Systemic Risk Survey

Survey results | 2011 H2

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The *Systemic Risk Survey*

- The *Systemic Risk Survey* is conducted by the Bank of England on a biannual basis to quantify and track market participants' views of risks to, and their confidence in, the UK financial system.
- This report presents the results of the 2011 H2 survey which was conducted between 20 September and 21 October 2011.

Probability of a high-impact event and confidence in the UK financial system

- The perceived probability of a future high-impact event in the UK financial system increased sharply in 2011 H2, compared with 2011 H1, and was reported to be at the highest level since the survey began in July 2008.
- Looking over a short-term horizon, 54% of respondents found the probability of a high-impact event to be high or very high in the 2011 H2 survey, 43% found it to be medium and only 3% found it to be low or very low. Over a medium-term horizon, the corresponding percentages were 60%, 34% and 6%.
- Respondents' confidence in the stability of the UK financial system as a whole over the next three years fell to its lowest level since 2009 H2, with 28% not very confident and 57% only fairly confident.

Key risks to the UK financial system

- The five risks reported most frequently by respondents to have the greatest impact on the UK financial system if they were to materialise were: sovereign risk (cited by 76% of respondents), the risk of an economic downturn (76%), funding risk (57%), risks around regulation/taxes (38%) and the risk of financial institution failure/distress (26%).
- Four of the top five risks were unchanged from the 2011 H1 survey. Only the risk of financial institution failure/distress was new in the top five, replacing the risks of property price falls and financial market disruption/dislocation which shared the fifth place in the previous survey. Compared with 2011 H1, more respondents cited funding risk (+15 percentage points) and sovereign risk (+10 percentage points) while fewer cited household/corporate credit risk (-15 percentage points), the risk of property price falls (-15 percentage points), inflation risk (-13 percentage points) and the risk of financial market disruption/dislocation (-12 percentage points).
- The risk cited most commonly as the number one risk was sovereign risk. This was cited as the top risk by 62% of respondents — the highest concentration around a number one risk since the survey started in July 2008.

Risks most challenging to manage as a firm

- The top five risks respondents would find most challenging to manage as a firm were the same as the top five key risks listed above, but with sovereign risk more dominant: sovereign risk was cited by 68% of respondents; the risk of an economic downturn by 38%; funding risk by 35%; risks around regulation/taxes by 31%; and the risk of financial institution failure/distress by 21%.

The *Systemic Risk Survey* is a biannual survey that asks market participants about perceived risks to, and their confidence in, the UK financial system. The survey is generally completed by executives responsible for firms' risk management activities. This report presents the results of the 2011 H2 survey, which was conducted by the Bank of England in the period from 20 September to 21 October 2011. The results presented are based on responses to the survey and do not necessarily reflect the Bank of England's views on risks to the UK financial system. Sixty-eight market participants, including hedge funds, banks, building societies, large complex financial institutions (LCFIs), asset managers and insurers (including reinsurers and monoline insurers), were invited to complete the survey. All 68 (100%) responded. Summary statistics are calculated by giving equal weight to each survey response.

This report is available on the Bank's website at www.bankofengland.co.uk/publications/other/srs/index.htm. Additional background information on the survey is available in the 2009 Q3 *Quarterly Bulletin* article 'Bank of England *Systemic Risk Survey*', available at www.bankofengland.co.uk/publications/quarterlybulletin/qb090305.pdf.

The publication dates in 2012 for future *Systemic Risk Surveys* are 15 June and 19 November.

Systemic Risk Survey

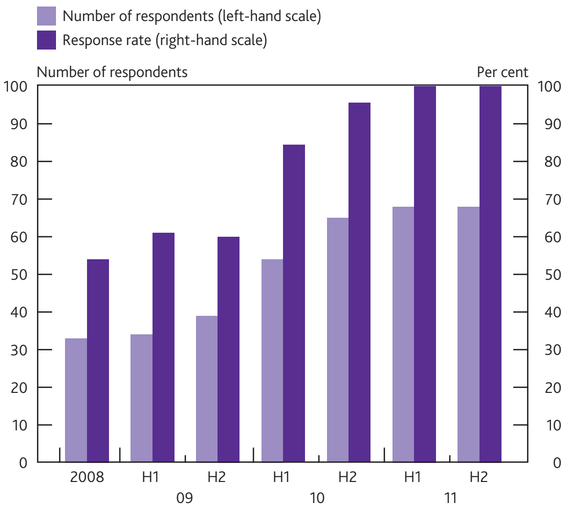
Introduction

As part of its statutory objective to protect and enhance financial stability in the United Kingdom, the Bank works to identify risks to the stability of the UK financial system. The *Systemic Risk Survey* contributes to this activity by quantifying and tracking, on a biannual basis, market participants' perceptions of such risks.

A pilot *Systemic Risk Survey* was conducted in July 2008 and subsequent full surveys have been undertaken biannually since 2009.(1) The survey results complement other sources of information used by the Bank to identify system-wide risks. In particular, they capture market participants' views of aggregate risks to the UK financial system through the perceived likelihood of a high-impact event in the UK financial system in the short and medium term, and respondents' confidence in the stability of the UK financial system as a whole in the period ahead. They also capture respondents' views of specific sources of risks, including those that would have an especially large impact on the system if they were to materialise and those that would be particularly challenging for firms to manage.

The sample size of the survey has increased over time (**Chart 1**), with just under 70 market participants responding to the survey in the three most recent rounds. This increase has been driven by a higher response rate, with over 95% of those contacts invited replying to the survey in these three rounds.

Chart 1 Survey response rates(a)



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) The percentage and number of contacts that answered at least one question in the *Systemic Risk Survey*.

The survey is generally completed by executives responsible for firms' risk management. The 2011 H2 survey was conducted by the Bank between 20 September and 21 October 2011.(2) Sixty-eight financial institutions — including UK banks and building societies (19%), LCFIs and large foreign banks (24%), asset managers (19%), hedge funds (21%) and insurers (including reinsurers and monoline insurers; 18%) — were invited to complete the survey.(3) All responded.

The remainder of this report describes the results of the 2011 H2 survey in four sections: 1) the perceived probability of a high-impact event in the UK financial system; 2) respondents' confidence in the stability of the UK financial system; 3) key risks to the UK financial system; and 4) risks that respondents thought would be particularly challenging to manage as a firm.

Probability of a high-impact event

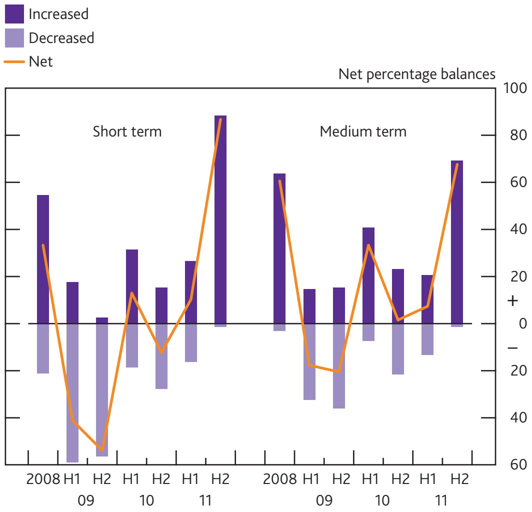
Respondents were asked for their view on the probability of a high-impact event in the UK financial system in the short and medium term, and how those probabilities had changed over the past six months. Since the 2009 H2 survey, the short and medium term have been specifically defined as 0–12 months and 1–3 years respectively. These terms were not explicitly defined in earlier surveys.

In the 2011 H2 survey, a record net balance of respondents thought that the probability of a high-impact event had increased over the past six months (**Chart 2**). For the short term, 88% of respondents thought the probability of a high-impact event had increased and 10% thought there was no change. For the medium term, 69% of participants reported a higher probability and 29% an unchanged probability.

Consistent with these reported changes, perceived probabilities of a high-impact event were at higher levels than recorded in the 2011 H1 survey (**Chart 3**). In the 2011 H2 survey, 18% of respondents considered the probability very high for the short term and an additional 37% considered it high. Weighting the responses into one measure as in **Chart 3**, the net balances of probabilities were at their highest levels since the survey started in July 2008 for both the short and medium term.

(1) Burls (2009) describes the introduction of the *Systemic Risk Survey* in more detail.
(2) Surveys from 2010 H1 onwards were carried out by the Bank. Earlier surveys were carried out by British Market Research Bureau (BMRB) on behalf of the Bank.
(3) Classification is based on the main activity of the group.

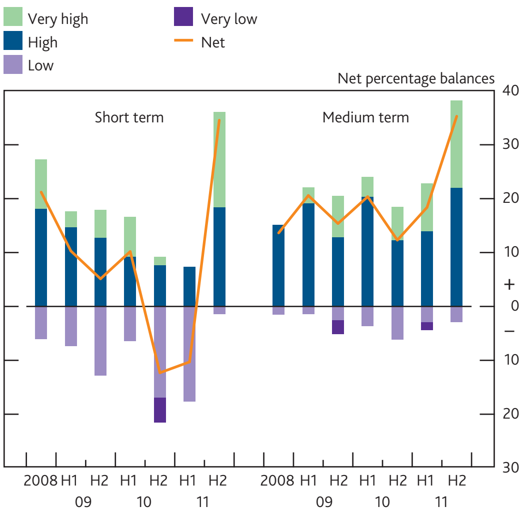
Chart 2 Change over the past six months in the probability of a high-impact event in the UK financial system[(a)]



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked how the probability of a high-impact event in the UK financial system in the short and medium term had changed over the past six months. From the 2009 H2 survey onwards, short term was defined as 0–12 months and medium term as 1–3 years. The net percentage balance is calculated as the percentage of respondents reporting an increase, less the percentage reporting a decrease. Bars show the contribution of each component to the net percentage balance.

Chart 3 Probability of a high-impact event in the UK financial system[(a)]



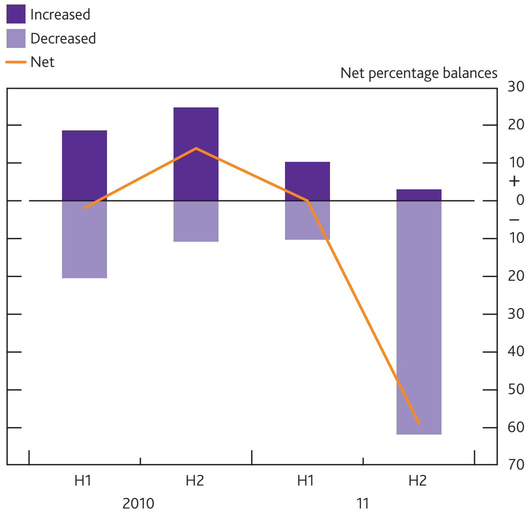
Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked for the probability of a high-impact event in the UK financial system in the short and medium term. From the 2009 H2 survey onwards, short term was defined as 0–12 months and medium term as 1–3 years. The net percentage balance is calculated by weighting responses as follows: very high (1), high (0.5), medium (0), low (-0.5) and very low (-1). Bars show the contribution of each component to the net percentage balance.

Confidence in the UK financial system

Respondents were also asked about their confidence in the stability of the UK financial system as a whole over the next three years and how their confidence had changed over the past six months. The results suggest that confidence had fallen sharply, with a net balance of 59% of respondents reporting decreased confidence over the past six months (**Chart 4**). Consistent with this decrease, the reported level of confidence in the UK financial system was sharply lower in this survey than in 2011 H1. This fall was driven by an increase in the number of respondents reporting they were 'not very confident' (**Chart 5**). Twenty-eight per cent of respondents were not very confident in 2011 H2, 57% were fairly confident and only 15% were very confident.

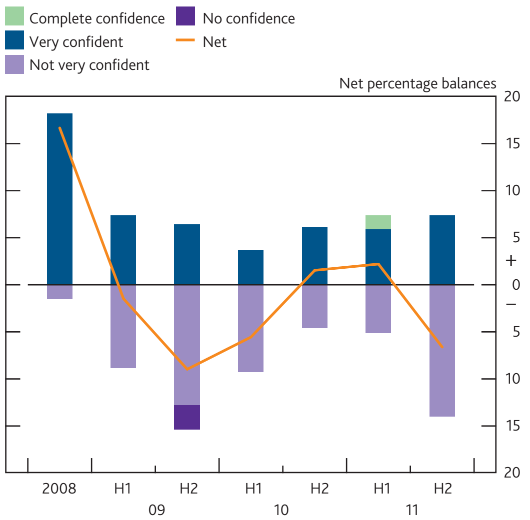
Chart 4 Change over the past six months in confidence in the stability of the UK financial system as a whole over the next three years[(a)]



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked how their confidence in the stability of the UK financial system as a whole over the next three years had changed over the past six months. The question was asked from 2010 H1 onwards. The net percentage balance is calculated as the percentage of respondents reporting an increase less the percentage reporting a decrease. Bars show the contribution of each component to the net percentage balance.

Chart 5 Confidence in the stability of the UK financial system as a whole over the next three years[(a)]



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked how much confidence they had in the stability of the UK financial system as a whole over the next three years. The net percentage balance is calculated by weighting responses as follows: complete confidence (1), very confident (0.5), fairly confident (0), not very confident (-0.5) and no confidence (-1). Bars show the contribution of each component to the net percentage balance.

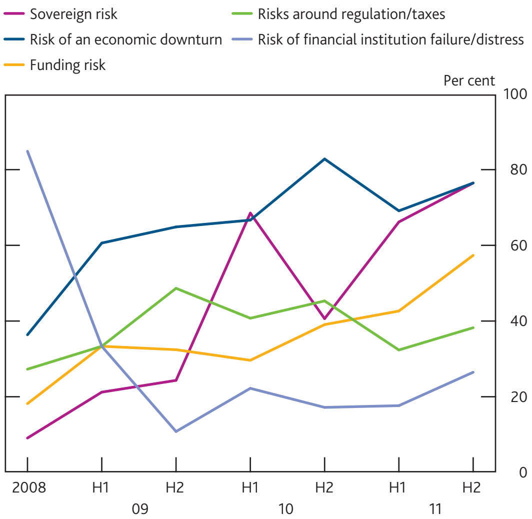
Key risks to the UK financial system

Turning to specific sources of risk to the UK financial system, respondents were asked to list the five risks they thought would have the greatest impact on the UK financial system if they were to materialise. Answers were provided in free format, but have been grouped into the 19 categories shown in **Table A2** in the data appendix to give an overview of the results. The categories used to summarise risks are adjusted over time in order to better capture current risks; risks cited in previous surveys have been regrouped into the new categories to ensure comparability across survey rounds.

The risks to the UK financial system cited by the greatest fraction of respondents in the 2011 H2 survey were (**Chart 6**):

- Sovereign risk (76% of respondents).
- Risk of an economic downturn (76%).
- Funding risk (57%).
- Risks around regulation/taxes (38%).
- Risk of financial institution failure/distress (26%).

Chart 6 Key risks to the UK financial system[(a)(b)]



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

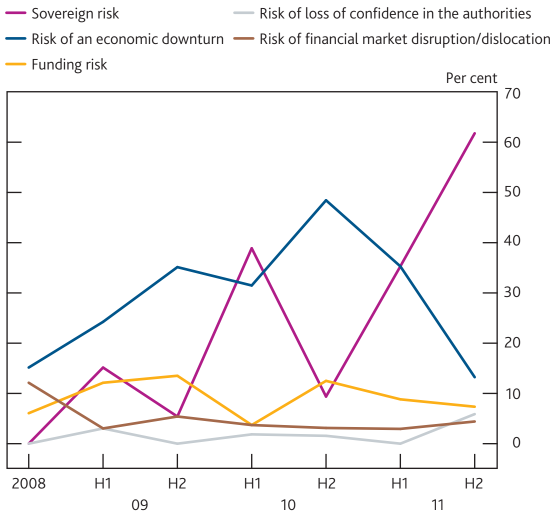
(a) Respondents were asked to list the five risks they thought would have the greatest impact on the UK financial system if they were to materialise. Answers were provided in free format and were subsequently coded into categories; only one category was selected for each answer. Chart figures are the percentages of respondents citing a given risk at least once, among respondents citing at least one key risk. The chart shows the top five categories; see the data appendix for additional categories.
(b) Risks cited in previous surveys have been regrouped into the categories used to describe the latest data.

Risks were listed in order of potential impact. Looking only at those risks that respondents thought had the greatest potential impact (ie their number one risk) the main risks were (**Chart 7**):

- Sovereign risk (62% of respondents).
- Risk of an economic downturn (13%).
- Funding risk (7%).
- Risk of loss of confidence in the authorities (6%).
- Risk of financial market disruption/dislocation (4%).

Agreement was therefore broad among respondents that sovereign risk was the risk with the greatest potential impact: 62% is the highest fraction of respondents that have cited the same number one risk since the survey started in July 2008. The specific concerns cited in the sovereign risk category related mainly to the euro area or countries in the euro area (cited by 51% of respondents, or 68% if including those citing Europe, the European Union (EU) and/or the European Economic Area), followed by the United Kingdom (13%) and the United States (4%).[(1)] As for particular euro-area risks, responses included for example a break-up or collapse of the euro, disorderly debt restructuring, sovereign default and contagion. For the United Kingdom, examples included a rating downgrade, loss of confidence in fiscal solvency or the gilt market, a debt crisis, and government default.

Chart 7 Number one key risks to the UK financial system[(a)(b)]



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked to list the five risks they thought would have the greatest impact on the UK financial system if they were to materialise, in order of potential impact (ie greatest impact first). Answers were provided in free format and were subsequently coded into categories; only one category was selected for each answer. Chart figures are the percentages of respondents citing a given risk as their number one key risk, among respondents citing at least one key risk. The chart shows the top five categories; see the data appendix for additional categories.
(b) Risks cited in previous surveys have been regrouped into the categories used to describe the latest data.

An economic downturn was the second most frequently cited risk. Responses in this category focused on a global and/or UK economic downturn (both cited by 50% of respondents). Only 4% of respondents cited the United States specifically and 1% the euro area or the EU. Responses that cited funding risks, the third most frequently mentioned category, cited for example funding difficulties for banks, closure of wholesale markets and a breakdown in interbank lending.

Risks associated with regulation/taxes were cited by 38% of respondents. Answers focused mainly on the potential negative aspects of regulation, including excessive or inappropriate regulation, regulatory uncertainty, and the implementation of UK-specific measures. Two respondents cited a financial transaction tax as a key risk.

(1) The percentages do not sum to 76% (the percentage citing sovereign risk as a top five key risk) because some respondents cited more than one area while others did not cite any particular area.

Four of the top five key risks in the current survey were also the top four key risks in the 2011 H1 survey. The only change to the top five resulted from the rise in respondents citing the risk of financial institution failure/distress between the two most recent surveys (+9 percentage points), which replaced the joint top five risks of property price falls (-15 percentage points) and financial market disruption/dislocation (-12 percentage points). The increased focus on financial institution failure/distress is consistent with increases in US, UK and euro-area bank CDS premia since the 2011 H1 survey. While the top risks were largely unchanged, there were a number of changes in the fraction of respondents citing other risks. In particular, fewer respondents cited household/corporate credit risk (-15 percentage points), the risk of inflation (-13 percentage points) or the risks surrounding monetary and fiscal policy (-10 percentage points).

Over a longer time horizon, the *Systemic Risk Survey* suggests a shift in key risks from the risk of financial institution failure/distress (58 percentage points fewer respondents cited this risk in 2011 H2 than in 2008) and the risk of property price falls (-29 percentage points) towards sovereign risk (+67 percentage points) and the risk of an economic downturn (+40 percentage points).

Risks most challenging to manage as a firm

Respondents were next asked which three of the key risks they had listed would be most challenging to manage as a firm. **Chart 8** presents the results where the free-format answers have been grouped into the same categories as the key risks above. Answers to previous surveys have again been regrouped into the new categories to ensure comparability over time.

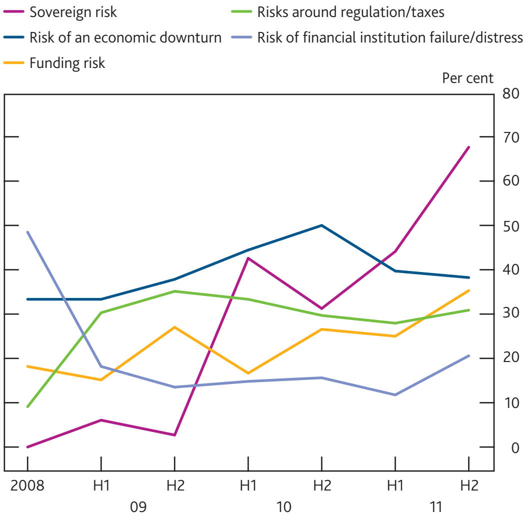
The risks that the largest proportion of respondents considered most challenging to manage as a firm were:

- Sovereign risk (68% of respondents).
- Risk of an economic downturn (38%).
- Funding risk (35%).
- Risks around regulation/taxes (31%).
- Risk of financial institution failure/distress (21%).

These risks are the same as the top five risks in **Chart 6**, but with sovereign risk more dominant. Compared with 2011 H1, more respondents had sovereign risk (+24 percentage points) and funding risk (+10 percentage points) in their top five risks they would find challenging to manage, and fewer had household/corporate credit risk (-9 percentage points) and the risk of financial market disruption/dislocation (-7 percentage points).

Risks listed may also be of concern if the number of respondents citing them as challenging to manage is large relative to the number citing them as a key risk. According to this measure, sovereign risk was still the main concern among respondents (the number of respondents citing the risk as challenging to manage was 88% of the number of respondents citing it as a key risk), followed by risks around regulation/taxes (81%) and the risk of financial institution failure/distress (78%).(1)

Chart 8 Risks most challenging to manage as a firm(a)(b)



Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) After respondents had listed the five risks they believed would have the greatest impact on the UK financial system if they were to materialise, they were asked which three of these risks they would find most challenging to manage as a firm. Answers were provided in free format and were subsequently coded into categories; only one category was selected for each answer. Chart figures are the percentages of respondents citing a given risk at least once, among respondents citing at least one key risk. The chart shows the top five categories; see the data appendix for additional categories.
(b) Risks cited in previous surveys have been regrouped into the categories used to describe the latest data.

(1) In this calculation, risks cited as key risks by less than three respondents have been excluded.

References

Burls, S (2009), 'Bank of England *Systemic Risk Survey*', *Bank of England Quarterly Bulletin*, Vol. 49, No. 3, pages 226–31.

Data appendix

The tables in this appendix in Excel format and the survey questionnaire are available on the Bank's website at www.bankofengland.co.uk/publications/other/srs/index.htm.

Table A1: Aggregate risks to the UK financial system[(a)]

	2008	2009		2010		2011	
		H1	H2	H1	H2	H1	H2
Probability of a high-impact event in the UK financial system in the short term[(b)]							
Very high	9	3	5	7	2	0	18
High	36	29	26	19	15	15	37
Medium	42	53	44	61	45	50	43
Low	12	15	26	13	34	35	3
Very low	0	0	0	0	5	0	0
Probability of a high-impact event in the UK financial system in the medium term[(b)]							
Very high	0	3	8	4	6	9	16
High	30	38	26	41	25	28	44
Medium	67	56	59	48	57	56	34
Low	3	3	5	7	12	6	6
Very low	0	0	3	0	0	1	0
Change in the probability over the past six months of a high-impact event in the UK financial system in the short term[(c)]							
Increased	55	18	3	31	15	26	88
Unchanged	24	24	41	50	57	57	10
Decreased	21	59	56	19	28	16	1
Change in the probability over the past six months of a high-impact event in the UK financial system in the medium term[(c)]							
Increased	64	15	15	41	23	21	69
Unchanged	33	53	49	52	55	66	29
Decreased	3	32	36	7	22	13	1
Confidence in the stability of the UK financial system as a whole over the next three years[(d)]							
Complete confidence	0	0	0	0	0	1	0
Very confident	36	15	13	7	12	12	15
Fairly confident	61	68	59	74	78	76	57
Not very confident	3	18	26	19	9	10	28
No confidence	0	0	3	0	0	0	0
Change in confidence over the past six months[(e)]							
Increased				19	25	10	3
Unchanged				61	65	79	35
Decreased				20	11	10	62

Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Entries are percentages of respondents and may not sum to 100% due to rounding.
(b) Respondents were asked for the probability of a high-impact event in the UK financial system in the short and medium term. From the 2009 H2 survey onwards, short term was defined as 0–12 months and medium term as 1–3 years.
(c) Respondents were asked how the probability had changed over the past six months for the short and medium term. From the 2009 H2 survey onwards, short term was defined as 0–12 months and medium term as 1–3 years.
(d) Respondents were asked how much confidence they had in the stability of the UK financial system as a whole over the next three years.
(e) Respondents were asked how their confidence had changed over the past six months. The question was asked from 2010 H1 onwards.

Table A2: Key risks to the UK financial system[a]

	2008	2009		2010		2011	
		H1	H2	H1	H2	H1	H2
Key risks[b]							
Sovereign risk	9	21	24	69	41	66	76
Risk of an economic downturn	36	61	65	67	83	69	76
Funding risk	18	33	32	30	39	43	57
Risks around regulation/taxes	27	33	49	41	45	32	38
Risk of financial institution failure/distress	85	33	11	22	17	18	26
Risk of financial market disruption/dislocation	45	24	32	30	27	31	19
Risk of property price falls	45	24	27	28	41	31	16
Risk of tightening in credit conditions	15	24	24	20	13	13	12
Household/corporate credit risk	12	36	49	17	19	25	10
Operational risk	21	18	8	13	17	15	10
Risk of loss of confidence in the authorities	3	9	3	9	6	7	10
Risk of infrastructure disruption	12	9	8	6	9	6	10
Inflation risk	6	9	14	13	9	19	6
Risk of lack of confidence in ratings, valuations and disclosure	12	18	8	11	2	4	4
Geopolitical risk	3	6	3	0	5	7	3
Risks surrounding monetary and fiscal policy[c]	12	3	24	9	8	12	1
UK political risk	0	0	3	17	8	6	1
Risks around public anger against, or distrust of, financial institutions	0	0	5	6	0	1	0
Other	12	9	8	9	9	3	7
Number one key risks[d]							
Sovereign risk	0	15	5	39	9	35	62
Risk of an economic downturn	15	24	35	31	48	35	13
Funding risk	6	12	14	4	13	9	7
Risk of loss of confidence in the authorities	0	3	0	2	2	0	6
Risk of financial market disruption/dislocation	12	3	5	4	3	3	4
Risk of financial institution failure/distress	55	12	3	2	5	4	1
Geopolitical risk	0	3	0	0	2	4	1
Risk of property price falls	6	3	3	4	2	3	1
Risks around regulation/taxes	3	3	5	7	5	1	1
Risk of infrastructure disruption	0	0	0	0	2	0	1
Risks surrounding monetary and fiscal policy[c]	0	0	8	2	2	1	0
Inflation risk	0	0	0	2	2	1	0
Operational risk	0	3	0	0	0	1	0
Household/corporate credit risk	0	15	14	0	2	0	0
Risk of tightening in credit conditions	3	0	3	0	2	0	0
UK political risk	0	0	3	4	0	0	0
Risk of lack of confidence in ratings, valuations and disclosure	0	3	0	0	0	0	0
Risks around public anger against, or distrust of, financial institutions	0	0	0	0	0	0	0
Other	0	0	3	0	5	0	0
Number of respondents citing at least one key risk	33	33	37	54	64	68	68

Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) Respondents were asked to list the five risks they thought would have the greatest impact on the UK financial system if they were to materialise, in order of potential impact (ie greatest impact first). Answers were provided in free format and were subsequently coded into the above categories; only one category was selected for each answer. Risks cited in previous surveys have been regrouped into the categories used to describe the latest data.
(b) Percentages of respondents citing each risk at least once in their top five, among those citing at least one key risk.
(c) This category also includes risks surrounding initiatives to support financial stability where there is an explicit taxpayer exposure, such as the Special Liquidity Scheme.
(d) Percentages of respondents citing each risk as their number one risk (ie the risk with the greatest potential impact), among those citing at least one key risk.

Table A3: Risks most challenging to manage as a firm[(a)(b)]

	2008	2009		2010		2011	
		H1	H2	H1	H2	H1	H2
Sovereign risk	0	6	3	43	31	44	68
Risk of an economic downturn	33	33	38	44	50	40	38
Funding risk	18	15	27	17	27	25	35
Risks around regulation/taxes	9	30	35	33	30	28	31
Risk of financial institution failure/distress	48	18	14	15	16	12	21
Risk of financial market disruption/dislocation	27	6	22	22	16	19	12
Operational risk	15	3	5	7	5	10	7
Risk of loss of confidence in the authorities	0	3	3	7	3	6	7
Risk of infrastructure disruption	6	6	5	4	6	4	6
Household/corporate credit risk	6	18	22	9	8	12	3
Inflation risk	0	0	5	6	6	4	3
Risk of lack of confidence in ratings, valuations and disclosure	6	9	3	7	2	3	3
Risks surrounding monetary and fiscal policy[(c)]	6	3	5	9	5	1	1
Risk of tightening in credit conditions	6	3	11	7	3	6	0
Risk of property price falls	18	6	5	6	8	4	0
Geopolitical risk	0	0	0	0	2	4	0
UK political risk	0	0	3	0	2	1	0
Risks around public anger against, or distrust of, financial institutions	0	0	3	2	0	1	0
Other	6	3	5	2	6	3	3
Cited at least one key risk, but did not cite any risk as challenging to manage (per cent)	0	3	0	2	2	0	0
Number of respondents citing at least one key risk	33	33	37	54	64	68	68

Sources: Bank of England *Systemic Risk Surveys* and Bank calculations.

(a) After respondents had listed the five risks they believed would have the greatest impact on the UK financial system if they were to materialise, they were asked which three of these risks they would find most challenging to manage as a firm. Answers were provided in free format and were subsequently coded into the above categories; only one category was selected for each answer. Risks cited in previous surveys have been regrouped into the categories used to describe the latest data.
(b) Percentages of respondents citing each risk as challenging to manage at least once, among those citing at least one key risk.
(c) This category also includes risks surrounding initiatives to support financial stability where there is an explicit taxpayer exposure, such as the Special Liquidity Scheme.

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