

Treasury Committee

Oral evidence: Appointment of Nathanaël Benjamin to the Financial Policy Committee, HC 443

Tuesday 9 January 2024

Ordered by the House of Commons to be published on 9 January 2024.

[Watch the meeting](#)

Members present: Harriett Baldwin (Chair); Dr Thérèse Coffey; Dame Angela Eagle; Stephen Hammond; Drew Hendry; Keir Mather; Anne Marie Morris.

Questions 1 - 73

Witness

I: Nathanaël Benjamin, Executive Director for Financial Stability Strategy and Risk, Bank of England.

Examination of Witness

Witness: Nathanaël Benjamin.

Q1 **Chair:** Welcome to this Treasury Committee evidence session on the appointment of Nathanaël Benjamin to the Financial Policy Committee. Can I invite the witness to introduce himself, please?

Nathanaël Benjamin: Good morning. I am Nathanaël Benjamin. I am executive director of financial stability strategy and risk at the Bank of England. I have been a financial regulator and central banker all my career, mostly in the UK but also in the US.

Q2 **Chair:** I just want to make sure that everyone is aware that I have a debate in another part of Parliament between 11 am and 11.30 am. I will discreetly slip out of the chair, to be replaced by my colleague Dame Angela Eagle, and will return after that, so please forgive me for that.

As you say, you have been a central banker all your career and have a very strong academic background. You were involved in mopping up after the financial crisis, and the Financial Policy Committee is very much part of the architecture that was put in place to address that. I wondered if you would start by addressing this question. Are you part of what people challenge as groupthink at the Bank of England or do you bring a fresh perspective to this role?

Nathanaël Benjamin: The way that I think about it is that, over the past decade and beyond, most of my roles have been squarely geared



towards providing challenge—challenging either my own organisations internally or stakeholders externally. I am happy to take you through each of those. My latest roles were mostly about challenging outside, banks in particular, but I am happy to talk you through how I have been challenging internally within the Bank of England.

Chair: A couple of examples would be helpful.

Nathanaël Benjamin: The latest example that I can think of is how I have challenged the extent to which the Bank should focus on exposures related to private equity as a market. This was already on the Bank's radar, but my experience as a microprudential regulator made me particularly concerned about that risk, so I have challenged this and there is an increased focus on it as a result. That is one example.

If I go further back in time, I was interim chief financial officer of the Bank of England, and part of my regular role was to challenge deputy governors on their budgets for their part of the Bank of England. That is what chief financial officers do.

Further back in time, I built and ran the Bank of England's second line of defence for its own balance sheet, which was built in 2015. A big part of that role was to challenge the extent to which risks to the balance sheet are taken. Every time market operations were being considered, challenge and debate were part of that decision in terms of the features of those operations, so I was very involved in that.

Q3 **Chair:** If I may challenge you in terms of some of the things that we hear from market participants, your current role that you are moving from is as executive director for authorisations, regulatory technology and international supervision. We hear feedback from market participants that it is an incredibly slow process and aspects of it can take a long time, which is frustrating for participants and for senior managers in those organisations. Would you like to comment on that external challenge?

Nathanaël Benjamin: It is the case that, on authorisations, particularly authorisations of senior managers under the senior managers regime, there had been a backlog of approvals for several years.

Chair: Under your watch.

Nathanaël Benjamin: That backlog predates my watch. This was a state of affairs that we were not happy with, as I have said before. That backlog has now been eliminated, thanks to the actions that the FCA and the PRA have taken. This was one of my priorities last year and that has been done. We care a lot about that and, more generally, about the efficiency of authorisations as a process. The last speech that I gave in my previous job was to set out how we think about it for the future and what an important part it plays in the competitiveness of the UK economy.

Q4 **Chair:** We published a report just before the Christmas recess on the



Government's and the regulator's progress on implementing the Edinburgh reforms that were outlined by the Chancellor at the end of 2022. Can you outline your views on those reforms and which areas you have had responsibility for implementing?

Nathanaël Benjamin: There are a number of aspects of the Edinburgh reforms that are positive for financial stability. I would pick out the consolidated tape to increase market transparency that the FCA has been overseeing. That increase in market transparency is positive for financial stability. I would think about the digital sandbox for financial market infrastructure, which is a positive development in fostering innovation in a safe way.

I also have in mind, of course, the senior managers regime, which is a very cherished and important part of our supervisory toolkit as a microprudential regulator. If anything, it has proved to be even more important during the latest banking sector turbulence. We have been operating that regime for a number of years, so it is entirely reasonable to review its effectiveness and we are very open to improving and strengthening it, so that it is positive.

Finally, I would mention the ringfencing aspects of the reforms. Likewise, that regime has helped to insulate and protect households from some of the turbulence in capital markets, so it has worked well, but it is entirely reasonable to take a step back and review how it is set up. There is a discussion about increasing the threshold for the maximum amount of deposits, which is a very reasonable thing to be considering.

Those are a few aspects of the individual reforms that I have in mind as a good thing for financial stability.

Q5 Chair: I am going to ask you about the ones that you do not like in a minute, but do you believe that, after the review, there should be any changes to the two that you mentioned, the senior managers regime and the ringfencing regime, which have not yet been implemented?

Nathanaël Benjamin: We have an opportunity to make certain aspects of the regimes more efficient and to streamline certain processes. We are in the process of reviewing the feedback that we got from the discussion paper on those topics, and it is important to seize this opportunity to improve efficiencies in the process, wherever that is desirable.

Part of our mindset in terms of the senior managers regime is to ensure that there is no unnecessary friction in those transactions. That is our focus and we will be reviewing the reaction to our discussion paper on that front.

Q6 Chair: Can you give us a hint as to when the conclusions of the review might be implemented?



Nathanaël Benjamin: In terms of the timetable, my expectation is that it will be this year, but I am not able to give you specific dates. We are still reviewing the responses that we have received.

Q7 **Chair:** Which of the Edinburgh reforms would you actively oppose?

Nathanaël Benjamin: I cannot pick out specific reforms that I would oppose. The contents of the reforms all have different impacts on financial stability, which is my focus. One way or another, all the implications can be managed, so I am not in a position to oppose or not oppose them. Those decisions are a matter for the Government, quite frankly, and our focus is the financial stability implications of those reforms.

Q8 **Chair:** One of the macroprudential risks that you highlight in your questionnaire, which we are publishing today, is around the level of public sector debt. National debt is just under 100% of the economy. Do you feel that that is a significant macroprudential risk?

Nathanaël Benjamin: It is a feature of the environment that we are currently in, not just in the UK but also in other major economies. In our financial stability reports, we have called out the importance of US treasury markets to financial stability. I would not necessarily call it a key risk to financial stability, but it is one of the important aspects where things need to be managed and we need to ensure that players in the financial sector have a set of prudent risk management practices around the debt markets, so that they can absorb rather than amplify any shocks that come to them.

Q9 **Chair:** In your opinion, is it prudent that the Bank of England is adding to that issuance pressure by quantitatively tightening to the tune of £100 billion this year?

Nathanaël Benjamin: The first thing that I would say is that, when we think about quantitative easing, it is very important—

Chair: Quantitative tightening.

Nathanaël Benjamin: First, I would say that matters related to quantitative easing or tightening are squarely matters for the Monetary Policy Committee. My focus is squarely on the financial stability implications of those matters. If your question is about the financial stability implications of quantitative tightening, the main vehicle that impacts financial stability is mostly interest rate transmission rather than tightening in the quantitative easing programme. The impact of that on financial stability is very moderate.

Q10 **Chair:** I am going to probe you a little more there. When the liability-driven investing problem surfaced in the gilt markets back in September 2022, it was, at that time, decided by the Bank to delay the implementation of the sales of gilts into that unstable market. This year, the Bank of England will be selling £100 billion of gilts into the market,



which is quite a large amount compared to the market's capacity. Do you not think that there are any macroprudential risks in doing that?

Nathanaël Benjamin: The important thing to have in mind is that this is returning to a situation that is more normal than the exceptional times that we have had over the past decade.

Q11 **Chair:** Selling £100 billion of gilts?

Nathanaël Benjamin: During the LDI episode, the tightening programme was suspended because it was important to restore financial stability. Indeed, some asset purchase operations were put in place, so that financial stability could be restored and monetary policy could be transmitted effectively to the financial sector. The pace of quantitative tightening is planned, predictable, smooth and gradual. The fact that it is happening has a controlled impact on the financial sector.

Q12 **Chair:** This is a monetary policy question. You said that quantitative tightening falls within the remit of the Monetary Policy Committee, but you have a sufficient mathematical and probabilistic analysis background. Does quantitative tightening have a real world impact?

Nathanaël Benjamin: The impact of quantitative tightening on the real world is not very material in comparison to the impact of the rise in interest rates, which I am happy to talk about later. The main tool for conveying the tightening is interest rates. The quantitative tightening impact is very small in comparison.

Q13 **Chair:** When you say "very small", could you put a number of basis points on it?

Nathanaël Benjamin: I am not able to do that. That is a matter for colleagues on the Monetary Policy Committee, but what I do know is that the impact is small.

Q14 **Chair:** Turning to artificial intelligence, you mention that as a possible risk in your questionnaire responses. Can you elaborate on how the Financial Policy Committee would deal with what it would see as growing risks in artificial intelligence?

Nathanaël Benjamin: On artificial intelligence, the reality is that we—the public sector and the private sector—are still in the foothills in terms of fully grasping the sheer opportunities and risks associated with it. It is important that all that analysis happens, because it is an ongoing phenomenon that will not go away.

In terms of the risks from artificial intelligence, there are two categories. The first is almost from a microprudential perspective in terms of the extent to which decisions are made by computers and machines instead of human beings, and how that affects the quality and safety of decision-making in individual firms. That will be a matter for the PRA, for example, in terms of that potential implication.



From a more systemic perspective, I would highlight three potential risks from artificial intelligence. The first is the extent to which it can lead to any form of herding of behaviours across different players in the financial sector or to any form of procyclical behaviour in that sector.

The second risk that we have on our radar is the extent to which it increases concentrations to critical third parties that are generative of the software or technologies providing artificial intelligence.

The third is cyber risk, which is already around but will be even more acute in a world where there is wide use of artificial intelligence.

Those are the key risks associated with artificial intelligence that we have to have in mind. We issued a discussion paper on the topic in 2022. We have an AI public and private forum, where we discuss those risks in partnership with the industry, but it is clear that much more work needs to be done, including by us, in terms of the specific financial stability implications of this development.

Q15 **Chair:** Will you be leading that work?

Nathanaël Benjamin: That work will happen within the Bank of England more broadly, and financial stability will be one aspect of the work that is done, but it will be a much more cross-cutting bit of work across the Bank of England.

Q16 **Chair:** You mentioned cyber. How worried should we be about a quantum apocalypse affecting financial stability?

Nathanaël Benjamin: A quantum apocalypse?

Chair: It is a cybersecurity term for massive power to attack the financial system through cyber.

Nathanaël Benjamin: Do you mean from the perspective of artificial intelligence?

Chair: No. We are moving on to a completely different subject.

Nathanaël Benjamin: Cyber risk is clearly one of the key aspects of operational regimes that we have on our radar. Cyber risk and dependence on critical third parties are out there, so it is definitely a worry. We are doing cyber stress tests, which kick the tyres on those things, but it is a very important risk on our radar.

Q17 **Chair:** So we should be quite worried about it.

Nathanaël Benjamin: It is one of the important risks to financial stability at the moment.

Q18 **Drew Hendry:** Combining that with the point on artificial intelligence, you talked about more work needing to be done. What is your assessment of how long that work is going to take? How easy or difficult will it be for you to put the rules, tools and recommendations in place



HOUSE OF COMMONS

that you need to in order to be in that place where you are relatively safe in the short to medium-term future?

Nathanaël Benjamin: In terms of the rules and the tools, the regulators already have a toolkit in place to deal with operational resilience. For example, there is already a lot of work happening within banks. Local regulators already have the toolkits.

Q19 **Drew Hendry:** You have acknowledged that more work has to be done. I am asking about that work that has to be done. What is your assessment of that? Does an assessment of that work exist at the moment?

Nathanaël Benjamin: That work is in the process of being done. My expectation is that it will take several years for the use of AI to be decided. Things do not happen in a vacuum. The use of AI is still much smaller at the moment than it might be in the future.

Q20 **Drew Hendry:** Given that you have said that it may take years, do you feel that enough urgency is being placed on this?

Nathanaël Benjamin: An increasing degree of focus is being put on it. That is definitely the case. It has risen in the profile of priorities across the different aspects that are being considered.

Q21 **Drew Hendry:** What does “profile” mean?

Nathanaël Benjamin: The profile has increased in terms of relative priorities. That is definitely the case.

Q22 **Stephen Hammond:** Good morning. The countercyclical capital buffer was put in place post the global financial crisis. It is one of a range of macroprudential tools. Could you give us some flavour of how successful it has been since its inception and where you place it in the range of importance of macroprudential tools?

Nathanaël Benjamin: It has had a good track record. Clearly, this is a tool that exists across different jurisdictions, not just in the UK, but it has enabled a setup whereby capital can be built gradually in periods when it is cheaper to do so. When capital is needed, because there is heightened volatility and a greater possibility of losses crystallising, then it can be dropped, so that capital does not act as a constraint on banks continuing to support the economy. Indeed, that is what we have seen at play, unlike in the global financial crisis, where banks were part of the problem, quite frankly, and acted to exacerbate and amplify the shocks.

We have now been through a period, which continues, where the banking sector has been able to support the economy in absorbing the shocks, rather than amplifying them. The countercyclical buffer has played an important part in that and in building up resilience at times when it is cheaper to do so, and doing so gradually. We are then able to reduce it so that capital does not act as a constraint on lending, which is mostly to households and businesses.



Q23 Stephen Hammond: Following on from that answer, I have two questions. First, if the countercyclical buffer moves by 0.5% or 1%, how much impact does that have directly on lending? Secondly, given that you talked about the ability to both drop and raise the countercyclical buffer, where is it more effective? Is it when it is dropped, so that it responds to a problem with macroeconomic conditions, or when it needs to be raised?

Nathanaël Benjamin: It is good to have a neutral level of countercyclical buffer in the UK of 2%. The reality is that, recently, capital has not been a constraint on the amount of lending that is done by banks. The constraints have been the demand for credit or the tightening of lending standards, and so releasing the countercyclical buffer would not have made any difference, because capital was not a constraint in the first place.

Q24 Stephen Hammond: During the reaction to the pandemic in March 2020, the CCyB was cut immediately from 2% to 1% to 0%. It was announced that it would come back in December 2022 and then up to the neutral level of 2% in 2023, and it was changed quite quickly. Given that that has not been the major constraint on lending, did the movement of the countercyclical buffer really have any impact at all during that period?

Nathanaël Benjamin: When it was dropped, it ensured that there were no constraints at all on banks lending. It is more important that it is there so that it can be released when needed.

Stephen Hammond: Could you say that again?

Nathanaël Benjamin: It is important that the countercyclical buffer is there at 2%, so that, should it really be needed if losses become very likely, it can be dropped.

Q25 Stephen Hammond: When it is dropped, there will also be the condition that the lack of capital would be a restraint on lending.

Nathanaël Benjamin: If there is a notion that the lack of capital might start to provide a constraint on lending, that is the time when we will consider dropping it.

Q26 Stephen Hammond: In your opinion, is 2% still the right standard level?

Nathanaël Benjamin: Yes, I think so, for two reasons. First, it means that it can then be dropped, so that firms can then have no constraints on their lending in times of stress and still remain above their minimum capital requirements.

Secondly, if some risks build up further and there is an increase in the overall level of risk in the system, it has a higher level from which to build. That means that this higher level can be built more gradually than would otherwise be the case. What can be disruptive, or at least very expensive, is if capital levels have to be built quickly. The advantage of



having a neutral level at 2% goes both ways. In case it needs to be higher than that, it is already halfway there.

- Q27 **Stephen Hammond:** Overall, you think that it has the impact that you want it to have, whether it is lowered or increased, in terms of macroprudential tools, and that its efficacy is equal in either direction.

Nathanaël Benjamin: Yes.

- Q28 **Stephen Hammond:** The 21 November FPC summary talked about the committee standing "ready to vary the UK CCyB rate, in either direction, in line with the evolution of economic and financial conditions". You have just talked about some of the risks that you see. For the sake of clarity, I wonder whether you could give some view to this Committee as to the circumstances in which you would be looking to move from the standard. Presumably, at the moment, given interest rate expectations, it might be either way, depending on how far interest rate expectations go down.

Nathanaël Benjamin: The way in which I think about it, as I said before, is that the point at which we would consider moving away from the standard is if we sensed that capital was starting to act as a constraint on lending. That is not something that we have observed. Capital has not been a constraint.

It is either that or if some losses were likely to be incurred, meaning that it is important to release the buffer, so that you do not force firms to hold capital for losses twice. Losses happen only once.

The third situation in which one might think about dropping the buffer is one where some risks just disappear and there is no longer any need to capitalise for them.

The key thing that we are watching in this particular case is the extent to which capital is or is not proving to be a constraint on the amount of lending to the real economy. We do not see that being the case for the time being.

- Q29 **Stephen Hammond:** I might want to pursue later on what the sources of capital are for lending at the moment. In the next six months, do you see the countercyclical buffer moving from the standard 2%? Given the balance of risks out there, and we can all have a look at the forecasts, etc, what would be your view at the moment?

Nathanaël Benjamin: Based on where I sit, it is clear that lending conditions have tightened. That has been driven mainly by lower demand but also by a tightening in lending standards. Capital constraints have not played a role at all there. It is a very uncertain environment, so we need to keep this under review. From where I sit, I see no signs that we are entering a period of a few months where capital might become a constraint, but we are at an uncertain juncture, so we need to keep that under review.



- Q30 **Stephen Hammond:** One of the uncertain junctures came out of the committee minutes of 21 November, where it was talking about market expectations for interest rates remaining high. In the last six weeks, the market expectation of interest rates has probably lowered somewhat, given the announcements that we have just seen about the recent movement in mortgage rates. How big an impact does that have on your thinking in terms of where you see the standard rate of the buffer?

Nathanaël Benjamin: Other things being equal, that will mean that the passthrough of interest rates to, for example, households will have an impact that puts less of a strain on their finances, which will be positive for their resilience. That will mean that the risk of losses to banks will be lower than it would otherwise be from that particular channel, which means that capital is even less likely to be a constraint on them doing the lending that they should be doing to the real economy.

- Q31 **Anne Marie Morris:** In your questionnaire, you said that moral hazard must not become entrenched. What are the key moral hazards that you are referring to?

Nathanaël Benjamin: I would give you two examples of that. Some of it is born of the experience from recent banking failures. It was clear in the experience of both Credit Suisse and Silicon Valley Bank that, although capital and liquidity were very important tools, they are, in and of themselves, not things that will prevent banks from failing. This is where, as supervisors, we go into the notion of risk culture and the basis on which decisions are made—whether they include risk when business is or is not taken up.

There are two specific areas in which it is very important to check the extent of moral hazard at play. One is the world of margining in the financial sector between banks and non-banks in particular. As I have said before, there are a number of markets where bilateral relationships between financial counterparties, where there are margin agreements in place, are not backed by a sufficient amount of initial margin, for example. The haircuts applied to the securities that are held as collateral are sometimes non-existent or very low.

Those are two examples of the fact that the players assume that things will be fine most of the time and, if they are not fine, the risk will be for someone else to sort out, rather than assuming that, if your counterparty incurs some problems, you will be left with the risk rather than someone else having to deal with it. Margining is a good case in point of the extent to which there might be some degree of moral hazard or people believing that, if bad things happen, it will be for someone else to sort out.

[Dame Angela Eagle took the Chair]

- Q32 **Anne Marie Morris:** What you are saying, which is also what you set out in your questionnaire response, is that there is now an assumption that central banks will do whatever it takes in times of stress. Is this belief



now so entrenched that it is going to be very difficult to remove? It is clearly a huge risk to the economy to allow that culture to remain.

Nathanaël Benjamin: I agree with your worry. The answer to that is that central banks have been shown to do whatever it takes to maintain stability. That is important and will continue. The important thing is that central banks should be the lenders of last resort, not of first resort. Central banks can and will intervene in extreme situations, which is normal.

In less severe situations, it is important that the financial sector and the different players within it act as a buffer and as the first line of defence. That is the distinction. There is a locus for central banks in extreme situations to restore market functioning and stability, but that should not be misread or confused by market participants as a lack of a need for them to be the first line of defence, to manage the risks and to absorb the shocks themselves.

- Q33 **Anne Marie Morris:** What you are saying is logical and correct. The problem is that we have a culture that needs to change. Given your new role, how are we going to change that culture? What are the steps that your organisation can take to make people think differently? This is not about a rulebook or the knowledge that, at the end of the day, if it is really serious, central banks will bail you out. As you say, it is that middle phase. We need to get these organisations to take a lot more responsibility. How are you going to change the culture?

Nathanaël Benjamin: That is a very good question. As a microprudential supervisor of banks, one tool that we have is the senior managers regime, which sets accountabilities for senior managers within the organisation to take responsibility for the decisions that are taken, so that business is or is not taken up on the basis of risk. That is an important tool that supervisors have around checks and balances in terms of the accountability that individuals have within the industry in that regard.

In terms of the broader financial ecosystem, international policy developments on things like margining and haircuts are also important developments in that context. If all jurisdictions adopt these tougher standards, all players in the financial ecosystem will have to think differently and take more responsibility for being the first line of defence. There is not one single tool but a range of tools that will force all the players in the ecosystem to have that mindset.

- Q34 **Anne Marie Morris:** It is not just a matter of tools. This is about culture. This is about the rhetoric that you use and the pressure that you apply, which has nothing to do with regulations. What are you going to do, in the way you manage the relationships that you have, in order to change that culture?

Nathanaël Benjamin: A big part of doing that is communicating, sharing our views, talking to stakeholders publicly and bilaterally, and



making those points very clear, in order to ensure that the incentives are aligned to what we need from a financial stability perspective. Communication is a very important aspect of how we should do this in order to raise the profile of these issues, to your point.

- Q35 **Anne Marie Morris:** If you fail to change that culture, where is the greatest risk if, at the end of the day, the Bank does not bail out? In a situation where the risk has been taken, as you have described, there is a sliding scale as to how serious it is and, when we get to the end of the scale, there is an assumption that the central bank will bail out. What if the central bank takes a different view of this scale and does not bail out? What is the greatest risk that we and our economy face?

Nathanaël Benjamin: The important thing to consider is who would stand to lose from a given shock because the risk has or has not been appropriately mitigated by the financial sector. It may be the case that informed investors incur some losses, which is potentially fine. What central banks will not necessarily let happen is for shocks to the broader economy—to households and businesses—to disrupt the provision of vital financial services. Central banks will always be there to guard against that, but it does not mean that the central bank will always intervene. If people take calculated risks, it is very important that they are allowed to incur losses on them, as long as the implication is not that the broader economy and financial stability are disrupted.

- Q36 **Anne Marie Morris:** There is a fine line. You are talking about theory, not practice. The line between where it is just the individual organisation that goes under, because it took a risk that it should not have, and where it impacts households is a very fine one. I must admit that I am still not entirely clear on what you believe you can do to change that culture. I would hate us to get to the point where there was a difference of opinion between the central bank and the market that was taking the risk, and we landed up with a real issue of challenging and unfortunate consequences of moral hazard.

Nathanaël Benjamin: I agree with your concern, but, by being clear that this is an issue that needs to be addressed in the banking sector by putting things in place to force the right incentives on players, that will be an important way of mitigating that.

- Q37 **Dr Coffey:** Thanks for your comments in the questionnaire on climate finance. You might not have heard of the quantum apocalypse, but there are people who believe that there is a climate apocalypse that we need to prepare for. Are climate risks a particular form of financial stability risk in your view?

Nathanaël Benjamin: Yes, absolutely. The risks from climate change are absolutely core to our financial stability remit. As I described in my questionnaire, I think about the current transition that we are going through as being from an era of a rather benign economic environment into one that is marked by climate change, digital transformation and



monetary tightening. Climate change is one of the key drivers of the change in the financial stability conditions that we are observing. The lens through which we are considering the impact of climate change is the impact on financial stability.

Q38 Dr Coffey: TCFD is in place for certain institutions, but I wanted to understand what more the FPC could do to mitigate the risks. Does it need additional macroprudential tools to do that?

Nathanaël Benjamin: The FPC has the tools that it needs for that. More generally, the Bank has already done a lot on the financial stability implications of climate change and has played a leading role. That includes the climate exploratory scenario that we launched, which was a premiere. That includes the supervisory expectations on banks and insurers for how they manage climate. We have now entered a phase in which the industry is busy doing the homework that has been set for it. The job is not done and there is more that needs to be done.

I am focused on one aspect of climate change, which is the shorter-term aspect of trading activities—for example, the way in which either physical or transitional climate events can impact commodity markets and their relationships, such as hedging contracts, and the extent to which banks and non-banks are involved in these markets. We have seen some disruption in these markets in the past, and it is likely that, because of climate transition, there will be more of those disruptions, especially for metals, energy or agricultural markets. That is an area where the implications of climate change are very important for financial stability, and it is on my radar. A lot has been done but there is more work that needs to be done.

Q39 Dr Coffey: Can I build on that a little further by also flagging nature and biodiversity? Climate and its impacts are well understood. What work could the FPC or other institutions do to consider nature? The Taskforce on Nature-related Financial Disclosures published its framework just a few months ago.

Nathanaël Benjamin: On nature and biodiversity loss, we are at the stage where we are studying and asking what the potential impacts are on financial stability. We do not have the answers to that yet. It is important that we do the work, and we are working very collaboratively with colleagues with Defra on that. We just need to do the homework on that in order to evaluate the nature of the challenges to financial stability, as well as their size and materiality. Irrespective of what that work shows, biodiversity loss is an issue. The question is whether it is also a material financial stability issue. We just need to do the homework to work that out.

Q40 Chair: I have a few questions about risk, building on earlier comments from colleagues. What is your view on the shift in the balance of lending between regulated banks and non-bank financial institutions? Does that increase risk? You had some views on that in your responses to the



HOUSE OF COMMONS

questionnaire.

Nathanaël Benjamin: If we look over recent decades, a number of employees and businesses have moved away from banks into the non-bank sector. That has been quite a material aspect of a movement that we have seen.

Q41 **Chair:** It has been a big shift from regulated to non-regulated, where riskier things happen. I am just trying to set this up for those who are watching.

Nathanaël Benjamin: That has been a big shift, both of people and of businesses, which means that people who used to work for banks are now competing with banks, or are their clients, to such an extent that the non-bank sector provides more than half of the funding to UK corporates. That gives you an idea of the size of the shift. That is a very clear fact.

I would say two things on this. By its nature, the non-bank sector has grown on the back of the lower interest rate environment. That has been one of the drivers. Therefore, the way in which this sector has grown has potentially built up some imbalances as a result of having grown on the back of the lower rate environment. There are a number of areas where the Bank has already been busy at work to bring about regulation for different non-bank sectors.

The work under the auspices of the Financial Stability Board here is very important, with the reform of open-ended funds, reform of money market funds and, more recently, domestically, reform of LDI funds. Many players in the non-bank ecosystem have seen reforms to address the risks in their bit of the ecosystem. But there are no two ways about it: it is a very complex sector.

Q42 **Chair:** It is also opaque.

Nathanaël Benjamin: It is much more opaque than the banking sector, which means that we have to accept that we will not be able to predict all future elements of turbulence coming from that sector. That is okay, but it is just a reality. As I mentioned in my questionnaire, one aspect of that sector that I am particularly concerned about is private equity. This has also grown on the back of the lower rate environment. Total assets under management in the private equity sector are around \$8 trillion, which is a lot. There is a combination at play here of opacity, a lack of transparent pricing, with no mark to market, a search for yield, and leverage.

Q43 **Chair:** I was going to mention leverage. With a higher interest rate environment, existing leveraged positions can become much less sustainable. When we look at the activities of private equity in the UK, there are some alarming signs in terms of the sustainability of such highly leveraged positions, for example in the social care and nursing home sector. Clearly, if a whole load of social care sector nursing homes went bust, the Government could not sit by and just allow that to play out. To what extent are private equity and hedge fund operators,



particularly in the provision of care sectors, expecting the Government to step in if there is a problem?

Nathanaël Benjamin: I cannot speak for what they are expecting. What I can say is that banks have an important role to play in terms of their relationship with private equity players, because they often provide funding to private equity sponsors, and whatever leverage is being sought is very often being sought from banks. That is the degree of interconnection with the banking sector.

Therefore, it is very important from a financial stability perspective that banks have a very clear line of sight of their exposure to private equity sponsors and to the different ways in which private equity activity plays out. That includes sponsors and limited partners in private equity funds, as well as the underlying portfolio of companies that are being invested in. It is very important that banks get a full picture of the aggregate exposures to those concentrations across the different aspects of those relationships. Part of the answer is for banks to manage those relationships carefully.

Q44 **Chair:** You mentioned the LDI issues last October/November, but they were not foreseen at all, or were they on your horizon?

Nathanaël Benjamin: As a potential vulnerability, LDI was on the FPC's radar as early as 2018. The question was how material a vulnerability it was. As I said earlier, it is not possible to predict all future episodes of stress, and we just need to accept that.

Q45 **Chair:** You have things coming over the horizon, but you have to then have some idea of what your response would be if that risk materialised. To what extent did that happen with the LDI pension funds?

Nathanaël Benjamin: LDI was on the radar. What was not anticipated was the combination of that particular vulnerability and what happened to the gilt yields.

Chair: No one anticipated what would happen with that Government, but anyway.

Nathanaël Benjamin: It is the combination of these two factors that elevated the materiality of the episode, combined with the degree of concentrations that banks had to LDI funds. It was a combination of three factors that caused it.

What did happen, though, is that the Bank showed that it was able and prepared to step in to restore financial stability to the extent that it was needed. Even though we are not able to predict all future crises, the Bank has shown that it is able to step in to restore market functioning when required.

Q46 **Chair:** To what extent should those in non-bank financial institutions be regulated, as leading members of banks are for their own personal responsibility, and perhaps be part of a register?



HOUSE OF COMMONS

Nathanaël Benjamin: That is an interesting question. As I said, the senior managers regime is an important part of our toolkit for banks.

Q47 **Chair:** Should it be spread to some of the more systemically important non-bank financial institutions?

Nathanaël Benjamin: There are a few things that would need to happen first. One is to cross the finish line with the reforms that are relevant for the non-bank sector under the auspices of the FSB, such as the reform of money market funds and open-ended funds. The FSB's leverage group is doing very important work on margining. I mentioned margining earlier and, to me, that is priority number one.

Q48 **Chair:** Do you then move on to a senior managers regime for some elements of the non-bank financial sector? It is getting bigger and bigger and may well continue to get more dominant when compared to the more regulated banking system. The reason for not regulating it is simply the view that, if it falls over, the losses have to be taken by those who have taken the risks, but when does the non-bank financial sector get so large and so systemically important that that is no longer the case?

Nathanaël Benjamin: It is important, especially to the extent that they get more involved and have a greater direct connection with the real economy. One thing we are considering is the extent to which liquidity can be passed directly to the non-bank sector, should it be needed, in very extreme circumstances. The question of the quid pro quo for that is out there. It is too early to tell, but that will be an important part of what will need to be considered in due course when these things happen.

Q49 **Chair:** The Committee is in the middle of an inquiry on sexism in the City, partly triggered by the revelations at Odey Asset Management, among others, which was a series of private equity funds. When you are thinking about fitness, to what extent do you think about non-financial conduct? It seems to me that, if you are thinking about a culture of risk and you have a private institution in which that kind of risk routinely manifests itself and nobody is doing anything about it, that may well have implications on behaviour in a financial as well as non-financial way. Do you take account of this kind of thing?

Nathanaël Benjamin: We do. This goes back to my earlier remarks about lessons to be learned from banking failures. The importance of diversity within those organisations is essential, not just because it is the right thing to do but because firms that lack diversity are more prone to making decisions that they will later come to regret and will have financial stability or safety impacts for them. That review is very welcome and this is a very important aspect. I talked about risk culture before, and the extent of challenge and the diversity of thought within firms are very important.

Q50 **Chair:** I understand the diversity points and that trying to measure them is also important, but what about misbehaviour? Something can be very diverse, but, if there is no internal challenge because of a climate of fear,



you are still going to get misbehaviour and non-financial risk taking, which may have a bearing on financial risk taking.

Nathanaël Benjamin: I completely agree. For us, it is absolutely essential that there are people who are competent and have integrity in key positions in firms. We need those two things. If those conditions are not met, bad things happen, so I completely agree with the premise of your question, and your review is very welcome on this front.

Chair: Before I move on, we are looking to see what our recommendations could be. It is not only about diversity, but about measuring the extent of misbehaviour. I wonder whether you might write to us about how the organisation that you are joining might be looking at that. It might help us with some recommendations.

Q51 **Keir Mather:** Thank you for coming in, Mr Benjamin. I would like to ask you some questions about financial stability risks in relation to the Chinese economy. We have seen a deterioration in the health of the Chinese property sector, with activity declining and real estate investment down by 17% last October, in a context where the general outlook for the Chinese economy remains subdued. How concerned are you about the financial risks emanating from China at the moment?

Nathanaël Benjamin: It is an important aspect of the financial stability landscape at the moment, especially on the global scene. As you rightly say, the key source of financial stability risk is the property sector in China. The root of the issues, as has been well publicised, lies in the nexus between property developers, local government and smaller banks, and the type of business that has been done there.

There is clearly an oversupply of property in mainland China, which is the picture that you see in terms of the imbalance that is there. A smooth resolution of those issues is very important for global financial stability, given the sheer size of the Chinese economy. It is clear that the authorities there are very focused on that and are looking to oversee a smooth resolution of those issues.

I would say two things in terms of direct channels of financial stability. There are some UK banks that are exposed to the property market in mainland China. Our stress tests of UK banks have shocked those markets, and those banks have proved to be resilient to very severe shocks in these markets, which are much more severe than the drops that we have seen so far. There is resilience in terms of the direct exposures of UK banks to the Chinese economy, both in mainland China and in Hong Kong.

There is another channel, an indirect one, which we are watching very carefully. As these imbalances get resolved over the next two to three years, what will the indirect consequences be? To the extent that some players have to incur some losses, are those players themselves exposed to institutions that have a greater degree of connection with the UK



economy? Those more indirect channels are the types of things we are watching quite carefully.

Q52 Keir Mather: I see. You made reference to the action that the authorities within the Chinese economy are taking to provide oversight and redress the imbalances that we see in the Chinese property sector. In March of last year, Xi Jinping announced the launch of the Central Financial Commission to administer oversight of the Chinese financial sector.

How difficult do these changed circumstances make it for us in Britain to perceive the financial stability policy decisions that are happening within the Chinese system? Does the opacity of that system create its own risk, from your perspective?

Nathanaël Benjamin: The reform of the regulatory system within mainland China has not made it more difficult for us to evaluate those risks. I was there two months ago as part of my previous role to discuss these issues with my counterparts and the banks, both the Chinese banks and the overseas banks that are headquartered over there. There has been a very good level of technical dialogue on the risks to individual institutions and the broader sector. The reform has not been a barrier to that dialogue and that understanding.

Q53 Keir Mather: In what ways have those reforms offered a change in how you perceive risk emanating from the Chinese economy and the transparency with which you can see policy decision-making happening? What are the dynamics of those changes?

Nathanaël Benjamin: The reforms have been aimed toward a greater centralisation of the authorities that govern the financial sector, bringing together the central bank and the different types of regulators. That is one aspect. That has almost been one of the design principles behind the reforms.

One aspect that has been discussed as a topic within the authorities is how data security laws fit with the need for transparency, the flow of data and people seeing the data they need to see. Those are discussions we have had with our counterparts and the positions are well understood.

Q54 Keir Mather: I saw recently that the record of the FPC noted that major UK banks were resilient to a severe global recession, including significant falls in real estate prices in mainland China and Hong Kong. Are there any ways in which the Bank may be being a little sanguine about the risk of these kinds of fluctuations in risk within the Chinese economy more broadly?

Nathanaël Benjamin: I would not describe our stance on the situation as being sanguine. It is one of the major potential threats to financial stability globally. In particular, the indirect non-bank channel that I described to you earlier is a source for concern. I would not describe our stance on that as sanguine. It is quite the contrary.



Q55 **Keir Mather:** But the UK financial system is sufficiently resilient to weather those challenges, irrespective of whether the Bank identifies them to be one of the most pressing risks.

Nathanaël Benjamin: That is correct. It is in a good position.

Q56 **Keir Mather:** As we look forward to the new year, I wondered whether you wanted to offer your personal perspective on what you see as being the main geopolitical risks that the UK financial system may have to weather over the course of 2024. Are there any ways in which the UK financial system is currently not resilient enough to be able to deal with those geopolitical risks?

Nathanaël Benjamin: The two main geopolitical angles that I would point out are the one we have just discussed in relation to China and the one related to the tragic events in the Middle East. The financial stability impacts of those tragic events have so far been moderate, in a sense.

The latest development around the Bab-el-Mandeb strait is just one part of the series of developments. It has implications for shipping lanes. The increased cost of shipping has been offset by lowering oil prices. The impact so far on financial stability has not materialised, but it is clearly something to watch very carefully.

Q57 **Keir Mather:** Finally, in relation to the war in Ukraine, is it difficult to foresee what the risk picture looks like in that conflict given the fact that circumstances have changed strategically on the ground over the course of the winter months? That must still rank extremely highly in terms of the risk factors that you assess within your role.

Nathanaël Benjamin: That is correct. That is another tragic situation in a different part of the globe. Again, the financial stability implications have so far been mitigated and managed. A lot of the supply chains have been rewiring themselves via different routes. That continues, in a sense. The financial stability risks are controlled, but it is very important, as you say, to continue watching those developments.

Q58 **Stephen Hammond:** Some of my questions follow on from what Dame Angela was asking. In your evidence, you say there are a number of vulnerabilities in market-based finance that pose a risk to UK financial stability. You have clearly outlined private equity. For the sake of clarity, do you believe that private equity is the biggest market-based finance risk to UK financial stability?

Nathanaël Benjamin: I would not necessarily say to UK financial stability. It is a risk to global financial stability. Different jurisdictions are exposed to it in different ways. The US is exposed to it quite a lot. As is the case with many aspects of market-based finance, these things are cross-border by nature. At the moment, it is one of the risks that I am particularly focused on. It is one of them, but there are others.

Q59 **Stephen Hammond:** Indeed, yes. In your submission, you make the



HOUSE OF COMMONS

point that it is global and highly interconnected. You also make the point that there are material gaps in data. How can we close those gaps in data? What international co-operation is needed to do that?

Nathanaël Benjamin: We have been doing quite a lot of collaboration with our international peers on the regulatory side to help improve some of the data we ask for from certain firms generally. That is the case for banks.

We are running an exercise at the moment, the system-wide exploratory scenario or SWES, to suss out some of the dynamics across the financial ecosystem as far as key core UK markets are concerned. That will be really important. It will give us greater visibility on those systemic reactions. I should make clear that we are getting data about those types of interactions from non-bank players to a much greater degree than was the case before.

I would also come back to my earlier comments about the collaboration between regulators. We are asking banks about the exposures that they have to the non-bank sector. By asking those questions, we can have greater visibility on the non-bank sector and exchange those data between regulators. That is also an important initiative that is underway.

There are initiatives underway, but there is more work to be done to reduce the degree of opacity that is there.

Q60 **Stephen Hammond:** Given that you have identified that as a key thing, that is presumably something you will be focused on when you are on the committee.

Nathanaël Benjamin: Yes.

Q61 **Stephen Hammond:** You rightly stated that the growth in non-market-based finance, particularly private equity, has been driven by lower interest rates. Another factor could be—that this has certainly been put forward as a view—that the retail ringfence forced banks out of particular activities, which therefore forced people who wished to access capital for those activities into non-regulated areas and market-based finance. Do you put any credibility on that view?

Nathanaël Benjamin: I am not sure whether that link of causality is borne out. I am not sure how material that effect is.

Q62 **Stephen Hammond:** There is an effect there, however material it was. Everybody acknowledges that banks were in that sort of financing prior to the ringfence being put in place. The average cost of capital rose and therefore banks either withdrew or people sought the capital elsewhere.

Nathanaël Benjamin: It is difficult to say how much is caused by that and how much by other factors. Ringfencing has managed to shield households from a lot of the shocks that have occurred over the last few years. It is part of the reasons why banks have been able to absorb the shocks.



- Q63 **Stephen Hammond:** I am not disputing that. I am just asking whether the fact that the ringfence is there is another factor in terms of what has led to the increase in market-based finance. You will have seen that there have been a number of reports recently about the set-up of new private credit funds, as opposed to private equity funds. Could you explain how you see the balance of risk to financial stability between private equity and private credit? Do you regard them as symmetrical risks?

Nathanaël Benjamin: It is interesting. Private credit has recently started to compete with private equity. In terms of relative size, private equity is bigger. The total market of public equity is around \$100 trillion; for private equity it is around \$8 trillion; and for private credit it is around \$1.7 trillion. That gives you the relative balance of size.

More recently, we have observed private credit starting to compete with private equity sponsors. Clearly, all of that is happening in a world where there is a search for yield. That search for yield happens in an environment where interest rates are changing. Investors are trying to seek the best returns in different possible ways. Private credit is trying to offer some solutions to investors that they cannot find elsewhere.

- Q64 **Stephen Hammond:** You see the macroprudential risk as being symmetrical to private equity.

Nathanaël Benjamin: The risks are similar in a number of ways, but there are some extra features in the world of private equity that are not necessarily present in the world of private credit, not least the fact that you have portfolio companies that are invested in. If some investors want to get their cash out, the portfolio needs to be sold. That is not necessarily the case with private equity. That is a bit of a difference. Therefore, the question is, "At what price is the portfolio sold?"

[Harriett Baldwin resumed the Chair]

- Q65 **Stephen Hammond:** In terms of non-bank financial intermediaries, if one of the world's largest online distributors were to enter the financial markets in a bigger way, what would the FPC's attitude to that be? What would it require in terms of regulatory supervision to ensure the risk was equivalent to that of it being a regulated non-bank financial intermediary?

Nathanaël Benjamin: We have the general principle of "same risk, same regulation". That is the guiding principle. It is our principle. This is the one that the Financial Stability Board is promoting internationally. The idea is that, if people carry out certain activities, they should be subject to equivalent levels of regulation. We will need to see the specifics.

- Q66 **Stephen Hammond:** There would need to be either a bank or a branch in the jurisdiction in which they are operating.

Nathanaël Benjamin: I cannot answer that question without knowing the specifics of what you know.



- Q67 **Stephen Hammond:** I do not know. I am just postulating that there are very large online distribution companies that are looking at ways of growing their revenue. One obvious way might be to go into personal finance to support their activities in purchasing and online distribution. That could be quite a major financial stability risk. We have seen the 'buy now, pay later' sector, with Klarna and others. Klarna has behaved pretty well. I am just picking a name out of the air. There are others that may not have behaved as well.

I absolutely take the point about "same risk, same regulation", but are we saying that we could regulate it as a non-bank? Given the scale and size, should it be a bank with a branch structure?

Nathanaël Benjamin: We will have to see exactly what business model they want to adopt. I am reasonably confident that, depending on what the business model is, we will have the tools, the options and the set-up to apply the appropriate regulation to that.

- Q68 **Chair:** Again, I apologise that my debate came directly at this moment. I will discuss with colleagues what has come up today. I just wanted to ask one final question, if I may.

You have come to this session prepared—I am sure very assiduously—for a whole range of questions. Were there any questions that you were expecting to come up that we have not teased out of you about the potential risks on the horizon?

Nathanaël Benjamin: We have covered a very broad spectrum. We have not spoken about the risk from the current high rate environment to households or businesses, but I am sure you will have opportunities to discuss that with other colleagues.

- Q69 **Chair:** Are there any risks that you want to flag to us there?

Nathanaël Benjamin: The situation at the moment is that the level of indebtedness of households and businesses is at historical lows. So far, they have been financially resilient to the current interest rate environment. That does not detract from the fact that many households are going through a very challenging time at the moment. That is the only thing I would say.

- Q70 **Chair:** As you say, we will have the Governor and the team to talk about financial policy tomorrow. I have one last question. Are you in favour of the Bank of England issuing what is known as Bitcoin or a central bank digital currency?

Nathanaël Benjamin: We will first need to do the work to see the use case for a central bank digital currency. It is not a question about whether it is needed today but whether it might be needed in the future. It is important to do the work so that, should it be needed in the future, we are ready to do it. The jury is out. It is really important to consider a range of things in terms of whether it is needed.



Q71 **Chair:** You are the jury, because there was a consultation. It has had the highest response rate of any consultation the Bank of England has ever done, but you have not responded to it yet. We were expecting that you would have responded by the end of last year.

Nathanaël Benjamin: This consultation was done jointly with the Treasury. I am not the best person to tell you about the exact timing of when the response will be shared, but I know we are doing the work and on the design.

Q72 **Chair:** Would a central bank digital currency create any macroprudential risks that you would be concerned about as a member of the FPC?

Nathanaël Benjamin: Aside from the potential benefits of a digital currency, there are a number of things that need to be considered. One is the extent to which it could disintermediate banks. That is why there will be a limit on the amount of CBDC deposits that any household can hold. Other concerns include privacy, programmability and access to cash.

These are the things that will need to be considered in the round, together with the potential benefits. Then a decision will need to be made based on what the world looks like at the time when it might be introduced. That world might be very different, with a range of stablecoins in circulation, etc. Those are the things that will need to be weighed up at the time the decision has to be made.

Q73 **Chair:** You cannot update the Committee on when they are going to publish a response to the consultation.

Nathanaël Benjamin: I genuinely do not know the answer to that question. I am not the best person to ask.

Chair: We will keep asking. That concludes the Committee's evidence session today. We will now meet in private. We will ask those who are here in a public capacity to leave the room quickly and quietly. We want to thank you, Mr Benjamin, for your time today.