



**BANK OF ENGLAND**

# News release

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## **Changes in the Nature and Balance of Risks in the UK Financial System**

The Bank of England is today publishing its second new-style *Financial Stability Report*. This provides an updated assessment of the risks to the UK financial system.

The UK financial system remains highly resilient. But strong and stable macroeconomic and financial conditions have encouraged financial institutions to expand further their business activities and to extend their risk-taking, including through leveraged corporate lending, and the compensation for bearing credit risk is at very low levels. That has increased the vulnerability of the system as a whole to an abrupt change in conditions. Financial innovation and the growing use of credit risk transfer markets have increased the risk-bearing capacity of the system – but also bring some risks. Recent developments in the US sub-prime mortgage market have highlighted how credit risk assessment can be impaired in these markets and how participants can be hit by sharp reductions in market liquidity. Similar problems in a more significant market, such as corporate credit, could have more serious consequences if credit quality were to deteriorate. It is important that participants in these markets are alert to these risks and that firms' stress testing takes them into account.

John Gieve (Deputy Governor for Financial Stability) said:

“Financial markets have continued to be vibrant, core institutions are highly profitable and the economic outlook is favourable. But risk-taking is increasing including through higher leverage, lower margin requirements and relaxation of covenants. The rapid growth in credit risk transfer markets is also making more participants dependent on continuous market liquidity and could amplify the impact of shocks like a sharp reversal in credit spreads from their current low levels. Risk managers need to further develop ways of measuring and managing these new forms of risk”.

### **Notes to Editors**

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.