



Treasury Committee

Oral evidence: [Bank of England November 2013 Financial Stability Report](#), HC 987

Wednesday 15 January 2014

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Members present: Mr Andrew Tyrie (Chair), Stewart Hosie, Mr Pat McFadden, Mr Brooks Newmark, Jesse Norman, Teresa Pearce, Mr David Ruffley, John Thurso

Questions [1–62]

Witnesses: **Dr Mark Carney**, Governor, Bank of England, **Sir Jon Cunliffe**, Deputy Governor, Bank of England, **Dame Clara Furse DBE**, External Member, Financial Policy Committee, and **Mr Richard Sharp**, External Member, Financial Policy Committee, gave evidence.

Q1 Chair: Governor and team from the FPC, thank you very much for coming to see us this afternoon. Can I begin by asking you, Governor, a couple of questions on the topical subjects that are knocking around at the moment on bank restructuring and on remuneration in banks? On the issue of restructuring—that is, the case for capping market share or balance sheet size in order to improve competition—the Vickers Commission did quite a bit of work on this and they came to the conclusion that neither approach was appropriate. You have come new to this, although you might have some Canadian experience to bring to bear. Have you had a chance to examine what John Vickers said in all this and what do you think?

Dr Carney: Thank you, Chair and members. In terms of my recollection of what the Vickers Commission said on this subject, I think the points they raised with which I would agree, or at least the ones I retained, let us put it that way—and I only retain the ones I agree with—that a sort of simple approach that caps size or, in the specific case they looked at, a specific number of branches that were going to be potentially disposed of and ultimately were or are in the process of being, you need to look at the entire package of the institution. What is the actual business model? What goes with the liabilities, i.e. the deposits and others that come with the branches? What is the asset

structure with the loans? Where are loans to deposits? What is the risk structure as a consequence of that? What are the Treasury operations that go with that? What is the risk management? What is the strategic objective?

Then also—and this gets into higher order questions of effective competition, which Sir John Vickers is very well placed to comment upon given his extensive expertise—just breaking up an institution does not necessarily create a more intensive competitive structure, and so relevant competition authorities need to look at it. I will make that general point, which is that it is not just about one aspect. You need to look at the entire business model and the risk profile and certainly, whether it is the PRA or more broadly the FPC, we would look at that.

I make a separate point from my experience, which is more international than Canadian, which is that in the United States there is a hard cap on deposits. You can't have more than 10% of the deposit share in the US and that is a rule that has been in place for—

Chair: That is Dodd-Frank, is it?

Dr Carney: It is a rule that has been in place for decades, so well precedes, obviously, Dodd-Frank. One of the points I would make from a Financial Policy Committee perspective is that obviously that rule, in and of itself, did not prevent the creation of large systemic financial institutions. In fact, one could argue a bit—but I would not overstate this—that, by limiting the absolute funding for certain large institutions—in other words, they cannot go above that 10% deposit cap—it encouraged on the margin more wholesale funding for expanding balance sheets, which created a risk in and of itself. So we have to look at this in the round. I will finish here. As this Committee is well aware, in part through this Committee's work and work through the PCBS, we now have a secondary remit at the PRA to have regard to competition with respect to regulation in our actions.

Chair: We had to work very hard to get it there, but I am glad we have.

Dr Carney: But it is there and we will discharge it, yes.

Q2 Chair: The Vickers Commission, concluded, "Capping market share and balance sheet size would not result in substantial improvements to competition in retail banking in the UK." Do you agree with that?

Dr Carney: I certainly have no reason to disagree with the conclusions of the Vickers Commission.

Q3 Chair: A cautious man, but I have the general gist.

On the bonus cap, the Parliamentary Commission—and there are a couple of members of it here now—looked at the EU bonus cap and we concluded, “We are not convinced that a crude bonus cap is the right instrument for controlling pay. Nonetheless, we have concluded that variable remuneration needs to fall.” Do you agree with that conclusion?

Dr Carney: Absolutely; absolutely.

Q4 Chair: Can I turn to the issue of leverage? Are you entirely happy with the Basel—no, you are not. There was a definite twitch even before I completed the word “happy”. Perhaps you could tell me what it is about Basel that you think would merit a bit of improvement.

Dr Carney: If I may answer the question directly, I would say we are satisfied with the Basel agreement. Let me go through the positives and I will highlight one or two issues. The first reason why we are absolutely satisfied is we now have a globally agreed standard for leverage, so it takes away the uncertainty for a leverage ratio. I will not go into all the reasons why a leverage ratio is important, unless people want me to, but we have a globally agreed standard. It takes away that definitional uncertainty, assuming that it is applied appropriately in the relative jurisdictions that we all watch. That is the first point.

The second point is we have a stricter definition than the definition that we were applying here in the UK and that was in CRD IV. It is stricter in terms of its treatment of credit derivatives as one example, and it is also stricter in terms of its treatment of securities financing transactions, so those are material tightenings.

The third reason to be satisfied is that there are sensible adjustments to this definition that will help the system function better. I will give you a couple of examples.

Chair: They are not get-outs?

Dr Carney: They are not get-outs. These are sensible things. I will give you the examples and hopefully you will agree with it. First is that there is now the ability to net cash margin against derivative positions, both initial and variable. If you have cash in hand against an exposure, you can net that off against the exposure. This is exactly what we want to happen in the market—that there is more posting of cash, more posting of margin against these exposures, and it reinforces that behaviour. Since it is cash in hand, not securities that are treated as cash, it is a sensible adjustment. That is the first thing.

The second thing is that there is on-boarding—bringing on balance sheet off-balance sheet exposures—and it uses the standardised approach. I should start with everything that is on balance sheet. Everything that is on balance sheet is there in the leverage ratio. Nothing is taken away. There are always arguments around the fringes and I would say going into this past weekend our concern was that there would be some success in stating that a certain asset is risk-free and, therefore, the one next to it is slightly, almost risk-free and so on and gradually you lose the great advantage of a leveraged ratio, which is simplicity. Everything on balance sheet is there. Another advantage is it is accounting neutral, so the treatment of it is neutral to the small—in some cases larger—differences between US GAAP and international GAAP.

It also brings on to balance sheet off-balance sheet factors and here is where the compromise is. This is part of the slightly unhappy—or accepting as part of a compromise. It uses what is the standardised approach in Basel for the risk of those off-balance sheet items, so a certain risk is applied to a back-up liquidity line and it uses that percentage. It is the one case where there is the use of a risk weighting to bring things that are off balance sheet on to balance sheet—contingent exposures. One of the reasons why we were happy with that is we received the other tightenings as part of the agreement in exchange for that and relatedly, as part of using that approach, we had a much more sensible approach to trade finance exposures. It was punitive to trade finance exposures, which are contingent exposures, and that proved to be problematic during the course of the crisis and in the immediate aftermath of the crisis, so this again is a sensible adjustment.

Q5 Chair: You are going to fully implement all this?

Dr Carney: Our intention is to fully implement it. We have to see how Europe translates this into European regulation but, on the assumption that it will be mapped to European regulation, as it was agreed, and since the EC was there and—

Chair: But what if it is not?

Dr Carney: I do not want to speak for the Committee, but my personal view is we would consider adjustments in calibration as opposed to in definition.

Chair: Just expand that.

Dr Carney: I have no reason to expect this because this was a unanimous agreement of the Basel Committee, but—

Chair: No, but if the definitions get watered down you will jack up the numbers. Why don't you say what you mean?

Dr Carney: That is a simpler way of saying it, yes.

Chair: Is there anything I have said that is incorrect?

Dr Carney: No, I agree with that.

Q6 Chair: Okay. In that case, a further question has to be whether you will stop at exactly what we have with Basel, assuming it is fully implemented, or whether you want to tack something on top.

Dr Carney: I want to be absolutely clear what is agreed in Basel. What was agreed in Basel was the definition and additional disclosure around that definition, so you could adjust all those things I just referenced by additional disclosure that banks were going to make. If you did not like the definition as an investor or a lender to a bank, you could make adjustments in their prescribed disclosure, but what was agreed was that banks will have to report in Basel at a minimum from 2015—in the UK it will be sooner than this—and then in 2017 there will be a decision of the Basel Committee about making this a formal pillar 1 requirement. Somewhere between now and then there will be calibration.

Because we have used this number internationally, the presumption is that it will be at least 3%. I think at least 3% is a reasonable presumption, but as we apply this definition in the UK—and, as you know, it is a priority of this Committee over the course of this year to review the leverage ratio and its application—we will give thought to calibration both on a base and with respect to ring-fenced banks and with respect to systemic banks. As I have indicated in the past, my personal—and I am not speaking for the Committee—inclination is that we would not jack up but gross up whatever the base level is for ring-fenced banks and for systemic banks in order to ensure that the leverage ratio fully performs its function.

Q7 Chair: There was something of a rally in banking stocks after this announcement, suggesting they thought things were going to be worse.

Dr Carney: There was a rally, yes. Any time that you have a very short-term market move, you are judging where the securities were relative to expectations. The largest rally was in European bank stocks. In UK bank stocks it was a very modest adjustment on the course of the day, which can be consistent with the way we have been applying leverage and the fact that this is a slight tightening.

Q8 Chair: Do you get the impression, as was reported in various places, that the banks were all over those taking the decision and that they—

Dr Carney: No, not at all. I think the banks were totally in the dark about what was going to be decided. As Chairman of the FSB, I am pretty confident about that. We had a consultation process as the Basel Committee, as we should have. I think the adjustments we made were sensible adjustments and I will stress that netting off of cash margin is a sensible adjustment. It is good for the derivative market and it reduces risk. The other adjustment we made, which is slightly arcane and complex, was an adjustment for the margin that banks hold when they clear on behalf of other clients through a central counterparty clearing arrangement. That is something that again reduces systemic risk because it promotes central clearing of counterparties. Those are the types of changes that we were able to make as a result of the consultation, but they were not the types of changes that institutions had any reason to expect that we necessarily would have made.

Q9 Mr Ruffley: Eligibility of mortgage lending—FLS. The stated reason for the change was, “There is no longer a need for the FLS to provide further broad support to household lending.” Could you explain what specific indicators you looked at when coming to that conclusion, Governor?

Dr Carney: Yes. Thank you for the question. We looked at a range of indicators in terms of the absolute levels of mortgages, both fixed and variable, the survey measures of the availability, and bank level data in terms of mortgage applications and mortgage lending. There has been a marked improvement. We also looked, for part of the broader consideration, at the overall change in bank funding costs in wholesale markets because, as you will recall, one of the original motivations of Funding for Lending was exactly to help reduce the funding costs of banks in the whole in order to promote lending both to the mortgage and the commercial sector.

Q10 Mr Ruffley: The mortgage lending withdrawal was in relation to the FLS extension and the additional allowance. Just explain this to me. There are still mortgages that attract FLS funding through the initial allowance, which is from April to December 2013?

Dr Carney: That is correct.

Mr Ruffley: My question is: when will that existing relief be withdrawn? In what circumstances will it be withdrawn?

Dr Carney: What we wanted to do with the change—and I will stress that this ultimately was a decision of the Bank and the Treasury; it is a joint scheme between the two; although the FPC was supportive of this change, as was the MPC—is that we did not want to and we did not renege on any part of the original agreement. If you earned an allowance through mortgage lending in the past, you retain that allowance and you can use that allowance over the life of the scheme, which runs through the course of next year. However, you cannot earn, as you well know, those additional allowances.

If I could put it in some context in the mortgage market, the analogy was taking our foot off the accelerator, not putting our foot on the brake, in terms of this change because our sense was—given where mortgage lending was likely to go, various scenarios for mortgage lending over the course of 2014 and the additional allowances that could be earned as a consequence of that—that it could provide an additional reduction in mortgage rates through lower funding costs of, I would say, up to 30 basis points. Mortgage rates have come down by a couple of hundred basis points as funding has come down, but an additional amount was, in our view, just not necessary at a time when mortgages are growing in high single digits at very competitive rates.

Q11 Mr Ruffley: Is there a sense that this existing relief will be unwound at some future date, and if so, when?

Dr Carney: The scheme itself runs out at the end of this year.

Q12 Mr Ruffley: Is there a sense that, when it does expire, the commercial lenders might hit a brick wall?

Dr Carney: I would say no for two main reasons. First, our observations of funding conditions for commercial lenders are very strong. Secondly, for the FLS to be consistent with its original spirit, which was to get funding costs down from extreme levels and support the funding market—it would become a backstop-type facility, so something that banks would draw on in the event that there were disruptions to funding markets. We have changed the way we supply liquidity to the system as a whole. There is a new sterling market framework and, in that sterling market framework, the banks can use mortgages and, in fact, a much broader range of collateral to collateralise, in any sort of distressed market condition, quite cost-effective funding from the Bank of England. We still provide the backstop, but we provide it on a much more coherent, comprehensive and permanent basis.

Q13 Mr Ruffley: Is there any sense that you might have to have tapering provisions at all?

Dr Carney: No.

Q14 Mr Ruffley: My colleague, Mrs Pearce, will be asking about house prices but before she asks those questions, Governor, could you just reflect on the credit conditions survey? The last one said that household demand for secured lending in Q4 rose at its fastest pace since the survey began in 2007. What do you think is driving this mortgage demand so high?

Dr Carney: Part of the answer is in the question and in the timeline of the survey. Obviously the survey came into being just as credit demand was at a peak and then it very sharply fell off. We are still in a position, as I think you are aware, that mortgage applications, mortgage transactions and housing transactions, for that matter, are running, on average, at about three quarters of the pre-crisis average levels. We have had an acceleration from quite a low level. As a Committee, obviously in all aspects of the housing market and certainly any time we see sharp increases in credit growth, we take an interest. We are monitoring this closely because it is the question of the momentum that is there and the length of time that it is sustained. We do have to put it some context, though—that it is running still below historic averages.

Mr Ruffley: What do you think is driving it?

Dr Carney: Housing activity. It is mortgage activity coming up from very low levels and it is purely transactional.

Mr Ruffley: You just think it is kind of a snapping back to—

Dr Carney: It has been a snapping back and the question is: will it snap back right through previous averages? Very importantly, one of the things this Committee has been very focused on, as has the PRA, has been: will further sustained high single-digit or even low double-digit growth in mortgage activity be accompanied, and could it only be accompanied by a deterioration in underwriting standards? We do not want to see that because that is the type of behaviour that obviously reduces the resilience of the system as a whole and feeds potentially extrapolative dynamics in the housing market, which is a risk that we are monitoring closely.

Q15 Mr Ruffley: A final question. Did the Bank or the Committee model the effect on mortgage demand of the withdrawal of mortgage lending within FLS? Did you do any analysis?

Dr Carney: We did analysis. The analysis to which I referred, which is the potential impact on spreads, and—

Mr Ruffley: What did it tell you, that this tweaking of FLS or its impact on—

Dr Carney: It told us that there would be slightly less rapid growth in mortgage activity. We do not have an FPC forecast of house prices. We do have an MPC analysis of potential ranges of house prices. We do not give a point forecast, but our general expectation has been for a continuation of current momentum, house price momentum and mortgage activity and credit growth momentum into 2014 before decelerating around the middle of 2015, towards 2016, towards growth in terms of debt; so total household debt more approximating the rate of growth of incomes. Again, this element of the adjustment was taking the foot off the accelerator, so that it was even stronger than we currently project.

Mr Ruffley: Thank you.

Q16 Chair: Sir Jon, I should have asked you before I left leverage whether you think the EU are going to do what is necessary to implement Basel.

Sir Jon Cunliffe: The EU has by this summer to translate the Basel definition into a requirement. Again, for the EU, it will be the requirement of disclosure. My guess would be yes. As the Governor said, they were present at the meeting. They were part of the agreement. I think one of the things where the EU definition in CRD IV differed from Basel was around trade finance and that point. That is now covered in the Basel definition. My expectation would be, having been part of the agreement, when it comes to translate the agreement into EU legislation for disclosure, which I guess will happen by the summer of this year, they will be faithful to the Basel agreement.

Chair: That is a yes? They will be faithful in full?

Sir Jon Cunliffe: That is my guess.

Chair: That is your main projection?

Sir Jon Cunliffe: My informed guess.

Q17 Teresa Pearce: Dr Carney, if I understood you correctly, I think you just said that you believe that the increase in house prices is down to increasing mortgage availability. Is that what you just said?

Dr Carney: No. What I suggested was that the growth in mortgages was a function of increased transactions in the housing market coming off very low levels—it was more of a mechanical point, which is: why is secured debt growing at that rate? It is growing because we have come off from about 50,000 or 60,000 transactions to move up towards about 90,000 transactions.

Q18 Teresa Pearce: What do you believe is the cause of the quite large increase in house prices, particularly in London, that we have seen in the last few months?

Dr Carney: There are a variety of factors. If one goes to central London, there is an element of foreign demand that is driving those, but if one adjusts—

Teresa Pearce: So that is exceptional?

Dr Carney: As we do highlight in the report, if you look at all the regions of the United Kingdom, we have moved over the last year from a period where house prices were rising only in London, to house prices moving up in all regions—with the exception, I believe, of Northern Ireland, at the point in time we looked at this. Why has that happened? I think you have to start with the fact that house prices went down and they certainly went down relative to income, so there is an adjustment back from that.

Secondly, there is the basic supply/demand dynamics in the housing market. There has been very little home building here relative to desired household formation for a long period of time, and that was exacerbated since the start of the crisis where there was a sharp fall-off in home building. Thirdly, as the financial sector has started to recover and fulfil its function there has been a change in mortgage availability, but it has not been complete because one of the dynamics we see in terms of house prices—and this is true across the United Kingdom—is that there has been more movement in higher-price house prices for a given region.

If you look at the upper quartile of house prices, those have increased more than those cheaper houses in relative terms. Our view, and we have reason to think this, is that is in part due to the availability of mortgages. It has been tougher to get mortgages if you are an entrant to the housing market.

Q19 Teresa Pearce: Yet in London, where house prices are vastly increasing, a large percentage of purchases of properties are cash purchases. The mortgage market there does not have an effect.

Dr Carney: That is absolutely true. In value terms, these are big numbers in London. In volume terms—so percentage of transactions—these are low single-digit numbers in terms of actual numbers of houses. Again, from a financial stability perspective, where is the risk? First, the risk, of course, is what is happening across the United Kingdom. Secondly, it is where people are borrowing as opposed to paying cash. People might lose money if they pay cash, but it does not create a knock-on effect and it is—what risks are being taken in those circumstances? That is where we are focused as a Committee.

Q20 Teresa Pearce: Dame Clara, why do you think house prices have increased? Why do you think we have seen this resurgence in house prices?

Dame Clara Furse: I think there is a large element of a bounce from quite low levels of activity and also, obviously, the housing market has been very subdued and house prices had fallen over a period of time.

Chair: Clara, I cannot hear you.

Dame Clara Furse: I am sorry; I shall try to speak directly into the microphone. I was saying that I think there is a large element of bounce-back taking place in the housing market from very low levels of both activity and also prices. I think there is a level of increased confidence in the economy generally.

Q21 Teresa Pearce: Do you think rising house prices are good for the economy?

Dame Clara Furse: Obviously, rapidly increasing house prices are not necessarily good for the economy, but it does depend very much on how much debt is being taken on in order to acquire whatever the asset is that is being acquired. It does come back to the indebtedness of households and that has been falling. Loan to income ratios have been creeping up a little bit, loan to value is around 95%, but all of that recovery is from a relatively low base.

Q22 Teresa Pearce: Sir Jon, this housing problem we have in this country—and we do have a housing crisis—do you think it is a problem of supply or cost or both?

Sir Jon Cunliffe: I think the position in the housing market is a pretty complex one. It is not one single factor that produces the situation you now have. I think the underlying issue is an imbalance between supply and demand in housing in the areas that people want or need to live. That has been the UK issue for as long as I can remember. We do have

an issue in the UK that, even when house prices go up and the economy is doing very well, the additional housing supply from previous booms has never been very great. We have never had the same sort of stocks of unsold houses when it has come to the bust in the housing market that you have seen in other countries. There is an underlying problem of supply and demand and that has been with us for a long time. I think what you see now is that the market was depressed. It was depressed because the economy was depressed. I think a lot of people—

Teresa Pearce: We were all depressed.

Sir Jon Cunliffe: Well, we were all depressed. A lot of people who wanted to move and have needed to move have not moved houses. I think you also see now that there is more confidence in the economy. Economic growth is coming back, and I would imagine that some of the demand that was depressed over the last few years is beginning to come back. As to what the problem is, I think the thing that one takes note of is the speed of the increase in house prices. Depending how you measure it, the levels are still below pre-crisis levels, but the momentum, as the Governor said, in the market is the thing that one watches.

Q23 Teresa Pearce: The OBR is still saying that housing supply per householder is still falling. How many houses do you think we would need to build to rectify that? How many homes do you think the UK will need to balance this? Any idea?

Sir Jon Cunliffe: I do not have a number for that.

Teresa Pearce: Mr Sharp, do you have any idea?

Mr Sharp: I think you are right that there is a supply problem. I do not know what the exact number is, but there is clearly a supply problem.

Teresa Pearce: But it is a big number.

Mr Sharp: It is a very large number. If you look at the housing construction, it has been lamentable. If you look at the household formations, they are increasing significantly: people living longer, people living separately. If you look at the amount that is spent per household on housing in this country versus other countries, it is higher. There has been a supply problem.

Teresa Pearce: Dr Carney seemed to be intimating he knew the answer to the question there.

Dr Carney: I do not know the answer to it, but I think I can give you a sense, which is very simple. As you know, I come from Canada.

Teresa Pearce: Really?

Dr Carney: It is still obvious, yes. There are roughly half as many people in Canada as the UK, and roughly twice as many houses are built every year in Canada compared with the UK. The demographics of Canada are slightly older than the UK. Obviously space is not an issue in Canada and so the planning and other elements are quite easy, but it gives one a sense of desired household formation. As Sir Jon intimated, in the areas where people either want to live or have to live, there just is not that order of magnitude of supply and it gives one a sense at least of the scale of the issue. It is an issue, as he also said, and we recognise it has built up over many years.

Q24 Teresa Pearce: We have an issue with supply. We have rising house prices, but I am hearing that that is just a sort of snap-back from a low level, possibly, and not a worry at this point, but how would you identify a housing bubble? It is your job to do that. How will you do it?

Dr Carney: I think one has to look at behaviours and the extent to which the dynamics in the housing market are driven by the expectations of future prices in the housing market. If there are extrapolative expectations of individuals and, very importantly, if that is accompanied by the expectations of lenders—in other words, if a lender is lending to an individual basically on the assumption that the risk is very low because the value of the underlying asset of the house is going to continue to go up, so as the lender I do not do a very good job of checking your ability to pay and I am willing to lend a very high proportion of the current value of the house because I expect it to continue to go up.

It has been that deterioration in underwriting standards, whether it was in the United States, whether it was in Sweden in the early 1990s or whether it was here at times in the last decade—it is that type of behaviour that drives the last bubble-like phase of the housing market and creates the financial stability problem. That is why the mortgage market review terms are coming into force in April of this year. That is why we are conducting stress tests, as both the FPC and the PRA, of the banks. That is why we are looking to have affordability tests as well, to stop this type of behaviour in its tracks.

I will finish with this. One of the issues right now and one of the issues in the last several years—and all of our answers give a bit of a sense of pent-up demand—and one of the things that is causing the snap-back

is there were people who could afford houses and wanted to move into houses, but they did not have access to mortgages. There is still some element of that in the market, particularly for those who are below median incomes.

Q25 Teresa Pearce: What you are talking about is responsible lending and then we have the Help to Buy scheme. Under the Help to Buy scheme, where people are given larger mortgages than they would have received normally, should house prices drop because supply increases—and possibly house prices will come down—the risk does not fall on the lender. The risk falls on the taxpayer because, if there is a negative equity or a person cannot pay, the bank or whoever lent the money gets their money first and the taxpayer loses their money. You have to be even more careful to make sure that when they are lending, when they are not bearing the risk, they adhere to those sensible policies that you have just outlined. Do you have to be even more rigorous with Help to Buy loans than we have with ordinary loans?

Dr Carney: Lenders have to be rigorous with Help to Buy loans. Lenders have to apply those mortgage market regulation standards from the start of the Help to Buy programme, so they do not wait until April. Those are already in place. They also take the first exposure before the taxpayer does.¹ The structure of it has a so-called vertical slice, if you will, of exposure that goes to the bank lender, but it is not the scale of the mortgage. You are absolutely right that the core of it is providing the additional insurance to reduce the effect of loan to value. The underwriting standards have to be there.

Now, the programme thus far, to my information, is about 6,000 applications and about 750 mortgages that have been written. They are mostly 95% loan to value, so high loan to value mortgages. The loan to income stats or one of the measures of the creditworthiness of the borrower are not elevated relative to other first-time buyers and the actual value of the properties are around the median and slightly below the median value of a property in the UK.

I will finish with this. From a Financial Policy Committee perspective, any evaluation of Help to Buy would be in the context of what impact it could have on the mortgage market in general and risk to financial stability in general. We are watching it. We do get the statistics around it. It is still of quite a modest scale relative to the scale of the overall market.

¹ *Note by witness:* the Government protects 95% of the first-loss on a given loan, and the lender is exposed to the remaining 5%. It is therefore right that lenders are exposed to some of the first loss; however they do not take the first loss before the Government.

Q26 Teresa Pearce: If it poses a risk to financial markets, that is a point at which you have to do something. What about if it poses a risk to individuals, to homeowners and to people who are trying to get one? Is it only financial markets you are looking at, or the wider public?

Dr Carney: Our responsibility is to assess risk to financial stability—so more broadly financial stability, which does not necessarily have to do with financial markets. It has broader implications. I will say that if it poses risks in a material way to individuals, so if there is a large cohort, to use a technical term, or a large group of borrowers who engage in a certain type of borrowing that is inconsistent with their prospects of repayment, and I have no reason to believe that is the case in this case—

Teresa Pearce: But if?

Dr Carney: If it were—for other mortgage practices elsewhere in the market we would look elsewhere in the market for those risks right now, quite frankly—that could have financial stability implications if it were on a large enough scale because of the boom/bust type nature that could develop because of the debt overhang that was there, the hit on balance sheets and the impact on broader assets and economic developments.

Q27 Stewart Hosie: Governor, the latest *Financial Stability Report* expressed concern regarding a further build-up of household indebtedness and offered loan to value and loan to income tools as a possible solution. Can you describe briefly how those tools could be used to curtail a rise in household indebtedness?

Dr Carney: Thank you for the question. As you are aware, what the Committee was careful to outline was a broad range of tools, which included those. It included sectorial capital requirements. It included things we are doing that are already in train and some additional measures that we are doing this year, including stress tests, the funding for lending adjustment that is there and others.

Loan to value and loan to income tools have been used in other jurisdictions for macro-prudential purposes. There are a variety of variants, but they would include an absolute cap on loan to value. By shifting that cap from 95% loan to value, which is the upper end at present in the UK, to something lower effectively is a quantity restriction in terms of lending in the market. A similar loan to income type measure would have a similar effect.

If I can put it in these terms, there is an important consideration in terms of stock and flow. With loan to value you have a stock question;

to put it in everyday terms, a question of downpayment. If you drop the loan to value ratio, if you have some cap that is lower, people have to save longer for a downpayment. Is that the best route if they can afford to continue to service the mortgage? The advantage of the loan to income, appropriately used, is it focuses on affordability and the ability to continue to service. One of the things that we are exploring with the FCA is to focus on affordability and create a new tool that we think has some promise, which is to change the qualifying interest rate or the interest rate that banks use in order to assess that affordability.

Q28 Stewart Hosie: Setting aside the specific detail of the tool for a moment, given that your role is macroeconomic stability, what conditions would need to be met before you would consider invoking such a tool?

Dr Carney: We would have to see broad-based momentum in the housing market with the prospect of it persisting, and associated rates of credit growth that increased risk to financial stability, including analysis of cohorts of borrowers—so by different ability to service borrowing over time. I would stress that we have to be a little careful in discharging our responsibilities not just to look at the aggregates but to drill down in terms of the various cohorts. That can also help us target the tool more precisely if we were to use it.

Q29 Stewart Hosie: I was going to say that. You can certainly look at cohorts and that makes sense, but the tool would be an aggregate tool. You would not be able to change LTI or LTV for a certain group of borrowers or even for a certain geographic location, would you?

Dr Carney: Put in the broadest terms, no. Again, to have financial stability implications for the United Kingdom economy it is highly unlikely that a single geographic location, as important as all of them are, would in and of itself create that scale of risk.

Q30 Stewart Hosie: Sir Jon, let me ask you, as the Deputy Chair for Financial Stability, this question. The interim FPC in March 2012 said it did not yet want to be given loan to value or loan to income tools as they lacked public acceptability. The FPC has now listed those tools as available, but only as recommendations rather than as directions. Has the assessment of public acceptability changed? Do you think now that the public understand why these tools might be used?

Sir Jon Cunliffe: I was not on the Committee then, but I think when the interim FPC made that statement they were looking at the directive power and they held that. The ability to make recommendations has been with the FPC from the beginning. I do not think it is so much a

question of whether the public understanding or acceptability of those tools has changed or developed in the interim, although my guess is, with all the focus there has been on the housing market and some of the problems that have been identified this afternoon about potential problems around affordability and so on, maybe there has been some form of shift.

What we were doing in the *Financial Stability Report* is laying out the things we could do within the powers we have. Of course, we have recommendation powers, including powers to the micro-prudential regulators, the FCA and the PRA, to comply or explain. That sets out the full suite of what we could do to address the problem, depending how it emerged. I think in this we did not go back into that question about whether Parliament should give the FPC directive powers. It is much more a question of what sort of instruments within the set that we have, including recommendations, we could use. I have to say I think the recommendation tools—my guess, as we have not used this—are quite powerful, particularly “comply or explain”, before you get to this question of whether the Committee should have directive powers.

Q31 Stewart Hosie: That is quite helpful. Can I just move on? I want to ask one question about securitisation. Dame Clara, can I ask it to you as an external? Andy Haldane has said, and I will quote this fully, “There is absolutely no reason—as US evidence makes clear—why we can’t create instruments that are simpler, whose structures are more straightforward, that can meet the needs of end investors with the needs of end borrowers. In other words to create in the UK, within Europe, a functioning, firing, robust securitisation market.” Do you think a new securitisation market is possible and necessary and, if it is, how do we avoid the contribution that securitisation made to the last crisis?

Dame Clara Furse: I think the main problem around securitisation in the last crisis was around structures and also the mispricing of product within the structures that were created. The structures were overly complex.

Stewart Hosie: It would be different this time?

Dame Clara Furse: No, that is not what securitisation is supposed to be for. Good securitisation allocates risk outside of the banking sector in a way that makes it attractive for investors to invest. If you look at the US system, they have done that very effectively. One of the reasons that the US banking business model is so very different from the European one is that they tend to have more efficient securitisation markets. Now, securitisation everywhere has obviously reduced markedly since the financial crisis, but it is an important component of

being able to invest in SME loans, for instance, more efficiently and transferring that risk or sharing that risk outside of the banking sector.

Q32 Stewart Hosie: That is helpful. Thank you. Just one final question, Governor. I know you are speaking in Scotland on 29 January and I know you have previously indicated your willingness to discuss monetary policy in terms of the Scottish independence referendum without prejudging it. Can you update the Committee? Have you any plans to meet with the First Minister or with other Ministers in the Scottish Government on your visit?

Dr Carney: Our offices are working to arrange a meeting and I very much look forward to that opportunity. I would say that that effort has been ongoing and there is certainly the will on both sides to have a constructive discussion.

Stewart Hosie: That is helpful. Thank you.

Q33 Mr Newmark: Mr Sharp, I would like to ask you, as a member of the FPC, this question. The FPC record notes that it was possible that any decision by the FPC to raise the MMR stress test interest rate in the future might encourage borrowers to switch to mortgage products with fixed interest rates rather than floating rates. Would that be a good outcome or not?

Richard Sharp: Earlier we were discussing the question of individuals exposed to risk as a result of house purchases at the margin; obviously a very important cohort, as described by the Governor. One of the risks associated with that and making purchases at increasingly elevated prices is the affordability. The affordability is clearly also a function, if they do not lock in the interest rates, of a real risk exposed to rising interest rates. Therefore, it is axiomatic that the risk is reduced if the affordability criterion is based upon a fixed interest rate. Certainly, the structure in the UK would have lower risk associated with the housing market if more mortgages were fixed and fixed for longer.

Q34 Mr Newmark: That seems to be more the American model. Do you see any evidence that it has worked better over there compared to maybe having fixed rates suddenly changing a culture here of buying into floating rates?

Richard Sharp: First of all, we have had a period of a 20-year decline in interest rates. In that sense, the individuals in this nation have benefited from being short of the curve going down the interest rate spectrum. For practical purposes we are now close to zero-rate bound, so you also have to make a judgment about the future. Certainly, my judgment would be, this would be a good time. Now, the US problems

on US housing were not to do with the structure of the interest rates. They were to do with the affordability and the prices that were paid. I do not know if that answers your question in relation to the US.

Q35 Mr Newmark: The record also notes that a greater take-up of fixed mortgages would enhance households' resilience to changes in short-term interest rates, which is sort of what you were saying. It also noted that this could lead to an increase in duration mismatches on lenders' balance sheets. I am not saying Northern Rock did that, but we saw the implications of having mismatches on balance sheets. Which is the more important effect for financial stability?

Richard Sharp: The banks themselves, were they to undertake longer term mortgage lending, do have the capacity in the derivative market to match their assets and liabilities across the interest rate spectrum. The issue then is the source of their liquidity and the funding in relation to the duration of the assets. That remains constant—them extending variable 20-year mortgages. That is still a 20-year asset they hold. However, the duration risk can be managed by the derivatives market in terms of making sure they are not exposed on the interest rate side to a mismatch.

The benefit for our banks and institutions would arise from the fact that, if they had fixed rate assets, they may then—coming back to the discussion with Dame Clara—have securitisable assets in the way that banks in the US can sell the mortgages that they originate into other institutional investors looking for assets to match their liabilities, such as pension funds. That would be a good thing and that would have more liquidity.

Q36 Mr Newmark: I will turn back to the Governor. Does rising household debt matter?

Dr Carney: Yes, it matters relative to the ability of households to pay. Of course, that ability to pay cannot be only measured at the point in time in which they take on that debt.

Q37 Mr Newmark: Is there a level of total household debt to income ratio above which household debt becomes a concern? Do you have something in mind there? Do you guys monitor this?

Dr Carney: We look at a wide range of metrics of household balance sheets, household indebtedness, actual and prospective. As you can appreciate, there is no one metric that is the predictor of future financial problems. I would say that, while level is important, servicing ability is that much more important. Prospective servicing ability, which

goes back to the exchange you just had with Mr Sharp, is important. One has to have the appropriate humility in anticipating potential financial problems and the timing of financial problems, but rate of change, particularly relative to historic trends, in terms of credit, aggregates and within specific sectors tends to be a better predictor of future problems than absolute level.

Q38 Mr Newmark: Total household net wealth is significant and I think Mr Sharp alluded to this. What are the financial stability implications of the distributions of debts and assets? I know you touched on this just now a little bit, but what are the stress points? Where do you see things moving and possibly having an impact? The reason why I am asking all this is that, as Mr Sharp said, many people have benefited from a yield curve that effectively has continued to drop. As the economy begins to turn, there will come a point in time in which interest rates are more normalised.

Dr Carney: Yes.

Mr Newmark: There are many people who have gone into the markets, particularly recently, at these record low interest rates. Their effective debt to equity ratios are very high and their incomes are not rising as fast as they perhaps were 10 or 15 years ago. There could be a double whammy on that and I guess that is driving my question.

Dr Carney: All of your points are on point and, collectively, they speak to some of the potential risks at this juncture. If we take the interest rate point in isolation, it is one of the reasons why it makes sense—and disciplined lenders are doing this already—to look at a household's ability to service a mortgage, not just at the current 2.2% best floating rate or the two-year fixed rate on a mortgage but where that rate could be five or seven years out and under various income scenarios. It is why we are looking more closely at so-called micro data or cohort-level data, and we will be reporting on them in subsequent financial stability reports—basically the quintiles of borrowers by type, in terms of debt servicing ability, how those are shifting and how they would further shift in higher interest rate scenarios.

Q39 Mr Newmark: You touch on two separate issues. One is an income issue: people's incomes and rising incomes or not. The other one is more of a balance sheet issue and people's personal balance sheets. You guys get loads of data, I know that, but do you think you have enough information to understand the distribution of debts among households and who is vulnerable to interest rate rises and what the impact of that would be?

Dr Carney: We have a considerable amount of information on that, but it is one of our priorities to further improve. Where one can be misled here is on the net worth side—to look at the asset side and miss the distribution of the assets—because there has been an improvement in financial asset values and now housing values and that could persist for some time. The matching of those assets and liabilities is, as you would expect, far from perfect. Basically, those assets are seldom available to help service those liabilities. We do use micro data and we will increasingly, and this is why—

Mr Newmark: No, maybe I articulated myself wrong here. What you have said is absolutely right. I cannot fault your answers. I am trying to understand the level of information, the data, that you have; to understand the distribution of household debt, effectively—do you have 100% of households in the UK?—to understand where the vulnerabilities are along that line.

Dr Carney: We have a couple of things. We have representative survey data; so the 10,000-household type data, which can be cut into representative households across the UK and across income strata and across demographic cohorts. For early, first-time buyers in the south-east we have that. Within the Bank of England writ large we are the regulator of all the mortgage lenders in the United Kingdom. We have access to additional data and perspectives from those institutions. One of the strategic priorities we have as an institution is to make better use of the potential synergies of that data, which is there for micro-prudential regulatory purposes. One of the things we ask ourselves is how we can better use that data to anticipate macro trends, both for financial stability and—not the purpose of today—also for monetary policy purposes. That is one of the potentials of the structure that this Committee and Parliament has put in place.

Q40 Mr Newmark: I guess my real concern, having lived through the 1980s and the 1990s and seen a lot of people get pulled into a market for a whole variety of reasons, is that we have had for some time now very low interest rates. People have almost forgotten what it was like when interest rates were double digit and some people's mortgages were double digit. Do you think households have become too used to low interest rates? Do you see that as problematic?

Dr Carney: Well, a couple of things. One is that the MPC will set monetary policy in a way that is consistent with low, stable, predictable inflation or inflation target at all times. We are certainly not anticipating some dramatic adjustment to levels of rates, but when we sit here as the Financial Policy Committee your question is on point, in that we need to ensure that lenders and households—and households are the first line of defence; they are the ones taking out the mortgages—

consider their ability to service their mortgages, retain their homes is what we are talking about, in more adverse, higher interest rate scenarios. That is one of the reasons why we are working with the FCA to create this tool, which is a qualifying interest rate.

I do not think you are confused about this but just to make sure anyone watching is not, this is something that would be used to assess affordability. It is not the actual rate that somebody would pay, but it goes directly to your point, which is to say, "What if interest rates were at X number?", a number that would be set by the FPC in order to assess the ability to service that mortgage through the cycle.

Q41 Mr Newmark: I guess it is not just the affordability issue. There is another impact, which is that psychologically if people see house prices going up they feel wealthier and they tend to spend more money. If you raised interest rates by 200 basis points, psychologically that is going to have an impact because people who are used to paying X are now going to be having to pay X plus 200 basis points multiplied by whatever. Do you see that having an impact? We are seeing a return to growth now and the Office for Budget Responsibility has now increased where growth expectations are for this year, next year and beyond. If you suddenly increased interest rates by 200 basis points—I am just pulling a figure out of the air, but that would normalise it to where it has been historically at least—would that have an impact on that growth trajectory or do you see that as not a big risk?

Dr Carney: There is a very fundamental point, which is that—and I am afraid we are straying into monetary policy—any decision to change monetary policy has to take into account the impact of that on growth, the utilisation of resources and the impact as a consequence on inflation. If it is a self-defeating change—in other words, it is one that then causes the cessation of the pressures—then it is mis-calibrated. From a financial stability perspective, though, it is not what we think is the most likely scenario. We have to look at, what if this happened? Your 200, 300, 400, 500 basis points example, a range of things like that, is what we do have to look at in order to assess what the risk would be to financial stability if for whatever reason this scenario were to transpire. Have we taken adequate precautions? Has the system taken adequate precautions? If not, what is the most proportionate, targeted and prudent response to that and, with respect to housing, from a menu of a very broad range of tools to which we have access?

Q42 Jesse Norman: Governor, I apologise for being late to join this. I have been in the Chamber. I want to ask some questions about stability, but there is one thing I just want to ask first arising from that. It

picks up something mentioned earlier by the Chairman. Have regulators dropped the ball on bank bonuses?

Dr Carney: No, I do not think so. There have been substantial changes to the structure. First up, from our perspective, from the perspective of the FPC, from a prudential perspective and from a system-wide risk perspective what we are most focused on is the structure of compensation, not the level. It is the structure of compensation. The mistakes in compensation from a financial stability perspective, from a prudential perspective—and there were many mistakes—in advance of the crisis related to, in effect, the immediate payment of cash compensation for activities that left risks in terms of actual risk, whether they were credit risks or liability risks or, shamefully, conduct risks, misconduct to be more precise, that remained with the institution for years and hit the institution.

From 2008, in various guises, Sir Jon and I were involved in this development internationally that put in place the initial framework to change the structure of compensation so that there was a much greater emphasis on deferred compensation and equity compensation and the ability to take back compensation if risks crystallised. The UK, to my memory, was if not the first then one of the first to take those rules and map them into a remuneration code, in 2009. That code was strengthened with European CRD III legislation in 2010. We intend to consult to do two things potentially this year. The PRA will consult on this, but potentially to lengthen the deferral process so that the deferral of compensation is longer than five years. It is not just a question of the ability to claw back deferred compensation if risks come to light, but you can claw back from past compensation that is paid as well.

Q43 Jesse Norman: Just briefly, Governor, is our regime soft touch, medium touch or hard touch at the moment by international standards?

Dr Carney: I would say that the regime, as it has been practised in the UK, is hard touch from a financial stability perspective. A concern, which I know Andrew Bailey at the PRA and I certainly share, with the CRD IV compensation rules is that it takes back some of the advantages of the approach that we have had because it will incentivise more cash compensation today—exactly the type of problem we had before—that we cannot claw back. We would rather see more deferral, more equity, and this ability to take it back when those risks come to light.

Q44 Jesse Norman: That is helpful. The topic I want to raise very quickly now is cyber security; obviously a very important aspect of the stability of the financial system. The question is: have other

Governments, to your knowledge, used offensive cyber capabilities against our financial system, including changing the amount that is sitting in people's bank accounts?

Dr Carney: To my knowledge, no, on that point.

Q45 Jesse Norman: Have you made enquiries on the topic? You would receive information and regular updates. You would be aware of these attacks if they took place.

Dr Carney: Let me tell you what we have done as the Financial Policy Committee. As you are aware, we have made a recommendation, which has been accepted and has been acted on by Her Majesty's Treasury, to update and extend the cyber security policy and approach of the Government for the financial sector to involve the financial sector. We have met as a Committee with senior Treasury representatives, representatives of GCHQ, of Downing Street Policy Unit, for an update on the steps that are being taken. We have as an institution, the Bank of England, changed our structure, and individuals for information technology and specifically for cyber risk are in the process as part of a broader effort to further invest in defence against cyber attack.

Q46 Jesse Norman: Banks are under an obligation to communicate to you if they receive attacks?

Dr Carney: It is being coordinated through the Treasury and Downing Street, with the relevant security agencies, including GCHQ, very heavily involved.

Q47 Jesse Norman: What would be more damaging, a criminal attack or a sovereign attack, or does it depend?

Dr Carney: I would say it would depend on the nature of the attack, but certainly what is damaging is not just the information or the impact of the attack per se or the outage that would come from the attack, but the associated confidence impacts on the system.

Q48 Jesse Norman: You run scenarios and damage assessment?

Dr Carney: We certainly run penetration assessments that have sharply increased in their sophistication.

Q49 Jesse Norman: What is your judgment of our vulnerability of our UK financial IT infrastructure?

Dr Carney: My judgment is that the FPC, prior to my time, was absolutely right to put emphasis on this and we need to continue to invest in it.

Jesse Norman: But what is your actual judgment of the vulnerability of it: high, medium or low?

Dr Carney: I think the only prudent operating principle is that the vulnerability is medium to high and that should motivate the action that is necessary. I will say that the reports we have received and our understanding is that the level of cooperation, both public and private, has improved. Mr Norman, I do not think, and nor does the Committee, this is an area where we can relax.

Jesse Norman: No. I am slightly unsettled by your unwillingness to give a substantive judgment as to what you think the vulnerability is. I understand the procedure could be to assume it is high or medium, but have you taken steps to assess for yourself whether our vulnerability is high, medium or low?

Dr Carney: I thought I said I thought it was medium to high.

Jesse Norman: Sorry, what you said was that we should behave as though it is always medium to high.

Dr Carney: I see.

Jesse Norman: What I am asking is the question: what is your actual assessment of it and have you taken the measures to determine an actual assessment of it?

Dr Carney: We have taken measures to determine whether there is a comprehensive cyber security plan across the public and private sector. The Treasury has outlined that plan.

Jesse Norman: Including points of vulnerability?

Dr Carney: Yes, including points of vulnerability. Quite frankly, I think this is best reported on by the Treasury and the relevant authorities who are managing the plan, as opposed to by one of the participants in it. As a Committee we have reviewed that plan and met with the individuals who are managing it. We are taking specific action within the Bank of England and we have kept the recommendation open for subsequent discussions and subsequent meetings with Treasury and other officials on the progress that has been made.

Q50 Chair: You said a moment ago that you are a bit concerned that there might be some backtracking on the need to tighten up

remuneration structure. You were referring to the issue of deferral and the mis-incentivising that could be generated by certain types of bonus payment. There is also scope for clawback in all this. As you know, extensive recommendations were made by the parliamentary commission in this field. We asked for statutory support for those. That was not agreed, but it was agreed by the Government that the proposals of the parliamentary commission would be implemented through the remuneration code. In the Bank of England's response to our proposals, you—that is, the PRA in practice, so I am asking you a question with your PRA hat on—said that you would consult and give effect to our proposals in the course of this year. When is that consultation going to start?

Dr Carney: Yes, and I referred to it maybe too obliquely. April is the intention. We intend to consult in April of this year.

Q51 Chair: When is it going to finish?

Dr Carney: I do not have the timeline to hand, but I would think it is a six-month consultation, Chairman.

Chair: I think it would be very helpful if you could provide us with a clear timeline on this issue, which is of considerable public concern at the moment anyway and of general concern since the crash. It would perhaps also be helpful if you could set out if there are any areas substantively in those recommendations that we made, which we put a good deal of work into, which you have concerns or reservations about. I am not aware of any at the moment that the Bank has expressed concerns about, but it would be helpful if we could be told that as well.

Q52 Mr McFadden: You said at the very beginning of this session that you took seriously the responsibility to have regard to competition. Can I ask you how you intend to discharge that responsibility?

Dr Carney: Yes. There are a couple of areas, some of which are in train and we will look to reinforce. Let me say something first. I think what the PRA needs to do, having been given this statutory responsibility by Parliament, is review its approach and prioritise how it gives life to fulfilling that. That is a review, I would suggest, that we would conduct under the oversight of the Oversight Committee of Court first and foremost. We would obviously report to Parliament directly through this Committee and other formats. We will need to add resources, so we are in a budgeting round right now to look at additional people that we would bring in or dedicate to this issue.

Then we would look in areas where our current activities are intended to be pro-competitive and promote competition. One of the areas that we have focused on and we should reinforce is the ease of entry into

the banking sector. We have streamlined our processes. How well is that working? We certainly have an increasing number of applications, but how well is that working? We have easier—maybe not the best adjective—liquidity rules and capital rules in the initial three to five years of life of the new institution, again for ease of entry. We are strongly of the view that ease of exit also facilitates ease of entry because I think there needs to be a shared understanding of everybody—but certainly the people in this room, current and future—that there will be failures of institutions.

Orderly failures of institutions are a good thing because it is pro-competitive. If we are charged with operating a zero failure regime then we will not have a competitive regime because everything will be gold-plated and safe. We have those aspects, and then, more broadly, we need to have due regard with new regulations. Whether it is in the capital framework, liquidity framework, “too big to fail”, other derivatives, other aspects of our regime—what is the impact on competition?

Q53 Mr McFadden: I am just trying to be clear about what the problem is that you would be trying to resolve through everything that you have outlined there. Tell me if you accept this. We have in the UK a very highly concentrated banking market, particularly on the retail side, which has become more so since the crisis. Is that a picture that you would start with?

Dr Carney: Yes. There is a degree of concentration here that is seen elsewhere but, yes, it is highly concentrated.

Q54 Mr McFadden: Therefore, your objective through this, having regard to competition, would be to change that picture and to get more players in the market in the interests of consumers. Is that a fair way to sum up how you see it?

Dr Carney: To a point, and my qualification on it would be that we do not have primary responsibility for competition policy in the financial sector. It is the responsibility of the FCA and the responsibility of the new competition authority coming in place in the spring. They have primary responsibility for competition. We have to take due regard for our actions and what impact they have on competition, and we will ensure that we do so.

Q55 Mr McFadden: Given the concentration, do you think more competition and more players in this market would be a desirable thing?

Dr Carney: Speaking as a member of the Financial Policy Committee, it is not always the case. There are degrees of competition that can be

short lived and bring instability, ultimately, and therefore are not desirable. I do not want to give a blanket “all competition is necessarily good”, particularly sitting here today as a member of the Financial Policy Committee. That said, we are taking steps through the PRA that we are in the process of re-examining and, if necessary, reinforcing to ensure that we are discharging our competition objective.

Q56 Mr McFadden: Can I just finish with a question about “too big to fail”? You mentioned exit as well as entry. You have a very broad international perspective on all the regulatory and other measures taken since the crisis and there have been a lot of them. We do not need to list them here, but there has been a lot of stuff. Not for the first time today to quote your colleague, Mr Haldane, he said, “There is plainly a significant degree of unfinished business here.” Could you just tell us your view on resolving this? It would be quite fair if consumers looked at everything done on ring-fencing and culture and individual responsibility both in this country and abroad and if it has not resolved the question of “too big to fail”, then isn’t that something of an indictment of what has been done so far? If that is the case, if Mr Haldane is right, what more needs to be done to resolve this and to get the taxpayer out of the dilemma that they found themselves in five or six years ago?

Dr Carney: We are absolutely clear, both as an institution and internationally, that we have not yet resolved “too big to fail”. We have not yet ended “too big to fail”. The objective of 2014 within the G20 is to make the final major international decisions and agreements that will unlock the international component of ending “too big to fail”. Sir Jon and I happily gave up our Sunday and Monday for a series of discussions not just about the leverage ratio, which we will set aside for this purpose, but with international colleagues on something called “gone concern, loss-absorbing capacity”—bail-in-able debt; in effect, the ability to bail in—which is absolutely essential to unlocking this. It was very productive. We set out the timetable that is consistent with Brisbane. We set out all the issues and agreed all the issues internationally.

What we are effectively trying to do is give life not just to—within Europe and, most importantly, the UK—the RRD, the recovery and resolution directive, but ensure that it is internationalised. If it is not internationalised, or that approach is not internationalised, then any of these international banks cannot be responsibly resolved without that recourse. That is absolutely a clear objective. We have to get agreement on quantum, location, type or components of this gone concern, loss-absorbing capacity this year in order to unlock this. We have to get some restructuring of how derivative markets work so that you can have stays in derivative markets of collateral. It is a very

important technical issue, if we had to resolve one of these without taxpayer reliance.

What we are also doing internationally—and obviously domestically, but what is relevant internationally for these purposes—is we are going through the resolution plans of all these major institutions, not just in the UK but with the Americans and with the other major centres, to make sure that in our view they work and, if they do not work, what we have to change about them.

The last thing I will say is on Vickers' ring-fencing. Yes, that is part of making this work, but I do not think we should forget that it is something that has been agreed. It has gone into legislation and now it has to be implemented. We will not sit here, and you would not want us for a second to do it, and tell you, "Oh, yes, we have all the components." I can tell you that we have all the components to do this, but they have to be implemented and they have to be agreed.

Q57 Mr McFadden: When can you look the consumer in the eye and say, "We have resolved this and the next time a big bank falls over we will not have to come to you"?

Dr Carney: I think that by the end of this year we should have a proposal on the GLAC that will indicate the ability to do this or not.

Mr McFadden: By the end of the year?

Dr Carney: That is the objective, by Brisbane. That is not an easy objective to get. Remember, this is an agreement that has to come out through the G20.

Mr McFadden: Would you bet one of those new plastic tenners that you will be able to do this by the end of the year?

Dr Carney: That means I will pay you in 2017—yes, that's right. By the time it is out, I will tell you that, I could do it. And in polymer, if I may.

Q58 John Thurso: Can I also apologise for missing the start? I chair another Committee, which was sitting. Dame Clara, can I very quickly follow up with you the conversation that we had at your appointment hearing? You will remember that we expressed quite a lot of concern about the fact that you did not seem to be aware of the need, or our feeling that there was a need, for external members to show considerable independence both from the Treasury and the Bank. Having now been an external member for some while, do you understand our concerns?

Dame Clara Furse: I certainly do understand your concerns and I am very sorry, indeed, that I gave the wrong impression because I think it is extremely important that the Committee is independent and is seen to be independent. I think I certainly have a reputation for being independent, which is partly why I was surprised by the questioning on this. Yes, I absolutely agree that it is extremely important.

Q59 John Thurso: Part of the concern, if I can invite you to perhaps respond a little bit further, is not only that the Committee is seen to be independent but that individual members are seen to be independent. One of the things that we observe and appreciate about the external members of the Monetary Policy Committee is, for example, their habit of going around making speeches which make it very clear that there are differences of opinion that are resolved within the Committee process. That is exactly what we want to see, that robust bringing of independent views. You have not had a chance to make any speeches yet, but do you see that as something that you would like to do to show us that you are individually independent as well as collectively independent?

Dame Clara Furse: Yes, and I am very much looking forward to doing that. I have some plans that I think are happening at the end of March. I will be speaking in north Wales and possibly also in Liverpool. I do completely agree that, particularly because the Financial Policy Committee is not an elected body and does have very great powers, it is extremely important that its members are seen not just to communicate actively with industry, with business and with the market, but are able to explain what the Committee does and how it does it, and the fact that it does so in a context where there is very good discussion and where independent members bring their expertise to bear.

John Thurso: I will look forward to listening to you.

Q60 Chair: Those are helpful replies. It is extremely important for the accountability of the FPC that the independents, as they are called, should perform this role. Have you made any speeches yet, Mr Sharp?

Richard Sharp: No. I was quite interested in the way you framed that question. Performing the role as an independent member is of absolutely critical importance, as I say, in relation to one of the things you were concerned about in the past, which was the groupthink and in some sense being dominated by the Executive, and also that we can make judgments that affect macro-prudential supervision and, therefore, affect the economy—that we make them with respect to the sole goal of financial stability.

I have deliberately not made any speeches because, first of all, I have wanted to gauge, through my own attending of the meetings, the subjects that we discuss and how we discuss them and also because I have a very acute sensitivity to the fact that some of the things that we are discussing have some elements of market sensitivity associated with them. What I have done is discussed with the Governor the development of a communication strategy.

As you no doubt know, the Chancellor in his remit to us asked us to make sure that our communications were fully coordinated. Differences in nuances can also in themselves create some instability. There is a skill in both demonstrating independence but also making sure that the FPC is seen to be coherent and stable, and not supplying different nuances associated with the same policies to too great a degree. This is an area, as I said when we met, of some discomfort for me but one I intend to tread into because I respect your desire to see members of the FPC engaging with the public. However, I will do so very carefully.

Q61 Chair: One of the things that has been of huge benefit to an understanding of monetary policy in this country has been the fact that MPC independents do speak up. They do not always say the same thing by any means, and people are expected to be mature and sensible in listening to this stuff to work out what the overall balance of the MPC is on those extremely sensitive issues, ones that can move markets very quickly. We are not looking for the removal of nuance. We are looking for the expression of genuine views and I very much hope that is what we are going to see in the months and years ahead as the FPC develops.

I have one slightly left-field question for you to end with, Governor—I am hoping we can finish before 4pm because there will be a vote—which you may or may not be aware of, which was brought to my attention by a journalist. It is in a report by the BIS, which purports to show that foreign claims on China by UK banks are higher than any other country's banks. Did you know about that?

Dr Carney: This must be the quarterly banking statistics or whatever. It is certainly not a surprise.

Chair: No, this is a separate paper written by Mr He and Mr McCauley.

Dr Carney: I am sure it is excellent. It is not a surprise that the world's leading global financial centre has higher exposures to the world's fastest growing and fastest internationalising market.

Q62 Chair: Don't feel the need to comment in any detail on it now because it is a left-field question, but when you have had a chance to examine it, if you do have thoughts, I would be grateful if you got back to me in writing.

Dr Carney: I am going to make you miss your vote, since you raised it—no, I will not, but London is the leading global financial centre. One of London's roles is intermediating capital from the asset side, from creditors to borrowers and from a variety of regions. One would be somewhat surprised if institutions resident here were not at the top or at least near the top in terms of exposure to the leading emerging market and one would expect that to continue.

Chair: Thank you very much, all four of you, for coming to give evidence today. We appreciate it very much and we look forward to seeing you again, I expect, before too long. Thank you.