four biggest banks because they were increasing mortgage rates but refusing to pass on higher rates to their savers. Is that still the case?

Andrew Bailey: I would draw a distinction, as I have said before, between the rates they were paying on fixed-term deposits and on sight deposits. The sight deposits were really the issue. For fixed-term deposits, they were raising their rates pretty much in line with what we were doing. It was about sight deposits. As I say, some of it was about this adjustment back to a normal relationship.

We observed, certainly over the summer, that the rate of change in their rates on sight deposits then started to follow what we were doing more closely, and we saw larger increases. We have now paused rates increases. That is not the issue anymore. We did see an adjustment in behaviour. The aggregate increase in sight deposit rates does not reflect the totality of what we have done, but it is now higher than it was in the early summer of last year.

Sarah Breeden: We saw that depositors were shifting their funds out of instant access accounts, where the rates were relatively low, and into fixed-term deposit accounts, where the rates were higher. I suspect that prompted a bit of the reaction from the banks in terms of that normalisation.

Andrew Bailey: There is now a deliberate incentive in the post-financial crisis rules that we have for liquidity, which incentivise banks to take fixed-term deposits because they do not run as quickly as sight deposits if there is a problem.

Q387 **Dame Siobhain McDonagh:** As you know, Governor, from your regular attendances at this Committee, one of the biggest issues and concerns for lots of constituents is the rate of bank branch closures. We have seen 645 closures during 2023, with Barclays having 180 of those, NatWest 138 and HSBC 114. It does not look like things are going to get much better this year, with 189 branches looking like they are closing, 60 from Lloyds, 34 from Barclays, 21 from NatWest and 16 from Bank of Scotland.

Given that the Committee and your report have identified that banks are in a good state, their profits are high, they are doing well and it looks like they have a good future, is it reasonable for them to be closing branches at this rate? That is not only because of the impact it has on their very vulnerable customers but also what happens in all our high streets and town centres.

Andrew Bailey: It is more of an FCA issue than a direct Bank of England issue. It is important, however, that people in this country have the ability to have direct access to their banks. By "direct" I do not just mean online; I mean physical access. If they want it, they should be able to get it. How it is organised is a question to be answered because changes are happening.

The banks will say, "Look, the footfall in bank branches has fallen a lot". They will say this; branches are just not used as much as they were before. I agree with you.

Q388 **Dame Siobhain McDonagh:** Except we have seen an uptick in the use of cash, have we not? People depend on cash.

Andrew Bailey: We have seen quite a big fall in the use of cash, but very recently we have seen a bit of an uptick in its use. By the way, the stock of cash in circulation has not fallen, interestingly. It is on our balance sheet, so we know.

We have seen that uptick. That is why we have been very clear and why I continue to be very clear that we have no interaction of withdrawing cash. If the public want cash, the public get cash.

Dame Siobhain McDonagh: Hear, hear.

Andrew Bailey: That is absolutely clear. We face the same issue with access to cash because it is part of the bank branch issue. The public have to have physical access to banking and those services. How it is organised is a question that should be asked.

Q389 **Dame Siobhain McDonagh:** Should they have free access to their own cash?

Andrew Bailey: Costs have to be covered one way or another. However that is done, it should be done transparently and sensibly. I am not going to be prescriptive about that.

The industry is facing the issue that it is important that there is physical access to these facilities. How it is organised and how it best could be done is a matter that a lot of thought should be given to.

Q390 **Dame Siobhain McDonagh:** Commensurate with the increase in bank profits, are we seeing an increase in bankers' bonuses?

Andrew Bailey: We are about to come into the bonus season. I will probably be able to answer that question better in a few months. Bonuses are quite seasonal, so we do not know yet. If the banks were here, they would tell you that, if you look at their share prices and their so-called price-to-book ratios, it is not a happy story.

Dame Siobhain McDonagh: I do not how happy it has to be for it to be a happy story.

Q391 **Danny Kruger:** I want to move on to the juicy topic of stablecoins, bitcoin, the digital pound and so on. The financial stability report reiterated the judgment that your committee has made before on the financial risks from crypto assets. It said that the risk to wider financial stability is limited because the exposure of the crypto asset sector to the wider financial sector is still quite small in itself, which implies that there would be a greater risk if crypto assets are taken up more and become more interconnected.

I do not mind which of you feels best able to answer. What would be your prediction for the future of crypto assets in terms of their integration into the wider financial system?

Andrew Bailey: You have said it already, but I want to answer that by distinguishing what I call unbacked crypto from stablecoins. Those are two different things. It is worth answering the question for both.

Q392 **Danny Kruger:** I want to come on to stablecoins.

Andrew Bailey: We will park stablecoins for the moment. This is for bitcoin-type unbacked crypto. My own sense is that it is not taking off as what I might call a core financial service. For instance, using bitcoin as a payment method is pretty inefficient. It is not taking off. It is no doubt used in certain circles, but it is not taking off generally. The evidence, such as it is, suggests that its integration into the financial system has not kept up its momentum. There was a bit of momentum a few years ago, but it has not kept up.

Let me say two things. First, we have to keep a very close eye on it. Secondly, I will say what I have said many times before. It has no intrinsic value. People may want it extrinsically because they want to own things, but it does not have intrinsic value.

Q393 **Danny Kruger:** I appreciate that. Hearing that there was momentum and it seems to have petered out might be a bit like someone saying in 2000 that the dotcom moment has passed. Crypto has had a big bump in the last year or so, but that should not lead us to assume that it is going to be some sort of minor niche parallel money that is unrelated to the wider financial system. If you look at what the share price of bitcoin has done over the last year, a lot of people still think it is the future.

Sarah Breeden: I want to say two things, and Carolyn may want to come in as well. First, part of the reason why traditional finance has not been involved in crypto is that there has not been the regulatory framework and infrastructure to enable them to do it in a safe way. We are seeing developments on that. The UK is putting out a regime. The SEC is considering an ETF for bitcoin, as I am sure you know. We have to keep a careful eye on what is happening and ensure that the regulatory regime is delivering a safe place for that activity to take place.

While unbacked crypto is perhaps developing more slowly and is dependent on the infrastructure and regulatory frameworks being built for traditional finance to use it, there is great interest in taking the technology and applying it to their own businesses. That is where the stablecoin issue comes in.

Carolyn A. Wilkins: I would agree with you about unbacked crypto. I would distinguish between that and stablecoins. The use of technology to tokenise deposits will create a lot of efficiency and safety from a back office point of view.

Secondly, even if it has no intrinsic value, there is an interest that is just out there. Depending on where the SEC and other regulators come out as to the products that are allowed to exist, such as spot ETFs, it could still have some legs in terms of attention from speculative investors for a while.

For that reason, we need to keep looking at it. For me, the future is really going to be reliant on being able to integrate with the traditional financial system, if it is going to be of any use at all. That is where backed crypto seems to have more value.

Q394 **Danny Kruger:** Shall we come on to stablecoin now? I think that is right. In a sense, I am always encouraged to hear you suggest caution around unbacked crypto and people investing in that. Stablecoin is safer in principle, although I understand that there are stablecoins out there that do not seem to maintain their parity with the currency that they are pegged to.

Andrew Bailey: That is the issue.

Q395 **Danny Kruger:** Nevertheless, we can see the potential opportunities, as Carolyn said. What is holding back the development of a sterling-denominated stablecoin in the UK? Why have we not seen that emerge yet? Will we see one soon?

Andrew Bailey: We have seen relatively limited development in all currencies other than dollars. It has developed somewhat in dollars, but its use is still quite restricted. It is mainly used as a bridge between the crypto world that we were just talking about and the conventional world.

You are right. Stablecoins purport to be money, in the sense that they can be used transactionally. That poses very different issues. At the moment, you are right that their value is not actually stable in a sense. In effect, they are a bit more like money market funds, and, frankly, somewhat opaque money market funds.

What are we doing in the UK? Parliament has already introduced the legislation that will enable the regulatory regime. With the FCA, we are putting together a regulatory regime for stablecoins. As you rightly say, when you call something "stable" it is very important that it is actually stable. If they are going to be money-like, people have to have confidence in them.

The good part of that comes back to the backing assets. What are the acceptable backing assets that are both stable and liquid? For the ones that have wider use, we will be setting out the rules on that. There are then issues around how they are structured and the legal structure they have. Between us and the FCA, we will be coming out with the rules.

As Sarah said, that is not only because we like rules but because it should enable these things. It is also an enabling factor for stablecoins.

Carolyn A. Wilkins: I have noticed one thing that has distinguished the UK from some other countries like Canada and the US. Because of the collaboration between the FCA, the Bank of England, the Treasury and the Government, there is a proactive view on crypto to get the enabling legislation and the rules set out, which should support responsible innovation in this area.

The challenge for stablecoins is, if you do it right and it really is stable, how you make money. What is the business model? That is the challenge.

Q396 **Danny Kruger:** It is a good thing in principle that the UK is forward-leaning in this area and likes innovation in financial services. That brings me on to the digital pound, where I am a lot more nervous.

Sarah, we discuss this when you were last here in September. I am keen to hear whether there is any update on the expected timing of the consultation response that we have been waiting for. I will come on to that in my second point.

The first point is about the general principle around the potential deposit limit that you were suggesting in the original consultation of between £10,000 and £20,000. There is quite a big difference between £10,000 and £20,000. I would be interested in your views on what the appropriate figure might be.

The EU is thinking about this and is suggesting the far lower limit of €3,000. The issue is the threat of a bank run. If it is so easy to put your money into digital pound, you can imagine that people will flock into it at the first moment of danger. As I understand from our last conversation, the expectation is that the resilience arrangements that we have are such that we could probably tolerate a single bank falling over but not a lot of them.

If all the commercial banks suddenly lost their depositors to the digital pound, we would be in very serious trouble. £10,000 to £20,000 is quite high. Are you sure that this is not a bit dangerous?

Sarah Breeden: Let me answer the process point first. When I was here in September, I did say that I hoped we would release our summary of the responses and our response to the responses to our discussion paper before Christmas. In the end, we have not been able to do that.

As we discussed, there were 50,000 responses. We want to make sure that we consider them fully. To Carolyn's point, we are going to respond jointly with the Treasury. We have just not had enough time, I'm afraid, to get that out. We very much hope to release that soon, so watch this space.

On the substance of your question about limits, I understand the concern. We as financial stability policymakers are very concerned about it. I would say that we are living with that risk anyway. It comes with digital payments, never mind digital money. It was exactly what happened with Silicon Valley Bank. If you can move your money at the touch of a button, you can move it to JP Morgan as much as you can move it to central bank digital currency. We have to think about that in the round:

the role of liquidity regulation and whether it helps to have access to the central bank balance sheet, as well as limits.

The reason why we have gone with a relatively high limit in our proposals so far is that we want to think about the use cases. We want to enable a salary to be paid in digital currency in order to be able to do the best possible job of understanding what the use cases will be. We will continue to engage with the banks on it. Similar issues arise with stablecoin as well.

Danny Kruger: I have one more question. I do not know whether there is time to get it in before we break.

Chair: Fire away, if we can have a quick question and a quick answer.

Q397 **Danny Kruger:** Have you now considered the questions of privacy and programmability? When we last spoke, you said that had not yet arisen and you did not regard it as part of the discussion at that point. Is it a part of the discussion now?

Sarah Breeden: It is very actively being debated and it will be part of our response.

Chair: Since the vote has come and every colleague has had a chance to ask you questions, I am proposing that we close the session now. We have a number of further questions that we were keen to ask you, but the time has got ahead of us. We will follow up by letter.

Andrew Bailey: If you want to send them, we will happily answer them.

Chair: Colleagues would prefer that we adjourn now. We will follow up by letter. We appreciate your time. Thank you very much. We will see you again soon.