HOUSE OF LORDS

Financial Services Regulation Committee

Uncorrected oral evidence: Growth of private markets in the UK following reforms introduced after 2008

Tuesday 21 October 2025

11.30 am

Watch the meeting

Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Baroness Donaghy; Lord Eatwell; Lord Hollick; Lord Lilley; Baroness Noakes; Lord Sharkey; Lord Smith of Kelvin; Lord Vaux of Harrowden.

Evidence Session No. 10 Heard in Public Questions 107 - 122

Witnesses

I: Andrew Bailey, Governor of the Bank of England; Sarah Breeden, Deputy Governor for Financial Stability at the Bank of England.

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Examination of witnesses

Andrew Bailey and Sarah Breeden.

Q107 **The Chair:** Welcome to today's meeting, the 10th oral evidence session as part of the committee's inquiry into the growth of private markets in the UK following the reforms introduced after 2008. I thank the governor and the deputy governor for attending. The session is open to the public, is broadcast live and is subsequently accessible via the parliamentary website. A verbatim transcript will be taken of the evidence and will be put on the parliamentary website. A few days after this session, you will be sent a copy of the transcript to check it for accuracy, and it would be helpful if you could advise us of any corrections as quickly as possible. If after this evidence session you want to clarify or amplify any points made during the evidence or have additional points to make, you are welcome to submit supplementary written evidence to us. Do you want to make an opening statement, Governor?

Andrew Bailey: No, I was not planning to*.*

The Chair: In which case, I will get on with the first question. We have heard that, post 2008, bank capital and liquidity regulatory requirements have squeezed the balloon, moving risk outside the banking system and the regulator's collective oversight. The collapse of First Brands Group and Tricolor Holdings in the US has brought that problem into sharp focus. What reassurances can you provide to the committee in the light of these developments, given that there seems to be a degree of regulatory arbitrage going on here? Are we in danger of, "Here we go again"?

Andrew Bailey: There are a number of parts to that question, if you do not mind me saying so. I will have a go at answering and I am sure that Sarah will come in to try to separate them out and go through them.

Let us start with the first question, which is: was there a regulatory arbitrage, what were the consequences and what lay behind that? I will then come on to the question of First Brands and Tricolor after that.

I do not think there was a regulatory arbitrage but I can understand why it is a question that that comes up. First of all, if you go back to 2008-09, we obviously inherited a banking system that had been through a very severe financial crisis. One of the causes of that financial crisis was that it was undercapitalised. As a consequence of that, it had exposures to assets that were not consistent with the purpose of banking. I will come back to that point in a moment.

In the period after that, from 2008-09 through to about the middle of the next decade, we had a rebuilding of capital in the banking system, or in some ways a building of capital in the banking system. It is true to say that, when you look at the pattern of bank lending to companies in this country, it was during that period that there was a shift in the mix between banks and non-banks. In other words, the total share of bank lending in total corporate lending went down and the share of non-banks went up. That was a period where we started with a banking system that was undercapitalised and saw it rebuilt.

Since then, it has been pretty constant in terms of share. There are two points I would make about that period. The first is that that period where we were rebuilding capital and banks were clearly reducing their share of lending to non-banks illustrates the problem, in a sense, that as banks were having to take steps to constrain their balance sheets and rebuild them, and the system was not effectively capitalised, there was a consequence in terms of lending to the corporate sector. That is what we want to avoid. The regulatory system is designed to support the economy. We were seeing an economic effect at a time when the banking system was, in effect, not capitalised; we were having to rebuild it.

The second big point is: is there an arbitrage? I can understand why, when people look at the treatment of the lending side, they say, "Well, it's different between banks and non-banks". But I would argue very strongly that that is not the purpose of the regulated system. The purpose of the regulatory system is on the liabilities side. Here is the big distinction. The non-bank sector is there, in a sense, to fund investment in the economy and to take risk. The reason I say that is because the liability side of the non-bank sector should therefore reflect that risk in the sense that the value of the investment is in no sense guaranteed. You can make profits, obviously, you would hope to make profits and you would hope to increase the value of your investment, but you can lose money as well. It is not the same thing in the banking system. In the banking system, the liability of the banking system is money. It is deposits, it is money.

The core point about the liability of the banking system is that the nominal value of the money in the bank—of the deposits—is assured. People want to know that their money—their bank deposit—is assured. Indeed, this supports payments. If I am going to pay money to you, we want to know that £1 in my bank account is going to be worth the same as £1 in your bank account and go on being so while the payment is happening. That lies at the heart of why we regulate the banking system differently, in my view.

Let me come on to First Brands and Tricolor. Obviously, we have seen the growth of private finance, and we can happily talk about that. I am sure we will have more questions on those two, but the opening point I would make on this is that the big question today—we were both in Washington last week and this was obviously very much a subject of conversation—is: are these cases idiosyncratic or are they what I call the canary in the coal mine? In other words, are they telling us something more fundamental about the private finance, private assets, private credit and private equity sectors, or are they telling us that in any of these worlds there will be idiosyncratic cases that go wrong?

That is still a very open question. It is an open question in the US. It is a question we have to take very seriously. We will obviously be adding this to the work we are already doing on private finance. I will end by saying, and I do not want to sound too foreboding at this point, that the added reason that this question is important is that if you go back to before the financial crisis, when we were having this debate about subprime mortgages in the US, people were telling us, "It's too small to be systemic. It's idiosyncratic". That was the wrong call. I am not saying that therefore the call should be the same this time, but it underlines why the question is apposite.

The Chair: So, on that point, you are rather hobbled by the known unknowns?

Andrew Bailey: There is a lot that we do not know about First Brands and Tricolor at this point in time, yes.

Sarah Breeden: The reason why we are particularly focused on those two defaults is because they illustrate some of the risks we have been talking about in this market for some time. It is about high leverage, opacity, complexity and weak underwriting standards. They are things we were talking about in the abstract as a source of vulnerability in this bit of the financial system, and they appear to have been at play in the context of those two defaults. We have seen banks say that they have lost money off the back of those defaults, which goes to the interconnections between this bit of the non-bank finance world and the banking system.

Andrew Bailey: To draw out the point about interconnections that Sarah has just made, you could reasonably say that if we have separated the world of investments and the world of money, then why does it matter if these things happen? That is a fair point. It matters not because they are investments but rather if the interconnections are going to cause the spread of this thing into the core of the system.

Q108 **Lord Sharkey:** Marc Rowan of Apollo has raised concerns over what he characterised as a "race to the bottom" in lending standards of the US private credit market. Apollo, of course, is funding EDF with a loan of £4.5 billion, unsecured, ranking with its other debts, and characterised as having non-trivial exposure to construction delays. It has also put it into one of its captive life insurance companies. Do you have any concerns with the culture and risk management in private markets, as Mr Rowan clearly does, and, as you said, with the connections with the banking system, such as indirect lending?

Andrew Bailey: I know Mr Rowan well and he is of course a major player in these markets. We are seeing, if you do not mind me saying so, a degree of finger pointing going on already at the moment. The job of us as the authority is to get to the bottom of it and find out what we know.

To pick up on a very important point you made about life insurance, this is another important part of this story in two respects, both of which are related to the life insurance industry. The first is that we have seen a growth, and we have published on this quite a bit in recent times, in what we tend to call funded reinsurance—in other words, life insurance, which, by the way, is of course in some ways a natural acquirer of these assets, because life insurers need long-term assets. So, in principle, there is nothing silly about life insurers having long-term illiquid assets of the sort that you can find in the private credit world or private equity world. We have seen a growth in funded reinsurance, where, again, there is a sense of regulatory arbitrage going on, where the contracts are reinsured into other financial centres, and then investments are made in these types of assets, particularly in the US.

The second is that we are seeing—again, I am not surprised by this; it is not me ringing a warning bell but something we have to just have in mind and be very alert to—private finance now acquiring life insurers in the sense of owning them. Again, this is not a ridiculous proposition, because they have assets they want to find homes for, and life insurance wants those sorts of assets. So it is not entirely surprising that this is going on. But again, we have to be very careful on things such as, for instance, conflicts of interest that might start to come in.

Sarah Breeden: On your point about risk management standards, that is not unrelated to the opacity in this market. There is not the same bright light shone on what is happening in terms of underwriting standards and the degree of leverage. In that context, different firms could well have different standards of risk management, which was something the FCA found when it did its work on transparency of valuations in the private equity ecosystem. In the context of a competitive market, there is obviously an incentive to compete on risk management standards. For us, being really clear that trying to get beneath that opacity, as insurers and banks deal with this bit of the financial system, is a really important part of our work as regulators of banks and insurers.

Lord Sharkey: We will come on to the issue of transparency later in the conversation.

Q109 **Lord Hollick:** The arbitrage, as you correctly pointed out, is partly around the appetite for risk. One of the themes that has been running through the work of this committee over the last 18 months or so is that the risk appetite of the traditional banking sector has diminished, particularly since 2008, and that that change in attitude has seriously reduced the availability of credit and finance to the real economy, which, as you correctly point out, is the purpose of what we are trying to do.

So, first, has the regulated banking side, the traditional side of the bank, become too risk averse? Secondly, related to the question you have just been discussing, are you satisfied that we can, at this stage, in the absence of a lot of information and clarity about the interconnectedness, take a relaxed view of the risks that are inherent to the private finance sector? As you pointed out, they are not systemic, at least on the information we have. However, as far as protecting the investor is concerned, there are some fairly racy risks being taken by pension funds—by other investors on their behalf—and that is obviously another concern that a regulator will have.

Have we become too risk averse on the one side and, on the other side, are we not taking sufficient notice of the new risks arising in private finance?

Andrew Bailey: That is an interesting point you make. I will try to enlighten it a bit. You have drawn out the point about the dilemma that you can have, with both sides of this argument going on at the same time. They are not wrong to go on at the same time; it is fair enough.

On the question of lending, or financing, there is an interesting contrast in there. To put my monetary policy hat on for a moment, we spend a lot of time going around the country and talking to firms. One of the things that does not really come up is a lack of supply of lending. That is quite consistently not a point that we are getting from firms in this country, or that comes up in our credit conditions surveys either.

On the whole, firms do not say they are struggling to raise money that they want to raise. I put the emphasis on "want to" because the second leg of this is that, when you look at the record of investment in this country at the macroeconomic, economy-wide level, I think we have a problem. We have a low level of investments in the real economy, particularly in the business side of the real economy, by international standards, over a very long period of time, going back 20 or 30 years at least. Those two things do not, on the face of it, sit very well together as observed pieces of the picture.

I think that there is an equity story. I am of the same view as successive Governments in that I think the share of investment in risk capital and the real economy that pension funds are taking in this country is too low. That has structural features to it with regard to the organisation of the pension industry in this country, and I think both the previous and current Governments are right to have the objective of seeing reforms that will, hopefully, free up equity investment, which is what we are talking about, not debt investment.

On the other side of the question, about risk and risk-taking, I will come back to two points that we have already touched on. The first is that the reason for drawing the distinction between money and investment is to enable risk to be taken in ways that might not be consistent with the need to have an assured nominal value of money. In other words, it is not wrong to develop an investment sector that is not connected to the banking system. But that does not get away from the point that Sarah just talked about, which is that there may still be problems in the way that is being done. Again, we come back to First Brands and Tricolor and what exactly that is telling us. We are certainly beginning to see, for instance, what used to be called slicing, dicing and tranching of loan structures going on. If you were involved before the financial crisis and during it, alarm bells start going off at that point. I sat in a session with people from the private equity and private credit world some months ago. Of course, they told me that everything was fine in their world, apart from the role of the rating agencies. I said, "We are not playing that movie again, are we?"

Again, this is not a criticism per se of rating agencies: it has already been said, I think, in terms of First Brands and Tricolor, that there were AAA-rated tranching structures being put together. Well, we remember that that stuff was a feature of the financial crisis, so we have to use these two cases as another reason to have more drains up, frankly, in terms of how this thing is structured and what these interconnections might be.

Lord Hollick: At your meeting in Washington last week, did other countries share the same anxieties about private finance?

Andrew Bailey: Yes.

Lord Hollick: Was there any output from that meeting as to what should happen?

Andrew Bailey: Because I do not have enough to do, I have taken on chairing the global Financial Stability Board. It was already part of our work plan, but it will be even more important going forward. The answer is yes.

Sarah Breeden: If I might add to that, I am a member of one of the sub-committees of the Financial Stability Board that does analysis of vulnerabilities. We already had work in hand, before the recent defaults, looking at the links between the private equity ecosystem—private credit in particular—and the banking system. We will be looking to expand that to think about issues more broadly, including insurers, pension funds, the role of rating agencies and the like.

Q110 **Baroness Bowles of Berkhamsted:** You have talked about your recent meetings in Washington. The IMF's recent *Global Financial Stability Report* raised concerns that the strong nexus of non-bank financial intermediaries, including private markets, increases the risk of contagion. This is not new; we all knew this. Given that the 2008 crash began outside the banks, with sub-prime mortgages, Lehman and the monoline insurer AIG, what is the Bank's assessment of current developments—particularly the increasing interconnections between private markets and banking, which I think we have accepted are happening? In the light of the policy fashion globally for there to be more investments in private markets—our pension funds are being encouraged to do that, of course; our pension providers, insurers and so on will, therefore, be increasing their exposures—what additional risk is that bringing?

I suppose a topical question that I could add is whether we should also think about the role of intermediaries such as brokers, which have helped to contribute, shall we say, to the car finance issue. You have had some warnings in your own working papers that the FCA rules may be encouraging brokers always to offer short-term mortgages. Is that some future consumer issue in the making that will cost billions?

Sarah Breeden: How about I talk through the private equity and private credit work that we have doing so far?

The first thing I would say is that we first started talking about these highly leveraged corporates in 2019. We first brought leverage lending, and the Bank's exposure to that, into our stress test in 2019. Since then, we have done further work to understand the broader set of links between this bit of the financial system and the banking system. We have quite good visibility into that, because we regulate the banks, so we can look to understand the Bank's exposure to the corporates and understand not only the leverages at the corporate level but the leverage at the fund level, as well as what exposures there are to the private equity sponsors. We did a really deep piece of work and wrote, in April 2024, a public letter to the banks setting out how they need to manage their interconnections in this bit of the ecosystem better.

The second thing that we have been doing is double-clicking on the insurance company links with private equity and private credit. As Andrew said, the role of funded reinsurance has been a particular focus. Indeed, we put out a set of supervisory expectations seeking to limit the links between funded reinsurers—the reinsurers who are invested in private credit—and the UK insurers who are ceding their business to them. That has been an important part of our work as well.

Importantly, one thing that we are seeking to do, which speaks to your broader point, is to think about this at the level of the system—that is, to bring in the pension funds and so on as well. What we are doing right now is working with all of the participants in this ecosystem—the banks, the insurers, the private equity companies themselves and pension fund investors—and seeking to pull together another system-wide exploratory scenario. That will look to apply an economic stress to this complex set of interconnections in order to try to drive through and understand where the losses might arise as part of that. I think that that speaks to the challenge.

The Chair: Is that what Bloomberg is reporting this morning?

Sarah Breeden: I have not seen Bloomberg's report, but it sounds plausible.

Andrew Bailey: I want to make just one big-picture point; I will use a parallel example to illustrate it. It is important that we enable risk to be taken in the economy. Let me give an example. We have warned recently—as have others, including the IMF—on the question of whether valuations are now very stretched in the world of AI investment. The reason why that could be true is that those valuations are a reflection of what the markets think are the future earnings of this industry, and they could well be becoming too stretched. I also made some remarks on Saturday in Washington about the need to support innovation and investment in this sector, because it is the most likely next thing that will increase the productive potential of the economy and the potential growth rate of the economy; we need those things very badly.

These two things are not inconsistent. We need this investment, and we need risk to be taken to support the productive potential of the economy and to increase the potential growth rate. We still have to warn where we think there are risks growing in the financial system, because there may need to be some adjustment, but it is important not to take away from the fact that we need risk-taking to happen.

Sarah Breeden: If I may, the aim of the system-wide exercise is to shine a light on what is currently opaque and to try to understand the complexity so that, with the potential for those high degrees of leverage and the losses that those might create in economic stress, we understand, ex ante, where they might fall.

Baroness Bowles of Berkhamsted: Is not one of the biggest problems likely to be not necessarily actual losses but losses through, perhaps, liquidity? A liquidity crunch is quite likely if you have a lot of hard-to-sell assets.

Sarah Breeden: That goes to an important point about the private equity ecosystem, which is that funding here is long-term funding. They are not runnable liabilities in the way we have for banks. As we saw crystallise in the financial crisis, one of the big reasons for this sort of finance developing is that it has long maturity and is flexible; it is therefore appropriate for these higher-risk corporates. Again, through this process we will be able to see whether that liquidity risk is there. That will be part of what we test.

This also relates to the question of whether these sorts of products become available to the retail market, because retail investors will expect liquidity. Currently the institutional investors here might be quite happy to have their funds locked up for a period of time, enabling the investments to ride out an economic cycle, but if retail investors become involved then maybe those liquidity issues may come more to the fore. Again, that is something we will look to explore.

Baroness Bowles of Berkhamsted: There is a toe in the water with LTAFs, is there not? There is the question of whether they are going to have much longer than three-month notice periods. We do not know what the appetite for that is going to be.

Sarah Breeden: Exactly. That is trying to create a vehicle that suits the nature of the investment.

Q111 **Baroness Noakes:** Can I follow up on the proposal to carry out another system-wide exploratory stress test? The last one reported less than a year ago, when you said you would be investing in further modelling and data to try to understand what was happening because you accepted that they were expensive and time-consuming exercises to carry out. What has made you decide to do another one so quickly after that? Is it because of the failure of these other things, like data gathering and modelling, or because something else has changed?

Andrew Bailey: We are looking at different things in them. The first one was focused very much on leverage in core markets—government bond markets. When you look at government bond markets in all the major economies, ours included, you see that the nature of those markets has changed dramatically in the last decade. There is the presence of non-banks and hedge funds, and the degree of leverage in those markets is vastly changed. That is what the exercise was focused on. I always characterise them like this. These are what I would call flow stress tests rather than stock stress tests. In the bank stress tests, you freeze it, stress it and see what happens. These are flow tests, in the sense that you put a stressor into the system. We have to get voluntary participation in these exercises; we cannot do them otherwise. We got 50-odd firms of various sorts participating. So the firm acts as the hub. You do not have to share information with each other. We will give you the stress, you tell us how you will react and we will aggregate that. We can then tell you, "You might think you were going to do that but, let us tell you, it wouldn't have worked". Out of that, we can spot where the points of stress are in the system.

So that was aimed at the government bond market, hedge-fund world. This one will be aimed at the private equity, private credit world, and they are completely different worlds. It is using the same sort of idea and somewhat similar toolkit but in a different setting.

Sarah Breeden: I emphasise that this is a voluntary exercise. We have been talking to the firms involved, asking them if they would find it valuable to participate, and they have been willing to do so.

The Chair: Why are you emphasising that point?

Sarah Breeden: Because it is important for us to recognise that the value of exercises like this is that we think about how the actions combine. It is about whether a private equity investor will get to learn through this. It will understand how the underlying institutional investors will react when a stress hits, so they will get some useful information out of the exercise as well as us.

Andrew Bailey: But, as a matter of practicality, we do not regulate that world, so we do not have any powers to go in and demand that they do it.

The Chair: But you are not getting any resistance?

Sarah Breeden: No.

Q112 **Lord Eatwell:** I apologise for stepping out just now. One always gets a coughing fit when the tenor is about to sing his latest aria. The notion of system-wide exploratory scenarios is interesting and exciting, really—I certainly find it exciting. That the FSB should be involved is important; after all, the system is not just a UK system but a global system that impinges on the UK. What I was trying to puzzle about was this. Once we have this picture and we have penetrated some of these opaque systems, what sort of criteria do we have for judging whether, in the words of *1066 and All That*, they are a good thing or a bad thing? You now have a cost-benefit analysis entity within the Bank, but I have always been puzzled as to how that could possibly work since one cannot measure the benefit, which is the reduction or increase in systemic risk. Cost-benefit analysis cannot work because you can look at the costs but not at the benefits. That therefore tends to give the biased view that there are terrible costs here but we do not know what the benefits are, or whatever it might be. What criteria would be applied to informing this committee, the public or whoever whether these developments were deemed to be beneficial to the UK or detrimental?

Andrew Bailey: I agree with you up to a point on cost-benefit analysis. It has a part to play, but you are right that if we were to invest it with the idea that it was the font of all knowledge then we would be going wrong, and I shall give you the reason why. It is not new, in many ways. All the big regulatory changes that were done post crisis were subject to cost-benefit analysis, but I can tell you what happened then: essentially, the cost of the financial crisis was put on one side of the balance sheet, and you can do a lot of things if you start from that position. The debate that we are now having, which I may come on to if you want, is about whether we overdid it in that period. The cost-benefits that were being done at that point in time were reflecting a valuation of the cost of the financial crisis. I think I agree with you that we have to be careful there and say that there are various judgments you can make on what are appropriate costs and benefits in that sense, so it is useful and an important thing to do. It is a good discipline, but we should not invest it with the idea that it is the font of all knowledge.

Lord Eatwell: So how are you going to judge?

Andrew Bailey: We have to use a variety of tools. The system-wide exploratory scenario is one tool, and the responsibility is on us to develop more.

You mentioned the Financial Stability Board. We could not actually do a system-wide scenario at that level; a multilateral institution like the FSB does not have the data-sharing powers. Interestingly, we are the only people who have done one so far, and it reflects the fact that, because obviously we have such a very big financial sector—

Sarah Breeden: And a global one.

Andrew Bailey: —and a global one, operating in the UK, we have access to these firms that many others do not have.

Lord Eatwell: Does BIS not have that sort of data?

Andrew Bailey: No, it would not have firm-level data in that way.

Sarah Breeden: If I might try to rise to your challenge about what good looks like at the end of this, I hope that we would be able to come up with an answer to the question, "Is a shock here likely to be contained or likely to, sub-prime-like, spiral in an amplifying way?". As Andrew described at the start, we can see the vulnerabilities here—the opacity, the leverage, the weak underwriting standards, the interconnections—and parallels with the GFC. What we do not know is how macro significant those issues are. I hope that we would be able to answer the question, "Are these risks of a level that are macro relevant, or would a stress here be something that can be absorbed?".

The other thing that we can look to do, to go back to the point that was made earlier, is identify where risk management might be improved—that is, whether a particular set of connections is not being well managed or aspects of underwriting are not being well examined. Those are the sorts of things that I hope this exercise will show concretely.

Andrew Bailey: Last year, the PRA issued what we call a "Dear CEO" letter, which is a public letter, to banks, based on its work in this area. It said that it had found that the standards of the ability of firms to aggregate and, therefore, to risk-manage exposures across the private finance sector as a whole were not what the PRA thought they should be.

Sarah Breeden: So we will be able to see whether they have improved.

The Chair: What is the timetable for when you can answer that question?

Baroness Noakes: Was that a "Dear CEO" letter or a "Dear CRO" letter?

Sarah Breeden: It was a "Dear CRO" letter.

Andrew Bailey: I am sorry; it was a "Dear CRO" letter.

Sarah Breeden: On the timeline, we are hoping to make an announcement later this year. The period of time that it will take us to undertake the exercise will probably be similar to the last one, which took around nine to 12 months.

Andrew Bailey: We usually do it in two rounds. The reason is that you learn a lot in the first round that you wish you had known when you started the first round. So we then tweak it for the second round.

The Chair: So, Christmas 2026?

Andrew Bailey: Probably.

Sarah Breeden: Hopefully.

Q113 **Lord Lilley:** Prior to the great financial crisis in 2008, the British economy was growing at roughly the same rate as the United States economy. Since then, the United States economy has recovered to its previous rate of growth but our economy has gone to a very sluggish level of productivity and growth. Why is that?

You can explain a divergence between the two economies only by a divergence in events happening subsequent to 2008. Two possibilities present themselves. One is that it was a divergence in financial policy—that is, we required a much greater rebuilding of reserves and tighter reserve requirements on our banks than the Americans, who applied it to systemic banks only and have only 800 regional banks. This might explain why their growth of credit went back to the previous level where ours did not.

The other possibility is that we, from about then, have progressively increased the cost of energy to our economy while they have progressively reduced the cost of energy to their economy. Which of those factors do you think is the most important, or are there other factors that I have omitted?

Andrew Bailey: There is another factor. I made some remarks on this in Washington on Saturday. By the way, the UK economy looks not unlike many other industrialised economies, but you are right that it does not look like the US economy.

Pre financial crisis, our potential growth rate was around 2.5% a year. Since the financial crisis, it has been about 1.5%. The point I made on Saturday was that this makes a lot of difference to economic policy-making. Look at all of the debates about fiscal policy at the moment. I did a very naive calculation in that speech and said, "Assume that we'd had the same fiscal policy throughout this period but the 2.5% growth rate had continued in the last 15 years". There is a difference in the debt-to-GDP ratios of over 10%; it is not on an increasing trend but, rather, on a shallow declining trend, if you continue to apply that.

Interestingly, when you look at the US economy, if you take the tech sector out, the US economy does not look very different to the rest of us. The big difference is the tech sector in the US economy. First, I should have said that two things make up the potential growth rate of the economy: productivity and labour supply. The post-2008 decline has most obviously been a story about productivity, which you can obviously trace back to investment quite easily. Labour supply goes up and down but it does not look like the main source of the story. The difference with the US economy is that it has a very big tech sector, which has grown, and it has big investment going on in that sector. That stands out as the major difference.

Your point about energy costs is right. One of the things where the UK stands out—certainly as compared to continental Europe but, I think, as compared to the US as well—is that business electricity costs in particular are higher in this country. That is a slightly different to the subject of today but it is a factor that stands out.

On the point about banking regulation, certainly for the major banks, the US situation is really not different to ours. However, as I said, there is a very big difference in the tech sector.

Lord Lilley: Is the tech sector largely financed by banks?

Andrew Bailey: In the US?

Lord Lilley: Yes.

Andrew Bailey: It is a mixture, I think.

Sarah Breeden: Historically, it has been venture capital—equity investment—that has supported the growth in the US tech sector. We are probably at a bit of an inflection point at the moment: rather than investing in coding and AI, people are investing in data centres, racks and chips. So there is a pivot point now where debt investment is increasingly important from here.

Looking backwards, I would say that it has mainly been a story of equity investment and scale-up finance.

Lord Lilley: That is very much my impression. So the rest of the US economy has been borrowing more but that has had no benefit to its productivity?

Andrew Bailey: Certainly, if you look outside the tech sector, the US's productivity story is not very different at all to that of this country in terms of potential growth rate.

Lord Lilley: Right. As far as the Bank's role is concerned, it spent quite a lot of time trying to discourage investment in parts of the energy sector in this country—though I attended a lecture by Ms Breeden, on which I congratulate her, about apparently dropping that policy. Has it formally been dropped?

Andrew Bailey: We have never seen ourselves as responsible for climate policy. We are responsible for that only in so far as it gives rise to financial stability risks.

Lord Lilley: Which was the belief that the energy industry might overinvest and be left with stranded investments.

Andrew Bailey: I must be very clear that it is for the Government to decide climate policy.

Lord Lilley: But they did not for a while, did they? You had it as part of your policy remit.

Sarah Breeden: We had undertaken another of our stress tests to shine a light on the potential climate transition risks. If I remember correctly, we conducted that in 2021-22. It showed us that there were some risks there, but they were hundreds of billions of pounds rather than being solvency-threatening for the banking system.

Andrew Bailey: There is one thing that underlies all this. If you assume that we are going to make the transition to net zero—as certainly was government policy and, I think, still is—we had to ask this question: does that imply that there will be so-called stranded assets that are already on the balance sheets of banks and insurers, in the sense that they have lent to old-fashioned energy companies but the transition to net zero means that there will have to be a structural change in the economy that will, in effect, cause the value of those assets to decline? That is a financial stability question, which we can try to answer.

The Chair: We are digressing a bit from our main subject.

Q114 **Lord Hollick:** I may digress a little further. To what extent was Brexit culpable for the sluggish performance of the economy?

Andrew Bailey: I will repeat what I said at the weekend; I have said it many times before. I say very clearly that I am a public official and I do not take a position per se on Brexit. That is very important. As a public official, it is not for me to take a decision. It was a decision of the people of this country, and it is our job to implement it.

However, as a public official—as the Governor of the Bank of England—I have said that, if you ask me about the economic consequences, I cannot decline to answer that in the same way. The point I have made in the past and will make again is that, in so far as Brexit has made the economy less open to trade, it will have a negative effect for a period. Trade is dynamic, and over time trade adjusts, but it is hard to know what that length of time is. In the initial phase, that would have an effect on productivity because it would reduce the openness of the economy and would therefore affect things like the ability to exploit the division of labour. I think we have seen that, and many economic studies point to it.

Brexit is not the only factor in this by any means because of what has gone on subsequently, where we are living in a world of much greater uncertainty. In economics, there is a relationship between perceived uncertainty and the question about businesses taking investment decisions, because investment decisions are typically irreversible. Once you commit, you have got to do it. You are committed. So the option value of delaying the investment to hope for a resolution of the uncertainty goes up. I should say that when we go around the country, as we do a lot talking to businesses at the moment, this is not a Brexit point. It is probably much more obviously a point about, you know, the current situation about Ukraine, tariffs and so on. We get that a lot. I mean, businesses say they are very cautious about investing.

The Chair: I think you have set Lord Lilley off.

Lord Lilley: Just to continue, our trading relationship with the European Union is one of no tariffs or quotas. It is very similar to that of Canada with its biggest neighbour, the United States—no tariffs, no quotas. Well, it has a few tariffs on eggs and chickens. Prior to Trump, do you think that your predecessor, when he became Prime Minister of Canada, should have sought a closer trading relationship allowing America to set Canada's laws?

Andrew Bailey: I would not dream to presume what the Prime Minister of Canada should do, I am afraid.

Lord Lilley: But that is the implication of your remarks.

Andrew Bailey: Look, I follow many of these debates. On the point that I was making about the benefits of openness, I accept that important lessons were learned about the robustness of supply chains in the Covid period, so that is relevant, but the underlying point—this goes back to Adam Smith; do not take it from me—about the benefits of openness and trade—

Lord Lilley: We have openness: zero tariffs and zero quotas.

Andrew Bailey: But Brexit has had an effect on trade.

Lord Lilley: It is very small.

Andrew Bailey: I am not sure firms would agree.

Lord Lilley: Exports of services since 2020 to Europe have gone up by 67%.

Andrew Bailey: There is a different story between goods and services when you look at trade.

Lord Lilley: We have been doing rather better in Europe. It is rather odd, is it not?

Andrew Bailey: To reflect on financial services, it is true to say, regarding many of the more pessimistic depictions post the referendum on the impact of Brexit on financial services, that by one means or another we have managed to offset quite a bit of that so far—I say "so far" because it is never over—and an objective that Governments have had is to try to stop that happening.

Lord Lilley: I have one more question on the role of the Bank of England. At the time of Brexit, the Government made forecasts about the short-term and the long-term impacts. Your former Deputy Governor of the Bank of England at the time gave what he said was a peer review of the Government's short-term forecasts, and said they were the best possible forecasts that could be made and as reliable as could be. They turned out to be absolutely wrong in every respect: instead of unemployment going up, it went down. Instead of employment going down, it went up. Instead of house prices falling, they rose only in respect of the exchange rate, which came down from being, in the IMF's view, very overvalued to somewhat overvalued. Do you not think the Bank of England should be a little cautious about making forecasts about highly contentious political matters when its track record is so bad?

Andrew Bailey: My commentary is not based on any forecast of the future. It looks back at the years since then. I am not making an observation about the future.

Lord Lilley: But we have done as well as France and Germany. Did they leave?

The Chair: We should move on.

Lord Lilley: I resign.

Andrew Bailey: I do not know what I said.

Lord Lilley: I mean, I resign the baton.

The Chair: The great thing about this committee is that we operate on the basis of consensus, so we probably need to keep off Brexit.

Baroness Noakes: I would love to carry on talking about Brexit.

The Chair: No, please do not.

Q115 **Baroness Noakes:** I will apply a self-denying ordinance. I want to go back to the impact of private capital on banks, in the view of the Bank of England. Governor, you referenced a moment ago the letter that was written to the chief risk officers in April 2024—a rather stern letter that told them to look again at all their risk management policies around that, and to report on it to the Bank of England. In your evidence to us, you said that the PRA had since received responses from the banks on that, which I am sure it did, and that the PRA continues to view this as a priority. The letter that you referenced as evidencing it being continued to be referenced as a priority was written at the beginning of this year, by Rebecca Jackson and Alison Scott. That did not mention anything at all about private equity-related financing activities, which was the focus of the April 2024 letter. So I am a bit concerned about what messages you are giving to banks, having written them the rather stern letter and told them to do lots of things and report back on that, when in the letter saying, "These are the priorities that you, chief executive officer, need to take into account", that was not mentioned at all, except for one tiny reference to counterparty credit risk for NBFIs. The whole issue of private capital seemed to have disappeared off the agenda. What is the message you are giving to the banks about how important this is for them to manage in the scheme of priorities for their activities?

Sarah Breeden: Can I rise to that challenge? The way that I think about it is that what we are trying to do, at the level of the CEO in particular, is to get them to think about their counterparty credit risk—their connections with the non-bank financial sector in the round. Andrew described earlier the increasing role of hedge funds in government bond markets. In our system-wide exploratory scenario, we had a focus on LDI funds and the relationship that they have with banks. There is also prime broking in terms of financing hedge funds' activities in equity markets. The point that we wanted to make to the CEOs was, "Don't just look at your repo book, your prime broking book and your private equity relationships. Please think about these counterparty credit risk issues in the round". What we have found over the years—when I was supervising the international banks in 2018, I signed letters to CEOs at the time about this issue—is that it really is the gift that keeps on giving, so we are trying to helicopter up and say, "Think about these issues in the round".

Baroness Noakes: So it is just a classic counterparty credit risk management issue, and nothing special to do with private capital.

Andrew Bailey: The CRO letter was particularly focused on private capital.

Baroness Noakes: The CRO letter was, but my point is that that had disappeared from view by January 2025.

Andrew Bailey: For CEOs we wanted to make the broader point, but the focus of the CRO letter was different. I remember the discussions. The supervisor said that, when they looked at the firms, they were concerned that, frankly, they were not able and therefore not doing just the adding up of their exposures within the private capital world. They therefore questioned how the firms were risk-managing those exposures and the exposures as a sum.

This had been a bit of a theme that we had identified in some previous incidents that were not quite directly in that world: the inability, as we saw it, of firms to actually look at the whole and therefore understand the risks. As Sarah said, when we write to CROs it tends to be much more focused. We say, "Look, in our supervisory work we have identified the following points, and here it is".

Baroness Noakes: In the banking system, does the Bank think the management of this risk is a big problem?

Andrew Bailey: I have to be honest: I remember, when we had the discussions on the work they have done on private assets—while obviously the story varied a bit from firm to firm—how far back some of them were in terms of being able to aggregate their exposures. And that starts to ring alarm bells.

Q116 **Lord Vaux of Harrowden:** I am going to change the subject slightly and go back to lending to the real world, particularly the SME world. You said right at the beginning that you did not believe that there was a regulatory arbitrage problem, but it appears that lending to SMEs has declined. We have received evidence, albeit slightly mixed, that that may be in part down to the fact that it is more expensive to lend to SMEs because of the regulatory system. I would like to understand more why you do not think that that is a problem. I want then to take that on specifically to the system of risk weighting, where we are prejudging what sort of lending is more risky and, therefore, adding costs to that by, in effect, increasing the capital requirements. I am sure that you saw Lord King's evidence and his suggestion that we could replace the risk-weighting system with something simpler; I am interested to hear your thoughts on that.

Andrew Bailey: First, as I said at the beginning, we saw a shift away from bank financing of SMEs in the aftermath of the financial crisis. That shift seems to have come to an end around 2014, if you look at the aggregate data; since then, it has been reasonably constant.

That shift away probably reflected a number of experiences that banks had with SME financing in the period around the crisis, some of which were pretty unhappy—I remember having to deal with some of them when I was at the FCA; it was not a good story—but it also reflected the fact that, as I said earlier, in an era when we were having to rebuild bank capital, there was probably rationing of lending going on. I am sure there was; I remember it going on in that period. We do not want to operate in a system where that sort of thing happens—that is, when you get some sort of big cyclical shock, banks start restricting credit into the economy.

One of the success stories of the past few years is that we have had very big shocks in the world economy and the UK economy—Covid and Ukraine—but we have not seen the sort of problem that we would have had with financial stability or the sort of problem that we had in the past with credit supply. The problem with financial stability is that success is when nothing happens, so it does not really get noticed.

On Lord King's point, I honestly do not agree with him. That is for two reasons. First, as a lot of this discussion has just illustrated, regulating a financial system for prudential and financial stability purposes without having regard to the risk that it is taking is a very dangerous slope to go down. If we do not understand the way in which risk is taken in a system, bad things can happen.

The second reason is that, as I think he would freely admit—in fact, I think that he has said this—the counterbalance in his proposal or idea of not looking at risk is to have a risk-free, leverage ratio-type approach. That sets a very high level as a way of saying, "I can be comfortable at that level. Whatever's going on in the risk world, it won't do bad things", but it leaves you with a very high level of capital in the system of protection. You would certainly get a pretty fierce response from the industry that that is not a system that allows the type of support for the economy that we all want to see to take place. So I am really not a supporter of that approach. It would have consequences and create risks. You have to think about the consequences of that for the overall supply of risk capital into the economy.

Sarah Breeden: Can I add something? Going back to the point about SME financing, it is really hard to disentangle the demand and supply of finance. We try to do that through the credit conditions surveys that we do, and we use our agents network to give us a sense of what is going on in terms of the availability of finance. As Andrew said, right now, the intelligence we get is that it is available, but we are always conscious of whether there is an unmet demand.

We did a survey of SMEs jointly with the Department for Business and Trade. It came back with some really sobering statistics: 77% of SMEs would rather have less growth in their business than have finance, while three-quarters of them wanted to pay down debt and get to a debt-free position. So it is important, as we think about these issues, to consider the demand side, financial literacy and all of those aspects, as well as the supply side. However, obviously, there are the high-growth companies that we were talking about in a different context—that small sliver—which really want access to finance to be able to grow and scale in that context. Perhaps it is about equity rather than debt.

Lord Vaux of Harrowden: We hear the number being bandied around. To put the question the other way round, is there anything in the current way in which we regulate the banks that you think is restricting lending? Is there anything that you think we could change to improve that?

Andrew Bailey: My approach to this question, which is obviously a very live question generally, is to say, as I keep repeating, that we have to have the anchor of financial stability. However, should we pretend that every one of our regulations is perfectly formed? No; it would be ridiculous if we said that. So I am very open to reviewing it and to the processes that are going on. The one big proviso I would make, though, is that we have to keep the anchor of financial stability. We will always look at it through that lens, but there is a lot of work going on at the moment to review the regulatory approach and structure; that is perfectly sensible.

Sarah Breeden: The other thing that we will do in response to our remit letter from the Government is that, in our December *Financial Stability Report*, we will do a deep dive on some of these SME financing issues to look at not just the regulation that we do but the financial system more broadly. As you well know, since the Macmillan report in 1931, we have been talking about SMEs being underserved by the financial system, so our aim is to see whether there are things that we can identify to support the provision of private finance.

Andrew Bailey: That is why, at the moment, we are also undertaking a further refresh of the work that we have done in the past in terms of what is the sensible answer to the question, "What is the appropriate level of overall capitalisation of the banking system?"

Q117 **Lord Eatwell:** I want to come in on the SME issue. I was very struck when we had a number of small and medium-sized fintech companies in front of us eight or nine months ago. All of them, I am glad to say, had successfully gone to their second round of funding, but all of it was in the United States—not a single bit was in the UK. Of course, that is mostly equity funding, but, considering this movement of private capital into debt funding, I wonder if there is a substitution effect going on. Is one of the reasons for the lack of equity funding, "Now we can do this with much less risk and easier return by diverting our funds into areas that used to be bank funding but are now private sector funding"? That is just a guess.

Andrew Bailey: One of the challenges that come with SME lending is establishing to what extent it is debt and to what extent it is equity. You see the recurring controversial issue of the security that banks take when they make these loans. That reflects this question: what exactly is the characteristic of this lending that is being made?

Sarah Breeden: On the investor side, what is particularly noticeable about pension schemes here in the UK is how small they are. The ability to consolidate and be at scale means that it is more likely that they will be able to develop the capabilities to do the sort of venture capital investment that might be important in a high-scale business.

Andrew Bailey: The diseconomies of risk management in that system are quite high.

Q118 **Baroness Donaghy:** I am very glad that Sarah expanded on the question that Lord Vaux asked about the supply of lending, because it seems to me that companies, particularly at the micro level, are exercising this self-denying ordinance, so they are not going to appear in any figures. You have a suspicion that your 77% would not dream of going to the banks. It has to be said that the Federation of Small Businesses implied that usurious interest rates are one of the reasons why they do not go to the banks. But even though some of these companies might not take over the world, if they all expanded by 5% to 10%, they would assist their local communities and regions to have a healthier society, which I cannot help think might in turn help the economy eventually. This is a plea to do a little bit more, if you like, concierge work to try to see how we can get those companies to think about even small amounts of expansion.

My second question is on the higher level. Andrew said it is a responsibility on us to develop more tools and talked about shining a light. The European banking system seems to have more of a central credit register approach, as does the Chinese one. Is there any argument for the UK starting to think about this, even though it might be a very expensive venture? Is this something that might help shine a light in future?

Andrew Bailey: On your first point on local communities, one of the issues we have to watch out for is the impact of branch closing. The economics of branch closing are different, but I certainly pick up from quite a lot of conversations I have been having around the country that one of the consequences of it—I think banks understand this and try to offset it—is that SMEs want to have somebody in the area that they regard as their banking contact.

Baroness Donaghy: But that is not going to happen.

Andrew Bailey: Well, the banks have to think, if you do not have the physical presence, which is just not being used in the way that it used to be, what the alternative is—and they are.

On credit registers, this is an old one. To be honest, I have always been a bit doubtful, partly from conversations with some of their users, about the quality of the information in some of these things and just how good the European ones are. I am afraid I cannot comment on China. They do not obviously seem to get used that much in some of the things we do. Some of the tools that we have been talking about already, such as the exploratory scenarios, are probably better in the modern era than trying to maintain big registers of lending broken down to a very granular level.

Sarah Breeden: A glimmer of optimism in this context is that some of the innovation we are seeing in payments, open banking and open finance enables there to be data on an SME's bank account transaction history that can be shared to support a credit assessment. So one can use open finance and some of the really significant data innovations happening in payments as a way of providing information that speaks to the same sorts of issues but in a different way.

Q119 **Lord Smith of Kelvin:** I come back to relational finance, as we now call it—your local bank manager, your local business and so on. Is it the burden of compliance that has caused its decline, or just the cost of offices in the high street? Is it a problem or not? I hear from the BVCA that it is a problem and that they cannot get to talk to people easily in banks and so on. I hear from Sarah, "Whatever high percentage it is, we are not really interested in that idea". Is it a problem? If it is, what can we do about the burden of compliance to actually open up the high street again a bit?

Andrew Bailey: To be fair, the physical presence of banks on high streets is just not used in the way that it used to be. We all have to ask when we last went in a bank branch. The banks will say, "Honestly, our branches are just not used in the way that they used to be, so the economies of running branches are very different from what they were in the past". It does leave a number of challenges in slightly different parts of our world. SME contact is one of them. I will give you an example. I was in the north-west, where one of the building societies was saying that it is picking up a lot of SME customers because it has maintained its presence in communities and is therefore picking up SME banking. In a way, that is fine; somebody is there. It does not necessarily have to be done via a physical branch presence, but we must have an eye on the fact that, if we cut SMEs off from what they perceive as access to banks, then that will have an effect. We certainly need to have that in mind.

Lord Smith of Kelvin: I think the word "concierge" could apply—someone you can talk to even if there is no branch there.

Andrew Bailey: I agree with you. It is important to have an eye on that.

Q120 **Lord Hollick:** The Chancellor has made the point that, to help competition and growth in the economy, she wants to see a 25% reduction in the cost of regulators. You have run one of the regulators for four years and obviously have a keen interest in the PRA. Do you believe that target of saving, which I see from newspaper reports today is being scored by the OBR, will actually promote growth, or will it weaken the regulatory role played by the financial regulators?

Andrew Bailey: It is right to have targets like that, and it is something we want to do in the Bank of England. As well as the question of reviewing regulation, there is a big question around efficiency. We have launched a future data review, with the industries we regulate, for two reasons. First, coming back to this post-crisis point we were making earlier, there is an element of procyclicality—are we collecting data that we do not need? The answer is probably yes. Very big data collection requirements were put in place after the crisis, so it is a good moment to do this. Secondly and almost more powerfully, as Sarah was just saying, we now have technology that should enable us to do all this a lot more efficiently. In the Bank of England, for instance, we have got to increase our investment in technology, data and AI in order to be more efficient. That is very clear. We are going to have to pivot from more traditional "business as usual" spending to investment. Out of that, I hope we would be more efficient and have lower costs.

Sarah Breeden: I have two examples from the financial market infrastructure side that might be helpful. We have had 15 applications to our digital security sandbox so far and we have made the application forms machine readable, so there can be more processing straight through. We have also automated much of the stress testing of CCPs that we do; a big data dump comes from the CCPs and we can automate it and do it with fewer staff than hitherto. That is just to give you two examples.

Lord Hollick: The target can be achieved through efficiency rather than a change or a reprioritisation.

Andrew Bailey: My answer was in two parts. There is reprioritisation in the sense that it is sensible to go and look at the question "Are we just collecting too much data?", for instance, which was a product of the response to the crisis. But then the second part, and maybe the more powerful part, is that we should be exploiting technology now that is developing to do this whole thing more efficiently.

Q121 **Lord Vaux of Harrowden:** This is a general question. You have talked several times about shining a light into the opaque world of private finance et cetera, and we have talked about the interconnections and the potential systemic risk. I am just curious to know what you do about it if you find that there is a problem, because most of this stuff is long term, illiquid and quite hard to deal with, and also dependent on a flow of finance through the system to keep it going. What do you do if you discover there is a systemic problem in this case?

Andrew Bailey: It depends on the nature of the issue. Baroness Noakes was referring to the first system-wide exploratory scenario that we did; Sarah might want to come in on this. One of the conclusions that we have taken from that, which we have got a discussion paper out on at the moment, was not that we should increase regulation but that we should encourage an innovation in the infrastructure, to encourage central clearing of gilt repo. That was a point in that exploratory scenario where we realised that there was potential stress going on but it could be alleviated by an improvement in the infrastructure. That could be one of the things that we get out of this. If we find some complete horror story in there, it is better to know than not know—that is the answer—and we will have to deal with it. That is the way in which I go into it.

Lord Vaux of Harrowden: There is a risk you end up triggering the problem by making it transparent.

Sarah Breeden: I think it does, though, come back to that point about risk management. If you are aware of the risks in their entirety in the context of the system, you will do a better job of managing them than if you are just seeing your slice of it.

Andrew Bailey: If we go back to Baroness Noakes's other point on the CRO letter that we wrote, the point of that letter was to say to the firms, "You are not doing the basic thing of adding up your exposures. Will you please get your act together—and hopefully before it is too late, as it were?" I think that has happened, because we have observed over recent years, in one or two quite well-known instances, that when problems have occurred, part of their underlying cause was firms taking exposures which they could really only have risk-managed if they could see the whole risk picture—and they could not. So, again, we have to shine the light and say, "How did you think you could risk-manage that based on what you knew?".

The Chair: Are you saying that, if you came to the view that there was a systemic risk arising from private credit, you would want the Government to bring private credit within your regulatory remit or not?

Andrew Bailey: It would entirely depend what the nature of the issue is. We would naturally go through whatever other tools would be available—tools that did not require that type of approach. For the reason that I said at the beginning, we have to have a system which encourages risks to be taken and investments to be made. So my first reaction is: how can we improve that? I would not go to regulation as the first answer to that.

The Chair: At the very beginning of this session, you emphasised the importance that you attach to people complying in a voluntary manner.

Andrew Bailey: Yes.

The Chair: But if you did discover a systemic risk, it is hard to see that you could just kind of continue on a voluntary basis—

Andrew Bailey: We could not sweep it under the table, let us be honest.

The Chair: —if you have not got the powers. I am not suggesting you should, but I am trying to get clarity.

Andrew Bailey: The Financial Policy Committee of the Bank operates on the basis that we can make recommendations very broadly. We can make recommendations to people who may have powers even if we do not. That would be our response. Obviously, transparency is the first disinfectant, if you like, to say, "We need to reveal these issues and get the actors in the industry to actually deal with them". But if we felt it went beyond that, we have the power to make recommendations very broadly as the FPC, and we should do that, obviously.

The Chair: You are obviously ahead of other countries and other central banks in the actions you are taking, but to what extent is this something which inevitably, given the scale, has got to be dealt with internationally?

Andrew Bailey: Sarah and I have both said that we are both heavily involved in the FSB. What we would naturally do, and we have done, is state what we are observing and seeing. We do have a responsibility here because, as Sarah was saying, we have a very big global financial presence. The IMF has described it as a global public good, and we are responsible for it. We therefore have to take it in to the FSB, if that is the appropriate body, and say, "Look, this is what we are seeing". We did that with funded reinsurance—we were pretty much the first people to take funded reinsurance and say, "Look, this is what we are seeing".

Sarah Breeden: On funded reinsurance in particular, the International Association of Insurance Supervisors is now doing work on that issue so, where something is surfaced, it is possible to take that into the international architecture.

The Chair: Baroness Donaghy, you can have the last word.

Q122 **Baroness Donaghy:** Thank you very much, Lord Chairman. One of our witnesses was saying that, in this world of private finance, the amount of imagination and resource and bright young people leaving banks to go into this area was without limit, and that he himself had indicated in a particular area there was no way that would ever happen, and 12 months later it did. He was trying to paint a picture of this wonderful, expanding world of imagination and resource. Given that and given that the people working there do not notice the boundaries or do not recognise boundaries, how are you going to be sure that your systems, which are much more traditional, if you like, are going to spot the Dr Strangeloves?

Andrew Bailey: This goes back to the discussion we were having earlier about the system-wide exploratory scenario. We were the first people in the world to do this; we are the only people so far who have done it. I think France is going to do one. That is a new tool—credit to Sarah and her colleagues for coming up with it—which we created in response to that. So there is an onus on us to, frankly, innovate ourselves as to how we go about assessing these risks and then dealing with them. It keeps us on our toes, which is good.

The Chair: On that note, can we thank you, Governor and Deputy Governor, for what has been a really interesting and actually quite reassuring session? We appreciate your time. You have been going for two hours and the committee looks forward to reporting in due course on what is obviously a very important issue, which you have got a grip on.

Andrew Bailey: Thank you very much. It has been very interesting.

Sarah Breeden: Thank you.