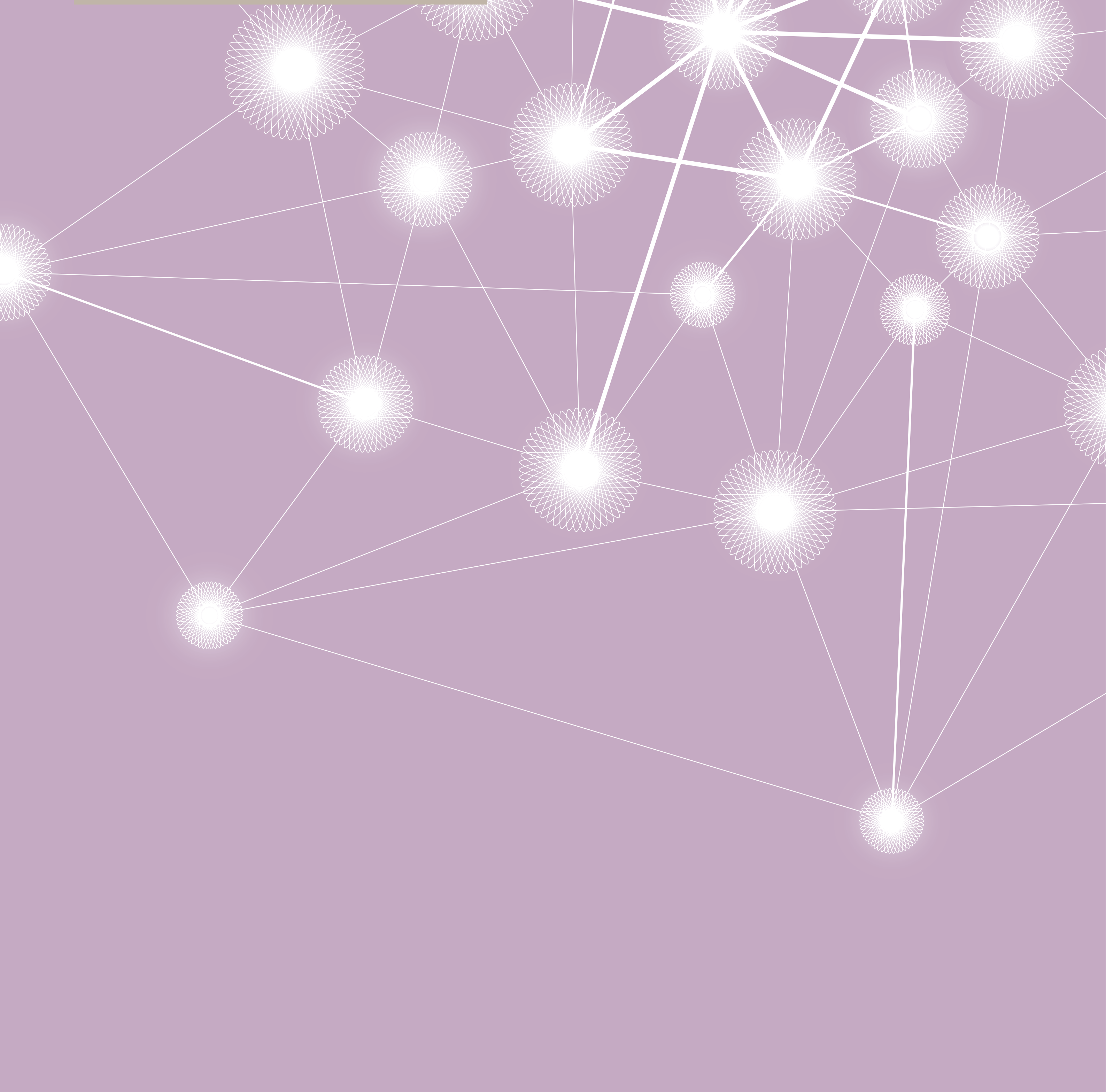
Systemic Risk Survey

Survey results | 2013 H2

BANK OF ENGLAND



BANK OF ENGLAND

Systemic Risk Survey

Survey results | 2013 H2

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 2013 H2 survey, which was conducted between 23 September and 24 October 2013.

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

- The perceived probabilities of a high-impact event in the UK financial system over both the short and medium term continue to fall, setting new lows since the survey began in 2008. 55% (+5 percentage points since May 2013) of respondents now consider the probability low or very low over the next year, 16% (+3 percentage points) between one and three years ahead.
- Confidence in the UK financial system has also risen. 18% (+1 percentage point) were completely confident or very confident in the stability of the UK financial system as a whole over the next three years, 78% fairly confident (+8 percentage points) and only 4% not very confident (-9 percentage points).

Key risks to the UK financial system

- Perceptions of the two main risks to the UK financial system remain sovereign risk and the risk of an economic downturn, although citations of both have fallen: 74% of respondents mentioned the former (-3 percentage points since May 2013) and 67% (-12 percentage points) the latter. Concerns over sovereign risk continue to focus on Europe, but unsurprisingly given the uncertainty surrounding US debt ceiling negotiations that prevailed during the survey period, there was a sharp increase in concerns around US sovereign risk.
- For the second survey in succession, risk surrounding the low interest rate environment was the fastest growing, with 43% of respondents citing it, up 17 percentage points since May 2013. Over half of the responses emphasised risks around low rates, with the remainder referring to risks associated with a snapback in those low rates to more normal levels. Perceived risk around property prices also rose, being mentioned by 36% of respondents, up 11 percentage points since the previous survey. Concerns were concentrated almost exclusively on the residential market, where responses focused on the risk of a house price correction.
- Other top risks include regulation/taxes (cited by 41% of respondents, up 1 percentage point since May 2013), financial institution failure/distress (+4 percentage points to 30%) and operational risk (+1 percentage point to 25%). Outside of the top seven, geopolitical risk has grown in prominence, with concern focusing on instability in the Middle East.

Risks most challenging to manage as a firm

- Six of the top seven key risks were also those listed as the most challenging to manage as a firm, but with a different ordering. Sovereign risk remains most widely cited as challenging to manage.

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 2013 H2 survey, which was conducted by the Bank of England in the period between 23 September and 24 October 2013. 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. Seventy-six market participants took part in the survey, representing a 99% response rate. Participants included hedge funds, banks, building societies, large foreign banks, asset managers and insurers. 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/Pages/other/srs/default.aspx. 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/Documents/quarterlybulletin/qb090305.pdf.

The publication date for the next *Systemic Risk Survey* is 9 June 2014.

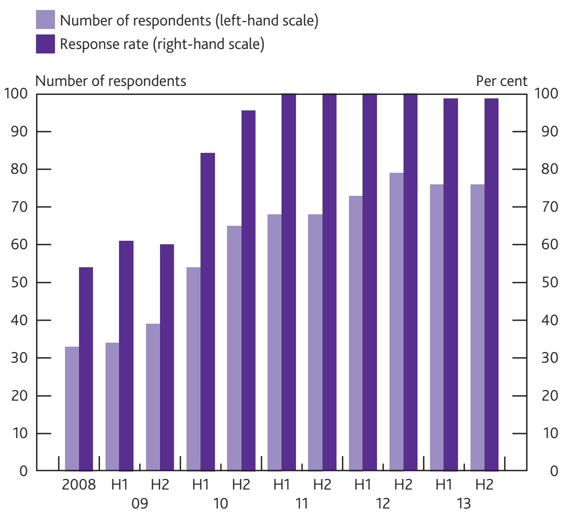
Systemic Risk Survey

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.(1)

The survey is typically completed by executives responsible for risk management at institutions including UK banks and building societies, large foreign banks, asset managers, hedge funds and insurers. Between 23 September and 24 October 2013, 76 participants took part, representing a 99% response rate (**Chart 1**). This report describes the results of the 2013 H2 survey.

Chart 1 Survey response rates(a)(b)



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*.
(b) 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.

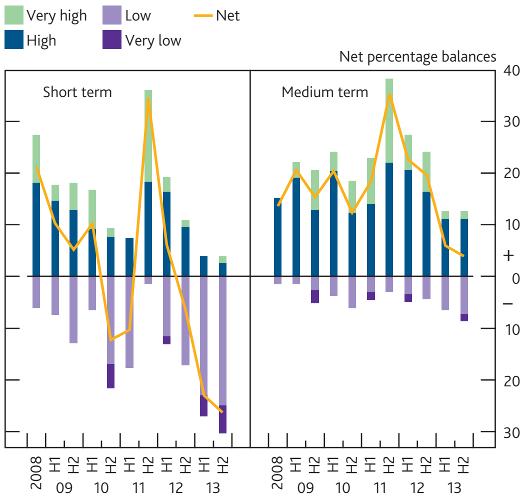
Probability of a high-impact event

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.(2)

In the 2013 H2 survey, the perceived probabilities of a high-impact event over both the short and medium term continued to fall, setting new lows since the survey began in 2008. These results were driven by an increase in the number of respondents considering the risk to be low or very low: in the short term, 7% of respondents consider the risk very high or high (down 1 percentage point since May 2013) but 55% now consider it low or very low (+5 percentage points). In the medium term, the same proportion as in May 2013 consider it high or very high (24%) but 16% (+3 percentage points) now consider it to be low or very low. **Chart 2** reflects these responses by weighting the probabilities into one measure.

These results tally with respondents' views on how the probability of a high-impact event had changed. For example, a large net balance of respondents (50%) thought the probability of a high-impact event in the short term had decreased (55%) rather than increased (5%) over the past six months.

Chart 2 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.

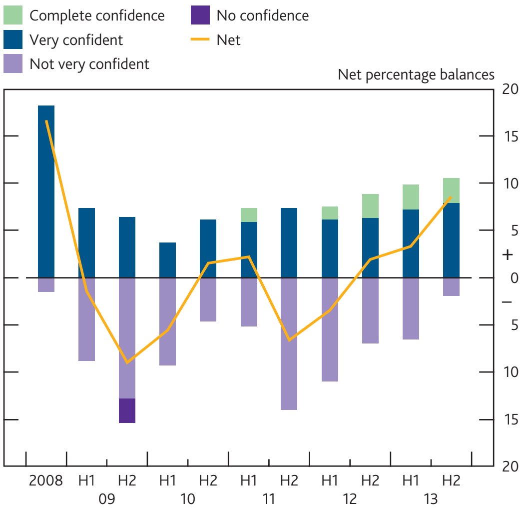
Confidence in the UK financial system

Confidence in the UK financial system has risen. 18% (+1 percentage point since May 2013) are completely confident or very confident in the stability of the UK financial system as a whole over the next three years, 78% fairly

(1) The *Systemic Risk Survey* has been undertaken biannually since 2009, following a pilot survey conducted in July 2008. It was published for the first time in November 2011. The survey results complement other sources of information used by the Bank to identify system-wide risks.
(2) Since the 2009 H2 survey, short and medium term have been specifically identified as 0–12 months and 1–3 years respectively. These terms were not explicitly defined in earlier surveys.

confident (+8 percentage points) and 4% not very confident (-9 percentage points). **Chart 3** reflects these responses by weighting the probabilities into one measure. Consistent with this, a net balance of respondents (28%) said their confidence had increased over the past six months (33% increased, 5% decreased).

Chart 3 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

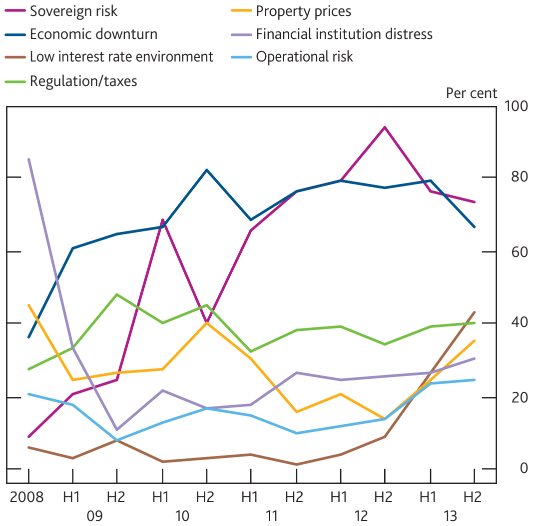
Turning to specific sources of risk to the UK financial system, respondents were asked to list the five risks they thought would have the greatest impact on the UK financial system if they were to materialise. Answers were provided in free format, but have been grouped into the 20 categories shown in **Table A2** in the data appendix to give an overview of the results.[(1)]

The seven risks most frequently cited in the 2013 H2 survey were (**Chart 4**):

- Sovereign risk (cited by 74% of respondents).
- Risk of an economic downturn (67%).
- Risks surrounding the low interest rate environment (43%).
- Risks around regulation/taxes (41%).
- Risk around property prices (36%).
- Risk of financial institution failure/distress (30%).
- Operational risk (25%).

The top seven risks are identical to those in the May 2013 survey. Outside of the top seven, geopolitical risk has grown in prominence, with 13% of respondents mentioning it (mainly focusing on instability in the Middle East), up by 8 percentage points to its highest level since the survey began. Household/corporate credit risk and the risk of a tightening in

Chart 4 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 in a free format and were coded into categories after the questionnaires had been submitted; 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 seven 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.

credit conditions have fallen back by 8 and 7 percentage points respectively.

The top two risks — sovereign risk and the risk of an economic downturn — were also those cited as having the greatest potential impact (ie respondents' number one risk) (**Chart 5**):

- Sovereign risk (39% of respondents viewed it as their number one risk).
- Risk of an economic downturn (25%).
- Risks surrounding the low interest rate environment (9%).
- Risks around regulation/taxes (8%).
- Risks around property prices (7%).
- Risk of financial institution failure/distress (3%).
- Risk of a loss of confidence in the authorities (3%).

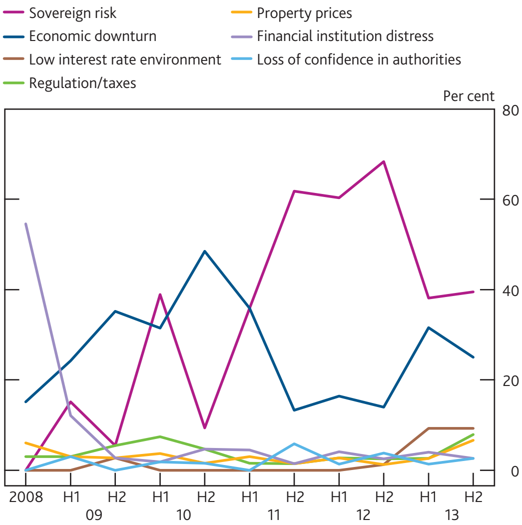
Agreement was therefore broad among survey respondents that the two largest impact risks for the UK financial system remained a crystallisation of sovereign risk and the risk of a further economic downturn.

Concerns over sovereign risk have dropped back further to the lowest point since 2011 H1. Responses continue to focus on Europe (mentioned in 65% of responses which indicated a particular region), but there was a sharp increase in concerns around US default, which were cited in just over 30% of these responses. This is perhaps unsurprising given the uncertainty over the likely outcome of negotiations on the US debt ceiling that prevailed during the survey period.

(1) These summary categories 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.

Worries about the risk of an economic downturn are down significantly since the previous survey (cited by 67% of respondents, down 12 percentage points). Risks to the global and UK outlooks were equally prominent (each cited in 41% of responses which indicated a region). 6% of these responses cited Europe, 5% the United States and 3% emerging markets and China respectively.

Chart 5 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 in a free format and were coded into categories after the questionnaires had been submitted; 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 seven 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.

For the second survey in succession, risk surrounding the low interest rate environment was the fastest-growing category, with 43% of respondents citing it, up from 26% in the previous survey. In allocating responses to different risk categories, the definition of this risk has been broadened out to include risks associated with a snapback in low rates to more normal levels as well as risks directly associated with low rates.(1) Just over 40% of responses specifically referred to a snapback in rates, with a couple of these responses pointing towards the potential impact of a sharp rise in interest rates on equity, property and credit markets. The remaining responses referred to risks associated with a prolonged period of low interest rates (for example, one specific response referred to the impact of negative real interest rates on investment behaviour).

Risk around property prices has also risen further since the previous survey, with 36% of participants citing the risk, up 11 percentage points since the previous survey. Concerns were concentrated almost exclusively on the residential market, where responses focused on the risk of a house price correction, with several respondents citing the risk of a bubble emerging in the near term.

Risks associated with regulation and/or taxes remained heavily cited, mentioned by 41% of respondents, up slightly on May 2013. The focus was on the potential negative impact of regulation, including excessive, inconsistent, or overly complex regulation, as well as on a loss of confidence in regulation.

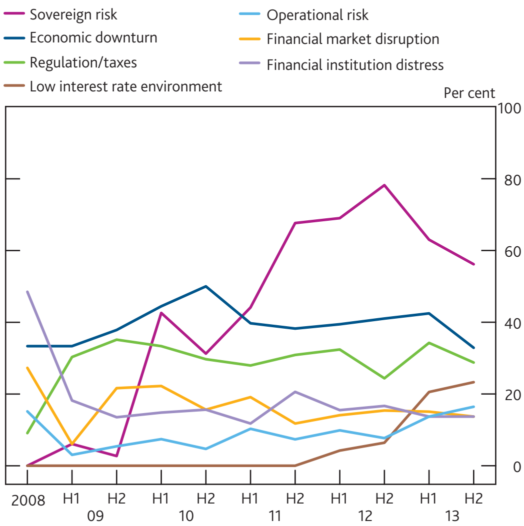
Risks most challenging to manage as a firm

Respondents were also asked which three of the key risks they had listed would be most challenging to manage as a firm. **Chart 6** presents the seven most cited risks, which remain the same ones as in the previous survey.

Respondents indicated they would find six of the seven risks from **Chart 4** the most challenging to manage. Risk around property prices does not appear in the top seven, indicating that this is perhaps easier to manage:

- Sovereign risk (56% of respondents).
- Risk of an economic downturn (33%).
- Risks around regulation/taxes (29%).
- Risks surrounding the low interest rate environment (23%).
- Operational risk (16%).
- Risk of financial market disruption/dislocation (14%).
- Risk of financial institution failure/distress (14%).

Chart 6 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 in a free format and were coded into categories after the questionnaires had been submitted; 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 seven categories only; 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) Previous survey responses have also been reclassified on this basis.

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/Pages/other/srs/default.aspx.

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

	2008	2009		2010		2011		2012		2013	
		H1	H2	H1	H2	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	3	1	0	1
High	36	29	26	19	15	15	37	33	19	8	5
Medium	42	53	44	61	45	50	43	40	46	42	38
Low	12	15	26	13	34	35	3	23	34	46	50
Very low	0	0	0	0	5	0	0	1	0	4	5
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	7	8	1	1
High	30	38	26	41	25	28	44	41	33	22	22
Medium	67	56	59	48	57	56	34	44	51	63	61
Low	3	3	5	7	12	6	6	7	9	13	14
Very low	0	0	3	0	0	1	0	1	0	0	1
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	27	11	7	5
Unchanged	24	24	41	50	57	57	10	48	54	54	39
Decreased	21	59	56	19	28	16	1	25	34	39	55
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	29	11	12	14
Unchanged	33	53	49	52	55	66	29	60	72	62	51
Decreased	3	32	36	7	22	13	1	11	16	26	34
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	1	3	3	3
Very confident	36	15	13	7	12	12	15	12	13	14	16
Fairly confident	61	68	59	74	78	76	57	64	71	70	78
Not very confident	3	18	26	19	9	10	28	22	14	13	4
No confidence	0	0	3	0	0	0	0	0	0	0	0
Change in confidence over the past six months[(e)]											
Increased				19	25	10	3	12	11	22	33
Unchanged				61	65	79	35	77	81	67	62
Decreased				20	11	10	62	11	8	11	5

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 what the probability of a high-impact event in the UK financial system was in their view, for both the short and medium term. In the 2009 H2–2013 H2 surveys, 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. In the 2009 H2–2013 H2 surveys, 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		2012		2013	
		H1	H2	H1	H2	H1	H2	H1	H2	H1	H2
Key risks[(b)]											
Sovereign risk	9	21	24	69	41	66	76	79	94	76	74
Risk of an economic downturn	36	61	65	67	83	69	76	79	77	79	67
Risks surrounding the low interest rate environment[(c)]	6	3	8	2	3	4	1	4	9	26	43
Risks around regulation/taxes	27	33	49	41	45	32	38	40	34	39	41
Risk around property prices	45	24	27	28	41	31	16	21	14	25	36
Risk of financial institution failure/distress	85	33	11	22	17	18	26	25	25	26	30
Operational risk	21	18	8	13	17	15	10	12	14	24	25
Risk of financial market disruption/dislocation	45	24	32	30	27	31	19	21	22	20	18
Funding risk	18	33	32	30	39	43	57	45	32	17	16
Other	12	9	8	9	9	3	7	1	1	9	13
Geopolitical risk	3	6	3	0	5	7	3	10	11	5	13
Household/corporate credit risk	12	36	49	17	19	25	10	14	14	18	11
Risk of infrastructure disruption	12	9	8	6	9	6	10	10	9	11	11
Risk of loss of confidence in the authorities	3	9	3	9	6	7	10	15	11	11	9
Risk of tightening in credit conditions	15	24	24	20	13	13	12	16	16	14	8
Risks surrounding monetary and fiscal policy	6	0	19	7	6	7	0	5	4	5	8
Inflation risk	6	9	14	13	9	19	6	5	5	7	7
UK political risk	0	0	3	17	8	6	1	3	5	4	5
Risks around public anger against, or distrust of, financial institutions	0	0	5	6	0	1	0	0	10	1	1
Risk of lack of confidence in ratings, valuations and disclosure	12	18	8	11	2	4	4	4	1	0	0
Number one key risks[(d)]											
Sovereign risk	0	15	5	39	9	36	62	60	68	38	39
Risk of an economic downturn	15	24	35	31	48	36	13	16	14	32	25
Risks surrounding the low interest rate environment[(c)]	0	0	3	0	0	0	0	0	1	9	9
Risks around regulation/taxes	3	3	5	7	5	1	1	3	3	3	8
Risk around property prices	6	3	3	4	2	3	1	3	1	3	7
Risk of financial institution failure/distress	55	12	3	2	5	4	1	4	3	4	3
Risk of loss of confidence in the authorities	0	3	0	2	2	0	6	1	4	1	3
Risk of infrastructure disruption	0	0	0	0	2	0	1	0	1	3	1
Risk of financial market disruption/dislocation	12	3	5	4	3	3	4	3	0	3	1
UK political risk	0	0	3	4	0	0	0	0	0	3	1
Funding risk	6	12	14	4	13	9	7	5	4	0	1
Other	0	0	3	0	5	0	0	0	0	0	1
Risks surrounding monetary and fiscal policy	0	0	5	2	2	0	0	1	1	1	0
Operational risk	0	3	0	0	0	1	0	0	0	1	0
Geopolitical risk	0	3	0	0	2	4	1	1	0	0	0
Inflation risk	0	0	0	2	2	1	0	1	0	0	0
Household/corporate credit risk	0	15	14	0	2	0	0	0	0	0	0
Risk of tightening in credit conditions	3	0	3	0	2	0	0	0	0	0	0
Risk of lack of confidence in ratings, valuations and disclosure	0	3	0	0	0	0	0	0	0	0	0
Risks around public anger against, or distrust of, financial institutions	0	0	0	0	0	0	0	0	0	0	0
Number of respondents citing at least one key risk	33	33	37	54	64	68	68	73	79	76	76

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

(a) Respondents were asked which five risks they believed 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 a 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 risk.
(c) In this publication, the definition of this risk has been broadened out to include risks associated with a snapback in low rates to more normal levels, as well as risks directly associated with low rates.
(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)]

	2008	2009		2010		2011		2012		2013	
		H1	H2	H1	H2	H1	H2	H1	H2	H1	H2
Sovereign risk	0	6	3	43	31	44	68	69	78	63	56
Risk of an economic downturn	33	33	38	44	50	40	38	39	41	42	33
Risks around regulation/taxes	9	30	35	33	30	28	31	32	24	34	29
Risks surrounding the low interest rate environment[(b)]	3	3	0	2	2	0	1	4	6	21	23
Operational risk	15	3	5	7	5	10	7	10	8	14	16
Risk of financial market disruption/dislocation	27	6	22	22	16	19	12	14	15	15	14
Risk of financial institution failure/distress	48	18	14	15	16	12	21	15	17	14	14
Risk around property prices	18	6	5	6	8	4	0	4	3	10	14
Risk of infrastructure disruption	6	6	5	4	6	4	6	7	6	8	10
Funding risk	18	15	27	17	27	25	35	23	18	7	7
Risk of loss of confidence in the authorities	0	3	3	7	3	6	7	8	8	4	7
Risks surrounding monetary and fiscal policy	3	0	5	7	3	1	0	4	4	3	5
Other	6	3	5	2	6	3	3	0	1	3	5
Risk of tightening in credit conditions	6	3	11	7	3	6	0	7	1	5	4
UK political risk	0	0	3	0	2	1	0	1	1	4	4
Household/corporate credit risk	6	18	22	9	8	12	3	4	6	8	3
Geopolitical risk	0	0	0	0	2	4	0	6	5	3	3
Inflation risk	0	0	5	6	6	4	3	1	3	5	1
Risks around public anger against, or distrust of, financial institutions	0	0	3	2	0	1	0	0	3	0	1
Risk of lack of confidence in ratings, valuations and disclosure	6	9	3	7	2	3	3	0	0	0	0
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	3	1	4	4
Number of respondents citing at least one key risk	33	33	37	54	64	68	68	73	79	76	76

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 a 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. Table entries are the percentages of respondents citing each risk at least once in this second question, among those citing at least one key risk.
(b) In this publication, the definition of this risk has been broadened out to include risks associated with a snapback in low rates to more normal levels, as well as risks directly associated with low rates.

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