



Treasury Committee

Oral evidence: [Bank of England Bill](#), HC 445

Wednesday 9 September 2015

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Members present: Andrew Tyrie (Chair); Mr Steve Baker, Bill Esterson, Helen Goodman, George Kerevan, John Mann, Chris Philp, Mr Jacob Rees-Mogg, Wes Streeting

Questions 1-104

Examination of Witnesses

Witnesses: **Anthony Habgood**, Chair of the Court, Bank of England, and **Bradley Fried**, Member of the Court, Bank of England, gave evidence.

Q1 Chair: Thank you both very much for coming to give evidence to us this afternoon. The last time we saw the Court, it did not go so well as a hearing; we are hoping for better luck this afternoon. It was the time before last, come to think about it. The time before last it did not go so well.

Can I begin by asking about the Chancellor's proposal that the NAO undertake value for money studies of the Bank and get your view of what value for money we will get out of those value for money studies?

Anthony Habgood: First of all, thank you for inviting us. It is a pleasure to be here. The proposed involvement of the NAO in the Bank has three aspects. One part is the external audit. I think there is general agreement that it is necessary for the fundamental auditor of the Bank to be a Big Four auditor.

Q2 Chair: You were going to say "of the company". It is a company, in fact.

Anthony Habgood: It is a company, indeed, but I was still correcting myself. Preferably one of the Big Four companies with central bank experience, because the accounts are quite complex. Even in this year's accounts, at a relatively trivial level, there was a question of the valuation of a BIS shareholding; we are drawing on experience from around the world as to what they should do with that. Also, I think all of us would really feel we would need the ability to call on the worldwide experience and strength of one of the Big Four if we ever got into a difficult, crunch series of decisions in the middle of a

night before a market opened the next day, or whatever, where you really can call on Big Four expertise.

Q3 Chair: That is the core audit function. I was asking about the value for money studies.

Anthony Habgood: That is the core audit function. It was not quite the question you asked, but I wanted to cover that off as well. Just before I leave that, it is worth noting that none of the G7 central banks use the public sector auditor for the external audit. A few of them use them to a degree—but only to a limited degree—in value for money exercises.

On the value for money side, it all really depends on the small print. There are two areas where one, if you are in my position, can be a bit uneasy about the proposal in the consultative document, depending on how you interpret it—as I say, depending on the small print. One is there is a potential threat to the very carefully constructed independence of the policy functions of the Bank. They are carved out under FSMA, but that is quite a limited carve-out. An awful lot of the Bank's functions are about either the formulation of policy or the implementation of policy and where that line is drawn is complex. If you are going to have the National Audit Office involved, that line needs to be drawn quite widely, as it is generally in other central banks where these things are involved.

Q4 Chair: Let us not get into those complexities today. You said there were two other points.

Anthony Habgood: That is one. The other is the question of what the role of Court is then. If, following this Committee's guidance as much as anything, the Court is becoming more and more of what I would call a modern unitary board, that board will be staffed with people who are used to doing their own value for money exercises and not used to having them imposed from the outside or being duplicate to what is going on. I say that with very limited knowledge of the National Audit Office as an operator. It has been the auditor of the PRA, as you know, but that is a very simple audit. I do not have any experience, negative or positive, about it—I am talking situational.

Q5 Chair: My question was, “How much value for money are we going to get from the value-for-money studies?” to which the answer is, “We do not know. The devil is in the detail and we need to think through how this proposal should be translated into statute.”

Anthony Habgood: Absolutely. I would never say that there was nothing that could be got out of a value for money survey. There always will be whenever you do anything like that, but you would an organisation to do those from time to time and, as you know, it has just been through—

Q6 Chair: You had a bit of a go at the NAO, did you not, in Court minutes on 16 April? I am quoting: “The Committee had also discussed the NAO’s published report on the regulators and had expressed disappointment that it did not reflect fully the baseline for PRA costs agreed on separation from the FSA, which had underpinned subsequent PRA budgets”. Even in the narrow field of the PRA, you were not happy.

Anthony Habgood: Can I ask Brad to answer that, as he was there and I was not?

Bradley Fried: Thank you, Mr Chairman. Anthony was not on Court at that time—that would have been prior to his joining—but I was. The issue concerned the separation of the PRA and the FCA out of the FSA, and there was a concern expressed on Court—and it was very clearly shown in the minutes—that the National Audit Office did not quite take into account the work that had been done by Andrew Bailey and his team in making sure that a minimum cost came over out of the FSA into the Bank of England. We expressed dissatisfaction because that is what we felt at the time. If I might, Mr Chairman, add to Anthony’s observation—

Chair: Briefly, if you would.

Bradley Fried: I will. The bigger concern for me around the involvement of the NAO in value for money studies is what you refer to as potentially the blurring of the lines or the creation of ambiguity. It does create ambiguity because you are asking Court to be accountable for the management of the resources of the Bank. As per the 2011 report, we feel very comfortable being accountable for that; we regard that as our role. It does create some sense of ambiguity or blurring of lines by having an additional value for money auditor being involved.

Q7 Chair: While you are on the subject of the PRA, the PRA and the FCA were both asked by the banking commission—subsequently supported by this Committee in the last Parliament—to put a cap on the cost of federal regulation as reflected in the levy. Are you doing that? Are you confident that for the pre-existing functions—they have been given new tasks as well; both bodies have enlarged their roles in various ways, insurance as an example—they are fulfilling that request from the banking commission?

Bradley Fried: Mr Chairman, I cannot answer that specifically but I would observe that the base case costs that came out of the FSA into the Bank of England were lower than expected, and that the expansion of responsibilities by the PRA in 2014-15 and the expanded budgeted responsibilities will not allow us to keep a cap on those costs. In 2014-15, the PRA did a tremendous amount of work on stress testing, structural reform, the implementation of the Parliamentary Commission on Banking Standards, and so on. It is very hard to compare apples to apples, but I have no doubt that we could get back to the Committee with those details.

Q8 Chair: It would be helpful, if you would, in writing, give us a preliminary assessment of the extent to which the PRA is fulfilling that request.

Bradley Fried: We will do that.

Q9 Chair: I am sure you will understand the reason we are asking is that the levy is ultimately just a tax on consumers and millions and millions of people who consume financial products one way or another.

Bradley Fried: We do understand that, Mr Tyrie. We will get back to you.

Chair: We are all paying for this; it is not free money.

Q10 Helen Goodman: I want to ask you about the Court's activity and effectiveness and about the Court membership. I have only just come on to this Committee and I was not following the behaviour of the Bank in the middle of the financial crisis so closely. There seemed to be other things in the headlines at that time, but I think there has been a general feeling that the Bank was maybe not quite as effective as it could have been and the Court was not quite as effective as it could have been, and that is why you have been appointed and the Chancellor is bringing forward these changes. One of the issues about the Court is to maintain a level of independence and to avoid groupthink. Is that a fair understanding of what you are trying to do?

Anthony Habgood: Yes, we want to avoid groupthink. When I talk about Court—this is why I do not like the word “Court”—I am using the word as I would use “board” in a corporate context, which is as a unitary board, i.e. including the executives and the non-executives together. Absolutely; when you are constructing a board, you try to avoid having everybody exactly the same and out of the same mould.

Q11 Helen Goodman: Have you thought at all about having on the board somebody with an academic background in finance and banking?

Anthony Habgood: The simple answer to that is yes. When we appointed the last three members, who were Dorothy Thompson, Dido Harding and Don Robert, we had quite a long longlist, which the Permanent Secretary and I went through down to a shortlist, but it is the Chancellor who appoints. We do not actually appoint—it is the Chancellor who appoints at the end—but the appointment and the shortlist were very close together, shall we say.

Q12 Helen Goodman: There has been some suggestion from time to time that there should not be a trade unionist on the Court. There has been a trade unionist on the Court for about 50 years. Do you have any criticisms of the trade unionists who have been on the board and their effectiveness in particular?

Anthony Habgood: I have only been on the board for just over a year and a quarter or so. It is Dave Prentis who is on the board. I have to say we have all found him a very effective board member. He has been very involved. He brings a perspective. He has been a very hard-working member of the remuneration committee as well, which does not

necessarily show up from looking at the numbers. There were a lot of informal meetings as they were working out the “One Bank, your reward”—as we were bringing the PRA into the Bank more fully—and he was very engaged in that and very hardworking. He brings an interesting perspective; there is no doubt. I have not been involved in a situation where there has been a choice. I do not think of him as a trade unionist; I think of him as another fully operating member of the board.

Q13 Helen Goodman: I guess he is used to managing an organisation that is about the same size as the one Dido Harding manages. That is right, is it not?

Anthony Habgood: Yes, exactly. It is another big organisation. Yes, absolutely.

Bradley Fried: If I might add, Mrs Goodman, he was extraordinarily helpful in integrating the compensation systems and approaches of the PRA and the non-Bank PRA. We called it “One Bank, your reward”. David was pivotal in making that happen as part of the remuneration committee; he brought a very unique perspective.

Q14 Helen Goodman: So, if we are to ensure that the Bank is performing its public service functions adequately and is accountable to the public other than via this Committee, having a wide spread of people on the Court is helpful.

Anthony Habgood: Yes, but, again, I do not look at him as a representative of a trade union. I do not look at him as that; I look at him as another fully engaged board member.

Q15 Helen Goodman: Is there any expertise that you are conscious that the Court does not have at the moment that you would like to see?

Anthony Habgood: You can always look at a board and say, “Would it not be nice to have more of something or other on it?” No, I do not think there is a crying gap. If I did, I would have tried to have filled it in the last round.

Q16 Helen Goodman: Do you have any anxieties about the number of women on the Court?

Anthony Habgood: Do I have any anxieties? Let us assume this legislation happens and Minouche Shafik is on the board—she is effectively now; she attends, but she is blocked by the legislation—we will have three women on the board, which is 25% of the board as women. That is well up to good corporate practice. You can say that is shifting, and all these norms are moving all the time, but, relative to where the Bank has ever been before, it is a long way ahead.

Bradley Fried: We might add to that, Mrs Goodman, that the GovCo comprises the deputy governors as well the Chief Operating Officer. Charlotte Hogg is the Chief Operating Officer and is very much involved at the highest level of the Bank.

Q17 Chair: Just on that, Mr Fried, are you happy with the level of bank financial experience that is on the Court? Do you see that there are good reasons for strengthening it?

Bradley Fried: Whilst we look at it as a unitary board, you ask a specific question, Mr Tyrie, so if I could disaggregate it. We have the five governors and deputy governors, indeed two of whom have worked in financial services firms. Both Mr Broadbent and Mr Carney have had financial services experience. If we look at the non-executive directors, we have right now quite a healthy mix of financial services experience. John Stewart is the Chairman of Legal & General and has been chief executive of a plc bank. I have run a bank and a private equity firm, and continue to do that on the private equity front—on the investments front. Don Robert has a very interesting background in financial services systems, which has become ever more pressing as Court pushes harder on topics such as cyber and the management of very large integrated systems. Right now, on balance, I think we are in the right place.

Q18 Chair: What is the right number of people with financial experience as non-execs on the Court?

Bradley Fried: It is going to be hard. I will give you a personal view, if I may, because we do not have a Court view on this. I did not mention to you Tim Frost, who has run a significant credit business. I would say, of the seven non-executive directors to whom the board refers, it would be very helpful in my view if three of those people had significant financial services experience. Right now we have four.

Chair: So you have one more than you need.

Bradley Fried: Yes, we have one more than we need. Not one more to come—one more than we need.

Q19 Chair: Yes. How many days a week are you devoting to this job?

Bradley Fried: Over the last year and a half or so, it has been about one and a half and sometimes two days a week. That includes weekend time. There is a tremendous amount of reading.

Q20 Chair: Mr Habgood, what about you?

Anthony Habgood: As I said, seven or eight days a month. There is some weekend time as well as that; I am not counting that in there.

Q21 Bill Esterson: I will say the same the thing Helen Goodman said. Being new to the Committee, this is a very new area to me. I suspect that most members of the public would say they lacked understanding; in fact, the whole area of anything to do with the Bank of England is pretty much a mystery to most people—including most MPs, I suspect. How do you think what you do is translated so the public

understand and have confidence in the role you are performing? Are there better things that could happen, building on what the Chairman was saying at the start about what happened in a previous evidence session, given that lack of understanding in the public as a whole?

Anthony Habgood: I do think that central banking is a particularly difficult area to explain to people, most of whom probably are not terribly interested in knowing much about it, other than being very interested that it works, if you know what I mean, and that it does its bit for the economy. Again, as I say, I have been here 15 months. We have tried very hard to increase the transparency and accountability of the Bank. From the beginning of my time—and Mark Carney is very much on the same page—we have increased the availability of Court minutes and so on to the general public who wish to read it. That is a challenge in itself.

The proposed changes in the MPC are designed to make that more transparent as well, so you have a really comprehensive release of data, which is much easier for people to get their minds around than having a drip feed of the same information over a number of different things, subject to all sorts of interpretation and so on. I am not going to pretend it is going to be easy, but I hope that the communications are clearer and more transparent. This Committee used the word “byzantine” quite a lot historically, and the other thing this change is trying to do is make it such that the FPC, the MPC and the PRA are more similar. Again, that makes it easier for you to get your mind around what it is we are doing here. There are lots of changes we have made that are attempting to help, but it is an uphill struggle, I suspect.

Bradley Fried: Mr Esterson, if I may add to that, there are also some very practical things that the Court makes sure the Bank is on top of. For example, if there is a consultation over polymer and a different kind of a banknote, that is where the public becomes concerned and very interested. There was clearly a lot of interest over images on banknotes. For good reason, the public became very interested in that, and we made sure that the consultations were completely appropriate. There is a dramatic amount of interest in where interest rates are going. Whilst the Court are not policymakers, we do take a keen interest in making sure that the public understand the very best way that they can what the trajectory of thinking is. There are some extremely practical things that we preoccupy ourselves with there.

Q22 Bill Esterson: You have given examples there that bring things to life and that people can grasp concepts around, but, for the vast amount of work that is covered, it is much more difficult to do that. Do you think there are practical things that you can do that would help so the public would want to take a greater interest? With the best will in the world, as you acknowledged, people are not going to read published transcripts.

Anthony Habgood: No, and there is no question they are difficult to read, even if you are well educated in the field.

Q23 Bill Esterson: That is part of the challenge, is it not? If everything is in jargon that only a handful of people can understand, there will immediately be a barrier, will there not?

Anthony Habgood: That is right. At a very small level, there is an attempt in the museum to explain very simply how the Bank things work—how monetary policy works, and things like that. It really is a difficult challenge, but it is one we should accept from you and continue to try to work on.

Q24 Bill Esterson: I am grateful for that. I would encourage any efforts to reduce the amount of jargon and find ways of explaining things in ways that lay people can understand.

Bradley Fried: We would support you on that one.

Anthony Habgood: We are extraordinary acronym-ridden, as well as jargon-ridden.

Q25 Bill Esterson: Yes. You touched on the point about the MPC and the decision to release transcripts. Martin Weale has expressed concern that perhaps this reduces the potential for discussion. What are your thoughts on that?

Anthony Habgood: If we had felt that, we would not have done it. We had a very careful review done by Governor Warsh from the Federal Reserve, who came over and spent a lot of time with all of us. It was very interesting, because he had a different perspective from where they come from. A lot of discussion went into what the best way of transmitting a single decision in a month or in a quarter was. In the end, everyone felt it was better to do it once than to try to do it three times and allow people to interpret and misinterpret and reinterpret when it is all one set of data, fundamentally.

Bradley Fried: To address Mr Weale's issues, Governor Warsh spoke about balance between being able to have space for policymakers to make policy and having that in a safe space where they would feel they could argue and discuss and have dialogue and debate. Then he spoke about the need for accountability and transparency, which, as you will see, is a pillar of the Bank's strategy, and a pillar that is quite consistent with the 2011 report from your Committee. Then he spoke about the need for making sure that the time of release is appropriate. He spoke about a five-to-10-year period. We have gone with an eight-year period for the full transcript of the second day decision-making, as well as an eight-year period for the policy decision inputs into that second day. The minutes will be enhanced to reflect the first day's thinking, which is more deliberation than decision-making. We think we have preserved the safe space.

Anthony Habgood: It is a balance. It is a judgment.

Bradley Fried: It is. The thinking of five to 10 years went through a tremendous amount of discussion amongst the MPC and the decision they came to was eight. We accept that and I think we have made that view plain.

Q26 Chair: Did any other members take Mr Weale's view that they might feel constrained?

Bradley Fried: It does not come to mind, but I suspect that that is a question for the MPC members.

Chair: All right. I will not press.

Q27 Bill Esterson: I will move on to something else. You are briefed regularly on monetary policy, the macro economy and financial stability matters, but you do not take part in policymaking. What is the value in those briefings? Are you able to influence, or do you attempt to influence, decision-making using those briefings?

Anthony Habgood: I do not think it is appropriate for us to try to influence monetary policy, for example, if that is your question. We are explicitly not doing that. On the other hand, if we are going to be involved at all in any sort of knowledgeable way with the Bank, we had better know what is going on. I think I have attended 13 MPC meetings in my 15-odd months—that is not the complete cycle; that is individual meetings—and similarly for the FPC. You are going there in order a) to make sure you know what is going on but b) to be able to make sure and reassure this Committee and anyone else that the processes that are being followed there are appropriate—that the whole thing feels good.

Bradley Fried: To make it practical, at the time of the stress tests, when there was a co-ordination between the micro-prudential supervisors at the PRA and the macro-prudential policymakers at the FPC, there was a peak staff utilisation of probably close to 175 people. Of a Bank that has 3,868 people, 175 of some of our finest people were deployed on stress testing. The Court is mandated to ensure that the Bank's resources are used correctly, so it is very important that we understand the macro issues and the macro trends, and the micro issues and the micro trends, so that we can figure out if the Bank is applying its resources appropriately.

Q28 Bill Esterson: So your role is to assess whether the process is being followed properly, not the outcome of the decision-making. It is how the decision is taken, not the decision itself.

Anthony Habgood: That is right.

Q29 Bill Esterson: And if you disagree, that is fine.

Anthony Habgood: That is right. And also to make sure that, for example, the risk implications a decision on the Bank itself are understood.

Q30 Helen Goodman: I just want to ask whether, in the time that you have been on the Court—and you have been on for different lengths of time—you have seen any shift and how you would characterise the shift in the culture at the Bank?

Bradley Fried: I could pick that up.

Chair: Do not be shy now. Tell us how it has really changed.

Bradley Fried: Let me start with what the situation is now. At the time that I joined the Court, the Court was in a state of flux and transition. There were pieces coming into it. The divisions had not fully settled. The PRA, indeed, did not exist; it was coming across from the FSA. There was a period of some degree of tumult, as one would expect in an organisation of that size in transition. It was very hard for an organisation that traditionally had a monetary policy brief, a financial policy brief that was a little ambiguous and no prudential policy brief to have a culture that can be compared to today.

I would argue that the culture of today is all about a plan that says, “We keep the future in mind”. We have a three-year plan to get to a “One Bank”. That “One Bank” should be a bank filled with diversity and talent; it should be open and accountable to the people of the United Kingdom through Parliament and this Committee; it should be mindful of execution and learn lessons when we have execution failures, as we have had and as this Committee is fully aware of; and it should be a bank that measures performance in a very straightforward way.

The starting point for that performance measure is the value system. The value system says: “Be inclusive, be accountable, be transparent, be open, be decisive and make sure that ultimately you are transparent”. That is the value system and that is what it feels like day to day. Can you wave a magic wand and make that happen in a value system? No. It is a period of intense teaching, training, mentoring and observation through the senior leaders of the institution.

Q31 Helen Goodman: This is a two-part question. Are you envisaging that people will move from being in the PRA to working on monetary policy analysis?

Bradley Fried: Yes, and they have already. That has begun.

Helen Goodman: I ask this because a long time ago I worked in the Treasury and there were very different cultures. You had the economists who turned up wearing kaftans and then you had the public spending people, and they were run by ex-Guards officers. They were completely different groups of people. I was wondering about integrating the different cultures that grow from the different specialisms in the different parts of the Bank.

Bradley Fried: That is a great question and it is very live in the institution. As a Court, we were very involved in the development of the strategic plan. Part of the strategic plan was the development of an organisational chart. The interesting thing about that organisational chart is for the first time there are shared reports to deputy governors, which was built by design to ensure that there would be systematic co-ordination. The fact that the deputy governors work extremely well together speaks to who they are, but we have tried to institutionalise that and make sure that there is co-ordination across the executive

areas and co-ordination across the committees. Indeed, this technical consultation on this Bill seeks to reduce the number of MPC meetings to allow for more space for co-ordination between the MPC and the FPC on matters that are common to them.

Q32 John Mann: Mr Habgood, Mr Fried was just eulogising about institutionalised co-ordination. Some people would criticise the Bank for having a cultural tendency to groupthink. Does the Court suffer from the same problem?

Anthony Habgood: I do not think it does, but perhaps I would say that, wouldn't I? In all boards, one is very aware of that as a potential problem. We do have a reasonably diverse membership of Court.

Q33 John Mann: When we did our 2011 report, we were not aware of the Bank's hidden knowledge of the LIBOR scandal, which was well tucked away and hidden. How many members of the Court are ferreting out future problems that are not recognised much outside the Bank and not known by us by definition? Who is doing the ferreting? Is that part of the role of the Court and of members of the Court? If so, do you do it as a group or individually?

Anthony Habgood: First of all, let me say on the whole question of scandals in the banking world that it has been probably the greatest surprise and disappointment that in the industry there has been a continuing stream of things coming out that you would rather had not happened in the past. Some of them have gone on more recently, and we all know what they are; they have all been in the thing.

When I joined the Grabiner forex investigation, it had started three months earlier, or something like that. There have been a lot of scandals in the environment and the question of to what degree the Bank has been involved in those, knew about them, etc., is something that was the subject of that investigation and others. Do we as individuals go out and try to find these things? No. We would not be able to do that. What you can do and we did do is have an attestation process, whereby people come forward and tell you things they have been worried about.

Q34 John Mann: One could throw the same criticism at this Committee. If we take the LIBOR scandal as an example and the knowledge of it that was hidden within the Bank at the time, one could criticise this Committee and say we did not spot that and we did not ask the right questions. In its defence, one could say this Committee is dealing with a whole myriad of different issues. The Court is not. It then transpires that there is a range of academic articles written about the manipulation of such markets, and LIBOR specifically. The Court is tasked with what is going on in the Bank. Some of this stuff was tucked away in minutes of sub-committees. You were not there, but my lengthy question is on the basis of what the role actually is, how that comprises itself, and whether the skill set and the will set are there to dig things out and shake things up—or are you in fact part of the groupthink of “Let's support the Bank”?

Anthony Habgood: Coming in from the outside, it would be extraordinary if I had any incentive at all not to get whatever might be there on to the table. LIBOR is difficult. As you know, we have just had one trial, we are about to have another one and then there is another one coming up. We are really quite constrained as to what we can say in that respect now. We have absolutely no interest in that. We consider it to be part of our job to get those things onto the table and dealt with.

Q35 John Mann: In that context, the question has been raised previously about how many people there are with huge, significant banking experience. Clearly there need to be some. Mr Fried, you suggested a number that you thought was a minimum appropriate. But would you agree that it is vital as well to have some people who are coming from an entirely different perspective, who are asking perhaps the simple questions but also the awkward questions, and, if they see things that do not seem to add up, are asking the questions that have perhaps not been asked in the past?

Anthony Habgood: That is always a balance you have to try to get. We have a reasonable balance. This comes back to how many people are deeply embedded in the industry and how many are not, and so on.

Q36 John Mann: Coming to your answers in relation to the TUC-recommended nominee who sits on the Court, your response was in relation to the personal qualities of the individual, and you are in a good position to observe that. Would it not be fair to say that that kind of perspective in itself is rather vital to the compact that is needed, hopefully with an individual who is up to scratch in doing the work and asking the questions, but in itself part of what is needed for you to do the job properly?

Anthony Habgood: I would always start with the individual, though. The individual has to be up to it, to my mind. Then, is diversity of background a good thing? Yes. Does that mean that therefore I will say now that, whenever Dave's turn comes up, which is many years in the future, he should be replaced by a trade unionist? Not necessarily. Let us see. Let us see how things go. Let us see how things develop. But individual quality and diversity are two things that I am entirely in agreement with you on.

Q37 John Mann: What is the minimum amount of time that a member of the Court should be allocating to working on Court business each week?

Bradley Fried: I do not think, Mr Mann, that the job can be done in less than a good working day a week. There is a tremendous amount of reading; there is a lot of work outside of Court meetings to do. It cannot be done for less than a day a week. That is on pure Court business.

Q38 John Mann: Is there a problem with any of the members not being able to give a sufficient amount of time?

Anthony Habgood: I do not feel there is.

Q39 John Mann: If there were, what would you do about that?

Anthony Habgood: You address it with the individual. Also, when you do an evaluation and talk to everybody else, you soon get other people's views as well. Nobody is interested in board members who are not pulling their weight.

Q40 John Mann: One of the questions that has been raised here by me and others over the last five or six years of non-execs is not so much, "Were you asleep at the time?" but, "Were you doing your various other jobs at the time and did you have the time to know what on earth was going on?" Is that a problem?

Anthony Habgood: Is it a problem now?

John Mann: Now.

Anthony Habgood: I do not think it is.

Q41 John Mann: But if it were, you would address it.

Anthony Habgood: You would have to try to address it, yes.

Q42 John Mann: One final technical question, just in terms of assisting us from the outside in knowing: in your attendance lists, is attendance also qualified by attendance by telephone at meetings?

Anthony Habgood: We have not had in my time a single attendance by telephone.

John Mann: That is good to know.

Anthony Habgood: I am not ruling out that it would ever happen, but we have not.

Bradley Fried: And that extends to the sub-committees.

Chair: Urgent things may require it from time to time.

Anthony Habgood: Sure.

Q43 Mr Jacob Rees-Mogg: I have a couple of technical questions, but if I could have one follow-on from Mr Mann, the Bank of England is the most prestigious organisation in the world; being on the Court is to be an Olympian within the City.

Anthony Habgood: After the monarchy.

Q44 Mr Jacob Rees-Mogg: The monarchy is not an institution; it is an individual. Anyway, may the Queen live forever. Is it not almost automatic that a member of the Court would go native as soon as you arrive at such a wonderful, historic organisation? I know I would. It is such a wonderfully prestigious position.

Anthony Habgood: I do not feel I have gone native, but perhaps I am the last person to know, again.

Bradley Fried: If I could have a crack at that, if you look at the Court members individually, Mr Rees-Mogg, and forget the building or the name “Court”—perhaps the name “Court” is not very helpful, because we do not think of it as a court; we think of it as a tough, hard-functioning board—

Q45 Chair: What should we call it?

Bradley Fried: We think of it as the board. Whether it is called “the Court” or “the board” does not really matter to us.

Q46 Chair: You seem to have just said that it does matter. You said it is not very helpful.

Bradley Fried: I am saying it is not helpful in that I think it generates thoughts, like those of Mr Rees-Mogg, that it is more special than it actually is. Let me describe how it is. It is a group of people, five of whom are ex chief executives or chairpeople, five of whom have experience in central banking, five of whom have experience in running financial services businesses or tangential businesses, and a number of whom have had experience in industrial firms. None of those people regard the idea of being on the Court as an arrival at anything other than a hard-working place. We cannot speak to what was; we can speak to what is. We take our accountability terribly seriously. To discharge that accountability, turning native makes you quite impotent because it just does not help you ask any questions.

Q47 Mr Jacob Rees-Mogg: I hope you will not change the name “Court”, because I like these historic continuations.

Chair: We were surprised by that.

Q48 Mr Jacob Rees-Mogg: I thought you might be, Chairman; my radical reputation is being undermined. To go to the proposed Bill, how much were you consulted by the Treasury? How much did you know about what was going to be in it? Did elements of it come as a surprise to the Court?

Anthony Habgood: The vast majority of it was our own proposals. We had a paper out—I forget whether it was in November or early December of last year—in which the vast majority of these things were proposed. Most of them came up from within.

Q49 Mr Jacob Rees-Mogg: Were there any elements particularly that you were surprised by that you might not even want to be in the legislation?

Anthony Habgood: I was surprised by the introduction of the NAO across the whole Bank, which came up earlier. That was the only thing that was a major surprise to me. Then there is the exact interpretation of the resolution terms and so on, which are slightly different than they might have been, but just about everything was what we had asked for.

Q50 Mr Jacob Rees-Mogg: One of the proposed changes is the removal of the Oversight Committee. How do you think that will end up working, if the Court rather than purely the non-executive directors is having oversight and perhaps commissioning reviews of the executive directors? Or will you have to have a court within the Court—an inner court, so to speak?

Anthony Habgood: I see this as an evolution from times well before my time, when there was a very big Court that was sufficiently big and difficult to manage as a group that effectively smaller committees were drawn together to take decisions. That may have been a way boards worked long ago; it is not a way, in my experience, that boards work today or have done for the last 15 years and more—considerably more. What I am seeing is an evolution from that towards a board that was still quite big but not really quite unitary, to a unitary board, which is what the rest of the world works with. To me, many reviews would be created by Court. If necessary, will the non-executives commission a review? Yes they can, but I would not expect that to happen very often.

Q51 Chair: When you say “yes they can”, have you made internal arrangements to enable that to be assured?

Anthony Habgood: Have I made internal arrangements? No.

Q52 Chair: For example, are the non-execs meeting independently and coming forward with a proposal with which they already agree and then asking the executives for it? How might that function were there to be a difference between the two groups? Perhaps I could ask you, Mr Fried.

Bradley Fried: I would be happy to try to answer it. We have not come to such an arrangement, Mr Tyrie. The idea is to process that in the unitary board, as it would be processed in all other boards outside the Bank in which we sit.

Q53 Mr Jacob Rees-Mogg: I was going to ask much the same thing. It is essentially the tension that other boards have that the non-executives are partly there to provide oversight, but they are part of a single team rather than of a supervisory panel. It is a question of how, when the Court has a very supervisory role, the non-executives can get together in the event that they are ordering a review. You will need to have something formally in process, I would have thought, to stop the executives blocking or giving bland assurances so that things do not get reviewed.

Anthony Habgood: I suppose in the simplest terms, although it never comes to this in my experience, the non-executives are a majority of the board. As I say, in my experience it never comes to that.

Q54 Mr Jacob Rees-Mogg: If it comes to that, something has gone so badly wrong—

Anthony Habgood: Something has gone badly wrong. How do I in my life over the last 15 years deal with that? It is by always having, at the end of a board meeting, a meeting of the non-executives—just getting together informally and chatting about how it is going. My feeling on that is that I have done it for a long time—since long before it was common practice. It is now in the listing rules of the New York Stock Exchange that you are meant to do that in and around every board meeting. They have more chairman/chief executive combinations and fewer non-executive chairmen. My feeling was always, “If people do not like what went on there, they are going to mutter about it going down the lift. Let us mutter about it together and let us get it on the table and deal with it, whatever it is.” You have a forum for that to happen, so if there is a strong feeling there that we need to do something it is then a matter of how you communicate that to the chief executive—or the Governor in this case. I have always found it very satisfactory.

Mr Jacob Rees-Mogg: That makes sense.

Q55 Wes Streeting: I have a series of questions about people and HR strategy. I was interested in the minutes of 10 April to see that Joanna Place, the Bank’s Executive Director for HR, was asked to review proposed targets for gender for new Bank recruits to make sure they were “feasible”. What were the targets that she originally proposed and what changes were requested?

Anthony Habgood: I do not have the answer to that in my head as to what they are, but my recollection—and it is my recollection; it may not be correct—is that the reason for that was that the target was such that in order to meet it you had to have an infeasible or at least an extreme set of incoming people, or you had to create more churn. My recollection is it was purely a mathematical thing. It was not a, “Let us change the target in principle”; it was, “We cannot do that unless something funny happens”.

Bradley Fried: The issue, Mr Streeting, was more as to how to get to our target through a combination of new hires and replacements.

Q56 Wes Streeting: Just so I am clear, in terms of recruitment, were you looking at recruitment at every level in terms of those targets—so, new entrants to the Bank at graduate level—or were you looking at every level? How would you currently characterise the Bank’s diversity challenge in terms of staffing?

Anthony Habgood: The Bank’s diversity challenge, like that of every other big organisation, is greater at the top than at the bottom. That reflects the fact that the gender divide coming out of universities and so on is quite different a) from what it was 30 years ago and b) from what the gender divide by the time you have had attrition going up the

tree. The challenge is greatest further up. The challenge was greatest on Court itself, but we are now 25% of Court, which is a similar level to C-plus grades for where are at present. The challenge will continue the whole way up, both for gender diversity and for ethnic diversity.

Q57 Wes Streeting: I am just trying to work this through because I would have thought that someone as senior as the HR director would recognise the challenge that you described, that you would need such a significant churn. I think something has gone wrong here. Either the HR director has arrived with something that plainly will not work, in which case I am surprised that someone would arrive in that position, or the Court is not ambitious enough. I am trying to unpick which of those two it is. You are bound to say “not us”.

Bradley Fried: No, not at all. I think on this occasion it is us, because it is not the HR director. It is a question of the minute not really reflecting exactly what the issue was. We would be happy to clarify it for you and for the Committee. We determined the targets as part of the strategic plan. Court determined those targets. Those targets we believe are ambitious. It is a 50% target for female staff and a 35% target for female staff at senior management and below; it is 15% target for what are called BAME staff at the level of the entire institution; and it is a roughly similar target for senior management and above. We are below those targets.

Q58 Wes Streeting: The clarification would be helpful. I say that with some humility, looking around the table at the diversity of this Committee.

Bradley Fried: We shall clarify.

Q59 Wes Streeting: We have our own diversity challenge, but from my perspective it reflects badly on Court that there are very few examples in the minutes where a challenge to Bank executives is provided and demonstrated. The fact that it is on this particular issue I felt reflected badly on Court. That may be superficial, because, as you say, the minute is not quite reflective of the decision, so that clarification would be helpful.

Anthony Habgood: You have to remember if you set a target for something like that at a point in time, life moves on in the meantime—more people have left than you thought were going to, fewer people have left than you thought were going to, etc.—so it cannot be static. But your point is well taken.

Q60 Wes Streeting: I now want to look at turnover. The NAO reported in March 2014 that “high levels of staff turnover in the regulators, and in particular at the PRA, is limiting the ability of supervisors to understand the firms that they are supervising”. What has the Bank done to reduce turnover at the PRA, and has staff retention improved since the NAO report was published?

Anthony Habgood: Staff turnover has been an area of focus. On the other hand, you have to be realistic. If you are bringing people in to these sorts of firms you will get substantial staff turnover, as you do in all private sector firms. When you are bringing in graduates, you get substantial staff turnover. I was not convinced when I first saw that that the staff turnover of the PRA was particularly high. It depends which number you are looking at. Remember that, as we were integrating the PRA into the Bank, we were forcing quite a lot of turnover. We were taking people from there into the Bank.

Wes Streeting: I accept that.

Anthony Habgood: You have to be very careful how you interpret it. Is it something of great concern? Yes. As you probably saw from my Chairman's statement in the annual report, one of the priorities was this whole business of talent management and succession planning. In my mind, that came under the heading of the need to professionalise the Bank. We are a bit behind the game in some of that. There is work to be done there, and I think you are pointing that out.

The more we integrate the business, the more we go to "One Bank", the more we have these joint working groups between the FPC and the PRA and between the MPC and the FPC, the more important "One Bank" is, the more important it is to think about how you can structure the organisation to facilitate that and to make life more interesting and more rewarding for people coming in.

Bradley Fried: The PRA was the example that you chose. The PRA is training up a group of regulators, all of whom become terribly attractive to the industry. As the need for compliance and risk management goes up and the complexity goes up, we believe the most superbly trained people are the PRA people themselves. We learn to live with that, and part of our challenge is making sure that we have a continued pipeline of very high-quality candidates.

Q61 Wes Streeting: Finally, I just wanted to ask about the escalation policy. Following Lord Grabiner's report, the Bank has a new escalation policy. How specifically does the new policy differ from what came before?

Anthony Habgood: There are lots of different aspects to that. Again, one of the things I mentioned in my Chairman's statement was the pulling together of a code of conduct for the Bank in general—there had been codes before, with some rules over here, some rules over there and some rules somewhere else—which I would expect of an organisation that size, and we have created a compliance function as well to test compliance to that code. What Lord Grabiner was referring to there was that, as the practices in the City change, as social media changes and as the way you communicate changes, the way we collected market intelligence needed to change as well.

The whole business about introducing the Market Intelligence Charter and various other measures that were talked about in that area was in response to that. You put it in the context of all these changes. There have been huge changes in the Bank, huge changes in the outside environment and huge changes in communications technology. We need to make sure we are keeping up with those—in fact, let us even try to get a little bit ahead of them—and not be lagging behind.

Q62 Wes Streeting: How has the new policy impacted on the number of incidents escalated under the policy? Has there been a change? Has it gone up? Has it gone down? Is there a pattern?

Anthony Habgood: I do not know the answer to that. We had a bit of a rush of things that were escalated because we encouraged escalation.

Bradley Fried: There was a backlog, if you will.

Anthony Habgood: You never know when you do that.

Q63 Wes Streeting: I wanted to touch on that point. In that context, and in the light of the review itself but also the public controversy, as much as we want there to be more responsibility and awareness, do you think a different sort of problem is at risk of emerging, which is risk aversion and people just escalating to cover their backs? Is the balance right?

Anthony Habgood: Of course, that is a danger. When you go through something like that, you will tend to over-compensate. I cannot remember the numbers, but quite a lot of things we escalated to the relevant authority—the FCA, for example—and they said, “We are not interested. We have looked at that.” I think the Bank felt, or those individuals felt, “In this environment we ought to escalate and see what happens”. That would suggest there was a bit of an over-correction.

Q64 Wes Streeting: Is the iteration working? Essentially, is it calming? Do people now have a better sense of appropriate escalation?

Anthony Habgood: Yes, I think so.

Bradley Fried: I think so. From 1 to 31 October of this year there is going to be a physical signing by every employee of the Bank of the Bank’s code of conduct. We have a one-month stretch. There has been a tremendous amount of training and roll-out of the Bank’s code of conduct.

If I might just comment on the topic you raise of the pendulum perhaps swinging too far, that might be very appropriate in a commercial banking environment where often risk aversion does set in. Our risk tolerance statement is quite clear on the kinds of risks we want to take. There are not many discretionary risks to take, and there are certainly no discretionary risks when it comes to our reputation or credibility in the market.

Q65 Chair: That is a very helpful and interesting way of looking at it. While we are on codes of conduct, although it is a fairly tangential connection, perhaps I could just ask you about Mr Vlieghe’s appointment. When he was appointed, it was felt that his connection with Brevan Howard did not pose any conflict of interest, but after his appointment, once an apparent conflict of interest with his potential to carry on benefiting from his previous connection with Brevan Howard was pointed out, it

was mutually agreed that Brevan Howard would buy back his shares. As you know, I wrote to the Governor about this, suggesting that he take a look at the code of conduct to see if it would benefit from change and review it. I would like to know whether you think that might be a good idea.

Anthony Habgood: There are two codes involved here. One is the code of conduct for the MPC and the other is the code for the Bank overall, which deals with financial interests. Strictly speaking, that is the code of the Bank, not the MPC, but they all interlink. I think we last reviewed the MPC code in April or May of this year. In the light of this and in the light of your concern about it, we will review it again. We were going to review it in September. What I decided just before we came here, when I observed that this was something that is of high concern to you, was that, rather than review it in September, we will review it at the audit committee in October and then we will review it at the October Court. We will give it more serious consideration and put it through the audit committee.

Q66 Chair: You will give it serious consideration and you will come back to us and either reassure us that the code is in good shape and that in this case there was just a glitch—because clearly this should have been picked up by the code and he should already have divested himself of this stock.

Bradley Fried: Neither in terms of the MPC code of conduct nor, indeed, of the Bank-wide code of conduct would he have needed to divest himself of the stock.

Q67 Chair: Why has he done so?

Bradley Fried: I cannot speak for Mr Vlieghe as to why he did so, but the stock, or the interest, was only transferable with the permission of Brevan Howard. It struck me that Brevan Howard, when this dialogue began, made him the offer to buy back the interest and he sold the interest, but neither under the MPC policy nor under the Bank's code of conduct would he have had to divest the stock.

Q68 Chair: There is one more general point in this area. Right through the last Parliament the Committee held the view—I doubt it will change in this Parliament, but we have not yet discussed it as a group because this is a new Committee—that a well-designed code of conduct, if sensibly applied, should be capable of avoiding conflicts of interest without diminishing the flow of high-quality applicants for the job.

Bradley Fried: We agree with that.

Q69 Chair: But it is extremely important that people maintain a sense of balance about these conflicts of interest.

Bradley Fried: We agree with that completely.

Q70 Chair: Nonetheless, something seems to have gone somewhat wrong here, because the perception, whatever the reality with respect to a conflict with the code, has caused some difficulty, has it not?

Bradley Fried: That difficulty has hopefully settled down, but, as a personal view, had Mr Vlieghe retained the interest and had he continued to benefit under that interest in the normal way—it was really akin to having a dividend out of a stock because he had a share in a partnership—I would have seen no problem with that retention.

Anthony Habgood: We will look at it and come back to you.

Q71 Chair: You have in mind that it is the appearance of a conflict of interest as well as the actual conflict of interest that has to be taken into account. You do agree with that, do you not?

Anthony Habgood: That is certainly the case, but I go back to your earlier point that we have to be careful that we intelligently interpret these things.

Q72 Chair: That is the exercise of judgment that I want you to continue to perform.

Anthony Habgood: Absolutely.

Q73 George Kerevan: I would like to ask some questions about stress testing from a value for money perspective. I know you gave us some numbers earlier on, but perhaps you could outline the staff time in particular, rather than just the numbers of staff, and the financial resources that go into the stress-testing exercise.

Bradley Fried: Mr Kerevan, I will need to get back to you with the hours involved, if you do not mind. We will get that to you. To give you a sense of the resources involved in stress testing, if that would be helpful, in 2015 there was a very significant stress-test event, and it was a co-ordination between the Financial Policy Committee on the macro side and the PRA on the micro side. For the PRA itself on the policy side and the supervisory side, in 2015 there were roughly 117 people working on stress tests at the peak. On the financial stability side, there were approximately 40. We had 45 members of staff involved in information systems and technology working on this, and 10 full-time project staff. As you can imagine, on the policy and legal side there had to be a very high-level review.

George Kerevan: So, quite a substantial investment.

Bradley Fried: Yes. At the peak, 216 people were working on stress testing in the Bank of England. It might be difficult to give you the man hours, but we can try to estimate.

Q74 George Kerevan: I understand that, but what I am interested in is the resources being diverted from what would be the Bank's mainstream activities. As an oversight board, you are looking at the best use of resources. We accept there is going to be stress testing. I am assuming that staff are being moved from activities they would otherwise have been engaged in. I think the Committee would be interested in knowing how the resources are moved across.

Bradley Fried: From my perspective, we would take it as a given now that stress testing, or an equivalent type of scenario planning, has become a way of life for financial institutions. Certainly, if we look at the stress tests that are going to happen next, which deal with a lot of non-UK issues—because the last stress tests primarily dealt with UK issues—they are going to require a lot of people as well.

Q75 George Kerevan: You will give us the numbers as best you can.

Bradley Fried: As we can, yes.

George Kerevan: That would be very helpful.

Anthony Habgood: Can I just make a very general point on the staffing question? As we have said, we have moved towards the “One Bank” situation. We have to have resources that are flexible. Not all these things happen at the same time. You are concentrating on stress tests at a certain time and something else at another time. Those resources need to flow. I hope we can do that in a way that also—in answer to an earlier question—makes the careers of the people coming in more interesting.

Q76 George Kerevan: I understand that it is not something you can avoid; it is the core of the management decision, but where I am going is that in previous stress-testing exercises, just looking at the minutes of the Court, there has been concern over whether the allocation of resources was correct. I see from a note from last year that Lady Rice, reporting back from audit and risk, said that there were resourcing issues around stress testing. Lady Rice is an old personal friend of mine. If she uses the word “issues”, it would ring alarm bells. I notice again in the minutes Sir Jon Cunliffe reported that the stress-testing programme had the danger of “diverting resource from supervision”. It is not a simple management problem. If we end up diverting resources to hypothetical stress testing, no matter how useful that is in the future, from current supervision work, we have a problem. That clearly was an issue that was being discussed on the Court. My question is: how did you get into a situation where you were worried about diverting resources away from supervision to stress testing, and how did you resolve it?

Anthony Habgood: That particular matter was before my day.

Bradley Fried: We occasionally do get into these situations where something comes up that was not planned for or something becomes bigger than we thought. It then becomes a question of re-prioritising projects or tasks that are already in the work plan. We often have it with Internal Audit, for example. If there is a matter that requires attention, the Internal Audit chief will re-prioritise his teams immediately to deal with that. This would

be no different. The escalation and the discussion in the minutes was perhaps a little more dramatic in this instance because the numbers involved were so large and it cut across financial policy, prudential regulation and all of central services. As time goes on with stress testing in particular and institutions start to do a lot more stress testing themselves, hopefully we will not have this unplanned-for diversion.

Q77 George Kerevan: I am the most ebullient and gentle person, but when you use the word “hopefully” when we are talking about whether we have enough resources for supervision, I become a little anxious. My question still stands. As the monitoring body, how will you make sure that this problem does not arise again? Is it just by constant supervision and discussing it with senior management?

Bradley Fried: That is a great point, and we will take that on board. We have budgetary sessions, we have quarterly reviews of actual versus budget, and when there needs to be a diversion of resources, we know about it. We will take that view back, express it to our colleagues and make very sure that question is asked not only about stress testing but also about all other matters when we get into the budgeting process.

Anthony Habgood: I was not there at that particular time—

George Kerevan: You are absolved.

Anthony Habgood: Thank you. I think it was exacerbated by the fact that it was very close to when the PRA was coming in and there were lots of changes of people among them. There was a certain unsettling of the organisation then, which is not there now.

Bradley Fried: That all being said, the point you raise, Mr Kerevan, is spot on.

Anthony Habgood: Yes.

Q78 George Kerevan: Assuming we have resolved that and the stress testing is going ahead—you will come back to us—do you think you are getting value for money from the stress-testing exercise? We could spend forever, and I would enjoy having a long debate about stress tests at a technical level and why they rarely work—I see the need for them—but what I am interested in now you are doing them is whether you think you are getting value for money for all the resources you put in.

Anthony Habgood: That is a very difficult question. It is also a serious policy question. The stress tests are coming from the FPC and PRC, and that is a decision of those committees. I do not think it is in our remit to challenge whether or not we should be doing those sorts of stress tests in those sorts of ways.

Q79 George Kerevan: That was not the question. I think we should do them. It is more: now you are committed to them, are you conducting evaluations retrospectively, having done them, to see whether they were robust? How do you go about assessing them? Having done it, surely you do not just say, “Oh, thank God

that's over now. Let's go on to the next one", or do you say, "We spent all that time and resources. What did we get out of it?" That is really what I am asking.

Anthony Habgood: I do not want to go to the individual firm level, but there were implications for individual firms from those, which were acted on. There is no sort of, "This was amorphous and nothing happened, so let's move on". They were very real and quite uncomfortable in certain places.

Q80 George Kerevan: Understood, but do you conduct your own internal assessment of how you conducted it and what you thought you got from it?

Anthony Habgood: We have not done so as a board.

Q81 Chair: It might be useful to find out whether you are happy with the way the Bank is conducting the stress tests.

Anthony Habgood: That is a slightly different question. Both of us have sat in on the various policy committees at different times, but during that process were we assessing that they were done properly? Yes, as best we can, and the Court has been monitoring them as well. I am not concerned about that. I was reacting a little to the, "Well, what's the value for money in this?" That is a very hard question. I do believe the stress tests are being done properly.

Q82 Chair: They are both questions for you.

Anthony Habgood: In a way, they are, but they are also very specifically policy committee-driven issues.

Q83 George Kerevan: I appreciate that, but is there any oversight or discussion that you have on the particular scenarios, for instance, given the experience on the board?

Anthony Habgood: Again, the scenarios—very specific—can come out of the policy committees. The scenarios are defined by the committees, and that is not within our remit.

Bradley Fried: But what is in our remit is a retrospective view of the impact of policy, and sufficient time has to elapse before we can get involved in that review so that we can see if indeed it had impact.

Q84 Chair: One of the central demands of this Committee for five solid years was that you should be empowered to do retrospective studies.

Bradley Fried: Precisely, and we have that.

Q85 Chair: That was fought tooth and nail for a while by the Bank and has now been conceded.

Bradley Fried: We have that. Mr Kerevan, no doubt that will be considered, amongst other reviews, as time goes on, but it is still happening and we are still in it. We need some time to elapse before we can do that review.

Q86 Chris Philp: I would like to turn to the failure last October of the real-time gross settlement system—the system by which businesses and banks pay each other. In October last year, it failed for almost an entire day. While the payments were eventually processed, time-critical transactions, like house purchases, were delayed. Can you comment as to the investigations that the Court has conducted into that episode and what the conclusions of those investigations were?

Anthony Habgood: Yes. That day we said we were going to do an investigation, and within days we had an investigation going. Brad and I were involved in the selection of Deloitte to do that, and it was a pretty thorough investigation of what went wrong.

If I go to a high level on that, for me there are two very big lessons in that whole area. One is the need for an organisation like the Bank of England to have a very clear crisis management set-up so that everyone knows what happens if this sort of thing happens, for operations as well as for shocks in the markets or whatever, which are more bread and butter for the organisation. That was one of the recommendations that came out of Deloitte. For me, that was very important. What happened worked, but it was not as slick as it should be, and if we go into a world of cyber threats, for example, it is very important to have those clear.

The other lesson at a very high level from my perspective is that if you have a relatively old system, when you make changes to it, that system is vulnerable. I have seen it so many times, because changes have unintended consequences. That is another very important lesson. That flows through to what is the plan for upgrading, how that will work, and so on.

The other area that is important to there, to me at a slightly lower level than that, is the whole question of what the back-up system is and how easily that can be switched on and off. That is always a trade-off in these systems. If you have it mirroring it, when one goes wrong the other goes wrong, and, if it is not mirroring it, it is much more complicated to switch it over.

Q87 Chris Philp: Before we look to the future, was there a particular process failure that meant that this error happened in the first place? For example, was there inadequate testing? Did you manage to identify the process inadequacy that allowed this to happen?

Bradley Fried: Yes, we did. We got to that very quickly indeed with a root-cause analysis before the Deloitte team came in. There are two systems relating to RTGS. One

is called the liquidity savings mechanism, which is a mechanism whereby there is matching of liquidity in the system so that for any one counterparty you can offset payments and receipts.

Chris Philp: A netting process.

Bradley Fried: Exactly. The other one is called the market infrastructure resilience service, which is a contingency plan. It is a back-up plan. Changes in respect of the liquidity savings mechanism and MIRS were made; they both had unintended consequences. The unintended consequences were to have knock-on effects into the COBOL-written RTGS that only came to light when one further thing happened. That was that one counterparty was taken off and another counterparty was put on. These three innocuous ingredients led to the failure of RTGS.

Chris Philp: It was a perfect storm of three unrelated things that combined.

Bradley Fried: Absolutely. That gets to Anthony's point about change management. When combined, they formed this toxic little mix that the executive got to grips with very quickly, but there were many other lessons around RTGS, the crisis management framework, the way the day progressed and the absence of written-down policies that made it harder to deal with.

Q88 Chris Philp: Could that toxic combination, as you put it, have been reasonably foreseen? Was it so unlikely and so implausible that it was one of those things that could not possibly have been foreseen, or do you think it should reasonably have been foreseen but, just through to lack of testing or lack of checking, was not foreseen?

Bradley Fried: That is a key question. A narrow reading of the Deloitte report would suggest that it would be hard to be reasonably foreseen, but—the “but” gets to Anthony's point—that does not really matter. The “but” is that the standards to which we hold ourselves are that we would have expected it to be foreseen and tested against.

Q89 Chris Philp: You said that the systems are old. As you quite rightly say, when you tinker with old systems, particularly when there are lots of very different systems that have been patched together, some of which probably date back to the 1970s or 1980s, although not the 18th century, which is the period Mr Rees-Mogg probably prefers, you may get this perfect storm of four or five apparently unrelated things coinciding catastrophically. Given those very considerable difficulties, what processes and systems can you put in place in the future to meet the high standard that Mr Fried just set out? It sounds like quite a tough job.

Bradley Fried: It is a tough job. The good news on RTGS is that it is less of a patched-together system than many of the other systems that are that old. It is probably about 18 years old, and throughout the financial crisis it had 100% availability. We have never experienced anything quite like this, so we have never had the problem. The changes have already been made. There are a number of changes. Besides the technical question of how to manage change in a system, there was an issue around governance. The report

showed clearly that the governance and the implementation had melded into one. We now have a RTGS oversight committee, which is chaired by Dame Minouche Shafik.

Q90 Chris Philp: Is that someone outside the Bank's executive structure?

Bradley Fried: Dame Minouche is inside; she is the Deputy Governor for Markets and Banking. We also have a delivery committee that is comprised of technical people. There is no way that unilateral decisions can be made without going through a very serious set of protocols. As to whether we can avoid them altogether, I will assure this Committee that the answer is no. Can we ensure that we have the right governance and technical skills in place to try to minimise those as much as possible? Yes.

Q91 Chris Philp: Had the combination of circumstances that occurred last October occurred under your new regime, do you believe your new regime would have caught it?

Bradley Fried: I think it would have had a much higher chance of catching it because of the changes in change management protocols.

Q92 Chris Philp: To ask a slightly broader question on the same theme, a number of individual banks—in particular RBS, NatWest and, in late August, HSBC—have had failures in their own payment systems where very large numbers of payments did not get made, including people's wage packets at the end of each month, which then caused them to miss their mortgage payments. I realise that you are not a policymaking board, but what steps have you taken to make sure that the relevant bits of the Bank of England are on top of the high street banks, which run their own payment systems on a day-to-day basis?

Bradley Fried: I do not think I can answer that question. There is co-ordination. If I can, Mr Philp, I will give you an example of co-ordination and try to get back to your question. For example, the co-ordination on cyber is such that the best of Bank of England practices are taken through to the supervisors and to the individual supervised firms. I cannot answer specifically as to what the supervisors have done in relation to those individual firms in relation to failed payments.

Q93 Chris Philp: Is that the kind of issue you look into, or do you consider that beneath the—

Bradley Fried: Not beneath at all. Very much not beneath, just not in mandate. That was a serious matter.

Anthony Habgood: It was a serious matter, but the core systems of the commercial banks is something that I am sure the PRA considers at a general level.

Q94 Chris Philp: But you do not check up on their checking up, as it were.

Bradley Fried: No. The PRA board would have a mandate to look at that, and it does look at that and at the policy consequences for that.

Q95 Chris Philp: I understand. Returning to the question of market intelligence, which Mr Streeter touched on earlier, in evidence that Lord Grabiner gave to this Committee previously on the forex scandal, he suggested that the way that played out may make some market participants less willing to supply the Bank with intelligence. Do you share his concern, and, as far as you can see, has that happened?

Anthony Habgood: Yes, one does share that concern. On the other hand, we are in a world of different forms of communication and more transparency, and there is a price we may pay for that in terms of the market intelligence being marginally less willing to come forward. What we have tried to do with the Market Intelligence Charter is to lay out quite clearly what the rules of engagement are so people know if they come and talk to us what they can say and what they cannot say. We feel that the sacrifices we make, if there are any, are ones we have to make.

Q96 Chris Philp: Do you make an ongoing assessment of how complete your market intelligence is? Are you fully informed about everything you need to know? I realise it is very difficult to quantify something as intangible as market intelligence, but do you have some sort of measure, if not quantitative then at least qualitative, of how good the Bank's market intelligence is? Clearly, you need that to be as complete and deep as possible in order to inform policymaking. Quite often, it is qualitative and anecdotal, but it can still be very valuable.

Anthony Habgood: I agree it is very valuable, and it is one of the things that we and the New York Fed have more than most of the others because we have more market in our immediate areas. We are in the hub of an area. Do we measure that and try to make some sort of assessment? We do not measure it, no.

Q97 Chris Philp: Is there any qualitative interrogation of the people on the executive team to say, "What is your assessment of how complete your picture is?"

Bradley Fried: Yes, there is. That happens at two levels: at the audit and risk committee. One of the risks is, exactly as you point out, that market intelligence will be incomplete, too superficial or too shallow.

Chris Philp: You may have unknown unknowns; you may not know there is a gap.

Bradley Fried: Precisely. You will only figure that out when there is a surprise that hits you that you did not know about. At the audit and risk committee we deal with the risks and at every single meeting of the audit and risk committee—there are six a year—there is a presentation by the Executive Director of Markets, Chris Salmon. Chris will take questions on any topic and market intelligence is clearly a live topic.

Q98 Chris Philp: Can you ask him questions like, “Have you or one of your team spoken to every principal dealer-broker in the market in the last three months?”

Bradley Fried: Yes. One can ask Mr Salmon whatever question one would like to ask. We will go to the level of detail we need to go to in order to figure out if the risk can materialise, whatever that risk is.

Chris Philp: I would suggest that is an area that does merit close oversight, because, to the extent the market intelligence is not there, it significantly inhibits the Bank’s ability to discharge its functions.

Bradley Fried: We would agree.

Q99 Chris Philp: On a different topic, when we had discussions previously with both the Governor and the Chancellor, there seemed to be a suggestion that regulation of buy-to-let mortgages, which currently is not part of the Bank’s regulatory sphere of influence, might be brought within it. Is that something you have considered and have an opinion on?

Anthony Habgood: I have certainly been in and around the FPC as it has been considering that; I have sat in on those discussions. Personally, as buy-to-let becomes an ever-increasing proportion of the housing market, I think it makes sense for it to be within scope, because, the bigger it gets, the greater the impact it has on the whole market.

Q100 Chris Philp: When the Chancellor came towards the end of July, he suggested that there was some communication relatively imminent on that topic. Do you know whether that has been received, or what the latest update is?

Bradley Fried: On the regulatory perimeter?

Chris Philp: On bringing buy-to-let mortgages into the remit of the FPC.

Anthony Habgood: I know it is a live issue. I do not know what the latest situation is on that.

Q101 Chris Philp: I would just put on the record that I share your view that it would be appropriate for the Bank of England to regulate buy-to-let mortgages. As you say, it is over 20% of new originations. There is some concern that they are less tightly regulated than owner-occupier mortgages and, as a consequence of that, it is tilting the playing field a little in favour of buy-to-let landlords rather than owner-occupiers and is pumping the market up. Both of those things are concerns. I would very much welcome the Bank of England taking this over and applying the same fairly stringent regulation to buy-to-let mortgages as it currently applies to owner-occupier mortgages.

Anthony Habgood: I can reassure you that the FPC is looking at all the sort of data you have just thrown around there very seriously.

Chris Philp: Good. I would also encourage the Bank of England to nudge and lobby the Chancellor to make that transition as soon as possible.

Q102 Chair: This Committee over the past few years has been seeking to empower the Court to perform a function much more recognisably that of a modern board. It has now been given very direct responsibilities for the allocation of the budget; for retrospective reviews as standard practice; and for monitoring the functions of the policy committees, with the power to sit in on them—and it should be accepted that you are sitting in on them. We also recommended streamlining the board. It has been reduced in size, with a better balance of externals and internals. We suggested increasing transparency. You are now publishing much more material about your activities. There is publication of your minutes, and there is the long-term issue about publication of policy material. We had a brief discussion about that. There has been a huge amount of change here. Have you got the powers you need to do the job that we are going to expect of you in this Parliament and beyond?

Anthony Habgood: With respect to the change, we have moved the institution very much in the direction that this Committee was suggesting. A lot of things are a bit different here and there, but in general the movement has been very much in that direction. Do I think we have the powers? Yes, I do think we have the powers.

Q103 Chair: Do you have the resources you need?

Anthony Habgood: I think so, because, as a unitary board, I regard us as having the resources of the whole Bank.

Bradley Fried: Is the question you are asking also—

Q104 Chair: I just want to make sure you have what you need to do your job. Now is the time to say you have not if you do not feel you have. You are our watchdog, really. We cannot watch every last flicker and move of this very powerful super-quango, so we are relying on you to do a great deal of the internal watchdog work for us. We expect you to come to us if you see things you do not like, and to keep us informed rather than push stuff under the carpet. It tends to come out anyway eventually, so it is better to get it out. I hope I have your assurance that you will do that when you see things you are not happy with.

There is one area about the Bill that does need to be touched on briefly. As I understand it, you are both supporters of the so-called “One Bank” culture that is now being designed. We have had some hint of that today. The converse of everybody agreeing that we are all moving in the right direction is groupthink. I just want to put on the table that thought and ask you to bear in mind that we expect the Court to be extremely vigilant in trying to clamp down on groupthink. You are there constantly to challenge the culture rather than to become absorbed by it. Can I have that reassurance?

Bradley Fried: You can.

Chair: With that thought, I bring this hearing to a close. Thank you very much. It has been enlightening and interesting. We are in a new era of Bank scrutiny.