

BANK OF ENGLAND  
LONDON EC2R 8AH

1 February 2012

James Cameron Esq  
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Dear Mr. Cameron,

Thank you for your recent letter in which you raise a number of interesting issues related to the exposure of UK financial institutions to carbon-intensive sectors. The Financial Policy Committee (FPC) takes seriously any material risk to UK financial stability, including medium-to-long-term risks.

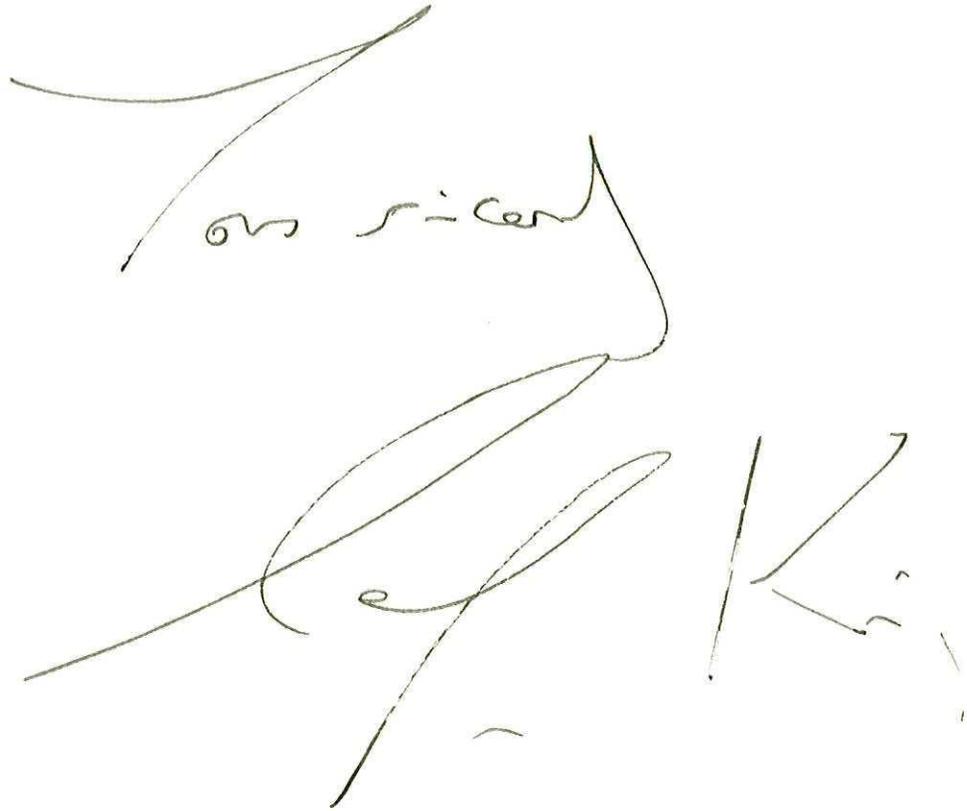
The particular risk you raise is that financial institutions are investing in carbon-intensive firms that may produce lower returns than expected – either through lower dividends on equity or, in extremis, default of corporate debt. The hypothesis is that, if such lower returns were realised, it would have an adverse impact on the financial health of investing institutions, with potentially large consequences for the functioning of the financial system.

To our understanding, such an eventuality would in broad terms require three key ingredients: First that the exposures of financial institutions to carbon-intensive sectors are large relative to overall assets; second that the impact of policy and technology working to reduce returns in high carbon areas is not already being priced into the market, either through lower expected returns or higher risk premia discounting these returns; and third that any subsequent correction would take place over an insufficiently long period of time for the relevant financial institutions to adjust their portfolios in an orderly manner. The necessity of all three conditions being met raises a question in our minds as to whether or not this is a potential threat to financial stability.

Nevertheless, there is clearly scope for further evaluation of these issues, in particular the potential scale of the risk and transmission mechanisms through which it might impact UK financial stability. To this end, we will endeavour to include this in the list of topics we regularly discuss with market participants, to assess whether or not this is a risk of which they are aware and the

extent to which they are taking it into account in their investment decisions. In addition, Andy Haldane, the Bank's Executive Director for Financial Stability, would also be happy to meet with you and discuss the issues you raise.

With all best wishes.



Tom Ricketts

The image shows a handwritten signature in black ink. The signature is written in a cursive style and appears to read "Tom Ricketts". The signature is positioned in the center of the page, below the text "With all best wishes.".