

Andrew Bailey: Challenges to financial stability

Speech by Mr Andrew Bailey, Governor of the Bank of England, at the Klaas Knot Farewell Symposium, Amsterdam, 3 October 2025.

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It is a great pleasure to be here today to celebrate Klaas's time as President of De Nederlandsche Bank and Chair of the Financial Stability Board. But more than that, to recognise Klaas as a very good friend and colleague.

Klaas's time as Governor covered most of the period since the financial crisis. But his career goes further back, both at the DNB and the Ministry of Finance here in the Netherlands. He has seen it all, and has been at the heart of rebuilding financial stability. It is I think therefore appropriate to concentrate on the theme of financial stability.

I am going to focus on a number of key questions. What has been achieved in the time since the crisis? What appears to be the challenge today to these achievements? And where do we go from here? There have been times in recent years when we might have treated these questions as matters of more academic speculation, that's not so today. They are real questions up for debate and challenge. I know that Klaas will want to be part of answering them. And Klaas, you need no encouragement from us, please do get stuck in, with your trademark elegance and force, the hallmark of Dutch football that you are such a keen supporter of.

What has been achieved in the field of financial stability since the financial crisis? Answer – a lot. Yes, today's world is a highly uncertain and unpredictable place sadly. We have experienced very large shocks – a pandemic, the longest war in Europe since 1945, I could go on.

But we have come through, so far at least, without a crisis of financial stability of the sort that has been seen in the past. Likewise, we have not had a major and lasting recession during these recent shocks.

But, this all reminds us that bad things happen in the world, and they can affect financial stability, this is always possible. That said, we start with a financial system that is much more resilient, which is a much better place to be. We have a banking system that after a long-haul post-crisis appears to be sustainably earning its cost of capital in terms of returns. This is reflected in market pricing, with market price-to-book value more consistently above unity.

Another lens through which to look at this point is to examine arrears and loan losses across the recent period of economic shocks. The evidence points to resilience here – such losses have been low by historical standards. Of course, this benefits banks and their shareholders, but it also helps consumers as customers and economies generally. Customers get better outcomes and particularly when they avoid having their business closed, losing their job, or having their home repossessed. The benefits of financial stability are real and tangible. Yes, but they may not be perceived as such. One of the challenges of financial stability is that it is a state of being in which success comes

when things don't happen, and don't go wrong. It is therefore susceptible to the problem of "out of sight, out of mind", in other words under-appreciated.

But, I am conscious that this story alone leaves open the charge that we have achieved the so-called stability of the graveyard. Nothing moves, there are no big dramas, because the system is moribund. Not true, is my response. The financial system has evolved and continues to do so. The record of the last 15 years indicates that the financial system has played its part in supporting economies through a series of severe shocks, and has acted to absorb rather than amplify these shocks. I would emphasise here that financial stability is not an end in itself. Rather, the goal is to support economic activity, a point I will come back to later.

When we look at the developments of the last 15 years or so we should also recognise how the financial system has changed, and it certainly has. I am not going to give an extensive review of the changes, but rather pick out a small number of key points and seek to explain their broader significance.

The first major change that we have seen is a rebalancing of the overall scale of global financial intermediation with an increase in the non-bank sector relative to banks. The non-bank sector is not, of course, homogenous, a point I will come back to. I think it is worth drawing out a number of closely related points that underline this shift in balance between banks and non-banks. The first is one that, I think, was clear during the financial crisis, and provides a backdrop to the changes that were to come. It is that the financial crisis was severely exacerbated by the concentration of assets and exposures on the balance sheets of banks which were too volatile and hard to value in a stress, and thus created too much uncertainty around the stability and ultimately solvency of banks.

One of the eternal questions that gets posed during such a stress is whether for banks it is a solvency or liquidity event. The presumption is that the latter is ok in the sense of manageable while preserving going concern, while the former is not. But the problem is that we only know the answer to this question ex-post. Illiquidity is a symptom which tends to point towards doubt around future solvency, but does not answer the question conclusively, either ex-ante or contemporaneously. The question is better put as whether there is sufficient uncertainty around future solvency to cause stress through illiquidity. The answer to this question in many, if not all, problem cases during the crisis was yes. From that answer, it is a logical step to conclude – as we did – that the tools of liquidity assistance available to central banks – let's call them the traditional Bagehot tools – should be reinforced and supplemented by tools of resolution, and this rightly became an important part of the post-crisis agenda for national authorities and the FSB, an agenda that Klaas has played a major part in leading.

We have made huge progress on the resolution agenda. Alongside that, we have also made huge progress on the Basel agenda for reforming the prudential regulation of banks. At this point, I must make the - obvious I hope but it has to be made anyway – comment that we must finish off implementation. Linking this back to the re-balancing of the bank and non-bank financial sectors, these developments help to explain why the re-balance has been a sensible and logical development. It has been a foundation reducing the probability of crisis in the banking system.

But, some of the argument for this was apparent at the time of the crisis, and some was less apparent. I think what has become more obvious over the last 15 years is why this change matters for financial stability, and what it tells us about the future. For me at least, this is where the concept of the singleness of money, and trust in money, comes in, and how it underpins the regulation of banks. Put simply, why were some assets problematic for banks in the crisis, and why did it matter?

The distinctive feature of banks is that their liabilities are typically substantially in the form of money deposits. In the regulatory world, it is deposit taking that is unique to banks. Most of the stock of money in our systems is commercial bank deposits.

These deposits underpin the functions of money – its role as store of value, unit of account and means of exchange or payment. The critical property of money is trust in its nominal value.

Put simply, a Pound or euro in my account has the same value as a Pound or euro in another account, and thus when we make payments we do not have to worry about variable nominal value. This is a key foundation of financial stability, and thus of public trust. In the crisis it was the uncertainty about the future solvency of banks that undermined this trust and thus ended financial stability itself. The underlying issue here was increasing doubts on whether the liabilities of banks did satisfy the properties of the singleness of money. So, a key objective of the post crisis reforms has been to rebuild confidence in the singleness of, and trust in, money.

However, if I stopped the account here, it would fall into the trap of adapting an old-fashioned view of banks that they are only deposit-takers, and not involved in activities which get loosely called investment banking. In what I regard as one of the best books on financial crises, Gary Gorton described the 2008 crisis in the US as a run on repo, prime broker balances, and asset-backed commercial paper.^{[1](#)}

At first sight, this appears critically to muddy the distinction between banks and non-banks. Can we be confident we know where the boundary lies? The lessons here are that the critical feature of banks is the singleness of money and the public's trust in the assured nominal value of their money. Moreover, since banks are ultimately single entities, their reputation and that trust depends on confidence in their balance sheets as a whole (which is not, of course, to ignore that their capital structures must involve loss-bearing in both going and gone concern states). In other words, we must be very focused on the money system in our economies and its stability.

That said, our economies rely on financial risk taking, and that is essential to support investment and growth. To achieve this, it's crucial in large parts of the non-bank system that there is not assured nominal value for the liabilities so that risky investment proceeds. It is critical that we maintain this distinction between banks and non-banks, and it is well understood by the public.

I will, however, add two important qualifications.

First, banks must of course take risks – that should not need to be said, but just in case. The point is that the risks must be managed to preserve the assured value of money. Most non-banks do not need to do this. But, second, some non-banks do write liability

contracts which contain promises of future value of one sort or another. Insurance is a very good example of this.

My key point here is that over the last fifteen years post crisis, the distinction between banks and non-banks and the importance of the money system has become better understood and defined. It is not new at all, but it has been important to define it under today's conditions. Failure to do so was a major flaw that led to the financial crisis.

There has to be a "however" though, and this brings in the second of the three big changes in financial intermediation that we have seen since the financial crisis. The "however" is that it would be a mistake to think that the greater scale of non-bank finance, and the distinction between money and non-money liabilities has led to a comprehensive separation of these two parts of finance. The two are as inter-connected as ever, but in ways that have changed. And, this is absolutely key to understanding financial stability today and the risks to it.

Let me use a prominent example. There has been a major change in the nature of trading in most major government debt markets, resulting in a much expanded non-bank presence and often much more leverage attached to newer trading strategies. But the banking system remains the ultimate source of liquidity for these activities. Banks' activities in prime brokerage have expanded substantially and rapidly. The financing is typically secured and margined to protect against risk. Often, this relies on another of the major post-crisis developments, namely the expansion of central clearing.

These developments are consistent with the post-crisis direction of policymaking, to strengthen infrastructures like clearing houses, put them at the heart of the system, and thereby manage and reduce the risk of serious systemic stress which threatens financial stability. There is a good case that these developments have to date worked. However, rather like the overall growth of non-bank finance, we should not be surprised that a stronger infrastructure has led to the growth, for instance, of more leveraged trading activities. Our job as authorities is to understand these developments and assess and if necessary tackle any vulnerabilities that they may give rise to. That's all work that Klaas has led in the FSB, and we are continuing.

I would describe developments such as the growth of leveraged trading as putting the post-crisis financial system to work. We may or may not like all of them, and they give rise to new risks, but we shouldn't be surprised that the system responds and evolves.

Another example of post-crisis developments in non-bank finance is private assets – private equity and private credit. These may fall into a somewhat different behavioural category, namely there may be aspects of public markets which encourage going private. Our job is to assess the consequences for financial stability purposes. It is not to presume that such developments are per se bad, but rather to ask questions and assess them with rigour and be transparent with our conclusions. In the lead up to the crisis, there was a different culture, more of an absence and at times disapproval of such scrutiny, and the consequences were regrettable.

A third big change in financial intermediation post-crisis that I would highlight is the growth of crypto assets. I'm not convinced that the cause of this was a response to post-crisis regulation. It seems to me to be more an outcome of technological advances. But

it falls into the category of new areas that require thorough assessment of possible vulnerabilities and their financial stability implications. I don't regard crypto as a homogenous world, and the distinction between investments and money helps with understanding the distinction. Crypto of the Bitcoin variety falls into the risky investment category, whereas stablecoins used for retail and wholesale payments, rather than just to support crypto trading, fall into the money category, or should do. Understanding the implications of this distinction is important for designing the approach to regulation. But, I will go further than that and say it should enable better stablecoins to emerge than would do in a world in which the distinction was not understood and followed up.

This point takes me to the last important theme I want to cover today, and again one that is closely associated with the leadership that Klaas has undertaken.

Today, we face a growing challenge to the post-crisis system of financial regulation. It comes with a number of descriptions and reasons. One is an old point made by Hyman Minsky, that as time passes memories of a financial crisis fade and this leads to a questioning of the continuing need for the responses. This creates the risk of history showing signs of repeating itself, remembering back for instance to the strength of the deregulation argument before the financial crisis. Those of us, like Klaas, who are veterans of dealing with the financial crisis, don't tend to forget, but I can see evidence in today's world of the truth of Minsky's observation.

But I don't think the Minsky theory is the end of the story. Another argument made is what gets described as the need for regulatory simplification. I think a reasonable interpretation of this argument is that it is perhaps natural that the response to an event as big as the financial crisis becomes over-complicated, and the passage of time exposes the need to stand back and take a hard look at whether some parts of the response are too complicated, or excessive. There is truth in this, and we should take up the challenge and respond – and we are doing so. But, again I don't think this is the full story on the reasons for the growing challenge to financial regulation.

A third argument I detect concerns the distributional effects of the regulatory changes, and comes in a few forms. The first is that the response to the financial crisis has changed the financial system and has thereby gone too far to create winners and losers. A second form of this argument is that the post-crisis regulatory system is inflexible and does not allow innovation. These are important arguments about competitiveness that we need to assess carefully. Brushing them off will not do. Again, where there is truth in the argument, we should respond.

The fourth argument I can see in many ways is the most fundamental namely that the regulatory system is impeding growth in economies. This is a very important challenge, for the simple reason that the potential growth rate of many developed economies has slowed markedly since the financial crisis, and particularly the growth of productivity. And since productivity is a main determinant of the growth of living standards, the evidence of a very flat growth in GDP per capita underlines the importance of this point.

So, we have four challenges to the state of financial regulation, all of which amount in different ways to saying that we have overdone it post-crisis. In my remaining time, I

probably can't do each or any of them proper justice, but this debate is now so central to what we are doing that it has to be taken on and given due consideration. To remind him again, I hope Klaas will be part of this effort.

I will start with the Minsky passage of time point. First of all, I think Minsky was right, and current events are illustrating his point. As I mentioned earlier, success in financial stability is when nothing happens, and not much has happened relative to the scale and nature of the shocks we have had – Covid, Ukraine etc. It is convenient to think, nothing has happened, job done with regulation, I rest my case for the benefits. But meanwhile, the argument is growing that since nothing much has happened, we must be overdoing it on regulation.

The answer to all of this is that it rightly pushes us to ground the case for regulation and keep doing so, because "out of sight, out of mind" does not lead to good long-run outcomes. Moreover, since the world constantly changes, it is a mistake to freeze the regulatory system because it appears to have worked in the recent period of time. Here I think it is important to set out the specific outcomes we seek in the financial system when we say we are aiming for financial stability. What I have in mind here are outcomes as follows: First, we want a system where confidence in banking is maintained in the face of economic shocks and where resolution regimes enable the continuity of financial services if a bank fails. Second, we want to maintain the singleness of money, including where new types of non-bank that have grown up in the crypto world seek to issue money for real-world payments purposed. Third, we want robust market and payments infrastructure that operates without interruption and recovers quickly from rare disruptions. Fourth, we want financing from banks and non-banks to the real economy that is sustainable through the economic cycle and avoids excess supply of debt followed by debt overhang. These are big building block outcomes that we have to articulate, otherwise the debate on regulation is dangerously ungrounded

Let me turn to the second challenge, the point on simplification. Regulation probably does go in cycles, and we should recognise this and respond. Post-crisis it was straightforward to advance a cost-benefit case for increasing regulation, and this happened. By the way, in my experience governments were very much part of this process, it wasn't just central banks and regulators. But pro-cyclical regulation is not a good or stable state of the world, and we should recognise this. There is little doubt that in some areas we collect too much data. There is also a growing risk that because of this, as the pro-cyclical tide turns, we are inhibited from collecting necessary data in new areas of risk. So, we must, and I think are, responding positively to the simplification challenge. Another case of simplification is the adoption of a simpler capital regime for small deposit takers, in the UK the so-called "Strong and Simple" regime.

The third challenge is the competitiveness one. As I mentioned, this comes in several forms – you have skewed competitiveness by regulating, and you have prevented innovation by doing so. These are basically the same argument taking on different forms. Here, too, we must respond, and we have to ground the response in the core building block arguments. The danger here, to be frank, is that arguments that are interest based – and I don't say this in a critical way, it's a matter of fact – swamp the fundamental ideas based grounding of financial regulation. We have seen this before –

its another form of the Minsky argument. It is the case that post-crisis regulation did intentionally change the competitive balance of banks and non-banks, for the reasons that we had ended up pre-crisis with an unstable and dangerous banking system which had lost the anchor of the singleness of money. That anchor could only be put back in place with massive state intervention at an unacceptable cost to taxpayers.

Today, I would argue that the financial system is not only more stable, but also generally earning returns which meet basic commercial objectives. It is up to firms then to increase their returns further, nothing is wrong with that. But there is a point in the third challenge. We must enable safe innovation and development of the financial system, otherwise competitiveness is an issue and it will undermine achieving the goal of financial stability. This enablement needs however to happen within a system that is grounded in the core ideas and principles. Yes, I'm back to points like the singleness of money again.

The fourth challenge, the growth issue, is crucial. We face a huge challenge on this front. However, I push back at the line of argument that post-crisis financial regulation caused the fall in productivity growth, by restricting business investment in the economy. I think it is a rather different line of argument. Big shifts in productivity growth over history have been shaped by advances in so-called general purpose technology – things like the steam engine, electricity etc. We had such an advance before the financial crisis, through ICT and the internet. Over time, the contribution of these advances to economic growth does run out – that's as distinct from their contribution to the level of economic activity. I think this is more what we have seen post-crisis, but the timing is coincidentally awkward for separating out causes.

All of that said, we need a financial system that is ready and able to finance the next general purpose technology advance, which I would guess is AI. This is the important question today. In my view this must be a stable financial system, grounded in the core areas and principles of financial stability, but one that must be set up to support growth.

To finish, all of these four challenges have a point to them. We cannot behave as if the case for financial stability can ignore them. That said, if the baby is thrown out with the bath water so to speak, and financial stability is relegated in terms of its importance, we won't achieve our objectives. There is no trade-off between financial stability and objectives like growth and competitiveness.

But nor is our system perfect in every respect and fit for an ever-changing world. Our system must be constantly assessed and adapted as needed. But that process must be grounded in the core principles and ideas of financial stability. Klaas, you have been a leader in ensuring we do this, and I hope and believe you will go on being so.

Thank you.

I would like to thank Nathanaël Benjamin, Sarah Breeden, Karen Jude and Sam Woods for their comments and help in the preparation of this speech.

¹ Gary Gorton, 'Misunderstanding Financial Crises: Why We Don't See Them Coming'. Oxford University Press, 2012.

