Financial Stability Report Press Conference

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Simon Jack, BBC: Thank you. Simon Jack, BBC News. Governor, have you reviewed or changed your view at the FPC of the risks posed by a disorderly Brexit, given the events of the last week?

Mark Carney: So, as I said in my opening comments, and it's indicated in the report, our job is to look at the worst-case scenario, so the worst-case scenario is effectively a no deal disorderly Brexit. The probability of that scenario has gone down because of the election results and the intention of the new government but the scenario itself, and that which the risks that we protect the system against, has not itself changed, it's just become less likely. So, the tail risk between which we have insured has become less likely but I think what you would expect us to do and what people would expect us to do is to continue to ensure that the system is ready so that the financial system is not forming a constraint to whatever negotiations are underway or discussions are underway but is part of the buffer for whatever happens but yes, the probability clearly has gone down.

Ed Conway, Sky News: Ed Conway from Sky News, kind of building on what Simon's asking. So, one of the phrases that keeps coming up a lot in the FSR is 'Brexit related uncertainty' and so what is your sense? I mean, you're going to talk to the economic implications in the MPC minutes later on this week but what's your sense of what this implies for the financial system and are you getting already a sense from what markets are doing in the last day or two that tells you whether that uncertainty is diminishing?

Mark Carney: Well, the markets are reassessing a host of political uncertainties, potential policy paths for the UK and probabilities around Brexit and they'll make their judgements. Again, from the FPC's perspective, what we have to do and what we have been doing is preparing for that worst-case scenario. Until we have a deal and a transition to that deal, you know, we'll continue to have arrangements in place whether they're additional liquidity, ensured that the capitalisation of banks are consistent or arrangements such as the temporary but important cross-border arrangements that have been put in place around the derivative markets, which are the product of discussions with ourselves and European officials as a bridge to the final relationship. You know, we'll just continue to ensure against that tail as the country moves forward. Thank you.

Brian Swint, Bloomberg: Hello, Brian Swint from Bloomberg News. Assuming that Brexit goes through on January 31st, as the current government policy is, do you still have Brexit risks in your stress test for next year or do they morph into something else?

Mark Carney: So, just to be absolutely clear, in this stress test we didn't have Brexit risk per se, so what we had in the so-called ACS stress test which we've run over the course of the last year is we had a very severe global downturn, including quite substantial outright recession, outright negative growth in China and in Hong Kong. Sharp falls in asset prices, a big stress on misconduct costs, which are above and beyond the misconduct costs that UK banks have experienced over the course of the year and then independently a sharp recession in the United Kingdom, including with unemployment going up 9%, interest rates going up by several percentage points and on, and on, and on. GDP down by more than 4%. That wasn't a Brexit stress, per se. We had, if you recall, about a year ago at the request of the TSC, well, the at the request of the TSC we revealed a separate Brexit analysis that we had been doing because we had wanted to make sure that the severe stress tests encompassed what could happen if we had a Brexit stress but not just a Brexit stress, in other words a disorderly Brexit, but also at the same time, for example, a trade war and a sharp global downturn so that the system could withstand both of those events and on top of that a bigger increase of misconduct cost and the judgement was revealed this time last year was that that was indeed the case, that Brexit was less severe, a disorderly Brexit was less severe in aggregate than the stress we are subjecting the system to.

So, the committee will finalise its judgement on the type of stress that it will run next year and we're in current discussions on that so I can't say exactly what that would be but what you would expect is it would be somewhat different from the type of stress that we have in the past because recall the banks change a bit with time but they don't change that much and so we've run a couple of years of a certain type of stress which gives us the confidence that we're encompassing, if I can use that term again, encompassing Brexit plus other risk and so naturally I think the committee will want to look at different types of risk for the 2020 stress.

Ben Martin, The Times: Ben Martin from The Times. Can I ask have you put in place any contingency measures in case of a market sell off if there had been a Labour majority in the election?

Mark Carney: We didn't put any special contingency measures in place. We've had contingency measures in place for the possibility of a no deal disorderly Brexit, most importantly the PRA supervisors have been monitoring liquidity and liquidity positions in aggregate of the major banks and building societies but also the foreign exchange liquidity positions of those institutions. That's been running for quite some time actually because, as you'll recall Ben, we've had a series of potential cliffs over the course of this year and we were potentially heading to, I mean, technically we still are but potentially heading to another one at the end of January. So, all of that was in place and it goes to a more general point which is that, you know, part of the value of stress testing and contingency planning is that it also prepares you for things you don't necessarily expect or, you know, events can happen, financial stability events can happen and over time as we look at different scenarios, if we prepare for different events, as the banks themselves prepare for this and think about different scenarios, you know, the risk that eventually comes may be entirely different. It may have a different genesis but that preparation will at least be helpful in that circumstance.

Tim Wallace, The Telegraph: Thank you. Tim Wallace at The Telegraph. Governor, if Brexit now or if a disorderly Brexit is now a lower probability event, what do you see as the most significant risk facing the UK's financial system after that?

Mark Carney: Well, there are a host of global risks, so the global scenario we have, which admittedly is quite severe but what is one which could be triggered by a deepening of the fragmentation of the global trading system, you know, certain geopolitical or political events beyond our shores. We're conscious of medium-term risk from indebtedness, corporate indebtedness and household indebtedness in general. We are reassured by a couple of things in the UK, which is first that the underwriting standards have held in, not just in mortgages, in part because of the mortgage measures but also on consumer credit where the PRA has been active and overseen that and those have stabilised, the underwriting standards have stabilised there but we're also, I would say, reassured that UK households in general have paid down debt. They've worked hard and paid down debt at least in relative terms and they are in a better position. What you do in those circumstances is to make sure that you have the appropriate buffers in that environment so that if risk did start to build we can act in a timely fashion, and if I may just make a short commercial for the CCyB, the change for the Countercyclical capital buffer.

Part of the reason to move it up to that level of 2%, which doesn't result on average in much of a change in the overall loss absorbing capacity but if puts us in a position that if risk were to start to build we could more readily get the buffer to a level that would make a material difference if we had the type of build-up and risk that we've seen in other more extreme risk environments but do you want to add anything on that?

Jon Cunliffe: No, I'll just say on the raising of the CCyB, you know, standard risk environment of 2% and there's some material actually in the FSR that if, for example, you look back at the crisis and pre-crisis period, the indicators didn't really start moving until 2004, 2005. So, if you wait until you start to see the indicators of risk moving significantly then there may not be time to move gradually, so if you can transfer loss absorbency to buffers in the way that we're doing it actually means that you could get to the level that you would need to get at the peak of the crisis. I think the estimates are we'd have needed a CCyB between 3.5% and 5% by the time we've reached 2007, 2008. This gives us a chance to move gradually towards that, given that often the indicators don't move until a few years before hand.

Oscar Williams-Grut, Yahoo Finance: Leverage loan losses are up in this stress testing. How concerned are you at the rising level of leveraged lending and also the declining standards within that sector?

Mark Carney: Yes, well let me start and then I'll ask Sam to expand. I mean, we're concerned to the extent when we look at, and it goes back to Tim's question, where do we see pockets of risk so, sort of, emerging areas of risk and the sharp build up in leverage lending, particularly into the United States, so the re-leveraging of Corporate America is an area where we do see there's been a steady build-up of risk there and so the quality of those loan books has deteriorated and that's part of the reason why we've spent as much time as we have in the last couple of years to determine, it's to try to follow the money. So, where are the actual exposures? Recognising these are largely exposures to the US, I'm oversimplifying but largely to the US and so which institutions have which types of exposures and how big are they relative to the size of their capital basis? Then we've subjected them to a more extreme stress than we did in previous years because we feel the global economic environment has become a little more difficult and therefore if things went the wrong way it would be more severe, so with that sort of headline but I'll hand to Sam to, kind of, dig into it.

Sam Woods: Thanks. So, just to add a bit more colour on the UK banks themselves, so the total exposures to the leveraged loan market as we define it for the UK banks are around £90 billion, which is just slightly less than half of their common equity tier one base, so that is obviously material. As the governor was saying, we dug deeper into those this year and you need to think of them as being in three buckets, so revolving credit facilities, which we've stressed to an impairment rate of 11% or 12%, which is higher than what they experienced in the global financial crisis but we think that is reasonable given the different interest rate path that we have in our scenario and the sliding underwriting standards that you described. Then there was what we call the 'pipeline', which is £11 billion out of that £90 billion which are, if you like, originate and distribute type exposures. We subject those to a pretty severe traded risk scenario which ends up with an impairment rate of something like 17% with those exposures. The UK banks have a much smaller exposure to the third bucket, which is CLOs. It's about £3 billion, they take losses of about £300 million on that. So, putting that together we are confident that we've got a good read on it, that we have that covered in capital.

To put it in perspective though, all of that when you tot it all up is 13% of the corporate impairments that there are in this stress, so it's important for the UK banks, it's important that we're on it but I think the bigger picture is really the one that the governor was touching on, which is about the overall dynamics in that market and what's been happening in recent years.

Caroline Binham, Financial Times: Thank you. It's Carole Binham from The Financial Times. Governor, the report reveals the latest thinking around open-ended funds. Should there be any restrictions around retail customer's ability to invest in funds that hold illiquid assets?

Mark Carney: Well, I think the very strong desire is not to have those restrictions and to have a structure that, you know, that responsibility makes available opportunities for retail investors on a fully informed basis to invest in what can be very attractive assets but which are longer term assets or more illiquid assets and assets that are not commensurate with daily liquidity. It's not the equivalent, as you well know, of having a bank account and having instant access to the fund. That shouldn't be something that retail investors find out about in a gating situation or a severe situation, it's something that they should know in advance and have an expectation of how long it would take to get the money out. Of course, as you well know, the core-, when we look at this, we look at it from a financial stability perspective, including how any changes to the structure of these funds could impact the supply of productive finance, I'll come back to that. The investor protection market integrity issues, of course, for the FCA but we're seeing a fairly strong overlap between those interests between those of the FBC, financial stability and those of the FCA and obviously we're working closely together on these issues with a joint review.

What we are sharpening our thinking around it, which has really three elements. The first is that the funds should have made judgements about the liquidity of their assets and normally that is a spectrum of liquidity, so it's not just one type of asset so they should put their assets into liquidity buckets, so to speak, and liquidity in that regard shouldn't be about whether something is listed or not or has certain technical characteristics. It should be about how truly liquid they are, how quickly does it take or how long would it take under reasonable circumstances to sell the underlying asset and provide it because remember, whether the investor is a retail investor or an institutional investor, you don't own the most liquid bit of the fund, you own the so-called vertical slice or a proportion of all of the funds' assets. So, when you redeem in a perfect world the fund is selling that vertical slice or giving you a price that would be consistent with it having to do that. So, the first thing is to understand the liquidity, the second is to play with two variables, (1) the price discount that would be applied if the money is paid out more rapidly than the timeframe to sell the representative proportion and the second factor is to adjust the redemption term upfront to reflect the time it would take to sell. Obviously, there are combinations of those two that could be determined.

So, we've set out this broad approach, as you've seen described in the report, and jointly with the FCA are going to consult and examine this. We are also very conscious that the UK is, you know, effectively the most open major capital market in the world, it's a major asset management sector, there are international linkages with this, there's a big international debate and discussion which we are helping to lead and so through Jon, Andrew Bailey, others, we will be playing a role at the FSB, jointly with IOSCO and other bodies to try to advance these issues.

Jon Cunliffe: On this question the governor mentioned an overlap between us and the FCA and incentives and objectives going in the same direction. I think these funds are collective vehicles and everyone is entitled to the same treatment within them, so from an FCA point of view if there are things in the fund that mean that people that move early get a better deal, not because markets are moving just get a better deal than people who come later. That's an issue for them. For us that could be the beginning of a run dynamic that people start to appreciate that if you move quickly you will get some of the scarce assets that are liquid and a better price. So, both from a micro regulatory point and a macro prudential point the two things really come together in that sense.

Daniel Hinge, Central Banking: On the open-ended funds again, you mention the international collaborations there. I believe Governor in the past you've expressed a certain degree of disappointment with the limited action to date. Have you seen any sort of increased willingness recently?

Mark Carney: Well, I think, again, I'll hand to John in a sec because he's sitting at the FSB table. We have seen some important progress over the course of the last few years and I'll give one example, which is the SCC's approach to so-called pocketing liquidity. We reference it in the report, we think this is a sensible approach. I mean, we'll look at it as a basis of classification starting off this process and, of course, we're conscious that the extent to which there can be similar processes followed by major jurisdictions, that's always in the industry's interest, it's in the market's interest, it's in authority's interests and I would say that the dialogue, at least in my experience with the governor table is these issues are increasingly appreciated. Just before I hand off to Jon let me make one point though, which is that we shouldn't forget that-, and we discussed it in the report but I want to underscore it, is that a better fund structure, one that's more commensurate with the types of underlying assets, they can be infrastructure assets, they could be real estate assets, small cap equities as three examples. Maybe more sustainable, resilient infrastructure as well would be a fourth. That's not daily liquidity FTSE 100 equity you can move in and out all the time but those are hugely important assets for growing this economy in a sustainable way and we should make sure that as many investors as possible have access to those in a responsible way.

So, this is where it crosses over from financial stability to relatedly productive finance but if you want to say on the that Jon?

Jon Cunliffe: Just on the international side, I think the cooperation and mutual understanding has improved very considerably over the past years. You have to remember the securities regulators have a market integrity investor protection mandate, they don't normally have a sort of macro prudential responsibility and I think we've come a long way since the FSB's recommendation on liquidity, which IOSCO, the International Securities Regulators Association, have taken up. We need to go further, I think, and see whether those recommendations will actually do enough, particularly in this area of liquidity and matching the underlying liquidity of funds to the redemption term. I think there's been a lot of progress in that area and I think IOSCO have just brought out their proposal on measuring leverage in funds, which is another FSB recommendation. It was published, I think, within the last couple of weeks. Again, I mean, we need to make sure that we've got everything really that deals with the risk but the two sides understand each other and work together now I think much more closely than they did a few years ago.

Fiona Maxwell, MLex: Thank you. Fiona Maxwell from MLex. My question is on LIBOR. So, in your October records I believe you said there was no justification for firm's increased exposure to LIBOR and you would be considering further potential policy and supervisory tools in this quarter and in today's records I think you said you'll still be considering further supervisory tools. So, are you still looking into policy tools such as prudential incentives or have you seen a sufficient improvement in banks' exposure to LIBOR?

Mark Carney: Yes. So, Fiona let me start, I'll hand to Sam as well. We are encouraged in general in sterling LIBOR on the progress that has been made, which we've certainly seen in both the cash and derivative markets. We have the engagement that we expect, and Sam can expand, of senior managers in the major firms on these issues for the transition. I mentioned it in my open remarks, it's in the report, I mean, we will look at in terms of, for example, our sterling monetary framework, which effectively is our liquidity facilities that we provide for the market. How long we will continue to accept LIBOR related collateral, for example, as the market builds up, it's an obvious point. Just from a risk management perspective we expect it to cease to exist after 2021. It's not clear why we would continue to accept that as collateral as one example. There are other sort of supervisory approaches we could take that would follow on from the so-called Dear CEO letter that was sent out but Sam do you want to add?

Sam Woods: Yes, I'd just say on those, I mean, it's naturally part of our preparatory work, if you like, that we look at what would those other mechanisms be and we've done that work, which I think is what people would expect but the conclusion we've reached for the moment is that the firms are very engaged, in particular the senior managers who have been given responsibility of this within firms are unsurprisingly very engaged on it. It's a frequent topic of discussion now at the most senior levels between us and the people running both the banks and insurance companies, so with that in mind we don't see a need to move further at this time but we have them prepared in case needed.

Brian Swint, Bloomberg: Hello, Brian Swint from Bloomberg. Governor, this is your last Financial Stability Report. I couldn't help but notice that you almost, but not quite, mentioned the name of another central bank in your opening statement.

Mark Carney: Yes. I'm feeling nostalgic.

Brian Swint, Bloomberg: Can you tell us anymore about your plans for yourself after January?

Mark Carney: That was well-spotted. No, after the end of this the only clear plans I have are this role helping out on Action Climate Finance for the UN but very specifically for the UK Italian COP 26 where, interesting enough, it has a financial stability angle. It has a broader UK competitiveness angle, actually, you know, if one (TC: 00:40:00) looks at where some of the bigger trends in finance one of the biggest is towards sustainable finance and that is an expertise here but, of course, it's addressing a much more fundamental issue. That's the only plan I have. Thanks.

Caroline Binham, Financial Times: It's Caroline Binham again from the FT. You said the PRA is going to consult on changes to bank's capital requirements whilst saying that the overall structure will remain unchanged and the Fed has said something very similar recently in the last couple of weeks but that's prompted concern at a global level, particularly while we're at this very delicate time on a stand-off on both sides of the Atlantic around implementing the finalised changes to Basel III. Is this not a renunciation of your personal legacy at the FSB in getting all countries to implement agreed minimum standards?

Mark Carney: No. No, thank you for asking the question. Absolutely not. We are fully committed to implementing Basel III or Basel 3.1 and we'll have it fully implemented for 2024 on schedule but I appreciate the question because just to be absolutely clear what the PRA is going to consult on is it takes into account the decision of the FPC to raise the countercyclical capital buffer to 2%, so this judgement that in a standard environment, for the reasons we've been discussing, it should have a higher resting point. Now, given that higher resting point, given that there's more of a buffer to be used up prior to the minimum being, you know, more of a buffer before you get to the minimum, whether it's in resolution or not, the question that is asked is, 'Well, given that contingent on that, what is the appropriate level, for example of Pillar 2A given that more losses will have been absorbed before you get to touch Pillar 2A, so to speak?' That's independent of these other changes, it's a product of a judgement of the FPC looking to rebalance, if it can, if it's appropriate, and it's not a decision it can take solely by itself, but rebalance between buffers and minima in order as a package, including with what the Bank of England has decided to improve the resilience, the responsiveness and the resolvability of the system.

So, that's what's being consulted on. The other thing, if I can just make a short plug for the aficionados, and you are an aficionado, of one of the more complicated bits of capital element, is we have laid out in the report potential enduring solutions, final approaches to IFRS9 because the interaction between that new accounting standard and the stress test can be quite dramatic and we have a short-term fix for it, which we've continued and we will continue next year, but there is a sensible approach, we think, or a few sensible approaches. We are genuinely looking for feedback on which one of them makes the most sense to ensure that the total loss absorbing capacity remains broadly the same in an environment where all that's happened is we've changed the accounting standard and the underlying economics risks have not changed. Now, there is value to changing that accounting standard because it gives greater visibility to expected losses, which has an impact on how banks manage themselves and how investors would look at banks and how regulators would look at banks for that matter. So, when we're going out to ask questions, we as a PRA, we're looking at those specific things. We're not opening up Basel III in anyway.

Simon Jack, BBC: Just on climate, Governor, can you foresee a time, or given your next job, where the Bank of England and other regulators will actually charge banks more to lend to certain types of companies and engage in certain things, for example fossil fuel and energy companies? Are we anywhere near that where, you know, there'll be higher capital charges for assets on the balance sheets of banks which are-,

Mark Carney: Yes. So, the first step is for there to be transparency in terms of the exposures of the borrower or the company in which an asset manager is investing. Their exposure to climate risks and opportunities, so both the physical risk and the transition risk related to changing climate policies. Then the second is for banks from a risk management perspective is for them to understand, and then make their own judgements, about the wisdom of continuing to lend to companies that have potentially quite material climate risks, including in the medium-term. On Wednesday we will be releasing with the PRA the discussion paper for the so-called biannual exploratory scenario, the climate stress test called 'Differently' which begins to look into those issues. Now, it becomes a business strategy, I mean, in the end we don't look to substitute financial policy, prudential policy for climate policy. So, in other words not change the capital charge as a proxy for a carbon tax, for example, however what we do look to have is the exposure, the transparency around those climate risks of the borrowers and for-, and what we're looking for management of banks to do is to think through their strategy about their exposure to industries, scale their exposure to industries that could be increasingly and materially exposed to climate risk and the question is, 'Well, how resilient is your strategy if you are concentrating your lending in areas that will be, you know, potentially, severely affected five, ten plus years out?'

That's the dynamic that's being set in train. If I just finish just on COP 26, you know, part of the objective should be for in finance for COP 26 is that the foundations are put in place so that professional, financial decisions can take into account climate change, right? Whether they're lending or investing and that the disclosure is there and the tools to make those assessments are in place. That will be driven, we will provide the framework for getting those tools in place and then the private sector will develop those but we'll use the focal point of COP 26 in order to get that done. Thanks.