



BANK OF ENGLAND

News release

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Balancing Risk and Return in the UK Financial System

The Bank of England is today publishing a new-style Financial Stability Report, which provides an assessment of prospects for the UK financial system.

The Report emphasises the high profitability and flexibility of the system, which has allowed it to weather a number of disturbances over recent years. However, it also explores six key sources of vulnerability, the shocks that might trigger them and their potential impact on the system. The Report does not forecast what is likely to happen but identifies risks from plausible but unlikely events in order to help guide risk mitigation work.

For much of the past six months, strong economic and market conditions and intense competitive pressures have encouraged financial firms to extend their risk-taking. This has pushed the financial system as a whole further up the risk spectrum. High risk-taking at this stage of the cycle is normal, but past experience shows it carries risks if conditions turn. Market adjustments in May and June may have led to some paring back of risk-taking. But they do not appear to have altered financial firms' medium-term risk strategies.

Sir John Gieve (Deputy Governor for Financial Stability) said:

“This Report demonstrates the resilience of our financial system but it also identifies some sources of vulnerability. Risk management in the financial sector has become much more sophisticated in recent years, but the pace of innovation and growth of financial markets is raising the bar. Firms need to continue to improve their stress testing against less favourable conditions. We are working with the FSA and Treasury and authorities abroad to mitigate the risks and improve contingency planning.”

Notes to Editors

A number of changes in style and structure have been made since the December 2005 Financial Stability Review with the aim of providing a clearer, forward-looking assessment of the key risks to the UK financial system. These changes are reflected in the renaming of this publication to the Financial Stability Report. The Report is produced half-yearly by Bank staff under the guidance of the Bank's Financial Stability Board, whose best collective judgement it represents.

Under the Memorandum of Understanding with HM Treasury and the FSA, the Bank contributes to the maintenance of the stability of the financial system as a whole. The Report is one vehicle for helping meet those responsibilities.

Key Resources

Financial Stability Report, Issue 20

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/publications/fsr/2006/fsrfull0606.pdf>

Memorandum of Understanding between HM Treasury, the Bank of England and the Financial Services Authority

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/financialstability/mou.pdf>