



BIS Working Papers No 1336

A public-private partnership? Central bank funding and credit supply

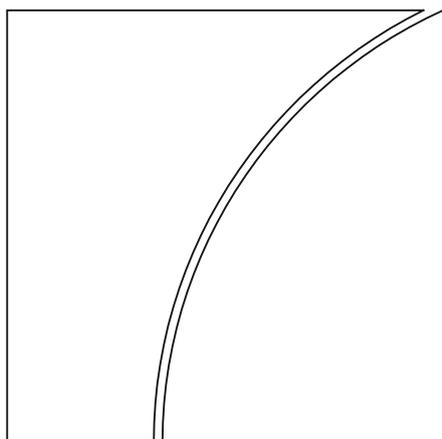
by Matthieu Chavaz, David Elliott and Win Monroe

Monetary and Economic Department

March 2026

JEL classification: E52, E58, G21

Keywords: central bank funding, mortgage lending,
bank funding risk



BIS Working Papers are written by members of the Monetary and Economic Department of the Bank for International Settlements, and from time to time by other economists, and are published by the Bank. The papers are on subjects of topical interest and are technical in character. The views expressed in this publication are those of the authors and do not necessarily reflect the views of the BIS or its member central banks.

This publication is available on the BIS website (www.bis.org).

© *Bank for International Settlements 2026. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

ISSN 1020-0959 (print)
ISSN 1682-7678 (online)

A Public-Private Partnership? Central Bank Funding and Credit Supply*

Matthieu Chavaz[†] David Elliott[‡] Win Monroe[§]

March 12, 2026

Abstract

We exploit the surprise announcement and subsequent amendment of a central bank funding scheme to test how public liquidity provision affects credit market outcomes. Contrary to the notion that public liquidity is primarily a substitute for private liquidity, banks that are more exposed to stress in private wholesale funding markets use *less* central bank funding. We rationalise this pattern by establishing an “equilibrium channel” of public liquidity. The mere *availability* of central bank funding reduces the cost of private wholesale funding. This stimulates lending by banks exposed to wholesale funding, regardless of whether they actually use the central bank funding. Using a surprise amendment to the design of the scheme, we show that the “strings attached” to central bank funding help to explain why it is an imperfect substitute for private funding.

Keywords: Central bank funding, Mortgage lending, Bank funding risk.

JEL classification: E52, E58, G21.

*The views expressed in this paper are solely those of the authors and should not be taken to represent the views of the Bank for International Settlements, Bank of England, or any of its policy committees. For valuable comments and discussions, we thank Cynthia Balloch, Sarah Bell, Elena Carletti, Andrea Fabiani, Chris Hansman, Marcin Kacperczyk, Iryna Kaminska, John Kandrac, Frédéric Malherbe, José-Luis Peydró, Raghuram Rajan, Ricardo Reis, Farzad Saidi, and seminar and conference participants at the Bank of England, Reserve Bank of India, and BoE workshop on credit market interventions.

[†]Bank for International Settlements, matthieu.chavaz@bis.org.

[‡]Bank of England, david.elliott@bankofengland.co.uk.

[§]Copenhagen Business School, wim.fi@cbs.dk

1 Introduction

Public authorities can improve credit market outcomes by supplying liquidity when private liquidity supply is subject to frictions (Holmström & Tirole 1998). One real-world test for this idea is the large-scale provision of liquidity by central banks in response to stress in private wholesale funding markets.

In that case, most obviously, banks can use public liquidity as a *substitute* for stressed private funding, and this can boost their lending to the real economy. However, substitution from private to public funding could have a range of side-effects. For instance, the transfer of private risk to the public sector could create moral hazard (Bolton et al. 2009), and public funds could support bank activities other than real-economy lending. And if reducing such leaks requires adding “strings attached”, this could make public funding less attractive to banks and thus less effective at stimulating lending (Bernanke 2022).

However, a less obvious possibility is that public liquidity acts as a *complement* to private liquidity, e.g. because the mere availability of a public outside option helps to resolve frictions in private liquidity supply (Tirole 2012, Philippon & Skreta 2012). Such an “equilibrium effect” could help to improve credit market outcomes without public liquidity actually being used, thus mitigating the potential side-effects from substitution into public funding.

The main contribution of this paper is to establish the existence, drivers, and consequences of this equilibrium effect. To do so, we exploit the surprise announcement of a Bank of England funding scheme, which was launched in response to stress in wholesale funding markets and offered banks access to long-term funding, conditional on banks’ lending to households and firms. Exploiting confidential loan-level mortgage data, we quantify the impact of this announcement on credit supply via an equilibrium effect, while controlling for the impact via banks’ direct use of the public liquidity (“participation effect”) that most research has focused on to date. Exploiting a subsequent surprise change to the terms of the scheme, we then test how the conditionality of central bank funding (“strings attached”) affects the scheme’s impact on credit supply.

Overall, our results suggest that the equilibrium effect is the dominant channel through

which central bank funding stimulates lending, and that this effect allows banks to enjoy the benefits of central bank funding while avoiding its costs. We establish four main results backing that conclusion. First, contrary to the notion that public liquidity is primarily a substitute for private liquidity, we show that banks more exposed to stressed wholesale funding markets are *less* likely to use the scheme. Second, we show that banks more exposed to stressed funding markets reduce mortgage rates by more after the announcement—irrespective of how much they use the scheme. While participation in the scheme also leads to lower lending rates, this participation effect is substantially smaller than the equilibrium effect in aggregate. Third, we show that the equilibrium effect appears to operate through a reduction in perceptions of banks’ funding risk, rather than through an increase in their bargaining power in funding markets. Finally, using the surprise change to the terms of the scheme, we show that the conditionality of central bank funding can be a significant non-pecuniary cost of using public liquidity relative to private funding.

The Funding for Lending Scheme (FLS) was announced in June 2012, when the euro area crisis was escalating and UK banks’ wholesale funding costs were reaching levels last seen during the Global Financial Crisis. Under the FLS, UK banks could get four-year loans from the BoE. To incentivise banks to use this funding to lend to the real economy, the quantity and price of funding were conditional on banks’ lending to households and firms—a design that was subsequently adopted by the ECB’s Targeted Long-Term Refinancing Operations (TLTROs). A key benefit from an identification perspective is that the announcement of the FLS did not coincide with policy rate cuts, asset purchase announcements, or government credit support schemes, unlike most other recent central bank funding schemes. In addition, the FLS was subsequently extended and amended, which helps us to identify the importance of conditionality and the role of different transmission channels in stressed vs. normal periods.

Our analysis starts by examining how participation in the FLS varies with banks’ pre-announcement exposure to wholesale funding. If FLS funding is mainly a *substitute* for wholesale funding, banks more exposed to wholesale funding should borrow *more* from the

scheme. By contrast, if the FLS mainly works through an “equilibrium channel” whereby the mere *availability* of public funding improves conditions in private wholesale funding markets, banks more exposed to wholesale funding might have *less* need to borrow directly from the scheme, since they would benefit from the improvement in private wholesale funding conditions. Our results are in line with the second hypothesis: a 10 percentage point increase in a bank’s wholesale funding exposure is associated with a 0.6 percentage point reduction in FLS borrowing (as a proportion of initial borrowing allowances).

Motivated by this pattern, our main empirical analysis examines the evidence for an equilibrium effect of public liquidity and its impact on bank lending. Indicators of UK banks’ wholesale funding costs fall sharply from their stressed levels when the FLS is announced, in line with the idea that the availability of public liquidity alleviates frictions in private liquidity supply (Tirole 2012, Philippon & Skreta 2012). The main focus of our empirical analysis is to estimate how this improvement in wholesale funding conditions affects bank lending. Importantly, we separate this “equilibrium effect” from a “participation effect”, i.e. the potential effect on bank lending from a bank’s direct participation in the funding scheme, which previous literature has found to be significant (Benetton et al. 2025). To identify the equilibrium effect, we run loan-level difference-in-differences regressions, where we exploit predetermined heterogeneities in wholesale funding reliance while controlling for confounding trends with granular fixed effects and a host of controls. To control for the participation effect, we use banks’ initial FLS borrowing capacity (which is measured before the announcement) as an instrument for realised FLS take-up in the spirit of Benetton & Fantino (2021).

We find that, relative to a bank without any wholesale funding, a bank with a wholesale funding reliance of 32% (the weighted average in our sample) would reduce mortgage spreads by around 68 basis points after the FLS announcement via the equilibrium effect. To put this into context, over the nine months leading up to the FLS announcement, mortgage spreads had risen by around 70 basis points. Importantly, the equilibrium effect remains large when we control for the participation effect. Our estimates of the participation effect are broadly consistent with Benetton et al. (2025). We find that the equilibrium

and participation effects have similar impacts on lending for a medium-sized bank. However, for the large banks that dominate UK mortgage lending, the equilibrium effect is significantly larger than the participation effect. Accounting for both the equilibrium and participation effects therefore suggests a significantly higher impact overall.

The equilibrium effect could be explained by two (non-mutually exclusive) mechanisms. First, the availability of a risk-insensitive public funding option could reduce banks' funding liquidity risk, and hence reduce the risk premia required by private wholesale lenders when providing funding to banks ("risk channel"). Second, the existence of a public outside funding option could reduce banks' (expected) demand for private wholesale funding and therefore reduce the mark-up that wholesale lenders can charge on this funding ("demand channel").

Exploiting granular confidential data on banks' liability structures, we find evidence in line with the risk channel but not the demand channel. In particular, we find that the negative relationship between wholesale funding reliance and mortgage spreads after the FLS is driven by exposure to short-term wholesale funding (which exposes banks to greater funding risk), and not exposure to stickier long-term funding. In addition, the equilibrium effect is significant when the FLS is first announced in 2012, when wholesale funding markets were stressed, but not when a new FLS program ("FLS2") is announced in 2013, when wholesale funding costs had returned to normal levels.

Taken together, our results are consistent with the idea that public liquidity "creates its own competition" (Tirole 2012). By indirectly lowering the price of private funding, the equilibrium effect allows banks to benefit from central bank funding without directly using it. Central bank funding thus does not need to "crowd out" private funding (Bolton et al. 2009), nor transfer private risk to the public sector (Flanagan 2019).¹ These findings also help to explain why banks that stand to benefit more from the equilibrium effect are less likely to use central bank funding. They also imply that the more successful the scheme is at "rejuvenating" private funding markets, the smaller participation might be. Funding schemes should therefore not be judged on take-up (Bernanke 2022, BIS 2023).

¹In line with these concerns, participants in the ECB's LTROs partly used long-term central bank funding to replace private wholesale funding (Carpinelli & Crosignani 2021).

In addition to indirectly reaping the benefits of central bank funding, the equilibrium effect could also allow banks to avoid any non-pecuniary costs associated with using this funding directly. In the last part of the paper, we look for evidence for such costs. Well-known costs from using public funding include stigma (Philippon & Skreta 2012) and political pressure (Chavaz & Rose 2019). Instead, we explore a cost that has attracted less attention to date: if authorities attach conditions to public liquidity, this might constrain banks' ability to deploy it towards the most profitable uses.

Our setting provides an ideal laboratory to test the importance of these “strings attached” because conditionality was a central innovation behind the FLS, and because subsequent changes to the program create two important shocks to the reach of this conditionality.

First, in April 2013, the BoE announced a second wave of FLS funding (“FLS2”), which would start in February 2014. The design of FLS2 implied variation over time in the conditionality of the funding. During the transition period between FLS1 and FLS2, new mortgages could still be funded with FLS1 drawings, but would also generate “initial allowances” for future FLS2 drawings. Importantly, these future drawings could be used to fund any asset; therefore, FLS2 drawings based on initial allowances constitute *unconditional* funding. In contrast, after February 2014, FLS2 borrowing allowances could only be unlocked by originating new loans to households or firms, thereby constituting *conditional* funding. Therefore, if banks find conditionality costly, they should have an incentive to unlock future unconditional funding by originating more mortgages during the transition period. In line with this idea, we find that during this transition period, banks more reliant on FLS funding reduce spreads more on new mortgages.

Second, in November 2013, the BoE unexpectedly amended the terms of FLS2. In order to incentivise corporate lending, mortgage lending during 2014 would no longer increase FLS2 borrowing allowances. We find that this amendment reduces the impact of FLS participation on mortgage spreads, consistent with the increased conditionality of FLS2 funding significantly reducing its impact on lending. In addition, during the short time window before the amendment becomes binding, we find that banks more reliant

on FLS funding reduce mortgage spreads further, consistent with an attempt to secure future FLS borrowing allowances before conditionality becomes tighter.

Together, these results suggest that conditionality matters, and that banks prefer public liquidity with fewer strings attached. This suggests a trade-off in the design of central bank funding schemes. Looser conditionality makes central bank funding a closer substitute to private funding, which is likely to strengthen the equilibrium effect and hence allow the central bank to support credit provision without taking risk onto its own balance sheet. However this also weakens the central bank’s ability to use the scheme to target specific sectors.

Relation to existing literature Our main contribution is to show evidence for an “equilibrium effect” that allows banks to benefit from central bank funding while avoiding its costs. Our findings add to two main lines of research.

First, our results suggest that central bank funding schemes can be significantly more powerful than previously established. Several existing empirical studies find that participating in funding schemes boosts credit supply (for example, [Benetton & Fantino 2021](#), [Benetton et al. 2025](#)). We find a similar “participation effect”, but we also show that the equilibrium effect makes a larger aggregate contribution to the overall impact of central bank funding.² Similar to us, [Carpinelli & Crosignani \(2021\)](#) also find that banks more exposed to wholesale funding increase lending in response to ECB long-term refinancing operations. However, they do not distinguish between the participation and equilibrium effects.³

Studying the Fed’s 2020 Main Street Lending Program, [Minoiu et al. \(2021\)](#) find that the mere *option* to sell business loans to the central bank stimulated participant banks’ lending by reducing their risk aversion and expected balance sheet constraints. Our

²[Churm et al. \(2021\)](#) also document that the FLS had a strong announcement effect on indicators of major UK banks’ wholesale funding costs. They estimate the aggregate implications of this effect using time-series methods, whereas we exploit loan-level data for identification.

³[Andreeva & García-Posada \(2021\)](#) find that banks whose competitors make greater use of TLTROs are more likely to report an easing in credit standards. The authors attribute this finding to the idea that participants substitute deposit funding for TLTROs, which lowers non-participants’ deposit funding costs. In contrast, our equilibrium effect can operate even if there is no actual take-up of FLS funding, and works through a reduction in bank funding risk, rather than a change in deposit market competition.

results cannot be explained by this option, since under the FLS, targeted loans must be retained by the originator. Instead, our results are consistent with the idea that the central bank indirectly “rejuvenates” private funding markets (Tirole 2012). This mechanism can extend to all banks, and not only participant banks.⁴

Second, our results shed light on the non-pecuniary costs that banks face when borrowing from central banks. Understanding these costs is key to the extent that they can hamper central banks’ ability to address financial crises and stimulate the economy. It is well known that borrowing from central banks can expose banks to stigma effects (Armantier et al. 2015) or political pressure (Duchin & Sosyura 2014, Chavaz & Rose 2019). Our results suggest that the conditionality attached to the use of central bank funding can further reduce its attractiveness to banks. This could help to explain why central bank funding is an imperfect substitute for private funding.⁵

2 Datasets and sample

Product Sales Database Our main source of data on bank lending is the Product Sales Database (PSD), a confidential regulatory loan-level dataset collected by the UK Financial Conduct Authority (FCA) that covers all residential mortgages originated in the UK. For each mortgage, we observe the name of the lender, and a range of loan characteristics including: the borrower income, age, credit history, and type (first-time buyer, home mover, refinancer); the property location and type; and the mortgage origination date, size, initial interest rate, fixation period, loan-to-value (LTV) ratio, loan-to-income (LTI) ratio, and term.

Unlike the US Home Mortgage Disclosure Act (HMDA) dataset, PSD does not report

⁴Our focus on the impact of the *announcement* of the FLS, rather than the effect of actual lending operations, echoes a large literature studying the effects of central bank asset purchase announcements (e.g., Gagnon et al. 2011, Boyarchenko et al. 2022).

⁵One hope was that funding-for-lending schemes would lead to less “leakage” than earlier unconditional long-term refinancing operations, which have been found to stimulate banks’ securities holdings rather than lending to the real economy (Acharya & Steffen 2015, Crosignani et al. 2020). How to best design conditional funding is an open question, and approaches vary. For instance, TLTRO-I allowances were partly linked to net new lending to corporates, but not TLTRO-II. Meanwhile TLTRO and FLS2 targeted only corporate loans, whereas FLS1 targeted both mortgages and corporate loans. These variations suggest that authorities view conditionality as important, but existing evidence on the impact of conditionality is limited.

loan sales. However, the vast majority of UK mortgages are retained during our sample period (Chavaz & Elliott 2023). UK mortgages also typically have a short “fixation period” (typically 2 to 5 years). After this period, the interest rate switches to a variable rate that significantly exceeds the original interest rate; the vast majority of borrowers therefore refinance at this point (Cloyne et al. 2019). Unlike in the US, borrower characteristics play little role in the pricing of mortgages in the UK. Instead, pricing is based almost entirely on the fixation period and LTV ratio (Robles-Garcia 2019, Benetton et al. 2025); in the remainder of the paper, we therefore refer to the combination of fixation period and LTV ratio as the mortgage “product”. Rates available for different mortgage products are published transparently by all banks, and contracted mortgage rates are similar to advertised rates.

Our main analysis of the effect of the FLS on mortgage lending uses mortgages originated between January 2012 and June 2013, which covers six months before the announcement of the FLS in June 2012 and one year after. When we analyse the impact of further announcements, we extend the sample further (see Section 7). We focus on vanilla fixed rate and adjustable rate mortgages.

Bank-level data We match PSD to quarterly regulatory data on bank balance sheets and income statements from the Bank of England, as well as bank-level data on FLS drawdowns and borrowing allowances. We use these datasets to construct our measures of the equilibrium effect and participation effect (discussed in Section 4.3) as well as bank-level control variables. After matching PSD to the bank-level variables, our baseline sample consists of 415,671 mortgages.

Other datasets Our additional tests use three supplementary data sources. First, we use a dataset of mortgage products advertised by all UK banks collected by Moneyfacts. For every mortgage product, the dataset reports the mortgage rate and fee, among other information. Since PSD only partially reports information on mortgage fees, we use Moneyfacts data to control for the role of fees. Second, we use a confidential Bank of England regulatory dataset (FSA047/048) which provides granular data on the maturity

structure of bank balance sheets. For each bank, we observe the outstanding balance for different asset and liability categories, broken down by remaining maturity. We use this information to shed more light on the mechanism behind our key result. Finally, to control for confounding euro area developments, we use data on CDS prices of euro area sovereigns and banks from Bloomberg.

3 The Funding for Lending Scheme

3.1 Original Funding for Lending Scheme (“FLS1”)

In a speech given on 14 June 2012, Governor Mervyn King announced that the Bank of England would launch a Funding for Lending Scheme (FLS) jointly with the UK government.⁶ The stated ambition was to “prevent an aggregate deleveraging of the banking system that might hold back recovery” by reducing “risk premia and bank funding costs.” This was against the backdrop of a “deterioration in the outlook” for the UK economy, driven in large part by the euro area debt crisis. The speech set out the key features of the scheme, i.e. the provision of “funding to banks for an extended period of several years, at rates below current market rates and linked to the performance of banks in sustaining or expanding their lending to the UK non-financial sector.”

The details of the scheme were published on 13 July 2012 in a joint statement by the Bank of England and Her Majesty’s Treasury (HMT).⁷ At any time during an 18-month drawdown window starting on 1 August 2012, all banks and building societies with access to the Bank of England’s Discount Window Facility (DWF) would be eligible to borrow funds for four years.⁸ Loans would be secured by collateral eligible for discount window borrowing, i.e. portfolios of loans, asset-backed securities, covered bonds, and sovereign and central bank debt (Churm et al. 2012).

In line with its stated ambition, the FLS was designed to incentivise lending to the

⁶<https://www.bankofengland.co.uk/-/media/boe/files/speech/2012/mansion-house.pdf>

⁷<https://www.gov.uk/government/news/bank-of-england-and-hm-treasury-announce-launch-of-funding-for-lending-scheme>

⁸Building societies typically have a regional footprint and focus mainly on mortgage lending and deposit taking. In the remainder of the paper, we refer to banks and building societies simply as “banks.”

real economy. Specifically, the terms of borrowing were conditioned on a bank’s lending performance via both a quantity-based and a price-based mechanism.

Under the quantity-based mechanism, the maximum amount that a bank could borrow was the sum of an “initial allowance” and “additional allowance.” The initial allowance was set to 5% of the bank’s stock of lending to households and non-financial businesses as of June 2012. Banks could draw down on their initial allowance as soon as the scheme opened or any time thereafter. The additional allowance was set equal to the bank’s net lending to households and non-financial businesses over the period July 2012 to December 2013. Therefore, additional allowances could be built up over the course of the scheme. In principle, there was no limit to the additional allowance that a bank could generate via new lending.

Importantly, the existence of both initial and additional allowances generates heterogeneity in the conditionality of FLS funding. Funding obtained via *initial* allowances could be used to fund any asset, including loans to sectors not targeted by the FLS (such as financial firms). This could therefore be considered *unconditional* funding. In contrast, funding obtained via *additional* allowances can be considered *conditional* funding, since additional allowances could only be generated by new lending to the targeted sectors, and hence could effectively only fund loans to these sectors. We exploit this heterogeneity in conditionality between initial and additional allowances in Section 7.

Turning to the pricing-based mechanism, the cost of borrowed FLS funds would decrease with the bank’s net lending to households and firms during the drawdown window. If a bank maintained or expanded its stock of eligible lending, it would pay an annual fee of only 25 basis points; instead if lending declined, the fee would increase linearly to a maximum of 150 basis points. That pricing effectively ensured that, as long as bank lending grew, the cost of FLS funding would be lower than the cost of private funding—abstracting from non-pecuniary costs such as stigma or costs associated with conditionality.⁹ The pricing also meant that the cost of FLS funding would not vary with

⁹In practice, the FLS lent UK Treasury Bills rather than cash, so the full cost of FLS funding would incorporate both the FLS fee and the cost of converting the Treasury Bills into cash, for example via repo markets. Churm et al. (2012) estimate that at the time the FLS was announced in June 2012, the all-in cost of FLS funding was around 200 basis points cheaper than comparable sources of wholesale funding

a bank’s riskiness, unlike the cost of funding from private markets.

3.2 Comparison with other schemes

Prior to the launch of the FLS in 2012, other central banks had deployed schemes providing long-term funding to banks, for example the ECB’s Longer-Term Refinancing Operations (LTROs) launched in 2011. The key innovation of the FLS was to explicitly design the scheme to incentivise banks to use central bank funding to lend to households and firms. Several subsequent schemes have adopted a similar approach, including the ECB’s Targeted Longer-Term Refinancing Operations (TLTROs), which started in 2014. As for the FLS, under TLTROs banks could borrow funds for several years, and borrowing allowances increased with outstanding and net new eligible loans to households and non-financial firms. However, unlike the original FLS, mortgages did not count towards TLTRO borrowing allowances.¹⁰

After the FLS, the Bank of England deployed two subsequent funding-for-lending schemes: the 2016 Term Funding Scheme (TFS), launched in response to the Brexit referendum, and the 2020 Term Funding Scheme with additional incentives for SMEs (TFSME), launched in response to Covid-19. Unlike the FLS however, these schemes were launched alongside other major monetary or fiscal policy measures, which complicates identification. Specifically, both the TFS and TFSME were launched alongside new Quantitative Easing purchases and cuts in the policy rate, while the TFSME was also launched alongside other government credit market interventions.

3.3 Extension and amendment (“FLS2”)

Our baseline tests exploit the introduction of the original FLS (“FLS1”). However, in further tests, we exploit the subsequent extension of the scheme (“FLS2”).

The original FLS1 drawdown window was set to close on 31 January 2014. But on 24 April 2013, the Bank of England and HM Treasury announced that a new one-year

such as covered bonds.

¹⁰As we explain below, mortgages were subsequently excluded from eligible loans for the second wave of FLS funding (“FLS2”).

drawdown window would open from 1 February 2014. During this FLS2 window, banks’ *initial* borrowing allowance would be a function of their net lending to households and non-financial businesses in the last three quarters of 2013 (the FLS2 “reference period”). Similarly to the original FLS1, *additional* allowances would then increase with net new lending to households and businesses during the FLS2 drawdown window.¹¹

However, on 28 November 2013, the Bank and HMT announced that (in contrast to the previous announcement) mortgages would not count towards additional FLS2 borrowing allowances. This was motivated by a desire to “re-focus” the benefits of FLS2 towards business lending (especially to SMEs), against a backdrop of rising house prices.¹² These announcements are summarised in Table 1.

4 Hypothesis and identification

In this section, we start by exploring the determinants of bank participation in the FLS. The results motivate our key hypothesis for the “equilibrium effect” of central bank funding. We discuss this hypothesis further in Section 4.2, and explain how we identify it empirically in Section 4.3.

4.1 FLS participation and wholesale funding exposure

In this section, we investigate the relationship between participation in the FLS and banks’ exposure to wholesale funding. While we do not seek to establish a causal effect, the relationship we observe helps to motivate the hypothesis that we explore over the rest of the paper.¹³

The FLS was launched in response to stress in UK wholesale funding markets. If FLS funding is mainly a *substitute* for private market wholesale funding, then banks more exposed to wholesale funding should make *more* use of FLS funding than other banks.

¹¹<https://www.gov.uk/government/news/bank-of-england-and-hm-treasury-announce-extension-to-the-funding-for-lending-scheme>. In FLS2, lending to SMEs increased both initial and additional allowances by more than lending to other sectors.

¹²<https://www.gov.uk/government/news/bank-of-england-and-hm-treasury-re-focus-the-funding-for-lending-scheme-to-support-business-lending-in-2014>

¹³For a causal analysis of participation in the ECB’s TLTRO-II, see [Fudulache & Goetz \(2023\)](#).

However, the opposite could hold if the FLS mainly acts as a *complement* to private funding. In theory, such complementarity could arise if the mere availability of central bank funding helps to alleviate frictions in private liquidity supply (Tirole 2012, Philippon & Skreta 2012). For example, the option for banks to obtain central bank funding at a low, risk-insensitive price might reduce risk premia in private wholesale funding, or might increase banks' bargaining power vis-à-vis lenders in private funding markets. In that case, banks more exposed to wholesale funding might have *less* need for FLS funding.

To investigate this relationship, we run simple cross-sectional regressions of FLS participation on exposure to wholesale funding. To measure participation, we consider three different dependent variables. To capture the extensive margin of participation, we construct an indicator variable equal to 1 if the bank participates, and 0 otherwise. For the intensive margin, we measure how much a bank borrows from the scheme, measured either as the bank's average or maximum borrowing amount over the FLS drawdown window (in both cases, we normalise borrowing by the bank's initial borrowing allowance).

Our key explanatory variable is the bank's pre-FLS exposure to wholesale funding, measured as the ratio of wholesale funding to total assets as of 2012:Q1 ($\%(Wholesale)_{i,2012}$). We also control for the bank's log total assets, cash ratio (cash / total assets), capital ratio (capital / total assets), and return on assets (net income / total assets). When the dependent variable is an indicator variable (extensive margin), we use a probit model; for the two continuous dependent variables (intensive margin), we use ordinary least squares.

Table 2 reports summary statistics for the sample. Around half of banks (46%) participate in the FLS. For the average bank, outstanding borrowing is equal to 1.5% of initial allowance in the average quarter during the drawdown window, and peaks at 4.3% of initial allowances (these statistics include both participants and non-participants). For the average bank, the ratio of wholesale funding to total assets is 16.3%, with substantial variation across banks (the standard deviation is 23.9%).

The results are reported in Table 3. For all three dependent variables, a higher exposure to wholesale funding is associated with *lower* participation in the program—both on the intensive and extensive margin. Focusing on the intensive margin (columns 3–6), the

estimates suggest that an increase in wholesale funding exposure from 0% to 16.3% (the cross-sectional average) is associated with a reduction in *average* FLS borrowing of nearly 1 percentage point (columns 3 and 4), and a reduction in *peak* FLS borrowing of over 2 percentage points (columns 5 and 6). These results are in line with [Fudulache & Goetz \(2023\)](#), who find that euro area banks more reliant on wholesale funding participate *less* in the ECB’s second TLTRO programme.

While our analysis does not allow for a causal interpretation, at face value the results are at odds with the notion that central bank funding is primarily a substitute for private funding. Instead, our results raise the possibility of a complementarity between central bank funding and private funding markets. As discussed above, such complementarity could reflect an equilibrium effect whereby banks can benefit indirectly from the availability of FLS funding without actually using it. We now discuss this idea in more detail.

4.2 Theory

Motivated by these patterns, the main hypothesis we want to test is that the availability of central bank funding stimulates lending through an “equilibrium effect”. That hypothesis has two main parts.

The first part of our hypothesis is that the mere availability of central bank funding reduces private wholesale funding costs. This idea relates to models where the mere availability of public liquidity helps to alleviate frictions in private liquidity supply and therefore reduces the price of private liquidity ([Tirole 2012](#), [Philippon & Skreta 2012](#)). As discussed in Section 3.1, the FLS was launched in response to stress in private wholesale funding markets, and the cost of FLS funding was designed to fall below the cost of private funding and to be insensitive to the riskiness of the bank. Therefore, if banks view FLS funding as a (perfect or imperfect) substitute for wholesale funding, the mere availability of an outside option (FLS funding) could put downward pressure on the price of wholesale funding. For example, the availability of a public funding backstop could reduce banks’ rollover risk, and hence reduce the risk premia charged by wholesale lenders. In addition, the outside option could increase banks’ bargaining power in wholesale funding markets,

which could reduce the mark-up charged by wholesale lenders.

Figure 1 provides support for the first part of our hypothesis. As the Euro crisis escalates over 2011 and 2012, indicators of wholesale funding costs for UK banks increase sharply. When the FLS is announced, there is a sharp drop in these indicators.¹⁴

The second part of our hypothesis is that this reduction in wholesale funding costs should lead to lower lending rates, particularly for banks with a greater reliance on wholesale funding. This is the key relationship that we test below.

4.3 Identification

To assess whether the availability of central bank funding affects bank lending rates via an equilibrium effect, we test whether banks more exposed to the fall in wholesale funding costs caused by the announcement of the FLS reduce their lending rates by more than other banks. In doing so, we also control for any impact of the FLS on lending rates via banks' direct participation in the scheme.

We focus on an 18-month sample period (January 2012 to June 2013) around the announcement of the FLS in June 2012. We estimate various forms of the following empirical model:

$$Spread_{i,l,t} = \beta \%(Wholesale)_{i,2012} \times PostFLS_t + \gamma Controls_i \times PostFLS_t + \theta_{i,p} + \vartheta_{p,t} + \epsilon_{i,l,t}, \quad (1)$$

where $Spread_{i,l,t}$ is the interest rate on mortgage l originated by bank i during month t , net of the maturity-matched risk-free rate, and p refers to mortgage l 's product category (discussed further below). $PostFLS_t$ is an indicator variable equal to 1 after the announcement of the FLS in June 2012, and 0 otherwise. We use the date that the FLS was originally announced (June 2012) rather than the date that full details were published (July 2012) because the original announcement introduced all the key features of

¹⁴Churm et al. (2021) estimate that, after controlling for developments in the euro area, the announcement of the FLS reduced the cost of long-term wholesale funding for major UK banks by around 75 basis points. Weale & Wieladek (2016) also document falls in UK bank funding costs following the FLS announcement.

the scheme (see Section 3.1); in line with this, indicators of wholesale funding costs fall sharply in reaction to the original announcement and not the publication of further details (see Figure 1).

To measure the strength of the equilibrium effect, our key variable of interest is $\%(Wholesale)_{i,2012}$, defined as the ratio of a bank’s wholesale funding to total assets as of 2012:Q1, before the FLS was announced. Our prior is that β should be negative and significant: the more a bank relies on wholesale funding, the more it should be affected by the fall in wholesale funding costs after the announcement of the FLS, and hence the more it should reduce its mortgage lending spreads. $\%(Wholesale)_{i,2012}$ is measured before the announcement of the FLS and is therefore not subject to concerns around reverse causality. However, this variable is not randomly distributed, which raises challenges around omitted variable bias. We therefore include a range of controls and fixed effects, which we now explain in detail.

Controlling for the participation effect A key part of our identification strategy is to control for the potential reduction in funding costs that banks could achieve by *directly* participating in the FLS (Benetton et al. 2025). Failing to control for this “participation effect” could bias the estimate of our key parameter for the equilibrium effect β . Indeed, in Section 4.1 we have shown that a bank’s propensity to participate in the FLS is correlated with its wholesale funding exposure.

The drawdown window opened on 1 August 2012—around 6 weeks after the original announcement of the FLS. Drawdowns picked up gradually from this point, with the majority of drawdowns falling after the end of our baseline sample (June 2013). However, if banks are forward-looking, they should anticipate the benefits of future borrowing immediately after the announcement rather than only when they receive the funding.

To control for the participation effect, we use a pre-determined source of variation in the amount that a bank can expect to borrow from the scheme, in the spirit of Benetton & Fantino (2021). Specifically, we use the ratio of the bank’s initial borrowing allowance to total assets (*Initial Allowance_i*). As discussed in Section 3.1, initial allowance is based on the bank’s pre-FLS stock of lending, and is therefore unaffected by its response to the

FLS. While a bank’s total borrowing allowance is also a function of its lending during the drawdown window (“additional allowance”), exploiting only initial allowance allows us to focus on variation that is outside of the bank’s control once the FLS is announced.

In our estimation, we use *Initial Allowance_i* in two ways. First, we include it directly in our regressions as an additional bank-level control variable (interacted with *PostFLS_t*). Second, we use *Initial Allowance_i* as an instrument for a measure of the bank’s *actual* borrowing from the scheme (*FLS Drawdown_i*), defined as the ratio of total drawing to total assets (again interacted with *PostFLS_t*). As demonstrated in our regression tables, *Initial Allowance_i* is a good predictor of *FLS Drawdown_i*, i.e. the instrument is strong.

Further controls In addition to our proxies for the equilibrium and participation effects, our model also includes a range of controls for potential confounding factors. First, we add bank-product fixed effects $\theta_{i,p}$, where a product is defined by the combination of mortgage fixation period and LTV bucket (for example, one product would be a two-year fixation period with an LTV between 75% and 80%). This controls for any unobservable heterogeneity across banks, even if the effect of this heterogeneity also varies across products (e.g. bank specialisation across products). Second, we include product-time fixed effects $\vartheta_{p,t}$. This controls for confounding aggregate developments that might coincide with the announcement of the FLS (such as changes in credit demand), including developments whose impact could differ across mortgage categories (such as changes in the demand for mortgages by riskier borrowers). We also include several loan-level control variables: log(loan size), mortgage term, mortgage type (fixed or floating), loan-to-value ratio (LTV), loan-to-income ratio (LTI), borrower age, and indicator variables for first-time buyers, home movers, borrowers with an impaired credit history, and brokered loans.

One remaining challenge is that $\%(\textit{Wholesale})_{i,2012}$ might correlate with other bank characteristics that could also shape the effect of the FLS on banks. We therefore include interactions between *PostFLS_t* and a range of bank-level characteristics: log total assets, cash ratio (cash / total assets), capital ratio (capital / total assets), and return on assets (net income / total assets), all measured in 2012:Q1.

Another challenge is that developments in the euro area crisis could affect UK banks’

wholesale funding costs (and therefore lending) for reasons unrelated to the FLS. For example, Mario Draghi’s “whatever it takes” speech was given in July 2012, around one month after the announcement of the FLS.¹⁵ To address this challenge, we follow [Churm et al. \(2021\)](#) and interact our main cross-sectional variable $\%(Wholesale)_{i,2012}$ with the first principal component of CDS spreads for several euro area sovereigns and banks, which summarises changes in euro area risk perceptions over time.¹⁶

5 Main Results

Table 4 reports estimates from a range of increasingly conservative variants of our benchmark model (1). Across all specifications, the parameter estimate β for our key coefficient of interest $\%(Wholesale)_{i,2012} \times PostFLS_t$ is negative and significant.¹⁷ In other words, after the FLS is announced, banks more exposed to wholesale funding reduce spreads on new mortgages. This is consistent with the idea that in response to the fall in wholesale funding costs after the announcement of the FLS (Figure 1), banks more exposed to wholesale funding markets pass these lower funding costs through to mortgage spreads; that is, the FLS operates via an “equilibrium effect”.

Our estimate of β is robust to a rich set of fixed effects (column 1) and loan-level controls (column 2). The estimate is also robust to controlling for developments in the euro area, as proxied by the first principal component of euro area CDS spreads (column 3). The parameter estimate for this time-varying euro area control is statistically insignificant. This is consistent with Figure 1, which shows that while the announcement of the FLS had a large impact on wholesale funding costs for UK banks, Draghi’s “whatever it takes”

¹⁵Figure 1 shows that measures of UK bank wholesale funding costs fell sharply when the FLS was announced, but did not react to Draghi’s speech. However, other developments in the euro area might have affected UK bank funding costs, or the impact could have built more gradually over time.

¹⁶We collect 5-year CDS spreads at daily frequency for eight euro area sovereigns (Belgium, France, Germany, Ireland, Italy, Netherlands, Portugal, Spain) and twelve major euro area banks (BNP Paribas, Societe General, Credit Agricole, BBVA, Santander, Intesa Sanpaolo, Mediobanca, Commerzbank, Deutsche, Unicredit, Banca Monte Dei Paschi, Banco Comercial Portuguese) and extract their first principal component, which explains 86% of their common variation. The time series variation of this principal component tracks stress episodes during the euro area crisis, with higher values indicating more stress. We then aggregate the principal component to the monthly frequency by taking the mean.

¹⁷Note that $\%(Wholesale)_{i,2012}$ is absorbed by bank-product fixed effects $\theta_{i,p}$, and $PostFLS_t$ is absorbed by product-time fixed effects $\vartheta_{p,t}$.

speech had no immediate impact. More broadly, this estimate suggests that euro area developments were not a key driver of UK mortgage rates once we account for the FLS.

In the remaining columns of the table, we introduce our control for the “participation effect” of the FLS. As shown in Section 4.1, participation in the FLS is negatively correlated with wholesale funding exposure. Therefore, failing to control for the potential downward pressure on mortgage spreads associated with directly participating in the FLS could bias our estimate for the equilibrium effect downwards in magnitude. In line with this, when we control for the participation effect, our estimated coefficient for the equilibrium effect increases further in size. This is true both when we control for the participation effect in a reduced-form way by adding a measure of banks’ initial borrowing allowances (column 4), and when we use this measure of initial borrowing allowances as an instrument for realised take-up (column 6). The IV first-stage regression confirms that the instrument is a strong predictor of realised take-up (column 5), with the Kleibergen-Paap first-stage F -statistic in excess of 40.¹⁸

For both the reduced-form and IV approaches, the parameter estimate for the participation effect is negative and significant (columns 4 and 6). In other words, much like the equilibrium effect, the participation effect is associated with reductions in mortgage spreads after the FLS announcement. This result for the participation effect is in line with existing evidence from the ECB’s TLTRO (e.g., [Benetton & Fantino 2021](#)) and the FLS ([Benetton et al. 2025](#)).

Finally, in column 7, we estimate our coefficient for the equilibrium effect separately for banks that do and do not participate. The two coefficient estimates are both negative, strongly significant, and statistically indistinguishable. This provides the most direct evidence for a strong equilibrium effect distinct from any participation effect, since the fall in lending rates holds even for banks that do not participate in the FLS at all.

¹⁸Our control for the participation effect is discussed in more detail in Section 4.3.

5.1 Economic magnitude

To assess the economic magnitude of the equilibrium and participation effects, we first consider the impact on the average bank in our sample. For the average bank, $\%(Wholesale)_{i,2012}$ is equal to 16.3%, and total FLS borrowing is 5.1% of total assets. Meanwhile, in our benchmark IV regression with the full set of controls (Table 4, column 6), our key coefficient estimates are -2.115 for the equilibrium effect ($\%(Wholesale)_{i,2012} \times PostFLS_t$) and -10.420 for the participation effect ($FLS Drawdown_i \times PostFLS_t$). For the average bank, the equilibrium and participation effects are therefore associated with reductions in mortgage spreads of around 34 basis points and 53 basis points, respectively.

However, these estimates for the average bank are likely to underweight the aggregate importance of the equilibrium effect relative to the participation effect. This is because mortgage lending in the UK is dominated by a small number of large banks, and large banks tend to have greater exposure to wholesale funding (so can benefit more from the equilibrium effect) while borrowing less from the FLS (limiting the participation effect). Specifically, if we weight banks by the number of mortgages originated during our sample period, $\%(Wholesale)_{i,2012}$ is equal to 31.9% on average, and total FLS borrowing is 2.4% of total assets on average (Table 2). Therefore, once we weight by mortgage lending, the equilibrium and participation effects are associated with reductions in mortgage spreads of around 68 basis points and 25 basis points, respectively.

Quantitatively, our estimates for the participation effect are broadly consistent with [Benetton et al. \(2025\)](#). Using a structural model, they estimate that the FLS reduces mortgage rates by 44 basis points, which lies between our estimates for the average bank (53 basis points) and weighted-average bank (25 basis points). Like theirs, our results therefore suggest substantial pass-through of the participation effect to borrowers.

However, our results also suggest a substantial reduction in mortgage rates via the equilibrium effect, over and above the participation effect—particularly for the large banks that dominate UK mortgage lending. To put our estimates into context, the average quoted spread for 2-year 75% LTV mortgages rose by around 70 basis points over the nine months leading up to the announcement of the FLS. Our estimates for the equilibrium

effect (34 basis points for the average bank and 68 basis points for the weighted average bank) suggest that this channel reversed a large proportion of that rise.

5.2 Alternative explanations

Our key result is that when the FLS is announced, banks more exposed to wholesale funding offer cheaper mortgages—irrespective of how much they can expect to borrow from the FLS. Our preferred interpretation is that this reflects an “equilibrium effect”, whereby the availability of an outside funding option reduces the cost of wholesale funding, which allows banks more exposed to wholesale funding markets to offer cheaper loans. Before exploring this mechanism further, we test whether our estimate of the equilibrium effect is robust to controlling for other mechanisms proposed by existing literature.

Fees First, we control for any fees that mortgagors must pay in addition to the loan rate.¹⁹ In our baseline regression, we do not control for fees because in our sample period, fees are reported in the PSD data for only a minority of mortgages. In column 1 of Table 5, we therefore restrict the sample to a subset of mortgages for which we can match fees using the dataset of advertised mortgage products collected by Moneyfacts. We then re-run our baseline regression, controlling for the log fee amount.²⁰ In line with [Benetton et al. \(2025\)](#), we find that higher fees are associated with lower loan spreads, and that controlling for fees significantly reduces our estimate of the participation effect ($FLS\ Drawdown_i \times PostFLS_t$). However, our key result for the equilibrium effect ($\%(Wholesale)_{i,2012} \times PostFLS_t$) is robust.

Other Bank of England policies In July 2012, a month after the FLS announcement, the Bank of England announced a program of Quantitative Easing (QE). This led to an

¹⁹Using a structural model, [Benetton et al. \(2025\)](#) estimate that after the FLS, UK banks participating in the FLS reduce their mortgage rates but increase mortgage origination fees.

²⁰Matching PSD and Moneyfacts data is not trivial because there is a significant number of cases in which an originated mortgage in PSD can be matched to more than one quoted mortgage product in Moneyfacts. For simplicity, we only consider mortgages to first-time buyers, and when there are multiple matches we take the highest observed fee. Our results are similar when using the average matched fee instead. We also find similar results when using the actual fee rather than $\log(\text{fee})$, or using the ratio of fee to loan rate.

inflow of reserves into UK banks, which could have affected banks’ mortgage spreads (Wanengkirtyo & Miller 2020). In column 2 of Table 5, we therefore control for bank-level inflows of reserves (as a ratio of total assets) generated by the QE program. Again, our key coefficient for the equilibrium effect is unaffected.

QE might also affect bank lending by affecting the yield curve. For example, if QE pushes down on longer-term yields, this might encourage longer-term lending by banks. To the extent this affects all banks similarly, it would be controlled for by our product-time fixed effects. However, it might affect banks differently depending on their exposure to wholesale funding. In column 3, we therefore control for the interaction between $\%(Wholesale)_{i,2012}$ and the QE factor of Braun et al. (2025), who use high-frequency data to capture the impact of Bank of England QE announcements on yields. Our key results are unchanged.²¹

In June 2012, alongside the announcement of the FLS, the Bank of England also announced the activation of the Extended Collateral Term Repo (ECTR) Facility. The ECTR offered sterling liquidity to banks via six-month repo operations, and therefore might have also contributed to the fall in bank funding costs observed from June 2012. However, given that the ECTR provided much shorter-term funding than the FLS (six months versus four years), it is less likely to have driven the fall in *longer-term* bank funding costs, which are most relevant for mortgage pricing (Figure 1). To confirm that the ECTR is not driving our results, we exploit the fact that ECTR operations were suspended from December 2012, following dwindling demand.²² Specifically, in column 4 of Table 5, we add the interaction between $\%(Wholesale)_{i,2012}$ and an indicator variable equal to one from December 2012 ($PostECTR_t$). The estimated coefficient on this interaction term is close to zero and statistically insignificant, while our main coefficients involving $PostFLS_t$ are unchanged, which suggests that the FLS, and not the ECTR, is driving our results.

²¹Our results are also robust to controlling for the shorter-term monetary policy factors (“target” and “path”) of Braun et al. (2025), as well as the ECB monetary policy factors of Altavilla et al. (2019).

²²Indeed, the low demand in ECTR operations was attributed to banks’ preference for FLS funding over ECTR funding (Belsham 2014).

Competition Next, we control for potential indirect effects of the FLS through competitive dynamics. If participating in the FLS allows banks to offer lower loan rates, then non-participants might also need to reduce loan rates in order to maintain market shares (Andreeva & García-Posada 2021). To control for this, we construct a proxy for how much a given bank could expect its competitors to benefit from FLS participation. Given our main findings, we also measure how much a bank could expect its competitors to benefit from the equilibrium effect.

To construct these two proxies, we first compute the weighted average values of initial borrowing allowance, realised FLS borrowing, and wholesale funding exposure of banks active in each segment of the UK mortgage market, where we weight by each bank’s share of total lending in that market in the five months before the FLS announcement. We define a market by the combination of mortgage product (LTV bucket and fixation period) and geographical location (district).²³ To convert these market-level measures into bank-level measures, we then aggregate each market-level measure across all the markets in which a given bank is active, weighted by the share of the market in the bank’s lending portfolio. Finally, we interact the weighted average realised FLS borrowing (instrumented by weighted average initial allowance) and weighted average wholesale funding exposure with $PostFLS_t$. Our key results (for both the equilibrium effect and participation effect) are unchanged (column 5 of Table 5).

Next, Benetton & Fantino (2021) find that banks that borrow more from the TLTRO increase lending more in areas with higher banking competition. We therefore construct a Herfindahl index at the level of a local market, and interact it with $FLS Drawdown_i \times PostFLS_t$.²⁴ Our key coefficient is again unchanged (column 6).

Borrower risk If banks expect the FLS to improve the economic outlook and therefore reduce borrower credit risk, the fall in mortgage spreads after the FLS announcement could reflect a compression in borrower risk premia, rather than a fall in banks’ funding costs. This could also be the case if the announcement reduces banks’ risk aversion

²³There are around 400 districts in our sample.

²⁴As above, we define a local market by the combination of mortgage product and district. For each local market, we compute the Herfindahl index over 2011.

(Minoiu et al. 2021).

Our regressions already control for several measures of borrower risk (LTV, LTI, credit history). To provide further reassurance, we exploit the idea that a reduction in credit risk or risk aversion should have a larger impact on higher-LTV loans. We therefore construct an indicator variable equal to 1 for mortgages with LTV ratio greater than 75%, and we interact it with our key variable $\%(Wholesale)_{i,2012} \times PostFLS_t$. The estimated coefficient on this triple interaction is positive (Table 5, column 7), which implies that the equilibrium effect is *weaker* for high-LTV mortgages. That is, the FLS lowers the cost of mortgages across the risk spectrum, rather than compressing risk premia.

6 Mechanism

In the previous section, we show that when the FLS is announced, banks more exposed to wholesale funding offer cheaper mortgages—irrespective of how much they can expect to borrow from the FLS. This result is consistent with the idea that the presence of an outside funding option reduces the cost of private wholesale funding, which allows banks more exposed to wholesale funding to offer cheaper loans. In this section, we consider two (non-mutually exclusive) mechanisms that could explain this “equilibrium effect”.

First, under a *risk channel*, the existence of a risk-insensitive outside funding option could reduce banks’ funding liquidity risk (i.e. the risk of being unable to obtain sufficient funding to meet payment and debt obligations as they fall due).²⁵ All else equal, this risk channel should reduce the risk premia required by private wholesale lenders when providing funding to banks. Second, under a *demand channel*, the existence of a public outside funding option could increase banks’ bargaining power in private funding markets and hence lower the price banks would be willing to pay for private funding. All else equal, this demand channel should reduce the mark-up that wholesale lenders can charge when providing funding to banks.²⁶

²⁵In line with this idea, Figure 1 shows that CDS spreads for major UK banks decrease strongly after the FLS announcement.

²⁶In line with this idea, Aldasoro et al. (2022) find that when money market funds are constrained from providing wholesale (short-term unsecured) funding to banks, this increases rates on short-term unsecured funding, consistent with an increase in the bargaining power of funds over banks. The shock

6.1 Evidence from banks' liability structures

To weigh up these two channels, we start by exploiting the fact that they make different predictions for where the equilibrium effect should be strongest depending on the structure of banks' liabilities, in particular along the dimensions of maturity and currency.

Maturity If the risk channel dominates, our main result for the equilibrium effect is more likely to be driven by banks' exposure to *short-term* wholesale funding. This is because short-term funding must be rolled over more frequently than long-term funding, and therefore entails more funding liquidity risk.

On the other hand, if the demand channel dominates, then our main result is more likely to be driven by banks' exposure to *long-term* wholesale funding. This is because the FLS provides long-term funding (four years), and so banks are more likely to see the FLS as a substitute for other sources of long-term funding. Therefore, under the demand channel, the FLS is more likely to reduce banks' demand for long-term wholesale funding, and hence reduce the mark-up that wholesale lenders can charge on this funding.²⁷

To confront these ideas, we use the granular regulatory dataset FSA047/048. This dataset reports outstanding balances for a range of funding instruments, broken down by residual maturity. Specifically, we replace our baseline measure of total wholesale funding exposure $\%(Wholesale)_{i,2012}$ with separate measures for short-term wholesale funding, defined as wholesale funding with residual maturity of less than one year, and long-term wholesale funding, defined as long-term instruments such as bonds and covered bonds.²⁸

Results are reported in Table 6. To ease comparison, in column 1 we replicate our benchmark regression using the FSA047/048 data to construct our measure of *total* wholesale funding exposure ($\%(Wholesale)_{i,2012}$), rather than the data used in our main regressions. The results are similar to our baseline regressions: the estimated coefficient for $\%(Wholesale)_{i,2012} \times PostFLS_t$ is negative and significant, i.e. banks more exposed to

from the FLS announcement can be understood as a similar shock in reverse, with the arrival of a new outside option for banks increasing banks' bargaining power vis-à-vis lenders.

²⁷In line with this idea, Fudulache & Goetz (2023) find that banks that participate more in the ECB's TLTRO tend to increase their money market funding and decrease their bond funding, consistent with long-term central bank funding being a closer substitute for long-term private funding.

²⁸Results are robust to alternative ways of measuring short-term vs long-term.

wholesale funding reduce mortgage spreads after the FLS announcement.

To shed light on the underlying mechanism, in column 2 we replace $\%(Wholesale)_{i,2012}$ with our separate measures of short-term and long-term wholesale funding. The estimated coefficient for short-term funding is negative and significant, and similar in magnitude to the effect for total wholesale funding in column 1; in contrast, the estimate for long-term funding is insignificant. In other words, the equilibrium effect appears to be driven by exposure to short-term wholesale funding, consistent with the risk channel.

Currency We next decompose wholesale funding exposure by currency (sterling vs. euro).²⁹ Under the risk channel, we would expect the equilibrium effect to be stronger for banks more exposed to euro funding, since euro wholesale funding markets were particularly stressed during this period, suggesting that greater reliance on these markets would be likely to increase rollover risk. Under the demand channel, however, the equilibrium effect could be stronger for banks more exposed to sterling funding, since the FLS provides sterling funding and is therefore likely to be a closer substitute to other sterling funding sources. For instance, banks with mostly sterling assets might prefer sterling funding if cross-currency swaps are costly, and wholesale funding providers with mostly sterling liabilities (e.g. UK pension funds) might prefer to lend to banks in sterling to avoid any currency mismatch. In this case, the FLS announcement is likely to exert greater downward pressure on the cost of sterling wholesale funding.

Consistent with the previous test, the results are more consistent with the risk channel (Table 6, column 3): the estimated coefficient is significant for both sterling and euro wholesale funding, but is substantially larger for banks more exposed to euro funding (the difference is statistically significant at the 1% level).

6.2 Evidence from the FLS extension announcement (FLS2)

To shed further light on the mechanism, we exploit the April 2013 announcement of the extension of the FLS (“FLS2”; see Section 3.3). If the risk channel dominates, we would

²⁹For this test, we use the Bank of England’s Form BT dataset, which provides bank balance sheet data decomposed into sterling, euro, and all other currencies.

not expect the extension announcement to trigger a significant equilibrium effect. By the time of this announcement, indicators of UK bank wholesale funding costs had largely normalised (Figure 1; see also [Bank of England \(2013\)](#)). Wholesale funding providers were therefore unlikely to associate the extension of the FLS with a significant further reduction in UK banks’ riskiness. On the other hand, if the demand channel dominates, then the FLS extension might strengthen the equilibrium effect, because it significantly prolongs the period during which banks have access to a public outside funding option and may therefore have lower demand for private wholesale funding.

To test these ideas, we interact our proxy for wholesale funding exposure $\%(Wholesale)_{i,2012}$ with an indicator variable equal to one after the announcement of the FLS extension in April 2013 ($PostExtension_t$). If the risk channel dominates, the parameter estimate should be insignificant, since the announcement would not be associated with a significant equilibrium effect. If the demand channel dominates, the estimate should be negative and significant, consistent with the extension announcement strengthening the equilibrium effect. To capture the extension announcement (April 2013), the sample period starts in July 2012 and ends in October 2013.³⁰ Controls and fixed effects are otherwise similar to the baseline model.

The results show that the parameter estimate for $\%(Wholesale)_{i,2012} \times PostExtension_t$ is insignificant (column 1 of Table 7). This suggests that the risk channel, rather than the demand channel, is the key driver of the equilibrium effect, consistent with our results in Section 6.1.

7 The role of conditionality

The previous sections suggest that the equilibrium effect allows banks to benefit from central bank funding without directly using it, in line with the idea that public funding “creates its own competition” ([Tirole 2012](#)). In this section, we test whether the impact of central bank funding is affected by funding conditionality (“strings attached”), i.e.

³⁰We start the sample in July 2012 to avoid the original FLS1 announcement in June 2012. We end the sample in October 2013 because an amendment to the extension was announced in November 2013; see Section 3.3.

constraints on banks' ability to deploy funding to their preferred purpose. To do so, we exploit three shocks to the degree of conditionality embedded in FLS funding.

7.1 Effect of the FLS extension announcement (FLS2)

To test the importance of conditionality, we first return to the April 2013 announcement of a second wave of FLS funding ("FLS2"). We exploit the fact that this announcement created a shock to the availability of unconditional funding, i.e. funding that can be used to fund any asset.

To see this, recall from Section 3.3 that FLS2 borrowing allowances are equal to the sum of "initial allowances" and "additional allowances." FLS2 *initial* allowances would be based on net lending to households and businesses during the last three quarters of 2013 (which approximately corresponds to the transition period between the announcement of FLS2 and the start of the FLS2 drawdown window). During this transition period, new mortgages could still be funded with FLS1 drawings, but would *also* generate initial allowances for future FLS2 drawings. Importantly, once unlocked, these FLS2 initial allowances could be used to fund any asset; therefore, FLS2 drawings based on initial allowances constitute *unconditional* funding.

Meanwhile, *additional* allowances would be based on net new lending to households and businesses during the FLS2 drawdown window (which starts in February 2014). Since additional allowances can only be unlocked by originating new loans to specific types of borrower, this constitutes *conditional* funding.

Therefore, if banks value unconditional FLS funding more than conditional FLS funding, then we should observe an increase in mortgage lending during the transition period, as banks take the opportunity to unlock future unconditional funding. And this effect should be larger for banks more reliant on FLS funding.

To test this idea, we return to our estimates in column 1 of Table 7, which compare bank behaviour before and after the announcement of FLS2 in April 2013. To isolate the impact of the announcement, this regression focuses on the period between FLS1 and FLS2: specifically, the sample period is from July 2012 (after FLS1 is announced)

to October 2013 (before FLS2 is amended). Figure 2 illustrates our research design graphically.

This time, however, we focus on how the FLS2 announcement affects bank lending depending on a bank’s reliance on FLS funding. To measure reliance on FLS funding, we use *FLS Drawdown_i*, defined as the ratio of total FLS1 drawing to total assets. As for our baseline regressions, we instrument *FLS Drawdown_i* with *Initial Allowance_i*, defined as the ratio of FLS1 initial allowance (measured in June 2012) to total assets. We interact *FLS Drawdown_i* with *PostExtension_t*, an indicator variable equal to 1 after the FLS extension announcement in April 2013. If banks more reliant on FLS funding have a stronger incentive to unlock future unconditional borrowing, then the coefficient on the interaction term *FLS Drawdown_i × PostExtension_t* should be negative and significant.

The results are in line with our prior: the more a bank relies on FLS funding, the more mortgage spreads fall after the extension announcement (Table 7, column 1). This effect cannot reflect a change in the expected cost of funding mortgages *during* the transition period, because all mortgages originated during this period could already be funded by FLS1 funding. Instead, the finding is consistent with the idea that during the transition period, increasing lending is more attractive because it unlocks *future* unconditional borrowing allowances under FLS2, which is especially valuable for larger FLS users. In other words, banks prefer unconditional to conditional funding.

7.2 Effect of the FLS2 amendment

To further examine the importance of conditionality, we turn to the subsequent amendment of the FLS2 program. In November 2013, the Bank of England and HMT announced that, unlike FLS1, and in contrast to the initial announcement of FLS2 in April 2013, any new household lending during the FLS2 drawdown window would *not* generate additional borrowing allowances; instead, additional allowances would be based on business lending only.³¹ The stated objective was to strengthen banks’ incentives to expand business lend-

³¹<https://www.gov.uk/government/news/bank-of-england-and-hm-treasury-re-focus-the-funding-for-lending-scheme-to-support-business-lending-in-2014>. It is credible that the announcement was unexpected; for instance the Council of Mortgage Lenders described the amendment as “a surprise.”

ing rather than mortgage lending, which was seen as no longer in need of support, given rising house prices.

For our purpose, this amendment is a useful shock because it tightens the conditionality of FLS funding. After the amendment, only loans to businesses unlock additional allowances, and not loans to households. All else equal, this should increase the cost of originating mortgages during the FLS2 drawdown window, particularly for banks more reliant on FLS funding.

To test this idea, we interact our measure of FLS reliance ($FLS\ Drawdown_i$) with an indicator variable equal to one after the FLS2 window opens in February 2014 ($PostFLS2_t$). As illustrated by Figure 2, the sample starts in May 2013 (after the initial announcement of FLS2) and ends in November 2014 (before an extension of the FLS2 drawdown window is announced).³² We omit the period between the amendment being announced and coming into effect (November to December 2013), since the effect of the amendment on the cost of mortgage lending will not yet have taken effect during this period (we examine this period in Section 7.3 below).

Results in column 2 of Table 7 show that after the start of the FLS2 window, banks more reliant on FLS funding tend to charge *higher* mortgage spreads. This is consistent with the idea that tightening conditionality mitigates the positive impact of the FLS on mortgage lending. This is the opposite impact to the announcement of the original FLS (Section 5) and its extension (Section 7.1). In other words, the amendment appears to reverse some of the beneficial impact of the FLS on the cost of mortgage lending.

7.3 The “reference period effect”

Finally, we examine how the amendment affects banks’ behaviour during the transition period after the amendment is announced but before it takes effect (November to December 2013), which we omitted from our previous test. During this period, banks already know that, from 2014, mortgage lending will no longer generate “additional” FLS2 borrowing allowances. However, during this transition period, mortgage lending

³²<https://www.gov.uk/government/news/funding-for-lending-scheme-bank-of-england-and-hm-treasury-announce-extension>

still generates “initial” FLS2 borrowing allowances, which are based on net lending (including mortgages) during the last three quarters of 2013 (the FLS2 “reference period”). Therefore, banks that are more reliant on FLS funding *and* expect the amendment to limit their ability to obtain FLS funds in the future might have an incentive to increase lending during these two months. And that “reference period effect” should be larger for banks that are more reliant on mortgage lending, since these banks will see their ability to generate FLS2 borrowing allowances reduce once the amendment takes effect in 2014.

To test this idea, we interact our measure of FLS reliance ($FLS\ Drawdown_i$) with an indicator variable equal to 1 during the transition period (November to December 2013) and 0 before ($PostAmendment_t$). The “pre” period runs from May 2013 (after the extension is announced) to October 2013 (before the amendment is announced). We then interact this measure with a proxy for a bank’s reliance on mortgage lending, namely the ratio of mortgages to total loans as measured in 2012:Q1, before the original FLS1 announcement ($\%(Mortgages)_{i,2012}$).

We find that the estimated coefficient on the triple interaction term ($FLS\ Drawdown_i \times PostAmendment_t \times \%(Mortgages)_{i,2012}$) is negative and significant (Table 7, column 3). That is, after the amendment is announced, banks that are more reliant on FLS funding (on the liability side) *and* mortgage lending (on the asset side) reduce mortgage spreads relative to other banks. This is consistent with the idea that these banks are incentivised to secure (initial) FLS2 borrowing allowances before conditionality becomes tighter.³³

Together, the results in this section suggest that conditionality matters: tightening the conditionality of central bank funding makes it less attractive to banks. This illustrates a key trade-off in the design of funding-for-lending schemes: the tighter the conditionality (in this case, captured by a larger role for additional vs. initial allowances), the more central banks can ensure that funding supports lending to targeted sectors, but the smaller the equilibrium effect.

³³Meanwhile, the estimated coefficient on the double interaction ($FLS\ Drawdown_i \times PostAmendment_t$) is statistically insignificant. This coefficient captures the effect of the reference period for a hypothetical bank with zero mortgage exposure. Given that such a bank is completely inactive in mortgage lending, it is unsurprising that it would be unaffected by the removal of mortgage lending from FLS2 additional allowances.

8 Conclusion

In response to shocks, public authorities can support credit markets by providing liquidity to economic agents. However it is unclear whether public liquidity mainly acts as a substitute or complement for private liquidity. In this paper we tackle this question by exploring the surprise announcement and subsequent amendment of a central bank “funding for lending” scheme. Under such programs, banks can obtain long-term funding at below-market rates, subject to expanding lending to targeted sectors in the real economy. While these schemes are generally thought to have succeeded in stimulating credit supply, there have been concerns about private funding markets being crowded out and private sector risk being transferred to the central bank, and, in some cases, about low take-up ([BIS 2023](#)).³⁴

We show that central bank funding has broader benefits and costs than previously established. If central bank funding is an attractive substitute for private funding, then it should not only lower the funding costs of banks that borrow directly from the central bank, but should also reduce the cost of private funding—even for banks that do not directly participate in the scheme. And the stronger this “equilibrium effect”, the less banks need to participate directly. Judging funding schemes purely on the basis of participation can therefore substantially underestimate their true impact—particularly in times of stress. But if the availability of funding is conditioned on lending to selected sectors, it is likely to be less attractive to banks, which potentially weakens the equilibrium effect.

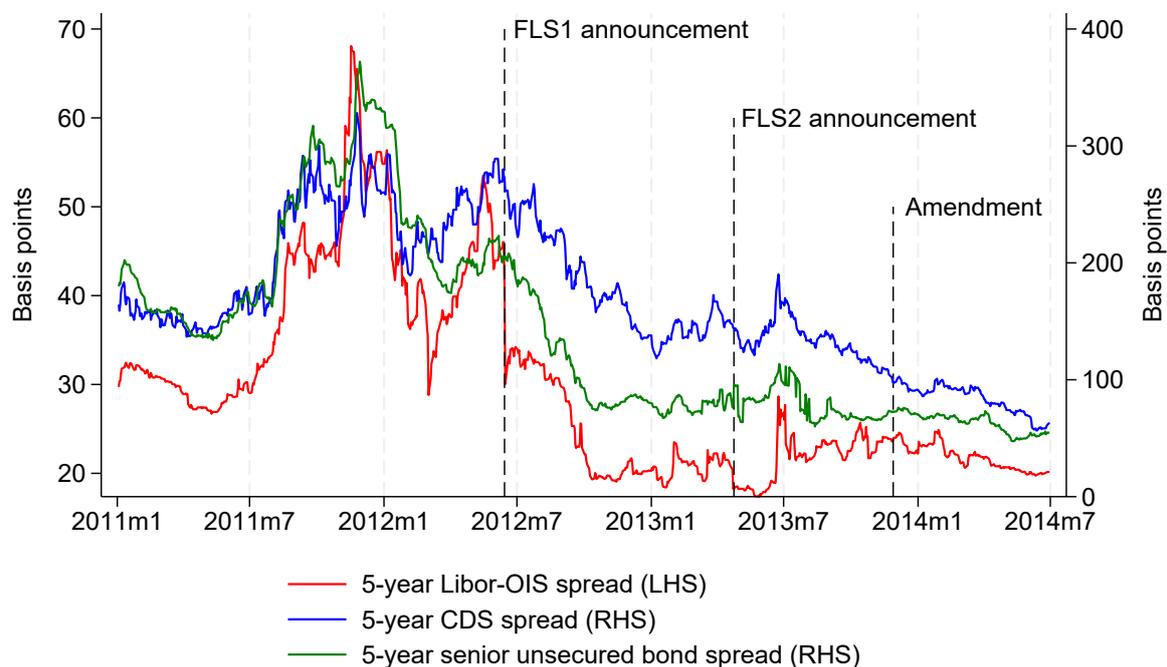
³⁴As of 2022, at least fourteen central banks had deployed such schemes ([BIS 2023](#)).

References

- Acharya, V. V. & Steffen, S. (2015), ‘The “greatest” carry trade ever? Understanding eurozone bank risks’, *Journal of Financial Economics* **115**(2), 215–236.
- Aldasoro, I., Ehlers, T. & Eren, E. (2022), ‘Global banks, dollar funding, and regulation’, *Journal of International Economics* **137**, 103609.
- Altavilla, C., Brugnolini, L., Gürkaynak, R. S., Motto, R. & Ragusa, G. (2019), ‘Measuring euro area monetary policy’, *Journal of Monetary Economics* **108**, 162–179.
- Andreeva, D. C. & García-Posada, M. (2021), ‘The impact of the ECB’s targeted long-term refinancing operations on banks’ lending policies: The role of competition’, *Journal of Banking & Finance* **122**, 105992.
- Armantier, O., Ghysels, E., Sarkar, A. & Shrader, J. (2015), ‘Discount window stigma during the 2007–2008 financial crisis’, *Journal of Financial Economics* **118**(2), 317–335.
- Bank of England (2013), ‘Inflation report, May’, *Bank of England* .
- Belsham, T. (2014), ‘Markets and operations 2014 Q1’, *Bank of England Quarterly Bulletin* **54**(1), 76–87.
- Benetton, M. & Fantino, D. (2021), ‘Targeted monetary policy and bank lending behavior’, *Journal of Financial Economics* **142**(1), 404–429.
- Benetton, M., Gavazza, A. & Surico, P. (2025), ‘Mortgage pricing and monetary policy’, *American Economic Review* **115**(3), 823–63.
- Bernanke, B. S. (2022), *21st century monetary policy: The Federal Reserve from the great inflation to COVID-19*, WW Norton & Company.
- BIS (2023), ‘Funding for lending programmes: Insights from a Markets Committee workshop’, *BIS Markets Committee* .
- Bolton, P., Santos, T. & Scheinkman, J. A. (2009), ‘Market and public liquidity’, *American Economic Review* **99**(2), 594–599.
- Boyarchenko, N., Kovner, A. & Shachar, O. (2022), ‘It’s what you say and what you buy: A holistic evaluation of the corporate credit facilities’, *Journal of Financial Economics* **144**(3), 695–731.
- Braun, R., Miranda-Agrippino, S. & Saha, T. (2025), ‘Measuring monetary policy in the UK: The UK monetary policy event-study database’, *Journal of Monetary Economics* **149**(C), 103645.
- Carpinelli, L. & Crosignani, M. (2021), ‘The design and transmission of central bank liquidity provisions’, *Journal of Financial Economics* **141**(1), 27–47.
- Chavaz, M. & Elliott, D. (2023), ‘Side effects of separating retail and investment banking: Evidence from the UK’, *Bank of England Working Paper* .
- Chavaz, M. & Rose, A. K. (2019), ‘Political borders and bank lending in post-crisis America’, *Review of Finance* **23**(5), 935–959.

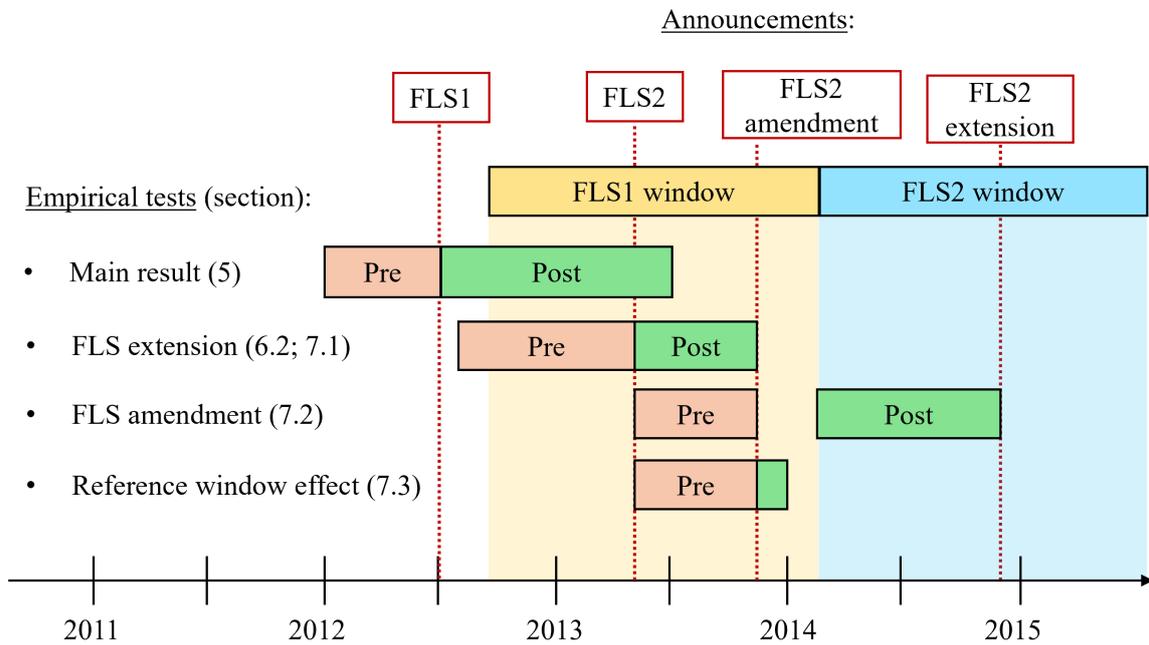
- Churm, R., Joyce, M., Kapetanios, G. & Theodoridis, K. (2021), ‘Unconventional monetary policies and the macroeconomy: The impact of the UK’s QE2 and funding for lending scheme’, *The Quarterly Review of Economics and Finance* **80**, 721–736.
- Churm, R., Radia, A., Leake, J., Srinivasan, S. & Whisker, R. (2012), ‘The Funding for Lending Scheme’, *Bank of England Quarterly Bulletin* **52**(4), 306–320.
- Cloyne, J., Huber, K., Ilzetzki, E. & Kleven, H. (2019), ‘The effect of house prices on household borrowing: A new approach’, *American Economic Review* **109**(6), 2104–2136.
- Crosignani, M., Faria-e Castro, M. & Fonseca, L. (2020), ‘The (unintended?) consequences of the largest liquidity injection ever’, *Journal of Monetary Economics* **112**, 97–112.
- Duchin, R. & Sosyura, D. (2014), ‘Safer ratios, riskier portfolios: Banks’ response to government aid’, *Journal of Financial Economics* **113**(1), 1–28.
- Flanagan, T. (2019), ‘Stealth recapitalization and bank risk taking: Evidence from TL-TROs’, *Working paper* .
- Fudulache, A. E. & Goetz, M. (2023), ‘Long-term deposit funding and demand for central bank funds: Evidence from targeted longer-term refinancing operations’, *Deutsche Bundesbank Discussion Paper* .
- Gagnon, J., Raskin, M., Remache, J. & Sack, B. (2011), ‘The financial market effects of the Federal Reserve’s large-scale asset purchases’, *International Journal of Central Banking* **7**(1), 45–52.
- Holmström, B. & Tirole, J. (1998), ‘Private and public supply of liquidity’, *Journal of Political Economy* **106**(1), 1–40.
- Minoiu, C., Zarutskie, R. & Zlate, A. (2021), ‘Motivating banks to lend? Credit spillover effects of the Main Street lending program’, *FEDS Working Paper* .
- Philippon, T. & Skreta, V. (2012), ‘Optimal interventions in markets with adverse selection’, *American Economic Review* **102**(1), 1–28.
- Robles-Garcia, C. (2019), ‘Competition and incentives in mortgage markets: The role of brokers’, *Working paper* .
- Tirole, J. (2012), ‘Overcoming adverse selection: How public intervention can restore market functioning’, *American Economic Review* **102**(1), 29–59.
- Wanengkirtyo, B. & Miller, S. (2020), ‘Liquidity and monetary transmission: A quasi-experimental approach’, *Bank of England Working Paper* .
- Weale, M. & Wieladek, T. (2016), ‘What are the macroeconomic effects of asset purchases?’, *Journal of Monetary Economics* **79**, 81–93.

Figure 1: Wholesale funding costs for UK banks



Notes: The chart shows measures of long-term wholesale funding costs for UK banks. The red line shows the difference between the 5-year sterling LIBOR swap rate and the 5-year sterling OIS rate. This provides a measure of expected bank credit risk premia over the next five years. The blue line shows the average 5-year senior CDS spread across major UK banks. The green line shows the average spread for senior unsecured bonds of approximately 5-year maturity across major UK banks.

Figure 2: Timeline of FLS announcements and sample periods for empirical analysis



Notes: The figure shows the timing of key FLS announcements and how they relate to the sample periods used in the empirical analysis.

Table 1: Timeline of key FLS announcements

Announcement	Date	Summary
FLS1 announcement (Mansion House speech)	14 June 2012	BoE and HMT to introduce “funding for lending scheme” providing long-term funding to banks at below-market rates, linked to banks’ real-economy lending.
FLS1 details	13 July 2012	Drawdown window to last from 1 August 2012 to 31 January 2014. Term of borrowing to be 4 years. Borrowing allowances equal to “initial allowances” plus “additional allowances”, where initial allowances are equal to 5% of stock of existing real-economy lending as of June 2012, and additional allowances are equal to net new real-economy lending from July 2012 to December 2013. Price of borrowing depends on net new real-economy lending over the same period.
FLS2 announcement	24 April 2013	New one-year drawdown window to open on 1 February 2014. Initial allowances based on net real-economy lending over last three quarters of 2013 (the FLS2 “reference period”). Additional allowances based on net new real-economy lending over 2014.
FLS2 amendment	28 November 2013	Contrary to previous announcement, household lending during 2014 will not contribute to additional allowances.
FLS2 extension	2 December 2014	FLS2 drawdown window extended by one year.

Table 2: Summary statistics

	Obs	Mean	Std Dev	Q1	Median	Q3
Summary statistics for cross-sectional analysis						
Indicator variable for participation in FLS	78	0.462	0.502	0	0	1
Average drawing / Initial allowance	78	0.015	0.062	0	0	0.013
Maximum drawing / Initial allowance	78	0.043	0.172	0	0	0.044
Wholesale funding / Total assets	71	0.163	0.239	0.022	0.074	0.163
Log(Total assets)	67	7.526	2.691	5.525	6.697	9.204
Capital / Total assets	67	0.175	0.059	0.138	0.161	0.189
Return-on-assets	67	0.052	1.838	0.012	0.226	0.481
Cash / Total assets	67	0.046	0.054	0.001	0.034	0.073
Summary statistics for loan-level analysis						
Interest rate spread (percent)	415,671	3.073	1.042	2.428	2.976	3.597
Wholesale funding / Total assets	415,671	0.319	0.157	0.197	0.311	0.403
Initial allowance / Total assets	415,671	0.024	0.012	0.017	0.018	0.037
FLS drawdown / Total assets	415,671	0.024	0.028	0.002	0.008	0.056
Indicator variable for participation in FLS	415,671	0.895	0.306	1	1	1
First principal component of euro area CDS spreads	415,671	4.001	3.247	0.671	5.117	6.883
Short-term wholesale funding / Total assets	415,671	0.104	0.089	0.042	0.081	0.104
Long-term wholesale funding / Total assets	415,671	0.120	0.044	0.093	0.120	0.148
Sterling wholesale funding / Total assets	415,671	0.145	0.036	0.124	0.153	0.168
Euro wholesale funding / Total assets	415,671	0.094	0.069	0.023	0.108	0.133

Notes: The table shows summary statistics for variables used in the regressions. Balance sheet variables are measured as of 2012:Q1. The sample period for the loan-level regressions is January 2012 to June 2013.

Table 3: Wholesale funding exposure and propensity to participate in FLS

Dependent variable:	Indicator variable for participation		Average drawing / Initial allowance		Maximum drawing / Initial allowance	
	Probit (1)	Probit (2)	OLS (3)	OLS (4)	OLS (5)	OLS (6)
$\%(\text{Wholesale})_{i,2012}$	-6.903*** (2.392)	-8.592*** (2.644)	-0.058* (0.034)	-0.057** (0.025)	-0.141* (0.079)	-0.133*** (0.047)
Log(Total assets)	Yes	Yes	Yes	Yes	Yes	Yes
Other bank-level controls	No	Yes	No	Yes	No	Yes
Observations	71	67	71	67	71	67
R^2	0.198	0.230	0.018	0.743	0.018	0.812

Notes: The table shows cross-sectional bank-level regression results of FLS1 participation on exposure to wholesale funding (see Section 4.1). The dependent variables are an indicator variable equal to one if the bank registers to participate in FLS1 (columns 1 and 2); the bank's average drawing from FLS1 over the full drawdown window (August 2012 to January 2014), divided by initial allowance (columns 3 and 4); and the bank's maximum drawing from FLS1 over the full drawdown window, divided by initial allowance (columns 5 and 6). $\%(\text{Wholesale})_{i,2012}$ is the bank's ratio of wholesale funding to total assets as of 2012:Q1. All columns control for log(total assets). Columns 2, 4, and 6 also control for the bank's cash ratio, capital ratio, and return-on-assets. All control variables are measured as of 2012:Q1. Columns 1 and 2 are estimated by probit. Columns 3–6 are estimated by OLS. Robust standard errors are reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 4: Main results

Dependent variable:	Spread _{<i>i,l,t</i>}	Spread _{<i>i,l,t</i>}	Spread _{<i>i,l,t</i>}	Spread _{<i>i,l,t</i>}	FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>}	Spread _{<i>i,l,t</i>}	Spread _{<i>i,l,t</i>}
Model:	OLS	OLS	OLS	OLS	IV stage 1	IV stage 2	IV stage 2
Instrument:						Initial allow _{<i>i</i>} × Post FLS _{<i>t</i>}	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
% (Wholesale) _{<i>i</i>,2012} × Post FLS _{<i>t</i>}	-1.596** (0.616)	-1.565** (0.593)	-1.380*** (0.481)	-2.581*** (0.670)	0.045 (0.039)	-2.115*** (0.316)	
% (Wholesale) _{<i>i</i>,2012} × Euro PCA _{<i>t</i>}			0.059 (0.047)	0.062 (0.047)	0.001*** (0.000)	0.071 (0.047)	
Initial allowance _{<i>i</i>} × Post FLS _{<i>t</i>}				-22.673*** (7.152)	2.176*** (0.340)		
FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>}						-10.420*** (2.395)	-6.345*** (1.366)
% (Wholesale) _{<i>i</i>,2012} × Post FLS _{<i>t</i>} × Part _{<i>i</i>}							-1.783*** (0.208)
% (Wholesale) _{<i>i</i>,2012} × Post FLS _{<i>t</i>} × Non-part _{<i>i</i>}							-1.206*** (0.298)
Bank × Product fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Product × Time fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Bank-level controls × Post FLS _{<i>t</i>}	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mortgage-level controls	No	Yes	Yes	Yes	Yes	Yes	Yes
Observations	415,671	415,671	415,671	415,671	415,671	415,671	415,671
R ²	0.685	0.692	0.692	0.693	0.970		
Kleibergen-Paap F-statistic						41.0	29.4

Notes: The table shows loan-level regression results for equation (1). The sample period is January 2012 to June 2013. Spread_{*i,l,t*} is the interest rate on mortgage *l* originated by bank *i* in month *t*, net of the maturity-matched OIS (overnight indexed swap) rate. % (Wholesale)_{*i*,2012} is bank *i*'s ratio of wholesale funding to total assets as of 2012:Q1. Post FLS_{*t*} is an indicator variable equal to one after June 2012. Euro PCA_{*t*} is the first principal component of CDS spreads for several euro area sovereigns and banks. Initial allowance_{*i*} is bank *i*'s ratio of initial FLS1 borrowing allowance to total assets (measured in June 2012). FLS drawdown_{*i*} is bank *i*'s ratio of total FLS1 borrowing to total assets. Part_{*i*} is an indicator variable equal to one for banks that register to participate in FLS1. Bank-level controls are: log(total assets), cash ratio, capital ratio, and return-on-assets, measured as of 2012:Q1. Mortgage-level controls are: log(loop size), mortgage term, mortgage type (fixed or floating), LTV ratio, LTI ratio, borrower age, and indicator variables for first-time buyers, home movers, borrowers with an impaired credit history, and brokered loans. Columns 1–4 are estimated by OLS. In columns 6 and 7, (FLS drawdown_{*i*} × Post FLS_{*t*}) is instrumented by (Initial allowance_{*i*} × Post FLS_{*t*}). Column 5 shows the first-stage regression for the IV regression in column 6. Standard errors are clustered by bank and reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 5: Controlling for alternative explanations

Dependent variable:	Spread _{<i>i,l,t</i>}						
Model:	IV	IV	IV	IV	IV	IV	IV
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
% (Wholesale) _{<i>i,2012</i>} × Post FLS _{<i>t</i>}	-1.566*** (0.253)	-2.266*** (0.355)	-2.129*** (0.315)	-2.115*** (0.330)	-2.384*** (0.388)	-2.338*** (0.359)	-2.794*** (0.384)
FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>}	-2.054 (1.316)	-9.668*** (2.089)	-10.407*** (2.397)	-10.421*** (2.404)	-10.031*** (2.797)	-10.187*** (2.352)	-12.701*** (2.916)
Log(Fee) _{<i>l</i>}	-0.0005*** (0.0001)						
QE inflow _{<i>i,t</i>}		-14.519** (6.094)					
% (Wholesale) _{<i>i,2012</i>} × QE factor _{<i>t</i>}			-0.946 (1.265)				
% (Wholesale) _{<i>i,2012</i>} × Post ECTR _{<i>t</i>}				0.002 (0.123)			
Competitor % (Wholesale) _{<i>i,2012</i>} × Post FLS _{<i>t</i>}					-0.143 (0.357)		
Competitor FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>}					0.029 (4.241)		
FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>} × Herfindahl						-0.144 (0.214)	
% (Wholesale) _{<i>i,2012</i>} × Post FLS _{<i>t</i>} × High-LTV _{<i>l</i>}							1.367*** (0.374)
FLS drawdown _{<i>i</i>} × Post FLS _{<i>t</i>} × High-LTV _{<i>l</i>}							6.063** (2.966)
Bank × Product fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Product × Time fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Bank-level controls × Post FLS _{<i>t</i>}	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mortgage-level controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	67,895	415,671	415,671	415,671	384,034	413,895	415,671
Kleibergen-Paap <i>F</i> -statistic	26.3	40.6	41.0	41.1	14.6	20.6	9.0

Notes: The table shows loan-level regression results for equation (1), with additional control variables (see Section 5.2). The sample period is January 2012 to June 2013. Spread_{*i,l,t*} is the interest rate on mortgage *l* originated by bank *i* in month *t*, net of the maturity-matched OIS (overnight indexed swap) rate. % (Wholesale)_{*i,2012*} is bank *i*'s ratio of wholesale funding to total assets as of 2012:Q1. Post FLS_{*t*} is an indicator variable equal to one after June 2012. FLS drawdown_{*i*} is bank *i*'s ratio of total FLS1 borrowing to total assets. All variables involving FLS drawdown_{*i*} are instrumented by corresponding variables involving Initial allowance_{*i*}, i.e. bank *i*'s ratio of initial FLS1 borrowing allowance to total assets (measured in June 2012). Log(Fee)_{*l*} is the log of the mortgage fee (from Moneyfacts); column 1 only includes mortgages to first-time buyers. QE inflow_{*i,t*} is the quantity of reserves received by bank *i* in quarter *t* as a result of the QE programme announced by the BoE in July 2012, divided by total assets. QE factor_{*t*} is the UK QE factor from Braun et al. (2025). Post ECTR_{*t*} is an indicator variable equal to one after December 2012. Competitor % (Wholesale)_{*i,2012*} and Competitor FLS drawdown_{*i*} are, respectively, the weighted average values of % (Wholesale)_{*i,2012*} and FLS drawdown_{*i*} in local markets to which bank *i* is exposed (see Section 5.2 for details), where a local market is defined by the combination of mortgage product (LTV bucket and fixation period) and location (district). Herfindahl is the Herfindahl index for the local market, calculated over 2011. High-LTV_{*l*} is an indicator variable for mortgages with LTV ratio greater than 75%. Bank-level controls and mortgage-level controls are as detailed in Table 4. Standard errors are clustered by bank and reported in parentheses. *** *p* < 0.01, ** *p* < 0.05, * *p* < 0.1.

Table 6: Mechanism for the equilibrium effect

Dependent variable:	Spread $_{i,l,t}$		
Model:	IV	IV	IV
	(1)	(2)	(3)
% (Wholesale) $_{i,2012} \times \text{Post FLS}_t$	-2.134** (0.839)		
% (Wholesale Short-term) $_{i,2012} \times \text{Post FLS}_t$		-2.320*** (0.653)	
% (Wholesale Long-term) $_{i,2012} \times \text{Post FLS}_t$		2.879 (2.517)	
% (Wholesale Sterling) $_{i,2012} \times \text{Post FLS}_t$			-1.993** (0.977)
% (Wholesale Euro) $_{i,2012} \times \text{Post FLS}_t$			-5.949*** (0.362)
FLS drawdown $_i \times \text{Post FLS}_t$	-3.554* (2.101)	-10.010* (5.134)	-10.933*** (1.059)
Bank \times Product fixed effects	Yes	Yes	Yes
Product \times Time fixed effects	Yes	Yes	Yes
Bank-level controls \times Post FLS $_t$	Yes	Yes	Yes
Mortgage-level controls	Yes	Yes	Yes
Observations	415,671	415,671	415,671
Kleibergen-Paap F -statistic	68.9	26.0	86.9

Notes: The table shows loan-level regression results for equation (1), with additional decompositions of wholesale funding exposure (see Section 6). The sample period is January 2012 to June 2013. Spread $_{i,l,t}$ is the interest rate on mortgage l originated by bank i in month t , net of the maturity-matched OIS (overnight indexed swap) rate. % (Wholesale) $_{i,2012}$ is bank i 's ratio of total wholesale funding to total assets as of 2012:Q1. Short-term wholesale funding is defined as wholesale funding with residual maturity of less than one year. Long-term wholesale funding is defined as covered bonds, securitised bonds, and unsecured debt securities. Sterling and euro wholesale funding refer to the currency of denomination. Wholesale funding measures are based on FSA047/048 (columns 1 and 2) and Form BT (column 3) as of 2012:Q1. Post FLS $_t$ is an indicator variable equal to one after June 2012. FLS drawdown $_i$ is bank i 's ratio of total FLS1 borrowing to total assets. (FLS drawdown $_i \times \text{Post FLS}_t$) is instrumented by (Initial allowance $_i \times \text{Post FLS}_t$), where Initial allowance $_i$ is bank i 's ratio of initial FLS1 borrowing allowance to total assets (measured in June 2012). Bank-level controls and mortgage-level controls are as detailed in Table 4. Standard errors are clustered by bank and reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 7: Impact of the FLS extension and amendment

Dependent variable:	Spread $_{i,l,t}$		
	Jul 2012–Oct 2013	May 2013–Nov 2014	May 2013–Dec 2013
Sample period:			
Model:	IV	IV	IV
	(1)	(2)	(3)
% (Wholesale) $_{i,2012} \times$ Post Extension $_t$	-0.240 (0.254)		
FLS drawdown $_i \times$ Post Extension $_t$	-3.530** (1.622)		
% (Wholesale) $_{i,2012} \times$ Post FLS2 $_t$		0.091 (0.143)	
FLS drawdown $_i \times$ Post FLS2 $_t$		2.210** (0.947)	
% (Wholesale) $_{i,2012} \times$ Post Amendment $_t$			-0.159 (0.273)
FLS drawdown $_i \times$ Post Amendment $_t$			24.246 (20.353)
FLS drawdown $_i \times$ Post Amendment $_t \times$ % (Mortgages) $_{i,2012}$			-34.996** (16.253)
Bank \times Product fixed effects	Yes	Yes	Yes
Product \times Time fixed effects	Yes	Yes	Yes
Bank-level controls \times Post	Yes	Yes	Yes
Mortgage-level controls	Yes	Yes	Yes
Observations	417,799	467,589	242,379
Kleibergen-Paap F -statistic	25.3	21.4	0.4

Notes: The table shows loan-level regression results for several variants of equation (1) capturing the announcement, drawdown window, and amendment of FLS2 (see Section 7). The sample period varies across columns; the sample period in column 2 excludes November and December 2013. Spread $_{i,l,t}$ is the interest rate on mortgage l originated by bank i in month t , net of the maturity-matched OIS (overnight indexed swap) rate. % (Wholesale) $_{i,2012}$ is bank i 's ratio of total wholesale funding to total assets as of 2012:Q1. FLS drawdown $_i$ is bank i 's ratio of total FLS1 borrowing to total assets. All variables involving FLS drawdown $_i$ are instrumented by corresponding variables involving Initial allowance $_i$, i.e. bank i 's ratio of initial FLS1 borrowing allowance to total assets (measured in June 2012). Post Extension $_t$ is an indicator variable equal to one after April 2013. Post FLS2 $_t$ is an indicator variable equal to one after February 2014. Post Amendment $_t$ is an indicator variable equal to one in November and December 2013. % (Mortgages) $_{i,2012}$ is bank i 's ratio of mortgages to total loans as of 2012:Q1. Bank-level controls and mortgage-level controls are as detailed in Table 4. Standard errors are clustered by bank and reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Previous volumes in this series

1335 March 2026	Tokenomics and blockchain fragmentation	Hyun Song Shin
1334 March 2026	Robots, ICT and employment: evidence from advanced and emerging EU countries	Costanza Bosone, Leonardo Gambacorta, Paolo Giudici, Enisse Kharroubi and Ulf Lewrick
1333 March 2026	Generative AI for surveys on payment apps: AI views on privacy and technology	Koji Takahashi and Joon Suk Park
1332 February 2026	Dollar funding and housing markets: the role of non-US global banks	Torsten Ehlers, Mathias Hoffmann and Alexander Raabe
1331 February 2026	The perils of narrowing fiscal spaces	Hanno Kase, Leonardo Melosi, Sebastian Rast and Matthias Rottner
1330 February 2026	Passive investors and loan spreads	Konrad Adler, Sebastian Doerr and Sonya Zhu
1329 February 2026	Adoption and welfare effects of payment innovations: the case of digital wallets in Peru	Arturo Andia, Jose Aurazo and Marcelo Paliza
1328 February 2026	The perils of narrowing fiscal spaces	Hanno Kase, Leonardo Melosi, Sebastian Rast and Matthias Rottner
1327 January 2026	A tractable menu cost model with an aggregate markup drift	Ko Munakata
1326 January 2026	Monetary policy and private equity acquisitions: tracing the links	Fernando Avalos, Boris Hofmann and Jose Maria Serena
1325 January 2026	AI adoption, productivity and employment: evidence from European firms	Iñaki Aldasoro, Leonardo Gambacorta, Rozalia Pal, Debora Revoltella, Christoph Weiss and Marcin Wolfski
1324 January 2026	The macro-financial impact of economic policy uncertainty in Latin America	Ana Aguilar, Rafael Guerra, Carola Müller and Alexandre Tombini

All volumes are available on our website www.bis.org