Bank of England

Financial Stability Report Q&A
29th November 2012

Sam Fleming, The Times: Could I ask - given the low investor confidence that you alluded to in your comments, is there a concern - or should taxpayers be concerned - that they may eventually need to stump up more money in order to ensure the capital adequacy that you want to see?

Mervyn King: No, I don't think the problem is on the scale where it should concern taxpayers. The Treasury have made it quite clear to the Committee that they do not want to put in new capital into the banks which are partially state owned. Now there are other ways in which it's possible for those banks to meet our recommendation without any need for the government to put in new capital.

Ben Chu, The Independent: I just want to clarify something. Are you talking in this Report about capital levels or capital ratios? And what sanctions would there be brought to bear on banks which didn't raise their capital levels?

Mervyn King: It's capital levels that we're talking about. It's very important to ensure that the three factors that the Committee identified - whether expected losses have been adequately provisioned for; whether future conduct costs, both compensation to customers and also regulatory fines, have been adequately provisioned for; and whether the risk weights are appropriate. All of those things need to be examined, because then it will be possible for investors to have confidence that the reported buffers against stress are indeed there and are real buffers available to cope with the stress.

In terms of how it would be taken forward and the actions that could be taken against banks that don't comply with our recommendation, of course what we are recommending is that the FSA will take this forward; we have no statutory authority ourselves. We will eventually, in terms of our recommendations, but we do not have the authority as an FPC over banks. That will be a matter for the PRA down the road, but today it's a matter for the FSA. So let me ask Andrew Bailey to say something about how the FSA will take this forward.

Andrew Bailey: Well I would simply add that - I mean, there's a very well established process for setting capital buffers. What this recommendation from the FPC does is to set out I think very helpfully a framework for looking at a number of issues - and remember that we are always looking at these, and this is a very key part of what we now do on a forward-looking basis.

And so this sets out a framework for doing that. The actions, as the Governor said, will then be taken within the framework we have for setting capital buffers. So that doesn't require a new process; it doesn't require new powers. This is part of the work we do. But the key thing I would say is this sets out a framework for looking at a number of areas that the FPC has highlighted, rightly, are areas that could be contributing - are contributing - to this uncertainty.

Larry Elliott, The Guardian: How much capital shortfall is there? You talked about the fact it varied from bank to bank, but what's the sort of macro capital figure that you're thinking about here? And over what sort of period do you expect banks to actually raise those capital levels?

Mervyn King: Well I think the key thing to note here is that we have not given a single number, because we think for the system as a whole that could be very misleading. What we've said is - we've identified very clearly three areas that the banks need to investigate, and these numbers will vary radically from bank to bank. So I think it would be misleading to give one number.

The Committee has spent a good deal of time looking at numbers for individual banks and for the system as a whole. We've worked with the FSA on that. The Committee spend a good deal of time discussing them.

It feels that the number is going to be material in aggregate, but the key thing is that what we want to do is to give clarity to the investor community by making sure that the banks themselves reveal very clearly the provisions they should be making under the three headings that I've identified today: expected losses, provision against conduct losses and more appropriate risk weights.

And the key thing is that FSA will now take this forward with individual banks. Individual banks will then be announcing actions themselves as to first of all how much they need to provide under these three headings, and then secondly what actions they will take in order to raise sufficient capital - or indeed to change their exposures, other than lending to the real economy - in order to be able to meet our recommendation.

Larry Elliott, The Guardian: I know you said you wanted the process to start straight way, but over what sort of period do you expect this to happen? Obviously if banks come back and say - well, we'd like to do it but in ten years' time or five years' time, that's presumably not going to be acceptable.

Mervyn King: No it's not, but I think equally we're not saying, you know, tomorrow morning be out there with the collecting tins in the market. FSA will have to discuss with banks. What matters is that banks make sure that there's a very clear and transparent process of adjusting for these provisions in the three areas I've mentioned, and then it's FSA's job to talk with the banks about the timetable. I don't know whether Andrew would like to come in.

Andrew Bailey: Well absolutely, and the process of going through this framework with the banks is the thing that will start straight away. And that will lead to conclusions, and those conclusions will follow.

And I think the other point I'd make is that, you know, as a consequence of actions that have been taken over the course of the last sort of six months or so, particularly the introduction of Funding for Lending and steps that we at the FSA have taken, we have seen a change in funding conditions and we do think there is a window of opportunity now to take these sorts of actions, and to take these sorts of actions more readily. And it's important that we use that window of opportunity.

Phil Aldrick, Daily Telegraph: If you're asking banks to take write-downs on some of their loans, is there not a risk that you will be forcing companies into insolvency as the banks respond to these requirements? Or even putting people out on the streets, if they're having to repossess homes as a result of these decisions?

Mervyn King: No, I don't think that's the immediate risk. I think it's making adequate provision for expected losses. And that seems to be the key thing. In other words, to have an honest and open statement of what the balance sheet is. One of the things that's been - I'll ask Paul to comment in a minute; he's closer to this than I am. But I do think that one of the things that's made confidence less secure than it would otherwise have been is just the sheer uncertainty about knowing how far these reported provisions are accurate or not. Paul.

Paul Tucker: The only thing I'd add is that - and this goes back to a couple of earlier questions - the watchword here is capital adequacy; it's not - there's no magic ratio here. And capital adequacy requires that banks have honest balance sheets. And they shouldn't be constrained by particular accounting policies. They need to look at their assets and say - well what rate of loss do we expect, given plausible macroeconomic and other assumptions?

And as the Governor and Andrew said, only after you've been through that exercise can you make a judgement - and do they now have a sufficient capital buffer to withstand the kind of risks from the broader international environment?

So in some respects this is going back to very old lessons from the past. Some of you here - Larry might remember the risk matrix, provisioning matrix for sovereign debt in the mid-1980s. Now we're not going as far as that; we're not setting out numbers - what the provisioning should be for different parts of the economy. But we are saying this is a major issue for all top bankers; they have to look at their loan books and say - well what actually do we think the rate of recovery is going to be? And actually that's what a prudent banker should want to do in any case, and the job of the authorities is to nudge them in the direction always of being prudent and true to their profession.

Andrew Bailey: Can I just add one thing - putting in place appropriate capital buffers does not involve writing down individual loans; it involves having an appropriate buffer of capital. And that's the important distinction in your question, because having those buffers then enables those banks to make sensible decisions about their policy towards individual borrowers.

Paul Tucker: That's right. In the old language this could be general provisions rather than specific provisions - a concept which went out of fashion, but which is actually quite useful.

Jennifer Ryan, Bloomberg News: Just on this issue of - on conduct issues - do you think that banks have set pay and bonuses at levels this year that are adequate to reflect the risk from further conduct issues, and especially with the upcoming bonus round?

Mervyn King: Well I think that's going to depend upon a careful analysis of what those conduct losses are likely to be. And again, I will turn in a minute to Andrew.

The banks have set aside an aggregate so far, about £13 billion, for conduct losses. But it's likely that that figure will have to rise, and it would be sensible to make provision for that now. Andrew, do you want to comment on the bonuses?

Andrew Bailey: As you say, the remuneration, which has an annual cycle, is just about to be upon us. There really are two important things in the remuneration from our perspective, and one of which is the first point you address - which is to ensure that the impact of costs that the banks have incurred is properly reflected into the allocation of post-tax income between building capital, paying dividends and variable remuneration. And that is critical, because obviously that determines on of the elements going back to our main recommendation of capital building.

The second thing is that the remuneration then has to be properly adjusted to create the right risk-taking incentives in institutions. And of course that's both forward-looking in the sense of risks that are being taken now and will be taken in the future, but also properly incentivising people to realise that there will be claw back from unvested deferred remuneration where that reflects past misconduct. I mean, that must follow.

Jennifer Ryan, Bloomberg News: On the issue of claw backs, have you had any indication for the upcoming round that there are going to be more claw backs, or that these are going in train?

Andrew Bailey: Well, I would only say that the claw back that is put in place must of course reflect what has happened over the last 12 months. That must follow.

Paul Tucker: Can I just say - there's some text on this on pages - bottom of Page 56, top of Page 57 of the Report, for you to look at later. And one of the things we do as a Committee is encourage the European authorities and the global authorities - the Financial Stability Board - at the appropriate moment, to revisit the codes on remuneration, to ensure that they've kept up with the lessons of the last few years; the codes are a few years - they were produced a few years ago.

Ed Conway, Sky News: We journalists are often accused of being economically morose and pessimistic and so on and so forth, but some people might look at this report and say the Bank is doing the same thing. I mean, look at some of these charts and it looks as if things are improving. Quite markedly across the eurozone the probability of default has fallen. Chart 1.7 suggests the probability of a high impact event in the UK financial system's fallen very sharply since this time last year. I mean, isn't the Bank being overly pessimistic with the mood music around this Report? And haven't things improved? Aren't we in a better state than we were before?

Mervyn King: The very first sentence of my opening statement was indeed that sentiment has improved. But the point I want to make is that FSA have been putting in place capital buffers to ensure that banks do have provision against potential stress. You can argue about how big they should be - we're not recommending any changes to that. What we're recommending is that the components of that buffer be accurately measured. And where there is good reason to believe that the stated capital levels have been exaggerated for the three very specific reasons I gave you, then it's appropriate that banks go back, take a realistic look at that and deal with it.

Now I was very careful to say, and it is important - let me say it again. This problem is manageable, perfectly manageable, but it requires some action now. So if there is a problem, it's perfectly manageable. Don't just leave it in the hope; just deal with it now. We can do it. There is no reason why the actions that need to be taken can't be done fairly quickly without any damage or difficulty for the UK banking system.

Chris Giles, The Financial Times: I'm sorry, we've all been terribly British about this so far, but I do think that we have to ask Paul Tucker if he would comment on his future after the recent appointment of Mark Carney. But I also wanted to ask another question - a proper question -

Mervyn King: You asked one. Paul will answer that, and then you can come back to your second question next time round. Paul.

Paul Tucker: I'm the Deputy Governor for Financial Stability. There's a job of work to be done; I'm doing it.

Mervyn King: Next question.

David Enrich, Wall Street Journal: You have talked a lot about efforts to improve the stability of the UK financial system. Are you concerned at all about the stability of non-UK banks that have big operations in the UK? And will these rules, will these increased capital requirements, apply to those banks as well?

Mervyn King: To the extent that we have banks which are subsidiaries and supervised by UK regulators, then the recommendation we're making to the FSA will obviously apply to them too, yes. To the extent that we have branches here, we can talk to the home regulators, but we have no direct sanctions over them.

But the general concerns that we've raised here will obviously apply around the world. I mean, these are not just specific to the UK; these are general issues about whether banks are making adequate provisions for expected losses. And there are certainly parts of the world that I would look to and expect to find much bigger numbers than you would expect to find in the UK.

Sam Coates, The Times: Given that you have looked at numbers for individual banks, can you give us any sense of which banks are less well placed than others? And if you are unwilling to go into specific banks, can you draw trends maybe whether the taxpayer supported side is worse off or better off than the non-tax payer supported side?

Mervyn King: I'm not going to comment on individual banks because that's not within the remit of the FPC. We clearly have looked - and the Bank next April will take responsibility for the regulation of banks. But for the moment the action and conversations with individual banks lies with the FSA.

George Hay, Reuters Breakingviews: Just wanted to ask about risk weights. Your analysis seems to suggest quite clearly that some banks are being too aggressive on that point. I just wanted to know - I mean, clearly from a capital point of view, this is a good stopgap if you raise capital, but what is the plan - the longer-term plan - for sorting out the risk weights? Is it to go to a more standardised risk weighting approach? Or what's the plan?

Mervyn King: Let me ask Paul to comment on that. He's been deeply involved in all of this at the international level.

Paul Tucker: I'll say something and then hand over to Andy who's on the Basel Committee.

The international policy is that there will be a risk weighted capital ratio backstopped by a leverage ratio. And the backstop is something that everybody welcomes, because everybody knows around the world that a risk weighted risk measure isn't perfect.

There are - the flaws in it have been identified in broad terms. There are exercises underway in Basel, both to simplify the regime of risk weighting for securitisation and for other portfolios - that will take some time. And there is also a debate about whether to introduce floors on risk weights of the kind that exist in the United States. And I think it's fair to say that a number of us on the Financial Policy Committee - maybe all of us indeed - would favour the introduction of floors. Both Adair and I are on record on saying that we would like that, and I think Andy is too.

But you're probably more familiar with the whole list of exercises the Basel Committee have underway.

Andy Haldane: One thing to say is that the concerns that have been expressed in the Report on risk weights are in some ways echoing the concerns that we're getting from investors generally about the opacity and consistency of these risk weights. So in a sense we're not saying anything that is not already known and indeed worried about by others than regulators.

I think Paul's set out very clearly what the range of options might be - all of which are being look at by the Basel Committee and ultimately I think by the Financial Stability Board. They would certainly include a greater degree of transparency, and efforts by the FSB are already making strides in this direction, to shed some greater light on the sources of discrepancy between risk weights. They would certainly include a consideration of backstop measures, of which floors are one and a standardised approach would be another.

They're all on the agenda, and I think the next year or two will be important in seeing which of those makes most sense. In the meantime, however, we thought it was important as a Committee to put in place some extra degree of protection on the capital side, to guard against potential imprudence in those risk weights as of today - very much as a bridge to this longer term solution, the options for which Paul and I have just set out.

Paul Tucker: It's worth mentioning one other thing on this, which we should all remember that the flag was first raised on this issue by some of the bosses of the world's biggest banks. So this isn't something where I would say the banking industry's thinking - oh hell, what are the authorities going to do now? I think many bankers themselves round the world want to get this problem pinned down and solved.

...., Reuters: Sorry. There's a line in the report on Page 40 suggesting the largest banks - that their capital ratios could be overstated by between £5 and £35 billion. Could you clarify how many banks would be included in that group of the largest banks, and does this then imply that those banks could need to raise up to £35 billion?

Mervyn King: Let me ask Andy to take that one.

Andy Haldane: So as Footnote A makes clear - it's in quite small print - these experiments cover the four big banks - Barclays, HSBC, LBG and RBS. They are experiments. They are illustrative experiments to give some proximate range for the amount by which risk weights may at present be understated, relative to what might be a more prudent norm.

I wouldn't take any of those numbers too literally, and I wouldn't say there's any one among those four that stands out consistently as marking in one particular direction.

But the aim of Chart 3.20 is to give some sense that these differences could be material, indeed even for the four banks, are material.

Andrew Bailey: Could I make one point on that as well just to be clear - that that doesn't get you to the answer anyway, because then you have to consider - as we will do in the follow up work - to what extent the existing capital buffers under Pillar 2 take some account of these issues. So I would just caution you against a literal interpretation in the same way that Andy cautions you.

Jill Treanor, The Guardian: The Deputy Governor seems to be implying that banks' balance sheets aren't honest. I'm wondering whether or not the Financial Policy Committee should have taken action long before now to do something about it?

Mervyn King: No, it's not a question of not being honest. They are constrained by accounting conventions which legally they're obliged to follow. And I think what we're saying is that there's been perfectly honestly available a range of options for using risk weights that are not terribly desirable and, as Paul said, what's quite interesting is that the whole Basel framework at international level started as an attempt to achieve a level playing field, and it was the banks themselves that said - well, hey, there isn't a level playing field because some of our competitors can use risk weights which are much more generous than we are using. And there doesn't seem to be any means of preventing it. And the sheer complexity of the models used and the proliferation of risk weights made that possible.

And that’s why the whole move now towards reassessing risk weights is a very important initiative. And what we're saying is that we recommend that the FSA now talks to the banks and say - look, you've got to take a more prudent view of some of the risk weights. That is an action which only the supervisors can map into a number or an action for individual banks. But it's an area we think has to be looked at. And as Paul pointed out, this has the support of the banking community because we want a level playing field.

In terms of accounts on expected losses, banks themselves also publish a number which purports to give the fair value of their loan book as opposed to the accounting value. But we think this does need to be looked at in a clearer way because, again, what maters here is what is likely to be (as Paul said) in an old-fashioned prudent banker sense, what would be a sensible provision to make against losses - even though you can't pin them to individual loans? What is likely to be the cost overall?

Now that I don't think is necessarily measured at present because people are looking for concepts like fair value which don't have well-defined meanings. And of course the provision for future conduct costs is something which the regulator is in a very good position to say - well, you'd better make a bigger provision.

And I think putting those in place and getting banks to reveal that very clearly, and explaining how they'll make up the gap - either through raising more capital or through taking other actions to alter their exposures - will put them back into a position where the buffers that they publish will be seen to be genuine buffers available to withstand future stress.

And I think that an absolutely fundamental point here, which seems to me still widely misunderstood - even, I regret to say, by the BBC - is that capital is not a pot of money in a box that you put in there, which you then can't use for lending. That is a completely false way of looking at it. Those are assets. Cash or loans are assets. Capital is a liability. And capital is there as a means of financing banks. And the crucial thing is that the less banks rely on borrowing money themselves, and the more that they have in capital provided by investors, the more there is to absorb losses and hence the bigger the confidence that new investors and new people who want to lend to banks can take in the safety of the banks to which they wish to provide funds.

And that's the fundamental point. This is nothing to do with somehow constraining banks from using money in exciting ways. It's the opposite - it's making sure that, when banks use money in exciting ways (we hope to lend more to the real economy), that they know - everyone knows - that the banks are backed up with sufficient loss absorbing capacity, in the jargon, so that everyone who's willing to fund a bank has greater confidence in the stability and the ability of the bank to withstand stresses when things go wrong.

Now there is no guarantee that stresses of a sufficiently extreme form will mean the banks are safe. A sufficiently extreme stress will mean that all banks will be in deep trouble. And you can easily imagine what they might be. But the FSA have made a sensible calculation about the buffers that it's wise to have, given the extent of the stresses. But the important thing - and this is the point of today's Report - is that those buffers have to be real buffers, not ones which are based on somewhat exaggerated views about the true capital position of our banks.

Tim Wallace, City AM: Governor, the Report says there might be too much forbearance by banks which could have damaging effects, and in part it says that's down to the low interest rate environment. Does that illustrate any potential conflict of interest between the MPC setting rates low and the FPC warning that low rates have damaging effects in some ways?

Mervyn King: I don't think so, I'll ask Andy in a second to come in and talk about forbearance. I mean I think what we find slightly puzzling is that in the 1980s and early 1990s we were all told that the big problem with banks was that they were not forbearing enough, and that good companies that did have a viable future were being shut down because of the need to finance very high interest rates in these days. And that this was causing severe difficulty.

Some of the forbearance now is of the form where companies which do have a viable long run future are able to stay in business and this is a good thing. However, there seems to be plenty of people out there who think that this is all a very bad thing because these companies must have very low productivity, and this accounts for the failure to rebalance the economy. I think that's an exaggeration.

Our concern on the FPC is what forbearance means for banks' own balance sheets and the riskiness of banks. And on that point, let me turn to Andy.

Andy Haldane: Well as the Governor says, there isn't any hard and fast rule about when and whether forbearance is a good or bad thing we have elements of both. I think the key factor when determining whether this is a good or a bad thing is exactly the point that the Governor has just raised. And this boils down really to how forward looking a bank is when it's providing for the loans it's making.

I think you know a forward-looking bank that can say - look I have a company or a household that's struggling today, but its prospects over the medium term are good, is doing the right thing by forbearing on that loan, as the Governor just mentioned. What it should do in that situation however is still to provide, to provision, for the possibility of that loan going bad.

I think an example of bad forbearance practices would be one in which the bank is not forward looking, it's not looking to the longer term prospects of that household or company, but instead is staving off the day of reckoning so as not to crystallise losses today.

And what we're saying as FPC today is we want banks to look forward, to provision not on the basis of where losses are today, but on the basis of where losses might be tomorrow, to expected loss provision, to look through, to lean against the tendency to exercise bad forbearance practices of the type I've mentioned.

And in Box 2 in the Report we look at the Japanese experience which is one in which for a lengthy period we had evidence of bad forbearance practices, banks weren't looking forward. They were keeping afloat companies that did not have a future, that clogged up their balance sheet, that made them less willing to make loans available to good businesses, and in turn retarded the recovery. Our recommendation is about leaning against that potential risk by having banks look forward at expected loss provision today.

Paul Tucker: In a nutshell it's about - forbearance and provisioning should be about the condition of the borrower, not about the condition of the bank.

Andy Haldane: Provision tomorrow as well as today?

Paul Tucker: Absolutely.

Patrick Jenkins, Financial Times: You mentioned the concept of general provisioning as a kind of somewhat out of fashion phrase, but also you talked about - in a different context I think accounting constraints. I just wondered in general how confident you are that your recommendations are consistent with what banks will be allowed to do by their auditors?

Mervyn King: I'm going to ask Paul - Paul used the phrase general provisions and he's done a lot of work in this area. The first thing I'd say, just to remind us that Adair Turner is at this very minute having early morning meetings in New York precisely about this kind of issue.

Paul Tucker: I'll say a few words and then hand over to Andrew. There are plainly constraints from the accounting regime on what can be counted as a provision in the statutory accounts. That does not mean that there are constraints on Pillar 2 buffers or other capital buffers which serve the same economic function.

So when you and I were young, there were specific provisions - general provisions against broadly expected losses and capital was held against unexpected losses. If the accounting regime sometimes doesn't allow provisioning against expected losses, and I don't say that it does that all of the time, but if it does that some of the time, well that isn't something which bank CEOs and boards and supervisors can just ignore. They nevertheless need to look at the economic substance and say - well actually, part of our capital buffer needs to be held against expected losses and part of our capital buffer needs to be held against unexpected losses or stress losses.

That's - in a sense what we're doing in this Report is going back to basics and saying - you know, how do you approach the assessment of the capital adequacy of banks? How do you ensure that capital adequacy is robust, notwithstanding the constraints that come from the Basel regulatory regime or from the accounting regime, but nevertheless do what is broadly right, which is what micro-supervision is about. Andrew.

Andrew Bailey: The only thing I would add is - in support of that is that I mean the really dangerous state of affairs was that if you go back to 2008 you saw in big picture sense a state of affairs where the accounting regime delivered no general provisions and there was almost no capital being held by the large banks in the Pillar 2 buffer.

Today we - in the last four years the Pillar 2 - the accounting regime is the same, the Pillar 2 buffer has increased quite substantially, but the FPC is helpfully, I think, setting out a framework which allows us now to do a test against that buffer, highlighting three areas where there is reason for doubt - I agree with that - to say have those buffers now reached the level that they ought to, with frankly as the Governor said in his introductory remark, a starting point of a doubt, a clear doubt?

Patrick Jenkins, Financial Times: And therefore they can become more idiosyncratic bank by bank, those buffers?

Andrew Bailey: Yes, oh that's …

Patrick Jenkins, Financial Times: And they haven't been up until now?

Andrew Bailey: Oh, that's the whole point about Pillar 2 buffers that they are idiosyncratic yeah.

Paul Tucker: It goes on their balance sheet.

Geoffrey Smith, Dow Jones: I'm inferring from the Report that …

Mervyn King: Can you just speak up a bit?

Geoffrey Smith, Dow Jones: Yes, sorry. The Report obviously - or the recommendation you have is obviously anticipating a direction which is taken by Basel anyway. How accurate would it be to infer from the fact that you're taking action today, that you're expecting Basel either to be delayed by a long time or perhaps not even to come into force at all, and so putting in place a regulatory framework that will do the job before the international community actually gets round to agreeing on a new set of standards? Or to get back to Andrew Haldane's metaphor, how long do you expect this bridge to be? And Mr Bailey really, is your approach - are your discussions with the banks in the next few weeks going to include floors, and will they be above the floors outlined in Basel III?

Mervyn King: Why don't you answer that? We'll take the last question as your one question and Andrew can answer that?

Andrew Bailey: Well the Basel III, the floors are important and I do think the floors are most important going back to some of the things Andy said in the context of the assessment of risk weights. That's one of the elements of risk weighting. But this is not really about to Basel III or not to Basel III; this is about the state of affairs we're in today.

Jennifer Ryan, Bloomberg: Could you talk a little bit about the concerns you might have about the UK property market both commercial and residential? And in particular on residential, you seem to indicate in the report that prices are a bit too high relative to incomes and to debt levels. So could you expand a little bit on your concerns there?

Mervyn King: Andy, why don't you take that?

Andy Haldane: Well just to be clear, I mean the remit of the FPC is not to form a firm judgement on whether any asset market, whether property or anything else, is over-inflated or under-inflated. What we have done is to work through the implications for the UK banks of either existing stresses or potential future stresses that may indeed have an impact on residential or commercial property prices.

I mean the area that I'd highlight which we have looked at very closely is not so much on the residential side but rather on the commercial side, where we do have a significant overhang of legacy loans, commercial property loans that account for fully half of all corporate lending by UK banks. A sizable chunk of those loans we know to be subject to forbearance - a third, perhaps more, of those loans are subject to forbearance. And we think in some cases there is evidence of those loans being under provided for.

Six months ago we said - it was already the case then that there was some degree of underproviding for on commercial property loans - and having looked at some portfolios outside of the UK we think the extent of that provisioning might be greater still.

The truth is for a large part of the commercial property market right now the existing prices, the existing valuations are not very firm because there's effectively no liquidity, no transactions in the secondary market, much less the tertiary market for commercial property. So there is an area that we're concerned about, we have looked at very, very closely portfolio by portfolio and part of our recommendation has been with an eye in particular to the commercial property market.

Ed Conway, Sky News: One of the key precepts of financial stability is knowing who's actually going to be in charge of the regime in a given amount of time and I just need to ask Paul Tucker again, you've said that you're doing your job at the moment, but do you intend to serve out your full term until February 2014?

Paul Tucker: I am the Deputy Governor for Financial Stability; I'm doing that job.

Ed Conway, Sky News: Do you intend to serve out your full term?

Facilitator: Chris?

Chris Giles, Financial Times: When you look at the recommendation of the FPC which says that it recommends that the Financial Services Authority takes action to ensure that the capital of UK banks and building societies reflects proper valuation of their assets, it rather raises the question what on earth was the FSA doing before that.

Has something gone wrong at the FSA that it wasn't seeking a property evaluation of assets and future conduct costs and prudent calculation of risk weights? And is the fact that you're not actually saying how much capital, additional capital, is needed in this press conference because you think the public shouldn't know that or because the FSA hasn't done it yet?

Mervyn King: No, let me take that last bit and then hand back to Andrew. It's certainly true that you can't give a completely accurate figure for the total number without looking at this bank by bank and that is something which FSA will now be doing. We've identified three things which in our view constitute the bulk of the uncertainty about proper valuations on balance sheets. We've done already quite a lot of work on this, in conjunction with the FSA, and we're fairly confident that we know, you know, where the numbers largely will come out.

But I think it's misleading to give a single number for the system as a whole because they do - the numbers will vary enormously by bank. And the important thing is for FSA to be able to speak to the banks, to make sure that the information is checked now, that the banks do have an understanding of what we want them to do and for the banks themselves then to set out a strategy for how they're going to deal with it.

The key principle of these tests is that if you're going to change the valuations you need an answer to the question - what are you going to do about it? And this will give the banks a chance to explain what they, as individual banks, are going to do about it. And I think that's important.

As I said earlier, this is a perfectly manageable process and it can be done reasonably quickly. You can see in the Report that we - you can see in the data in Table or Chart 2.14 that banks in Europe, even in Europe, the heart of the biggest problems in the banking sector, outside the United Kingdom, have already raised £30 billion of new capital this year, many of them in banks where the market value is well below book value. This can be done. And it's something which we want the banks to do where appropriate.

But there are choices here and it's reasonable to give the banks themselves the choice. Do they raise more capital, or do they restructure their exposures? And that's something which we think is appropriately discussed between the FSA, the supervisors and the individual banks. But we will expect FSA to report back to us before the March meeting about the actions that they will already have taken by then. Andrew.

Andrew Bailey: Yes, I mean I think the - going back to the answer I gave to the earlier question, I think that you have to distinguish between sort of the pre 2008 regime and the regime that has held since then. Going back to the point I made about there being no buffers before 2008, your charge in a sense obviously follows. But the buffers have been built up substantially since then.

Now if you take each of the three elements that the FPC has highlighted today, asset valuations are an issue - when you're a forward-looking supervisor - you always have to look at, and you always have to keep relooking at them. And that's entirely appropriate that we keep relooking at them.

And the second point I'd make, as we've already covered, is that in an environment where the accounting standards tend, or act to dissuade prudent - to use Paul's phrase - prudent general provisioning, you need to make sure that the buffers are being used to counteract that.

Conduct costs of course are a much newer element and a much more uncertain element. And also there, there is a concern I have that the accounting standards tend to counteract a more prudent approach to estimating future possible liabilities.

And thirdly - just finishing off on risk weights - there are elements - so let me take the one element that is possibly the most useful to give here because it follows on at the point that Andy has just made on commercial property - we have at the FSA essentially taken out quite a few of the models that were developed under Basel II for commercial property, and said that we want a so-called slotting approach.

Now that is quite clearly counteracting something that's happened in the past that we don't think is prudent. And the interesting point about that to a point that Paul made earlier is that that is an approach which is rather like the old matrix approach towards developing country debt. It's not trying to be very clever about your model; it's saying look at a number of factors, put your loans into a sort of limited set of buckets because that is a more prudent way, frankly, of doing it than we have seen.

So there are reasons for all of these three factors, and there are reasons now to look again at all of these three factors. But we mustn't take away from what has already happened on capital buffers.

Hugo Duncan, Daily Mail: Looking at Table 2.A on Page 23, how concerned are you about continued exposure of UK banks to the eurozone, in particular in Spain, but also in France, recently described as the time bomb at the heart of Europe?

Mervyn King: Well clearly these are exposures which raise the possibility of future stress. No one can easily put a number on how big that stress will turn out to be, and it's largely for that reason that FSA has ensured that banks have had to build up buffers against that stress.

In response to an earlier question, I said that sentiment has improved a bit since we last met in the summer. I don't think the big picture has been a significant change here in the potential losses in a stress situation, which is why the banks need the buffers and why the specific actions that we are recommending FSA take today are designed to ensure that market participants can have confidence that the buffers mean what they say and are therefore adequate - insofar as any buffer can be adequate - for a stress of the kind that might result from really unanticipated developments in the euro area.

Sam Fleming, The Times: A question for Andy Haldane, it's the one about the future. How will you decide whether or not you stay at the Bank for the next five years, and do you expect to serve a full five years still here?

Facilitator: If we can have questions on the Financial Stability Report, Ben?

Mervyn King: Let me assure you that all the people around me here can stay in the Bank as long as they like, except for me. And a question to, you know, what's going on is - I'm not going on, the 1st of July next year I will have left, and you'll be left with this fantastic team of people here to come and question after the 1st of July.

Ben Chu, The Independent: A question for Andy Haldane. In your recent 'Dog and the Frisbee' speech you seem to suggest that the thrust of the Basel III approach which is the emphasis on complexity might be misconceived. Mark Carney, who we now know is going to be the next Governor of the Bank of England, suggested that your concerns were uneven and not based on a full appreciation of the facts. Are we looking at a misunderstanding there or is it a fundamental difference on the philosophy of how you regulate the banking sector?

Andy Haldane: Just a couple of points on that if I can, Ben. So on the Basel III question just to be absolutely clear what I said in the speech you mentioned. There's no question in my mind - and I've said it repeatedly - that Basel III was a significant improvement over Basel II, in particular in clarifying and simplifying and raising the numerator of the capital ratio, okay. But the part it left untouched was the denominator, which is risk weighted assets and concerns we have about its opacity, about its complexity, about its inconsistency - in fact exactly the things we discuss in today's Report.

So I wasn't saying we should be - that somehow Basel III was wholly wrong - in many respects it was a huge improvement over what we had. But is there unfinished business? You bet there's unfinished business.

On to the second point, I mean if you, as I know you have, if you were to put Mark and I's speech cheek by jowl, you would find not so much as a fag paper of difference between them on the regulatory reform agenda. The particular issue you mention actually concerned the leverage ratio. And guess what? The country - one, that has a leverage ratio, and two, has been one of the biggest supporters of it because it protected them from the storms we've had over the last few years - was indeed Canada, and has indeed been Mark.

So I think, insofar as there's anything at all, there is complete consistency on what we want by way of the future regulatory agenda, and improving risk weights are one element of that.

Brooke Masters, Financial Times: On this three part agenda for the FSA, should we as the public expect to hear from the banks what they've done about it - you know, with actual numbers? Obviously they will tell the regulator, but should we look at the end of year reports that we have provisioned ex amount or we have done such and such to our risk weighted assets? And if it isn't public, how are we supposed to believe them?

Mervyn King: You should expect to hear from individual banks. I'm not going to give a time frame on it; that will depend on the conversations between FSA and the banks. But they should be saying and responding to you, as a member of the public, and to investors, saying - this is how we, Bank X have responded to our conversations with the FSA, which in turn followed the recommendation of the FPC.

Phil Aldrick, The Telegraph: Given that there is quite a welter of evidence that shows that the problem with credit is on the demand side rather than the credit extension side, it's not entirely clear how raising the capital ratios or the capital levels will help the economy which was one of your guiding purposes.

The banks are also saying if they have to sell off assets now, that would be detrimental to their capital position because they'd obviously be selling at sort of fire sale prices. And I'm just wondering whether you know whether there is a chance that this could retard economic growth, and whether Mark Carney would actually be supporting these proposals, in your opinion, you know, given your knowledge of him on the FSB?

Mervyn King: Well these proposals today are the proposals of the Financial Policy Committee, and they're supported unanimously by every member of the Financial Policy Committee. I don't believe that these will retard the recovery, in fact precisely the opposite.

We have put in place the Funding for Lending scheme as a temporary scheme to provide a breathing space. It provides a subsidy to banks that cannot possibly continue indefinitely, and therefore banks have to get themselves into a position where they have sufficient confidence in the investor community for people to be willing to lend to banks and to buy equity in banks at rates which make it possible for our banks to lend to the real economy at normal premia over Bank Rate.

That is not happening at present, and it will need to take place before we get back to a fully-fledged recovery. You see, I'm not pretending for a minute that this is, you know, a silver bullet to ensure rapid growth in the British economy, it's not; it's one of the factors which have been affecting us, but nevertheless it is an important one. And it is important - and that's what the FPC are saying today - that the banking system is open and transparent about these three particular factors which have led, so far, capital to be somewhat overstated.

The reason why this is important and why it will not damage lending is that it is perfectly manageable. Banks elsewhere have done it, our banks can do it. We'll do it in a sensible way. The FSA will have conversations with individual banks, they in turn will make announcements to the public. But this can be done and our banks will demonstrate that they can get back to a point - as I said, we will get them back to the start line where they can support an economic recovery.

Facilitator: We have time for one more question and Larry is going to ask it.

Larry Elliott, The Guardian: Given that the state is a very big investor in two of the biggest banks, have you had discussions with the Treasury about this big recommendation and whether it implies any further exposures for the taxpayer involved here?

Mervyn King: There is a non-voting Treasury member of the Financial Policy Committee and the individual comes and can participate in our discussions. It was made very clear that the Treasury did not want to put new capital into the state owned banks; that's perfectly understandable and rather sensible. But this recommendation does not imply that the state would have to do that. Capital can be raised from the private sector, or other adjustments can be made of the kind that I mentioned in my speaking note. The exposures can be adjusted in other ways.

But it is important that we take this seriously, that the recommendations are put into effect. And Andrew will be taking that forward straight away. This problem can be handled, we shouldn't be frightened of it; we should face up to it and do it and then we will take great pride in fact that the UK will have a banking system that is at the start line ready to support our economic recovery, with balance sheets in which people can have confidence because the numbers mean what they say.

Facilitator: I'm afraid that it all we've got time for, so it only remains for me to thank you all very much indeed for coming.

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