



Treasury Committee

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

Tuesday 20 October 2015

Ordered by the House of Commons to be published on 20 October 2015

[Watch the meeting](#)

Members present: Andrew Tyrie (Chair); Mr Steve Baker, Mark Garnier, Helen Goodman, Stephen Hammond, George Kerevan, John Mann, Chris Philp, Mr Jacob Rees-Mogg

Questions 105-271

Examination of Witnesses

Witness: **Andrew Bailey**, Deputy Governor for Prudential Regulation and Chief Executive Officer of the Prudential Regulation Authority, Bank of England, gave evidence.

Q105 Chair: Morning. Thank you very much for coming in to see us. We have another busy morning—another busy week—ahead of us as a Committee. Your institution, which is a subsidiary of the Bank of England and has a very high degree of independence built into the existing legislation, is now going to be moved back into being part of the Bank, with a similar status in terms of policy implementation to that of the MPC or the FPC. What is lost as a result of that?

Andrew Bailey: I hope in terms of the effectiveness of the PRA nothing is lost. That is very important to me as Chief Executive. I hope—but that is for you to judge—that the PRA has delivered its statutory objectives over the first two and a half years of its life, and I want that to continue. The reason, however, that I support desubsidiarisation is because it simplifies the governance of the Bank of England and it simplifies the role of the Court in overseeing governance of the Bank of England. That is important for many reasons that this Committee has probed and has produced conclusions on.

I have looked very carefully at the Bill and have been involved in discussions with the Treasury on it and I think the Bill has in it sufficient protection of the independence of the PRA. It is very clear in the Bill that the PRA continues to exist as the prudential supervisory authority for banks and insurers. It is very clear that it must be separated in terms of the governance of the Bank of England from the decisions on resolution. That is important because that has to be consistent with the requirements now in European law, but it is important anyway, because there is all sorts of potential for conflict and muddle if you do not get that right. The Bill quite rightly focuses on that point as well. I think there is satisfactory protection in there for the PRA to continue to do its work. When I say that,

that is in good part because there is a clear difference between the framework and the nature of the decision-making of, say, the Monetary Policy Committee, which is focused, in essence, on a single decision, and of the PRA, which is the opposite end of the spectrum; it is focused on many decisions that are taken at high frequency. That is all fine. The independence protections are maintained, and that, I can assure you, has been and will continue to be a very strong focus of mine. Desubsidiarisation simplifies the Bank of England's governance.

Q106 Chair: Would it be fair to say that the PRC and the PRA, which sits alongside it, is still exactly as it was before—a fully independent regulatory authority—for the purposes of its relationship with the regulated community?

Andrew Bailey: Yes. The way I interpret the Bill—I hope I am right—is that the Bill makes clear that the Bank of England has to vest the regulatory objectives to the PRC.

Q107 Chair: Let us just explore this. When the PRA, with you as Chief Executive, comes to a clear view about a course of action that the FPC disagrees with and the Chairman of the PRC comes to you and says, “We have to sort this out” and you say, “I do not think this can be sorted out. We think X has to happen and you are saying Y”—let us suppose it is triggering the process for full separation of a bank under the electrification provisions—you are giving us an assurance that you feel the legislation gives you as much ability to speak up independently about that and to implement it, notwithstanding disagreement from the Chairman of the FPC, who will also be the Chairman of the PRC, who will also be the Governor of the Bank.

Andrew Bailey: And who is also today the Chairman of the PRA Board.

Chair: Exactly.

Andrew Bailey: The names of the committees change, but I do not think it changes anything in that respect. I am in the same position; I am a member of the FPC and of the PRA Board. We have to be very clear in our own roles and thinking which hat we are wearing at any given point in time, and to date I think we have done that effectively and successfully. I do not see that as a problem.

In thinking about this change, I do not think anything changes in the area of regulation and supervision. The focus of desubsidiarisation is not that; it is about the internal running of the institution. I should say on that there is one thing I want to be very clear on, because this matters hugely to me and I think it will matter hugely to you in the future. There is no change in terms of the robustness of the accountability for the use of the levy. One of the very important things for the PRA is that we have been given the power to raise the levy. That is an important power and it is one that we have to use robustly and with accountability. I would be very concerned—and I have said this throughout the discussions on the Bill—if in any sense that was being muddled. I do not think it is, and I will go on ensuring that it is not.

Q108 Chair: But your independence is dependent upon far more than whether you can raise the lolly to do your job.

Andrew Bailey: Oh, yes.

Q109 Chair: That is why I have been asking you to comment on an example where there is a clear conflict. You are saying, as I understand it—correct me if I am wrong—the management of a conflict between different policy organs of the Bank has not changed in any respect whatsoever.

Andrew Bailey: It does not change, no.

Q110 Chair: And you are confident that not only you but also your successor will be just as robust in standing up privately and, if necessary, publicly not just to say this is what you think but to impose the decisions. You do not feel, for example, that triggering of the electrification provisions has now in some way become dependent upon full Bank oversight and approval.

Andrew Bailey: No, I do not. Let us also be clear that the line of accountability to this Committee of the PRC would be exactly the same as the line of accountability of the PRA Board. Nothing changes, in my view, in that respect.

Q111 Chair: We might come back to the levy because it is related to value for money and the NAO and all that, but other colleagues will want to ask about that. I just want to ask one more question on a different topic. There has been quite a lot of press coverage about whether the administration of the ring-fence in some way has led to a watering-down of the degree of separation that was put through in the 2012 legislation. Has it been watered down?

Andrew Bailey: No, it has not. I have to be honest with you; this press speculation is enormously frustrating. I will go back in a moment to refer to the Independent Commission. This press speculation has essentially flown a kite that has then been shot down and in shooting it down it has been said there has been a watering-down. The substance of the matter in respect of dividend payments is that what we said in the consultation paper that we put out last week was that if a ring-fenced bank meets its capital requirements—those capital requirements would be the capital it has today and then there will be a stress-testing regime for ring-fenced banks, which will be part of assessing the capital requirements—there is not a restriction on paying excess capital in the form of a dividend.

If you go back to the Independent Commission report that John Vickers produced, what it says is that “dividend payments and other capital transfers should only be made after the board of the ring-fenced bank is satisfied that the ring-fenced bank has sufficient financial resources to do so”. They also say that approval by us as regulators would be required if any such payment took the ring-fenced bank below its capital requirement. We have flipped that round, because we think it is more robust to say that the ring-fenced bank

needs our approval to pay the dividend, whether or not it is going to take it below, and we would not allow it to be paid if it was taking it below. That was what Vickers said.

The curious thing about this press speculation is that what we have said is no more than confirming what Vickers said: that if a ring-fenced bank has excess capital—it has earnings that, when retained, produce a capital position in excess of its requirement—then it can pay that in the form of a dividend. There is nothing unreasonable about that. It is what was envisaged by the commission. I am, frankly, in one sense puzzled by the speculation about this, because it is not a watering-down. What I would say to you is that I am afraid this is one element of what I see as a noisier world out there in terms of speculation around these issues generally.

Q112 Chair: You think this circle we need to try to square, where we want a subsidiary to be independent enough to fend off the imposition of risk from the centre but as much a subsidiary enough so that the centre can warn it and control it if it starts to take on too much risk—that problem—can be sorted out in the governance aspects of the ring-fence.

Andrew Bailey: Absolutely.

Q113 Chair: The banks are constantly telling us that these governance issues are hugely problematic for them and how to create two boards in one sense but a unitary board in another is posing great problems for them. You give that short shrift too.

Andrew Bailey: No, because again going back to what Vickers and the commission said, what they said was, “The board of the ring-fenced bank should be independent” but they then said, “The precise degree of independence appropriate would depend on the proportion of” the bank’s assets that are inside the ring-fence.

Q114 Chair: To be fair, when they published their interim report and when they came to see us, they had not thought about this governance aspect at all.

Andrew Bailey: No, but what I have just said is in their final report.

Q115 Chair: In the final report they basically said, “Well, we have to think about this depending on the bank’s culture”.

Andrew Bailey: I have just quoted you from the final report.

Q116 Chair: Yes, but is that not pretty much what they said?

Andrew Bailey: What they said was independent, but if there is a very substantial overlap between the ring-fenced bank and the whole, that is something that should be considered in judging the governance structure. We have already made the rules on governance. That was last year’s consultation paper. Because this is a simpler way of doing it, we said governance should be independent, but we can use waivers—and we will

use waivers when we have got to the point where we see the final plans—to achieve what the Vickers Commission said, which was “be proportionate where there are cases where substantially the ring-fenced is the same as the whole”. That is what we will do.

Q117 Mr Rees-Mogg: I wonder if I can ask about the PRC minutes and what is going to happen to those. You are not required to publish them. Do you think you should be, even with some delay?

Andrew Bailey: The difficulty is that there would be a very substantial amount of redaction in them, for commercial reasons. The amount of commercially confidential information that is covered in the decisions that the PRC will take on firms would mean that the minutes would be substantially redacted. That is why we have taken the view that we would not have publication in the way that the MPC and the FPC do. The PRC does not exist at the moment and it has not considered formally the question of minutes in that sense, but I would qualify that it is for that reason that I am very clear that I do not think the legislation should require it. The committee should have a discussion as to whether there is something that it could produce that would be useful notwithstanding those issues.

Q118 Mr Rees-Mogg: You will have to balance to some extent the commercial confidentiality and transparency. How far ought you in principle to be leaning towards transparency?

Andrew Bailey: I am a supporter of transparency, so there is no question that in principle we should lean towards transparency. It is a matter then of balancing the objectives and seeing whether there is something that we could do that would be useful.

Q119 Mr Rees-Mogg: In terms of internal minutes, you will have full internal minutes that will be published in 100 years’ time or 30 years’ time or whatever.

Andrew Bailey: Yes, as we do at the moment.

Q120 Mr Rees-Mogg: That will happen anyway.

Andrew Bailey: Yes. We have to have a record, yes.

Q121 Mr Rees-Mogg: So, the responsibility to history is—

Andrew Bailey: Yes. It is also a legal responsibility for the decisions we make.

Q122 Mr Rees-Mogg: And also the discussions, because from a historical perspective the discussions may be more interesting than the decisions about the concerns that have come up and the financial institutions that are questioned from time to time.

Andrew Bailey: Yes. We have already decided that we are going to have a discussion about the form of the minutes, precisely for the reason that you give, which is even if the minutes remain internal for a period of time, how much of a flavour of the discussion should be in them.

Q123 Mr Rees-Mogg: The Basel core principles for effective banking supervision state as one of their central criteria that “the supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives”. Does the Bill ensure that this will happen?

Andrew Bailey: I think so. Parliament gives us our objectives, so those are laid down in statute, we publish an annual strategy and we also publish two documents, which we maintain and update at least annually: our approach to supervising deposit takers and our approach to supervising insurers.

Q124 Mr Rees-Mogg: The Warsh review stated that “the PRA should also be accountable for its general approach to supervision—the nature of its oversight, its interactions with and expectations for firm-level senior management and boards of directors. These types of PRA policy transparency are best accomplished through periodic reports and testimonies to the Treasury Committee, rather than contemporaneous policy statements and meeting transcripts.” How can the PRA or the PRC and its members be held accountable by this Committee if we are not getting the records until the 30-year rule has passed and our grandchildren, assuming they get elected to Parliament, are coming to hold your successor to account?

Andrew Bailey: You have started a regular pattern of hearings already, which is a good thing. It is a good question. Perhaps we should take it away and think about, in terms of thinking about the answer to question you asked about whether we would publish something, whether we could give you some form of résumé or headings on what we have done. I am all in favour of you having every chance to hold us accountable. I am a great supporter of it. If you do not mind, can I take that point away?

Q125 Mr Rees-Mogg: It does seem to be a very interesting point. I completely understand why you have to keep things confidential for commercial reasons, but you need to have oversight and you want to be as open as you can. We cannot do our job properly if we do not know the background to your decisions, but, on the other hand, the more people you tell, the more risks there are of leaks.

Andrew Bailey: Yes. The risk then is—well, I would not say “risk”, but it is an issue—that you can only hold us to account for the things that turn up in newspapers and so on, whereas there is a large amount of what we do that does not. That is a really good point. Can I take it away and we will think about it?

Q126 Mr Rees-Mogg: Thank you. Finally, your colleagues in other parts of the Bank of England—the MPC and FPC—are great speech-makers. Should we be expecting fine oratory from the PRC?

Andrew Bailey: From the members of the PRC?

Mr Rees-Mogg: Yes.

Andrew Bailey: There is no prescription. We have not said to members of the PRA Board, “Please make speeches”, again because a lot of what we do is done behind the scenes, as it were, for the commercial reasons I said. It is not something that we have suggested to members of the Board they should do, because, as I say, the nature of the decision-making is different in that respect, but there is no prohibition on it at all and I certainly know some of them participate in various events. They are usually not published events, but they do participate in events.

Q127 Mark Garnier: Mr Bailey, can I turn to the issue of the reversal of the reverse burden of proof, which constitutes an O-turn, really, does it not? Can I start off by asking you what discussions you have had with banks? I refer specifically to the *Financial Times* talking about banks having “high-level meetings with the Bank of England about it as recently as last week”. Were you party to any of those meetings?

Andrew Bailey: There has not been a high-level meeting. I have had quite a lot of discussions with banks about it. I have had even more discussions with lawyers about it, I have to say. I would be very happy, if you like, to give you a perspective on the question, because it is in the Bill. There is no question that if you look across the Senior Managers and Certification Regime the issue that has attracted most attention has been—whether you call it the presumption of responsibility or the reversal of the burden of proof, it is essentially the same thing. That is the one that has attracted most attention.

Q128 Mark Garnier: What I am trying to get a sense of is, if there has been lobbying that has been going on, where that lobbying has been coming from. You talk about the banks—they have met you once, I think—and lawyers. Presumably lawyers are arguing the legal case of whether or not you can have this reverse burden of proof to start off with and whether it necessarily would work in a court of law. What about the Treasury? Have you had many meetings with the Treasury?

Andrew Bailey: Yes, because in the creation of the clauses that are in the Bill we were consulted on those, as we would expect to be.

Q129 Mark Garnier: You talk about this being a change of process, not one of substance. Can you expand on what you mean by that?

Andrew Bailey: I would love to, yes. The key thing for me in the Parliamentary Commission recommendations in this respect—certification is very important, but I am talking about senior managers for the moment—is that the problem with the existing Approved Persons Regime is that the test of substance is whether you can point to something for which the individual is personally culpable. Did they sign off on loan agreements that go bad? Did they sign off on provisioning agreements that were bad? As you know because we have had many discussions in this Committee, the problem then turns out that these cases do not stand up at this point.

The substance of the Senior Managers Regime, as I interpret it, which is very important, is that it holds the individual responsible for the outcomes in the area for which they are responsible. It shifts it from having to prove they did something or they deliberately did not do something to responsibility in their stated area, and you are not relying on finding individual actions. That is crucial. If there were any suggestion in this legislation that that was changing, I would be here telling you that I did not support it, but that does not change.

What does change—this goes back to my point about process—is that the presumption established that in respect of one area, the duty, or the responsibility, was placed upon the individual then to prove that they had not strayed from the path of responsibility, not upon the regulator. It is that that has caused all the noise.

My judgment on this is that we are at risk of two things happening here. One is we are at risk of the noise—you have probably heard this as well—quickly morphing into “guilty until proven innocent”. There are a lot of lawyers going around talking about the human rights legislation. The second thing that has led to, in my estimation, as we have gone through this process over the summer and into the autumn, is my worry that, as you know, the test then is one of whether they took reasonable actions and there is a tick-box mentality coming back in here. I am getting a lot of people coming and saying, “You have to tell us how you will interpret this”. “If we have a risk appetite statement the board has adopted, that is a tick in that box. If we have a risk committee, that is a tick in that box. If the CRO is alive, that is a tick in that box.” That is not the point. The point is this is judgment, because our regime operates on judgment. If that is the way the presumption ends up, then we are going to end up in the same place we have ended up with the Approved Persons Regime; it is not going to function.

My view—and I give you this view—is that I support the change, because what the change does is turns the process round and puts the judgment back on to us. I would rather it does that than have us heading down this tick-box regime with legal questions around it over human rights. I do not want to come back or have one of my successors come back to you in the future and have to say, “I am sorry; we could not use this regime in the way that was intended, because it was always a bit doubtful that we could make it stick”. It is far better we come at this point to you and say, “I do not think this has a sufficient probability of being effective”.

The other point I would make is that the other change the Bill introduces is that it extends the regime across the whole of the fiscal population. That is effectively the whole of the PRA and FCA population, so it is up to about 70,000 firms. It is better, in my view, that it is done consistently. We would rather have one regime than more than one. I do not think there is a strong case for introducing the presumption across the whole shooting match, so, again, that is a good reason for what is done. The key reason is that I have to say I am worried that this piece of this regime, which is crucial, might not work.

Q130 Mark Garnier: The key point behind doing this—and the banking commission spent 18 months looking at this—was all down to the behaviour of senior managers. What was interesting was when we published the report a lot of news commentators were turning round and saying, “Had this been in place, would Fred Goodwin, for example, have gone to prison?” My answer when asked that question

was, “No. Had this been in place, we would not have had the financial crisis in the first place. This was seen as a nuclear option, not necessarily to punish people for getting things wrong but to try to drive behaviour in order to make sure that we do not get into these problems in the first place.” Are you absolutely confident that you are going to be driving the right behaviour with these changes?

Andrew Bailey: I think we are more likely to get that outcome. What worries me, as I say, is if all the focus becomes on, “How do I set up a legal process that avoids the outcome?” then we will have run directly into where you did not want to go and I do not want to go. My judgment at the moment is that we are more likely to get your outcome by the change than by not making it.

Q131 Mark Garnier: That is very helpful. On extending it to the whole of the regulated universe, if you like, again, this was very much brought in in order to try to change the behaviour of systemically important banks, starting with banking. Everybody has to get involved in banking. Not everybody has to buy insurance services; not everybody has an IFA. Is this not necessarily putting extra burden on the wider financial services industry than perhaps is needed?

Andrew Bailey: Two things on that. First of all, we are doing this with the deposit-taking population. We will apply it proportionately. We have already said that in the case of deposit-takers the way we will apply it for a credit union is very different from the way we will apply it for Barclays or HSBC, because it would be quite inappropriate to do it any other way. That is the first point.

The second point I would make is if you go back to the point I made about the substance of the test and the underlying principle behind that, which is that if you are a senior person you are responsible for the function, that is a general principle. That is the thing that does not seem to me to be specific to banks; that is a general principle. Leaving the old regime in place for the rest and saying, “We have to find personal culpability” seems to me to be inferior.

Q132 Mark Garnier: One last question, to do with the resourcing of enforcement of this. You have now talked about the fact that the burden has been pushed over to you guys. There has been a debate going on certainly going back to the original LIBOR thing about the resourcing of prosecutions against individuals who have caused problems. Again, this comes back to a behavioural issue: we want to drive better behaviour so we avoid having to go through all of this. One of the complaints that has come across my desk from a couple of people—Colette Bowe and also the City of London Police Chief Constable—is that there is not sufficient resourcing to pay for SFO investigations into problems with—

Andrew Bailey: Enforcements under the Senior Managers Regime and Certification Regime would be done by the FCA and the PRA, unless it was way into the realm of the SFO.

Q133 Mark Garnier: I agree with that, but the resourcing is a serious issue across a number of different levels. First of all, do you have the resource to be able to do these investigations? They can be quite expensive. I guess you can do them through 166 orders. The suggestion has been that with some of these large banking fines that are coming through a proportion of those banking fines is diverted to a resource fund that would pay for prosecutions. Do you think that would help in driving better behavior?

Andrew Bailey: Bear in mind that the PRA is not an enforcement organisation in the way the FCA is, so it is a question you might want to ask the FCA.

Mark Garnier: We are always interested in your opinion.

Andrew Bailey: We are in the same position. We do not retain fines that we levy; they are paid over to the Treasury, except that they cover the cost of enforcement action. We are able to cover our costs, as is the FCA. The only difference between where we are today and the idea you floated is that you would have what I might call an ex ante fund whereas we recover ex post and there is a certain amount of uncertainty as to whether we get the end results, as it were, and if we do not get the end result then we bear the cost of it.

Q134 Chair: Unless you investigate the whole thing through a 166.

Andrew Bailey: But you have to do an enforcement. A 166 is a way of gathering evidence; it does not get you to enforcement.

Q135 Chair: Yes, but that is three-quarters of the work, is it not?

Andrew Bailey: We have to bear the cost of that ourselves and if the thing is successful and leads to a fine we get to cover our costs. It is worth thinking about. It is much less relevant for us than it is for the FCA, I suspect, because we do not do anything like the same amount of enforcement. I should say to you that my enforcement colleagues have said to me that they think it is quite likely there will be some more activity with the new regime. I do not want to give the suggestion there is going to be a whole wave of it, but there might be some more activity. As you might expect, they have raised the budget issue with me. That is one we will consider; it is not for today.

Q136 John Mann: You haven't half changed your tune, Mr Bailey, from when you came in front of this Committee in 2014. Is it that you were playing to the gallery in 2014 and you wanted to appease the Committee?

Andrew Bailey: Changed my tune on what?

Q137 John Mann: On this. After what you said to us—I was here—in 2014, your tune has totally changed. Have you been cowed by the lawyers?

Andrew Bailey: I have given you my assessment and my concern. Let me go back to 2014. I agree with the commission and probably you as well at the time—I cannot

remember the exact exchange we had—that in principle there is no reason why the presumption of responsibility should not work. The underlying substance—I keep coming back to this point about substance, if you do not mind—is vitally important. I have not changed my tune one bit on that from 2014. It is crucial that we change this. You are right that where I have changed my view is that I am concerned, as I said to Mr Garnier, that there are signs of developments in the way people are approaching this regime that introduce unhelpful behaviours. It is my job to tell you this. You would, frankly, be unhappy, I would think, if I did not tell you.

Q138 John Mann: The banks are lobbying. Are any of these lawyers who you have been meeting lawyers of the banks?

Andrew Bailey: Some are, and I am sure some of the outside lawyers work for banks.

Q139 John Mann: So, it is not the banks you are meeting and who are lobbying you; it is the lawyers of the banks you are meeting.

Andrew Bailey: It is both, actually. I meet a lot of people in my job.

Q140 John Mann: Do not be coy. Who precisely? Which banks' lawyers have you met?

Andrew Bailey: I have met a lot of banks. I meet a lot of banks.

Q141 John Mann: Which ones? Have all the main banks been in on this?

Andrew Bailey: It is a pretty widely held view across those parts of the legal profession that are involved in this. They take the view that the way in which the reversal of the burden of proof works introduces risks that there may be problems around legal enforceability. I do not put a huge weight on that, because, frankly, this went through a legislative process that had a large amount of legal advice at the time; this was not something anybody did on a whim. What I do put weight on is that if this regime is going to be operated in a way that, frankly, does not achieve what we want, which is clear judgment-based application of the clear point of substance—I keep coming back to this point of substance—then that is something that makes me nervous.

Q142 John Mann: When Lloyds and HSBC employ lawyers, those lawyers are working for those banks. That is who is paying them and that is their duty. They would not be operating properly under Law Society rules if they were not working for their clients. They are representing a vested interest and that vested interest has won.

Andrew Bailey: No, they have not won. I do not agree with you on that. The change that this Bill introduces says, “Let us come up with an alternative way of making sure that we can enforce the substance”. Where I would differ from you is that this is not a watering-down in the sense that it says, “Let us change the substance”. As I said earlier, if

I thought that was happening, I would tell you, and I suspect you and I would probably agree on it.

Q143 John Mann: Under the changes as they are now coming out, would Douglas Flint or Lord Green or Mr Geoghegan be responsible for the breaches of the law at HSBC in relation to the Swiss subsidiary?

Andrew Bailey: The responsibilities of a banker do not change, because—I keep coming back to this point—the crucial point is that what the Government is proposing does not change the substance.

Q144 John Mann: Yes, but is that not the problem—that the responsibilities are not changing? They were there before, so we are exactly where we were before. Those responsibilities were there before.

Andrew Bailey: You are making a different point, then, with respect. I thought we were having a discussion about the proposal in the Bill. I think you are making a point now that you do not agree that the Senior Managers and Certification Regime appropriately changes the responsibility. That has to go back to the regime that has been introduced and was a product of the Parliamentary Commission. I do not agree with you on that, for the reason I set out, which is the crucial change from the old regime, which failed us during the crisis, is the fact that you do not need to prove personal culpability; it is responsibility for the area for which that person is responsible. That is crucial.

Q145 John Mann: I am merely trying to ascertain why you have changed your mind and your advice to us so dramatically within such a short period of time when what one can see are the banks explicitly lobbying in public and, from what you have told us, the banks' lawyers in private carrying out those wishes and attempting to influence. That is what I am attempting to—

Andrew Bailey: Let me try to make the same point in a different way. I do not want a regime that has a flaw in it that they can exploit. There is no reason in principle why the presumption should not work, but I am concerned that there is a flaw in it. I am not coming here saying, “Let us water this regime down so they can get away with things”. What I am saying is, “Let us make a change to the process that stops that happening—that has a higher probability of doing what we always wanted to do”. I come back to this point: I have not changed my view on the substance of this one bit. What I am saying to you very seriously is I think this change is the right one to make to increase the probability that what we always wanted to do to correct the failings of the past can be made to work.

Q146 Chair: I just want to ask one more question on this. You have said that the regulator in the past found it impossible to identify individual responsibility because everybody had hidden behind the collective board responsibility; everybody and nobody was responsible. That was the purpose of this proposal, which lies originally not even with the banking commission but with a consultative document from the Treasury, which, ironically, is now reversing the reversal of the burden of proof,

which is quite similar to one of its own proposals in the consultation paper. The problem remains, does it not, that we may face that problem all over again next time? A board concludes, “We all took this decision collectively. We have the paper trail to show it. This was not an individual decision.” How are you going to get round that problem in the new regime? Are you confident—which was another main reason why in the end the banking commission came out in favour of the reversal of the burden of proof—that there has been no dilution of the pressure that it creates to ensure that on a board each board member is looking at the other saying, “Look here. You are responsible for that and I am responsible for this. Let us just be clear who is responsible for what”?

Andrew Bailey: The test of that when we implement this regime is that the so-called statements of responsibility are clear and can be acted upon.

Q147 Chair: That last bit is the key bit. Can they be acted on?

Andrew Bailey: Yes, I accept the last one probably follows from the previous one: if they are not clear, then the probability of acting upon them goes down. That must be the case. Interestingly, the largest amount of debate on this has been around the role of non-executive board members, not the role of executives; it is clear that what this regime does is to say an executive has responsibilities. A key point here is if you are chief executive of a firm, you do not sign the loan agreements, but what we cannot have is this world that we have had before, where the chief executive said, “Well, I never put my name to that so it is his responsibility”. I have said before you cannot delegate responsibility. We all delegate tasks; you do not delegate responsibility.

Q148 Chair: You are giving us a pretty rigorous assurance on this key point.

Andrew Bailey: That is what we are doing. That is what we are determined to do. Nothing has changed on that. The key thing there is getting this thing set up with appropriate and clear statements of responsibility. We have had to work on this. Again, I have said to them, “Do not deliver a very long book with so many caveats in it”. We have set a limit to these things because the clarity—

Q149 Chair: Well, if they do, we will expect you to come back and tell us.

Andrew Bailey: We will tell you.

Q150 Chair: And we have empowered you, through electrification of the ring-fence if necessary, if they are gaming this to take very rigorous action. This goes right to the heart of whether we are improving standards in banking.

Andrew Bailey: It is at the heart of it. I agree with you.

Q151 Stephen Hammond: A lot of the questions I was going to ask have already been asked by Mr Garnier and Mr Mann, but can I pick up some of the things that you

have said? It is right to reverse this, is it not, because there is still a burden of proof on those executives?

Andrew Bailey: Yes.

Q152 Stephen Hammond: So, despite what you claimed about a lot of noise, the reality was that what had been put in place was contrary to natural justice.

Andrew Bailey: The noise is around that point. The tricky thing here is to say that Parliament passed something with substantial legal advice that was contrary to natural justice is quite a strong claim for me to make. Whether or not it is contrary to natural justice—I use this word possibly a bit loosely—there is too much noise around it and it needs to change.

Q153 Stephen Hammond: The key point you are telling us is that the burden of proof on those executives has not changed.

Andrew Bailey: Does not change, yes. That is key.

Q154 Stephen Hammond: You said in response to one of Mr Garnier’s questions that judgment was back on the PRA. Can I just explore what that really means? To use a CPS analogy, the CPS may make a judgment that it is right to prosecute, but that does not necessarily mean that that judgment will necessarily be upheld later on in terms of enforcement.

Andrew Bailey: No. The same is true for us.

Q155 Stephen Hammond: Can you explain what the judgment process is going to be?

Andrew Bailey: The judgment process in the first instance would be, “Is there a case to be brought?” The judgment on whether there is a case to be brought rests with us. You are right that then there is a process—and that process too is in the process of being changed—by which justice has to be done. There are appeal mechanisms and so the decision ultimately is not ours, but the key judgment at the start is by us: “Is there a case to be brought?”

Q156 Stephen Hammond: So, the key is you will make the case—

Andrew Bailey: Make the case, yes. Absolutely.

Q157 Stephen Hammond: The only difference between now and previously is that now you will have to not only make that case but prove that case.

Andrew Bailey: Yes.

Q158 Stephen Hammond: Presumably in your own minds you will not be making that case unless you have enough evidence to prove that case.

Andrew Bailey: True.

Q159 Stephen Hammond: So, in reality, the reversal of the reversal has not made any real difference to the substance of the regime, which is the point you have been making.

Andrew Bailey: Except to take out this point that you regard as substantially a breach of natural justice and I am saying there is too much uncertainty around—but leave aside that question. That is the piece that gets taken out.

Q160 Stephen Hammond: Can we explore another one of your answers to Mr Garnier? This whole regime is now extended to effectively 60,000 firms of varying types, but all of which are authorised by the Financial Services and Markets Act. You said that you think that is right. Did the Treasury consult you about whether or not it was appropriate to have all those firms covered?

Andrew Bailey: I should say that this is really an extension into the FCA's world; it does not really change our world. We have talked about this issue really ever since the Parliamentary Commission was sitting, because from the point of view of the PRA and the FCA, we would prefer to run one regime, first of all; it is just simpler to do that. I fully understood at the time of the Parliamentary Commission that the Parliamentary Commission was about banking; it was not about the rest of the financial services industry and—the Chairman made this point to me at the time—it was not appropriate for the Parliamentary Commission to make a broader recommendation. There was then an introduction of an insurance regime. The reason that came in was because of the requirements of the Solvency II Directive, predominantly. I will not repeat the whole thing, but I still think the point of substance holds that this is a better approach for all firms but it must be applied proportionately, as we certainly will in our world. If you do not do this—

Q161 Stephen Hammond: That comes very clearly to my next question. There are two issues here. It may or may not be simpler to have an application across the whole area, but that may or may not be correct. As we are seeing, there has been an attempt to apply a deposits regime across the whole of financial services, which is wholly inappropriate to asset management but right for banking. It may be simpler or not, or it may be proportionate, but the point about it is you are now going to try to use your judgment, or the FCA are going to use their judgment, to apply that proportionately when different regimes for different parts of the industry would be the more sensible way to proceed, rather than just one regime everywhere.

Andrew Bailey: That is a question that you do need to ask the FCA, because it is outside my area of responsibility. If you would like, I would be happy to write and lay out how we are implementing it proportionately in our world, which is banking and insurance. I

gave you the example of a credit union; I could happily lay out, if you would like, how we are doing that. It is important. I am very conscious of the fact—by the way, it is entirely consistent with our competition objective—that we should not try to implement this thing in the same way for a small firm as we do for a global firm.

Q162 Stephen Hammond: That would be helpful, if you could.

Andrew Bailey: That is fine.

Q163 Chris Philp: I would like to ask some questions about bank resolution. The Bill, implementing the European Directive, requires the supervisory functions to be separate from the resolution functions. Can you comment to the Committee on practically how you are achieving that?

Andrew Bailey: We achieve that by separate governance. To give you a clear example, supervision reports to me as the Deputy Governor responsible for prudential regulation; resolution reports to Jon Cunliffe as the Deputy Governor who is responsible for financial stability and resolution. Where there is a formal decision-making process that involves the use of the resolution powers, I would not be involved in that, because I would have a conflict. We work very closely together in the area of resolution planning and recovery and resolution plans, because they are crucial to the operation of institutions in today's world, but what the Bill lays out—and we have done this—is how we put in place the separation of governance for the formal decision-making process.

Q164 Chris Philp: Can you update the Committee on what progress you have made in investigating how resolvable different large banks are? That is to say, how easily or how practically could they be separated and wound up in an orderly fashion should it become necessary?

Andrew Bailey: There are two phases to resolution, really. I always say—unfortunately I have had to do this quite a few times, because I used to run resolution in the Bank of England—there is how you stabilise the thing on the weekend when it all goes wrong and then there is what you do thereafter to either, as you say, close it down or recreate it in some stable form. The work broadly divides, therefore, into two parts. The first part, the crucial agreement, which we are right on the cusp of having, is in the global Financial Stability Board, which Mark Carney chairs, and the G20, which is about bail-in and total loss absorbing capacity. I do not want to tempt Mark's fate, as it were, but I think we are very near to having an agreement internationally, which he has driven, to get total loss absorbing capacity for all the globally significant banks. That is a huge step forward, but it is not the end of the story.

The end of the story then comes with the other side of the work that goes on, where, frankly, the devil is hugely in the detail with this stuff, which is how you get resolution plans that you think you can put into effect. There you get into issues like how you ensure operational continuity on institutions—which we also put a consultation paper out on last week, by the way. There are issues around derivative contracts and so-called stays on derivative contracts, which we are also in the process of consulting on. There are

issues around the interaction of legal-entity structures. Bear in mind that large international banks have many thousands of legal entities in them. These are complex issues. Stripping all this down is the other big area, which, again, Jon leads the work on, but we work very closely together on this because it affects supervision as well. We have a big international work programme on that. The final area is international co-operation. For global banks, none of this works unless we have close working relations and trust—I would emphasise the word “trust”—amongst authorities. We have all had bad experiences and we have to get back from that.

Q165 Chris Philp: On the question of resolution plans, if you take, say, the 15 or 20 largest banks that operate in the UK, whether they are UK banks or UK subsidiaries of foreign banks, how many of those have resolution plans that in your opinion are robust and implementable should they ever be required?

Andrew Bailey: We have been very careful to say that we have not yet got to the point when we can say to you that the too-big-to-fail problem is solved.

Q166 Chris Philp: Is the answer currently zero?

Andrew Bailey: Pretty much, yes, because the total loss absorbing capacity agreement has not been reached yet. It will be very soon—a matter of weeks, I hope. There has then been work going on over the last several years, as I said, on the other front to get the banks to put themselves into a position where they are resolvable—resolvable without the use of public money. That is the crucial thing. I can tell you relative to what I had to deal with in 2007, 2008 and 2009 we are a huge amount forward on that, but we are not there yet.

Q167 Chris Philp: To be clear, if there was a problem with a major bank, it would not currently be possible to disentangle one part from another and therefore the institution as a whole would have to be in some way rescued, as happened five years ago.

Andrew Bailey: We are not where we were five years ago. There are two caveats to that. One is we have a lot more capital in the system, so it is a lot more robust today than it was then. It is hugely more robust than it was then. Secondly, we have made a lot of progress on the disentangling point, so it would be dependent on the circumstances and the shock, but I would just caution that we are not all the way there yet.

Q168 Chris Philp: When would you envisage being, to use your phrase, all the way there?

Andrew Bailey: Over the next few years. It slightly differs from institution to institution. The TLAC agreement will come into place over the next few years. You also have to bear in mind that, as you read about, quite a few of the major banks are going through pretty fundamental restructurings of their business models. That is in itself a response to the changed landscape post-crisis. You see this somewhat more at the moment in Europe than

elsewhere. What is very important and we are very focused on is that out of that you have to get business models that not only work but can be resolved as well.

Q169 Helen Goodman: The PRA has already had value for money audits by the NAO, has it not? How have they gone?

Andrew Bailey: The NAO did a value for money review quite early in our life, and it was published. I do not want to put words into the mouth of the NAO, but I think it somewhat also gave them the opportunity to get inside us and learn about us, which I was very happy with. The conclusions they drew from it were ones that I certainly found useful. They highlighted the fact that at that time we had a higher staff turnover than we do today and that we had to be concerned about our level of staff turnover. I think it was somewhere around 14% or 15% at the point when they came in; about 9.2% was the last figure I heard. This is an issue we always have to be attentive to, because our staff are attractive to the firms we regulate and to the consultancies. They highlighted that, amongst other things. It was a useful experience.

Q170 Helen Goodman: Did you have any discussion with the NAO about what constituted value for money and what constituted policy?

Andrew Bailey: On value for money, we very much in a sense were guided by what they wanted to do. They made it clear that because it was such an early exercise in our life they were not there to draw strong conclusions about the value for money of the PRA because they recognised that we were still in the process of setting it up at the time. They looked in a rather broader sense at where they thought there were issues that we would have to address. On the policy point, yes we did. When the review was set up, we had an exchange of letters with them, which in essence set out the scope of the thing, and it basically said that the review would not be—I think I am using the exact language—concerned with the merits of the PRA’s general policies or principles in pursuing our objectives. That is, I think, a way of saying they were not questioning our policies, and that is important in terms of the role of the NAO, in my view. It also made clear that there was a carve-out in terms of confidential information for this purpose.

Q171 Helen Goodman: Why do you think the Court is concerned that the NAO might stray into policy areas?

Andrew Bailey: The Court comes at it from the point of view that they have been established as the board of the Bank of England and therefore they feel that they should have a relationship with the NAO that allows the board, as they would in a commercial environment, to have some say in what the scope of this work is. That is particularly in respect of the point I mentioned, which is the policy point. It is getting the boundary right between what is appropriate, in my view, which is value for money in terms of the way we run the Bank of England, and questioning the basis of monetary policy, which would not be in my view appropriate. It would not be appropriate to call into question, for instance, the decision to use quantitative easing; it is appropriate to call into question the basis on which we run the Bank of England to implement it. That is where the Court wants to have the voice, if you like, in that line.

The key point is that all of that would be transparent. It has to be. What is very clear is the Court cannot do some behind-the-scenes exercise to muzzle the NAO; it would all be done transparently. Not being an expert on Parliament, I do not know quite where the NAO would report to in Parliament, but let us say it would come through this Committee, for the sake of illustration. All of that ought to be transparent to this Committee, and you would then hold any hearing you wanted to on it.

Q172 Helen Goodman: Why do you think the Bank's position is different from the position of the other institutions that the NAO audits? No other institution is able to say, "You must not touch this part of our work".

Andrew Bailey: The reason I would say is because the Bank of England has been given operational independence under statute for the policy functions that it carries out. That is not true of a Government Department.

Q173 Helen Goodman: It is not true of a Government Department, but it is true of the BBC. Why do you think the Bank of England's independence is more important than the BBC's editorial independence?

Andrew Bailey: I am not an expert on the BBC; I am not knowledgeable. I would have thought that it would be an issue if the NAO felt that it could exercise some judgment over the editorial policy of the BBC. I am sorry; I am not familiar with the BBC.

Q174 Helen Goodman: The point is that the NAO itself makes the judgment about where and how to follow the money; the BBC Trust does not. In this case, it is being proposed that the Court should decide. That is why Amyas Morse, the Comptroller and Auditor General, has criticised the proposals. I am saying to you: why in the case of the Bank of England should the institution itself decide rather than allowing the good judgment of the NAO and the C and AG?

Andrew Bailey: I think of it, frankly, as a more robust and transparent process if the Court does have a say in it, because it allows the Bank of England's governing body essentially to have a voice in terms of what it thinks is the boundary of policymaking versus efficiency and value for money. The protection, as I said, on this is that it all has to be transparent. I read the point that the Comptroller and Auditor General made, but I would say in response as all of this will be transparent to Parliament I do not think he should worry that in some sense his position will be muzzled.

Q175 Helen Goodman: Well, it precisely will be muzzled, because he will not be able to do the work.

Andrew Bailey: No, it will not.

Q176 Helen Goodman: It is not that he will do the work and it will not be published; he will be told by the Court, "You cannot go there".

Andrew Bailey: No, because frankly, if Parliament said to the Bank of England, “I am sorry, but you are wrong on this. You have over-interpreted the scope of policy”, it is pretty clear to me what the outcome would be.

Q177 Helen Goodman: What would the outcome be?

Andrew Bailey: The work would get done, would it not? I doubt that we would end up in some lengthy stand-off.

Q178 Helen Goodman: That is not how it is drafted at the moment, is it?

Andrew Bailey: It is drafted in such a way that it says the Court has this role but all of it has to be transparent and all of it comes to Parliament, and I think there would be a judgment made.

Q179 Helen Goodman: Just flipping back to the burden of proof, do you know anything about the French system? Does the burden of proof not work the other way in the French justice system?

Andrew Bailey: I am not a lawyer, but it is a different code. It is the Napoleonic code, so I can well believe it is different, but I am sorry; I am not an expert on French law.

Q180 Helen Goodman: Could I ask you to look into this, please? The French system is ECHR compliant and they do have a different system. If English lawyers are arguing that this is not ECHR compliant and we can find examples from a whole other country where they run this system and it is compliant, is that not worth looking at?

Andrew Bailey: I will certainly do that. I will take that on, but I have been very careful—I said this to Mr Hammond—that I am not saying to you it is not ECHR compliant. That would be, frankly, a rather odd thing for me to say, because that would essentially be saying Parliament passed something that was ill-considered and not consistent with the law. I, frankly, would be pretty surprised if that was the case. The point I have made is: given the risk of noise around this and given the importance of the substance, what is proposed to my mind is a better way and a safer way of doing it. I will take your task on, of course.

Q181 George Kerevan: Good morning, Mr Bailey. The Bill calls for the PRC to make a report at least annually to the Chancellor “on the extent to which the exercise of the Bank’s functions as the Prudential Regulation Authority is independent of the exercise of its other functions”. Why do you think that is necessary?

Andrew Bailey: That is necessary, I hope, to give confidence—going back to an earlier question—that, for instance, we have not compromised microprudential supervision to the interests of macroprudential supervision. It is sensible for the PRC to be asked to give a report to say that we have been able to discharge our functions and that our relationship

with the Financial Policy Committee is as it should be as set out in the legislation, and, going back to Mr Philp's question as well, also to say that the relationship and the governance of the resolution arrangements and the supervision arrangements have worked as the legislation says they should.

Q182 George Kerevan: I read that as this report being about demarcation rather than proof of independence.

Andrew Bailey: No, it would also be about proof of independence.

Q183 George Kerevan: What criteria would you use to prove that you are independent in a written report?

Andrew Bailey: Ultimately the board, or certainly the committee, would have to in some sense sign off—I am not sure I would use the word “attest”, but sign off—that they were confident that the independence has been maintained.

Q184 George Kerevan: But what are the criteria? What is the checklist that they would look to?

Andrew Bailey: You would have a range of criteria. I have gone through the points about not being dominated by the FPC and consistency with the resolution arrangements, but then you come down to a range of other things. Is the Bank giving it the budget it needs? Has the Bank given it the wherewithal to recruit the staff it needs? Is the Bank ensuring that it has the IT systems it needs?

Q185 George Kerevan: You would recommend those points were in the report.

Andrew Bailey: Yes.

Q186 George Kerevan: Against the criteria of what you thought, or the committee thought, were the necessary resources it should have.

Andrew Bailey: Yes.

Q187 George Kerevan: You would be happy to go public on that in the report.

Andrew Bailey: Yes.

Q188 George Kerevan: I find that reassuring. Who is going to sign off on the report? Is it going to be the Governor?

Andrew Bailey: The whole committee would have to sign off, but the Governor would be chairman of the committee, so ultimately he would probably have to put his name to it, yes.

Q189 George Kerevan: And there is no contradiction between the Governor on the PRC saying he is independent of the Governor over here. That is the problem.

Andrew Bailey: There are real advantages to us having these cross-memberships, because it means that we can inform macro and micro. The Governor and I and others are in the same position. We have to do what I sometimes jokingly call the left half/right half thing. You just have to work this, but I think we have been pretty effective in making those things work.

Q190 George Kerevan: Staying with the issue of independence, the Basel rules are all about identifying operational independence, but, as we move through the Bill, I see that the Treasury is proposing to issue a new letter of remit to the PRC. Again from the Treasury document: “These new remit letters will outline the government’s priorities for increasing competition and innovation in financial services” and ensuring London is an attractive financial centre. “The government has ... asked both the PRA and FCA to publish Annual Reports on how they are delivering against their respective competition objectives across financial services”, etc. Is there any friction between your operational independence as defined by the Basel rules and this letter of remit from the Treasury, which could be interpreted as going into a range of political demands beyond simply microprudential regulation?

Andrew Bailey: Independence is an interesting word. We are not independent.

Q191 George Kerevan: Indeed. From my point of view too.

Andrew Bailey: Books could be written on the subject. We are not independent of Parliament and we should not be independent of Parliament. Nothing that Basel writes should in any sense over-ride that. This is true across the range of activities of the Bank of England. Parliament gives us our objectives and it is then for us operationally to go out and put those into effect. Parliament has given us a secondary objective in respect of competition, which I agree with, and it is for us to put that into effect and I am very happy to be asked to provide an annual report on it. No problem whatsoever there. Were there to be a situation where there was a return to what I call the implicit or explicit pressure for light-touch regulation that in some sense contradicted what we were doing, we have a duty to tell you.

Q192 George Kerevan: Tell the Treasury in your report.

Andrew Bailey: Tell you as well—both. That is not, in my view, the intention of the remit letter. The remit letter, as with the MPC and the FPC, will set out what the Government’s policies are towards competition, as you said, and towards technology. However, I will, and I am sure my colleagues will, be very carefully watching them, because if over the future—because we want this to last for a long time—there were any question that we were back into the world of what I might call compromising regulation, as, frankly, happened in the past, that would be a big issue. There is no reason to think that this structure has to lead to that outcome.

Q193 George Kerevan: But if there were any such worries, that would be included in your annual report.

Andrew Bailey: Yes. Otherwise we are not doing the job.

Q194 Mr Baker: Good morning. The Bill seeks to promote the One Bank agenda. What are the dangers of groupthink within that agenda?

Andrew Bailey: I do not think the One Bank agenda makes groupthink any more or less likely. It is a point that has been made about the Bank of England in the past. Having more transparency and more accountability is one protection against that. Having a more robust Court is another protection against it in terms of the governance structure. One Bank is not about groupthink; it is about making the pieces work together more effectively. After all, that is why we brought microprudential supervision back from the FSA to the Bank of England. That is why we did it. It is also, by the way, about making the Bank more efficient in terms of the way it runs the services to support all its activities, whether it be IT, HR or finance.

Q195 Mr Baker: There is a One Bank research agenda, is there not, which presumably will establish the intellectual framework within which the Bank will operate?

Andrew Bailey: The One Bank research agenda is run by Mr Haldane, who is one of the most iconoclastic people in the nation.

Q196 Mr Baker: He is not quite as iconoclastic as I would like.

Andrew Bailey: If you start accusing Andy Haldane of groupthink you are on an interesting track. Let me put it like that.

Q197 Mr Baker: A few minutes ago I think you said—I did not write it down exactly—it would not be appropriate to call into question the use of QE. Could you just explain what you meant by that?

Andrew Bailey: No, I said it would not be appropriate for the NAO to call into question.

Q198 Mr Baker: I see. But it is quite acceptable for the Bank of England to call into question.

Andrew Bailey: Yes. That is part of the policy debate.

Q199 Mr Baker: Are you concerned, as I am concerned, that the actions of the Bank of England in using QE appear to have legitimised circumstances within which Her Majesty's loyal Opposition can now be led by people who seem to think that

something called “people’s QE” can be used to solve all sorts of problems, like building infrastructure?

Andrew Bailey: If you do not mind me saying so, that is a debate that you have in the Chamber of Parliament, not with me.

Q200 Mr Baker: It will be a problem you have if they are leading the country, will it not? They will be changing your mandate to tell you to print money to build infrastructure.

Andrew Bailey: Let me come back to a point I made a few minutes ago. We are not independent of Parliament. Parliament sets the Bank of England its objectives; Parliament can change those objectives. I would not recommend that, by the way, but it can and it has over the years, and that debate has gone backwards and forwards. The Bank of England’s objectives are now in a much better place than they used to be; the regime is a much clearer one than the Bank I joined in the mid-1980s and I would not recommend that the basic framework is changed, but you have to have these debates in Parliament.

Q201 Mr Baker: The Bank does have a very strong collective identity, does it not?

Andrew Bailey: Yes. That is quite important.

Q202 Mr Baker: And it relies on the loyalty of its staff.

Andrew Bailey: Yes.

Q203 Mr Baker: And it has a hierarchical decision-making process.

Andrew Bailey: Most organisations do.

Q204 Chair: The Bank has a particularly hierarchical tradition, does it not?

Andrew Bailey: By tradition. I would like to think that there has been some reform to that.

Q205 Mr Baker: Let me just put three names to you and ask you what you think these three names have in common. Walter Bagehot, Milton Friedman and Alan Greenspan.

Andrew Bailey: They are all authors in economics.

Mr Baker: Indeed, yes.

Andrew Bailey: Are they all people who you particularly read?

Q206 Mr Baker: They are all people who at some stage in the course of their careers advocated the abolition of central banks. Is that something that is ever discussed in the course of discussing the work of these authors within the Bank of England?

Andrew Bailey: That is really for Parliament, if you do not mind me saying so. We discuss a lot how we fulfil the responsibilities that we are given as a central bank. I know you take a particular view on the role of central banks, or the lack thereof. I know my colleagues and I are happy to debate this in what I might call a more academic setting, but we do not sit down at the Monetary Policy Committee or the Financial Policy Committee and say, “Shall we have a central bank or shall we not?”

Q207 Mr Baker: Much of the conversation in this session has centred upon the culpability of individuals. It is a matter of the most acute practical sensitivity to my constituents that if they were operating a small business, borrowing from a bank, and they messed the whole thing up they could well lose their family home, and yet they see people who have earned vast sums of money and ruined the whole economy and we end up now cutting tax credits. It is a matter of profound practical importance to my constituents that people have not been personally culpable for what they have done. Does anybody ever sit in the Bank and say, “Let’s go and have a look at Steve Baker’s proposals to radically increase the commercial liabilities of actors within the banking system” that I brought forward in the last Parliament?

Andrew Bailey: We would be happy to discuss them with you.

Mr Baker: I will make sure to write to you.

Andrew Bailey: Mr Haldane I am sure would be happy to discuss them with you.

Q208 Mr Baker: Does anybody ever sit down and say, “Hey, you know what? These value-at-risk models, which are based on a normal distribution of market events”—

Andrew Bailey: Yes, we do.

Q209 Mr Baker: You do. What is the consequence of having discussed them?

Andrew Bailey: First of all, there has been a general move towards what I call stressed value-at-risk models, which shift the normal distribution assumptions. Secondly, the whole approach towards modelling has changed—a subject in its own right, of course. The problem with the way that the Basel II system was introduced was that there was inadequate scrutiny of the models. I am not against having models; they serve a purpose, but if you have a regime with internal models in it you have to take it seriously and you have to have the people who can do it.

Q210 Mr Baker: The point I am making is that the whole framework within which you operate takes as an assumption that value-at-risk models and other models, which

we know to be founded on incorrect distributions of market events, are fundamental to everything—

Andrew Bailey: That is why we have stress tests.

Q211 Mr Baker: I have previously criticised them too. Things like IFRS—do you end up all of you working within the same trammels that we must use IFRS? If you do, I have previously explained how that leads to overstating capital—

Andrew Bailey: Let me give you an example. There is a very substantial debate about how IFRS 9 is going to be introduced, which is all about expected loss provisioning.

Q212 Mr Baker: I will probably leave this one here and just go on and ask you about culture. You said earlier that One Bank was about making sure that the whole Bank works together within one culture. How is that progressing at a staff level? How are you bringing people together culturally?

Andrew Bailey: It is progressing pretty well. It is no great secret that back in 2010 when the proposals to break up the FSA and to move prudential supervision were put in this was not greeted in some circles in Canary Wharf with enthusiasm, and we knew we had a task on our hands to build the PRA as an effective supervisor and to build it as part of the Bank of England. I have devoted the last four and a half years to this, or however long it is now. It is still work in progress, but we are a lot further forward. I see very real illustrations of how it is working within the Bank of England, so I am encouraged, but it is not finished by any means.

Q213 Mr Baker: We have a very hierarchical decision-making structure. We are increasingly bringing people into the same homogeneous culture. We have explored some of the areas technically within economics where there is a broad consensus within the Bank about models, their shortcomings and the need to rely on them and test them with various other pieces of apparatus. Do you think there is any danger that the Bank could end up herding the entire financial system in a particular direction?

Andrew Bailey: You may be already, but come to the open forum that we are holding. It is on 11 November, if my memory is correct.

Mr Baker: I will see if I can.

Andrew Bailey: We are putting many issues on the table. Andy Haldane is arranging it. You are most welcome.

Mr Baker: I will look forward to it.

Chair: Thank you very much for coming and giving evidence to us this morning. It has run on rather longer than had been intended, which is a reflection of some of the interest expressed round the table. Thank you for coming.

Examination of Witness

Witness: **Dr Mark Carney**, Governor of the Bank of England, gave evidence.

Q214 Chair: Good morning, Governor. It is still morning. I am sorry that this session has been somewhat delayed, but we have had a lengthy session with Andrew Bailey, which I think you have had the opportunity to hear. There is a good deal in the Bank of England Bill that is now before the House that owes its roots to the work of Parliament and this Committee some years ago, but there are some aspects that certainly do not owe their origins to us, one of which is the symmetry that is now being created between the three committees: the PRC, the FPC and the MPC. What have we gained from this symmetry?

Dr Carney: Good morning and thank you for the invitation. As you are aware, at present the three main policy bodies of the Bank are of different standing. The MPC is a committee of the Bank; the FPC is a committee of Court; and the PRA Board is just that: it is a board of a subsidiary of the Bank of England. There is no difference in the relative importance of our three main policy functions, but there is difference in the stature of the committees. There are differences in the lines of accountability of the committees—multiple lines of accountability in some cases. There are differences in terms of the communication to those committees, including, for example—I know you had a brief discussion of it—the fact that the PRA Board does not receive a remit letter. It is the only one of the committees that does not receive a remit letter, nor does it have the opportunity to reply to that remit letter and promote clarity and accountability in that regard.

As you are aware, the proposal in the Bill is to equalise the status and lines of accountability of the three main policy committees. The advantages are clarity of accountability, consistency of accountability mechanisms and transparency. I would say there are softer advantages, if I may use that term, within the institution: that the Bank of England is not a monetary institution that happens to have macroprudential and microprudential responsibilities; it is a modern central bank that has been given by Parliament enormous responsibilities across macroprudential and microprudential supervision and monetary policy. They are equally important. There are opportunities for synergies between those policy functions—not always, but there are opportunities—and where there are those opportunities, we should exploit them as policy committees. My last point, which is separate from your question but important as well in terms of accountability, is there are opportunities, which we are starting to realise, for synergies in terms of the operations that support those various committees.

Q215 Chair: We might come on to synergies in a moment if we get time. Just one more question on what is gained or—let us put it in reverse—what is lost. Is the PRA just as independent as it was before?

Dr Carney: Absolutely. Without question.

Q216 Chair: We reckon we can pick up these synergies and get this consistency and symmetry across the Bank without in any way imperilling that independence.

Dr Carney: Yes. One of the things one can liberate is a portion of the time of the members of the PRA Board that is spent duly exercising their responsibilities as directors of a company, which is what they are at present. You can liberate part of that time—not all of it, because there still will be this responsibility to attest that the resources are adequate in order to perform the policy functions, but not all the conventional responsibilities of a board member will be required. That time is freed up to do their core job—what they are there for—which is to provide guidance on judgment-led supervision.

Q217 Chair: This is my last point on this question of symmetry. Most people—certainly everyone in the Bank—have said the PRA has been a success: it has been going about five years; it was created in crisis; it was a very tough job to do that, but they seem to be largely succeeding, or at least they have made a very good start. Didn't anybody say, "If it ain't broke, don't fix it"?

Dr Carney: No, no one did make that point. This is an opportunity to make a broader point. The proposed changes in the Bill to the external and internal governance of the Bank of England are absolutely in the spirit of the 2012 Act. Having operated the model for a few years, there was some legislation needed, as you are aware, specifically to formalise the position of the Deputy Governor of Markets and Banking. We have been thinking about how to operate the institution more effectively, as we should, and with this opportunity we saw the opportunity to regularise the committees, make them more effective, and provide scope and stature to work together as appropriate. The thrust of this is taking a ground-breaking reform and making it work as best as possible.

Q218 Helen Goodman: Dr Carney, your previous answer moves us very neatly into another thing about making the Bank more effective, which is the NAO audits. We have seen in the minutes of the Court that you were concerned about the NAO's involvement. Would you like to set out for the Committee what your concerns are about the NAO's involvement?

Dr Carney: The question is the scope of the NAO's involvement, as any public sector auditor's involvement, for a central bank. The NAO, as proposed in the Bill, would review the external audit of the institution, it would have access to the papers, it would participate in the process of the selection of external auditors, it would audit indemnified activities of the Bank—cases where there are public funds at risk, and, in the case of the Bank of England, with the Asset Purchase Facility, that is substantially all the balance sheet of the Bank of England; it is over £375 billion—and it would be able to conduct, as you are aware, value for money reviews on operational activities of the Bank.

We very much welcome those roles for the NAO in providing their unique perspective on our activities. The concern, which is a concern that is shared across all G7 countries and G7 central banks, is the desirability to preserve the operational independence of a central bank. The evidence—unfortunately it is a long history of sorry evidence—shows that if there is external influence on policy, particularly on monetary policy, the experience has been poor outcomes in terms of inflation, and ultimately in terms of unemployment and broader economic outcomes. It is for that reason that it is the case for all G7 central banks that when a public sector auditor such as the NAO is involved there have been explicit carve-outs in legislation from conducting any value for money—I will

use that term; different countries use different terms, but it describes the same thing—audits of the central bank.

If I may, what is attractive in terms of what is proposed in the Bill is there is not an *ex ante* judgment that is being made in legislation. There is a continuum of activities, and where do you draw the line exactly around the policy? But there is this mechanism, such that if there are proposals by the NAO, if there is a response by Court, if there is a counter-response by the NAO and if there is a disagreement, that is all made public and that is open for public scrutiny. That should be an effective and practical way to draw that important boundary.

Q219 Helen Goodman: Do you think it is fair to describe an audit that comes after the event as an influence on policy?

Dr Carney: It was not a discussion specifically about the NAO, but I recall two and a half years or so ago at my pre-appointment hearing at this Committee we had a discussion about reviews and the proximity of reviews to a policy decision. A review of a policy decision taken last month by the MPC by its very nature influences the policy decision taken next month by the MPC. There is a question of time. There are other questions in terms of substance, but, yes, reviews can be used to influence policy outcomes. Parliamentarians always take these issues seriously. This is legislation; this will live for some time, and having a mechanism that could potentially be used to influence policy is something that is best avoided and the mechanism that is proposed in the Bill provides, in my judgment, an appropriate way to do so.

Q220 Helen Goodman: Members of the Court of the Bank of England will be pleased that the Bank of England has a veto on what can be examined and what cannot be examined, but, as we have also heard, the Comptroller and Auditor General is not so satisfied and I think would prefer either for the judgment as to where he can go to be his or for it to be set out in the legislation now in a straightforward way. I wonder what conversation you have had with him since he made his remarks to allay his concerns that this is not really providing the accountability that it appears to be offering.

Dr Carney: Let me answer your direct question. I have not had a conversation with the Auditor General. He has made no effort to contact me on these issues. I take the legislation as proposed and provide my commentary to you on it today and any other time you so wish.

The accountability mechanisms of the Bank of England have been materially, consistently strengthened over the course of the last several years. This is a crucial point. This Committee particularly has totally changed the role of Court. It is has reinforced Court and made it much more transparent and much more accountable. We have taken steps on our own in that spirit. The front-line accountability for value for money rests with all the employees of the Bank of England and particularly with the senior managers of the Bank of England—and I would note that we are applying the Senior Managers Regime to the Bank of England on the same timetable as the private sector—but the Court views itself as the front line in ensuring that value for money is obtained at the Bank, and it is not shy, it has not been

shy and it will not be shy about instituting its own reviews, including, appropriately circumscribed, into areas of policy. For example, they have an Independent Evaluation Office that reports to Court, which has conducted a review on Bank forecasting that will come out on 5 November. There is a review of how the PRA is fulfilling its responsibilities with respect to facilitating effective competition—that is another review of the IEO, which is commissioned by Court; it was a decision of Court to do—and how we are doing it and how effectively we are doing it. Those reviews go directly into the public domain. That is part of how Court fulfils its role. If I may just finish, my personal view is that the NAO's role is complementary to that core role of Court.

Q221 Chair: Governor, just one more point on this. Everything—a great deal, at any rate—seems to rest on what the legislation says on this NAO issue. As I read the legislation—and I have it in front of me—when the Court says no to the NAO, it is not that the Court may decide to go public. Under whatever clause it is—I cannot find it very quickly, but I am looking at it—the NAO is under a duty to explain publicly why not and to publish the exchanges it has had with the Court and then to say that it has been thwarted and to say what it is missing out on for which it has made a reasonable request. The question here has to be what the stomach in the Bank is going to be for a stand-off with the NAO on such an issue. If this arrangement gives you genuine protection against a serious mistake by the NAO in demanding something, you are going to have to explain that publicly, extremely thoroughly and clearly here. Is that right?

Dr Carney: That is right.

Q222 Chair: If, on the other hand, the Court has played the NAO a merry dance, it is going to be uncovered, isn't it? Or is it not?

Dr Carney: I did not draft the Bill. My understanding is it is a two-way obligation. In other words, if it were the view of the Auditor General after an exchange that—

Chair: That he is not getting what he wants.

Dr Carney: It was being unreasonably withheld and the explanation of Court was not satisfactory, it would be appropriate for that exchange to be in the public domain and justified by Court.

Q223 Chair: In that case, we are going to have the Comptroller in here and we are going to ask him, “Why do you need this?” and once we have heard it from him we are going to have you in and say, “You had better supply it”.

Dr Carney: Yes. I presume you would have the Chair of Court, respecting governance. I am happy to come as a member of Court.

Chair: He can come along with you.

Q224 Mark Garnier: Morning, Governor. Can I turn to the subject of the Senior Managers Regime and the reversal of the burden of proof that is coming through? I do not know if you had a chance to see Andrew Bailey's evidence a little bit earlier, but we were asking quite extensively about this whole thing. One of the interesting points he came up with was that he suggested that the reverse burden of proof could ultimately end up being a box-ticking exercise where a senior manager could turn around and say, "Look, on the basis that I have complied with these tests, you cannot prosecute me". What Andrew Bailey was saying was they are trying to bring that back into the PRA and the FCA so the new regime will be one where they have to take responsibility. Do you agree with this? More generally, what are your views on this whole area?

Dr Carney: I did see part of Andrew's testimony. I am afraid I did not see all of it, but I am familiar with his thinking and I agree with it. I will speak for myself, but I think it is consistent with Andrew. I view this as a change in process as opposed to a change in substance. The responsibility—the key point—lies with the senior manager. Those responsibilities are going to be clearly articulated—and we will hold them to this—in the responsibilities road map that is put out, one of which we will also do as senior managers of the Bank of England. That brings the individual's accountability not just for their own actions, as was the case under the old Approved Persons Regime, but a responsibility for the institution and for those areas of the institution for which they are responsible and the behaviour there. That is entirely in the spirit of the Senior Managers Regime. That is a major innovation. It ascribes responsibility where it needs to be.

To answer your question, yes, it becomes the responsibility of the regulator to make the judgment whether those responsibilities have been upheld, and ultimately there is an enforcement process if necessary, but regulators are there to make judgments. It is not new to have the regulator making the judgment as opposed to the individual. As part of the exchange, I recall—I will not try to quote you exactly—the spirit of what you were saying to Andrew earlier is exactly right. To get this to work, yes, we need an enforcement mechanism and, yes, we need these responsibility maps and, yes, we need education, etc., but this is a cultural change. If you are running a bank, you are running a bank and you are responsible for the activities. If you are running the trading desk, you are responsible for that. If you are the independent director in charge of the audit and risk committee, that brings certain higher levels of responsibilities, and if you are not comfortable with those responsibilities then you should not be in that role. We have to make sure that the culture is there. One of the things that has been a concern of Andrew—and he has been closer to the legalistic discussions, if you will, around this—is that this had morphed into a legal discussion as opposed to the spirit of it, which was a cultural discussion.

Q225 Mark Garnier: That is very interesting and very helpful. One of the suggestions that a number of banks were making to me was that, particularly in the case of the international banks, the Senior Managers Regime, as it was, was potentially going to prevent very good quality people coming to work in this country because they just would not see that it was a risk worth taking under that regime, and that therefore, over a period of time, you would get an attrition of the very high quality people you need to run these banks. Do you think that was a fair criticism at

the time? Do you think this has resolved that? Do you think where we are now in terms of regulation with regard to the Senior Managers Regime is not going to put people off coming and running these banks, when we genuinely need very good people to run them for us?

Dr Carney: I am unaware of a specific instance where somebody was hesitating because of their perceptions of the Senior Managers Regime. By the same token, there was widespread concern about this element of it, and I would say—again, not being a lawyer—fairly widespread misunderstanding, potentially, of its import. As you are aware, the Senior Managers Regime started with the banks and it was extended to insurers without the presumption of responsibility, and as a consequence of the Fair and Effective Markets Review it was recommended to the so-called buy side of the industry so that you cover fixed-income, commodities and currencies both on the sell side and the buy side—all the senior managers there—and well beyond into retail banking and into insurance. My experience in discussing that extension has been that that is viewed very positively by the best in the industry because it reinforces something that they do anyway. They do take responsibility for their conduct and for their risk-taking. There were a lot of others—I said this in a speech once—who free-rode on those reputations without sanction or without mechanism to sanction. We are in the process of updating the codes of those sectors—the fixed income, currency and commodity codes that manage them—through a financial markets standards board, which is being driven by the industry across the piste.

The alternative to this—and I know some members had an exchange on regulatory burden—speaking from the markets side, is to have a slew of new black-line regulations for each bespoke type of derivatives or currency or commodity, as opposed to having codes of behaviour, appropriately specified, that are tied in through the Senior Managers Regime in order to promote best practice.

Just to finish, the extension brings great value, in my judgment, but extending it also brought forward the question of harmonisation. There should not be differentiation between senior responsibilities, with one caveat: we will proportionately apply it within the PRA, as you would expect. Andrew appropriately used the extremes of a credit union and a globally systemic bank. Clearly, there is a difference in the scope of their responsibilities.

Q226 Mark Garnier: My next question is about the behavioural outcomes of this. Certainly the Senior Managers Regime, as we talked about it within the banking commission, was about driving about behaviours. The question that many of us on the commission were asked at the time was whether this reversed burden of proof meant that people like Fred Goodwin would have gone to prison—I use him as an example, not specifically—to which the answer was “no”. If it had been in place in the first place, RBS would not have gone bust. It was about driving better behaviour rather than retribution. You hinted at this in your answer, but you would agree that this is absolutely within the spirit of the better behaviour outcome.

Dr Carney: Absolutely. That is the power. With any mechanism, ultimately some enforcement cases will come to light, and they were helpful, but this is about the mass of senior managers, not about the extreme outliers. We want that change in culture around the mass of senior managers. I would come back to this point that if there is a director or

somebody who is considering coming to a position of responsibility and influence in the UK and they are uncomfortable with having formal responsibilities and writing them down and mapping them out, we are not interested in them fulfilling those roles. They self-select out.

Q227 Mark Garnier: Yes. That is a very important point. Just one final question, which is a much more general question. Within the media recently, over the last two or three weeks, when these changes have been talked about—indeed, also the perceived changes with the ring-fencing—there has been criticism that bankers are getting the upper hand in the lobbying stakes, if you like, and the Government is bending over backwards. Do you get the sense that that is the case, or do you see these as very sensible, pragmatic changes to make a good idea even better?

Dr Carney: Very much the latter. You can tell from my comments on senior managers that is where I come out. To be honest, I am as baffled as Andrew by the press on the ring-fence. Let me give a very simple example. Let us say that a group of entrepreneurs decide to set up a new bank that serves the high street, and that is exclusively what it does, and over time they are successful, they bring competition to the high street, they build up deposits, build up loans and build up capital—and build up capital in excess of what is required for prudential reasons. Are we really saying that those entrepreneurs cannot pay themselves a dividend because they are operating domestically? Why would we say, given that we are applying higher capital standards for ring-fenced banks—appropriately so—in the UK, that their shareholders would not be able to receive any dividends out of excess capital? Of course Parliament never said that, and of course it was never our intention to do that. How this is viewed as some sort of easing of that regime I do not see.

I will make a meta point, which is that there has been a tremendous wave of regulation. It has absolutely been in the right direction and I would support the vast majority of it. It would be a miracle, though, if all of that regulation, which was often developed in different work streams, some for conduct, some for prudential reasons, some for macroprudential reasons, some for consistency with European legislation, some international standards, perfectly fit together and there was no duplication or underlap and there were no contradictions in that. I appreciate Andrew ended on the open forum we are having. That is one of the reasons we are having a bit of a stock take ourselves, particularly around the role of markets and how they function. I do think you see that given some of the interaction between some of the regulatory decisions once you layer them on top of technological changes and other factors, there may need to be some adjustments, but if they do need to be adjusted we will go through a very transparent, open process that takes into account all range of views before we propose something.

Q228 Chair: You have said you support the vast majority of the regulation that has come through in the last five years. What is the small minority that you do not?

Dr Carney: We have had discussions on this in the past. As you know, I do not support the bonus cap from a prudential perspective; I view that it adds to risk as opposed to reducing risks. In part, it is the framing of the issue. What used to be a bonus is now compensation that is held back, and it reduces the ability, effectively, of the regulators to hold back more compensation until the point we realise that excessive risks have not been

taken or there has not been misconduct. That is one example. I recognise that is not domestically generated.

Without giving you a long list, we have to be quite thoughtful in our application, for example—and this goes to a market question—of the leverage ratio when there are pass-through deposits through major banks. Quite often they are indirect clearers, effectively, for clearing agencies—they get deposits; they pass them along—but that process builds up their balance sheets. That would be one example—and some of my colleagues share this concern—that in times of stress that which is an irritant could become much more problematic. That is an example of something that we should be very thoughtful and open about and if we think we need to make changes we would propose that very clearly. There is a longer list, but those are two examples.

Chair: That will do for now.

Q229 George Kerevan: Governor, under the new Bank of England symmetry, the PRA/PRC is to get its own letter of remit from the Treasury. Why does a standalone microprudential regulator need a letter of remit on broader policy from the Treasury?

Dr Carney: First off, as you say, symmetry. If there is any judgment that has been made—shading of direction—by the Government, that should be clear and that should be in the public domain. What would also be in the public domain upon receipt of a remit letter, assuming the Bill goes forward and the PRA Board becomes the PRC, would be the response of the PRC, which would inevitably clarify from the PRC's perspective and put on public record how to circumscribe the limits, if you will, of any subtleties or change of direction or judgment or guidance that was in the remit letter from the Government. I am sure there would not necessarily be a need for much of that, but I would use the example of the exchange of letters for the remit this year between the Government and the FPC. There was a greater emphasis on growth from the Government, and a reminder by the FPC—I am grossly paraphrasing—that financial stability is a necessary condition for productivity growth. You know well from your research and others' that one of the biggest hits over time to productivity growth is if you have a financial crisis—so the importance of not losing sight there. I cannot anticipate the exact example, but I could anticipate that there could be an opportunity to have that type of helpful clarification.

Q230 George Kerevan: I appreciate that. I suppose I am coming from the fact that I am not sure of the need for the symmetry. I can understand the remit letters for MPC and FPC, but for a body that is fundamentally regulatory, where the Treasury says, in the section dealing with why it wants a remit letter for the PRC, "It is vital that regulation remains proportionate", that seems to me to suggest—not referring to this specific Government—Treasuries now and in the future may feel that they can vary the regulatory regime and that becomes a pressure on PRC. That is what I am wondering. I am just probing the need, apart from symmetry of the Bank, to create that possible tension between the political and the operational independence of the PRC.

Dr Carney: Thank you for bringing out a specific example. Here is one reason—let us take the proportionate regulation—why that could be useful. As you know, the PRA is a

judgment-based regulator and is not a zero-failure regulator. We are very much against disorderly failure, as you would expect, but we recognise and welcome that in a true private financial sector there will be firms that fail from time to time. It is important that they fail in an orderly way, but it is important that they are able to fail. There is a question about what are risk tolerances as the PRA as a whole. Ultimately, that is a decision for the PRA Board, as it is at present, and the PRC in the future. In terms of proportionality, there are two ways one can use the word. In terms of types of entity, is one less strict, if you will, for new entrants versus established firms? Does it depend on size? How does it depend on relative size? There is also a question of proportionality that feeds back from those decisions to: what is our tolerance for non-disorderly failure? That type of dialogue and pulling that out more clearly is quite helpful for common understanding and judgment about whether or not we as the PRC are performing our job effectively.

Q231 George Kerevan: So, there is a dialogue between the PRC and the powers that be over those tolerances.

Dr Carney: Yes. May I say I have tabled an issue; I would like to assure the Committee that these are exactly the type of discussions we are having on our own accord at the PRC in terms of looking again at the operating model of the PRA and how they apply judgment-based supervision, and thinking through more clearly what our risk tolerance is so that we are allocating resources appropriately and giving the appropriate guidance.

Q232 George Kerevan: We pursued with Mr Bailey the issue of the report that the PRC will have to put in at least annually to the Chancellor reviewing the extent to which the Bank's functions as prudential regulation authority and the exercise of those functions are independent of the rest of the Bank. Who will sign off on that report?

Dr Carney: In the normal course, a report from a committee would be signed by the chair of the committee, but it is signed by the chair of the committee on behalf of the committee. I am not able to sign something on behalf of the PRC, as it would then be, without the agreement of the PRC. If there were disagreement or dissension, it would be noted in the report.

Q233 George Kerevan: There are clearly grounds for conflict here if we have the PRC reporting on its independence from the rest of the Bank when we have an overlap of personnel. It just seems to me that undermines the whole thing.

Dr Carney: The Governor does sit on all the committees and has an equal interest that all the committees are acting independently. This is a situation that he or she would face and it is the nature of the position. Having been in the position for the last few years, it is eminently manageable. When I am chairing the PRC I act as the Chair of the PRC, not as somebody who happens to be on the MPC and the FPC as well. I would say in terms of influence there are very clear mechanisms with respect to the role of the FPC—we all know the directive powers—but if there are recommendations from the FPC they are to be made explicitly and publicly.

Q234 George Kerevan: That was no portrayal of your abilities, Governor. I am sure it is very manageable by you, but having read the long history over the years of various governors of the Bank of England, I am looking to the future and I am not always quite so sure that one governor would be quite as responsible as you, and all those committees—

Dr Carney: I was not taking any personal judgment from what you were saying. Let us go to the PRC. I would say that here, where the provision is for at least six externally-appointed members—members appointed by the Chancellor—it goes to those individuals and the appointment process as well as a bulwark against this risk. That is a substantial protection against it. Also, while the CEO of the PRA is no longer CEO of a subsidiary UK company, the role in substance is absolutely as before, and that individual has personal responsibility, buttressed by a Senior Managers Regime as a supplement, to ensure that the supervisory responsibilities of the PRA are being discharged appropriately and independently. If it were not the case now or in the future, I would be stunned if that individual did not make that known directly through this accountability mechanism if no other—but also through the other ones—not least because it would be in violation of their duties as CEO of the PRA but also as a senior manager.

Q235 Chair: I just want to come back to the role of the IEO, which the *Financial Times* reported recently as having been in place for a year without having yet produced any reports. You mentioned earlier that they are going to get a bit more active, or at least evidence of activity will shortly be available to us. I just want to clarify the lines of accountability for the IEO. Is the IEO able to investigate what it wants, or does it need to be told to investigate something by Court?

Dr Carney: The priorities of the IEO are set by Court.

Q236 Chair: Are those general priorities?

Dr Carney: No, specific—

Q237 Chair: You have this work going on on competition. Has someone said, “You really ought to make competition a priority” or has someone gone to them and said, “We want you to look at this specific issue”? If so, who?

Dr Carney: The remit is provided by Court to assess the Bank’s forecasting accuracy over this period. The IEO goes and supplements the core team and does an independent evaluation of our forecasting performance. That, as I say, will be published in a couple of weeks.

Q238 Chair: So the IEO does not pick up stuff independently of Court; it requires Court to say, “Why do you not go and take a look at X?”

Dr Carney: These are very intensive reviews. You chose your words carefully. The IEO has been very active. I would add a couple of things. First, the core of the IEO

participated in the development of the Warsh report, from which a hugely intensive amount of work came out. The work on forecasting has taken nine months. It is about to come out. The work on competition is five months in. It is about to come out.

Q239 Chair: I am not asking about that, though. I am asking about the origins and the overall direction of this work. Who is in charge? It is the same question I asked at the beginning, to which I have not yet had an answer. Can the IEO—

Dr Carney: I am afraid, Chair, I have given the same answer, which is the IEO reports to Court—

Q240 Chair: Let us ask nice simple questions. Can the IEO independently decide to start an inquiry?

Dr Carney: No more so than—no, is the short answer.

Q241 Chair: So the answer is no to that. Just to clarify, the word “Independent” in Independent Evaluation Office actually is “Independent (only inasmuch as court has directed it to be)”. Correct?

Dr Carney: Yes. It is independent of all the policy functions of the institutions—

Q242 Chair: But not of Court.

Dr Carney: Not of Court, no.

Q243 Chair: Right. If Court says, “We would like you to look at X” and the Independent Evaluation Office thinks, “Thanks very much; we do not think there is very much meat in that” are they in a position to say, “We will not do that this year”? Your hesitation on these things is suggesting that the relationships between these bodies have not been very carefully thought out.

Dr Carney: No, it is clear. My hesitation is because I am trying to conceive of the merits of an entirely free-floating entity. We have an internal audit function, which sets its internal audit priorities.

Q244 Chair: That is very well known. That has been around a long time and this Committee has looked at it often. We are going with the Independent Evaluation Office, which is a new institution, and that is what I want to know.

Dr Carney: Let us go to the thrust of this, which is: what are the areas of the Bank’s activities that Court, in its oversight role, most wants an independent assessment of? The *Financial Times* from time to time will say we are not very good at forecasting. Court will say, “We need independent expert advice. We need a review of the Bank’s forecasting record. How do we perform as forecasters? If we do not perform up to snuff, why and what else should we be doing?” That process, which is independent, puts pressure on the

management of the Bank. Inevitably there are issues; how do we respond to those? Is Court fulfilling its oversight function?

Court is there to make judgments about what its priorities are. It is answerable to you in terms of whether it has set those priorities. It is the judgment of Court that the PRA has been given this additional remit on facilitating competition. There is a concern expressed from time to time in this Committee and elsewhere that that will be ignored or that will always be secondary or tertiary and so on to safety and soundness. Court takes that seriously, wants to know what the PRA is doing, what the best practice is and what else can be done, so it commissions the IEO. I would suggest that Court has a responsibility to address the issues that are most important and most complex, and the judgment will be whether or not it has ducked obvious issues that should be performed.

Q245 Chair: Just to be clear, I am not necessarily challenging the arrangements that have been put in place; I am trying to clarify what they are. We now have a little more clarity than is available to us from the description of the IEO on the Bank of England website, because I have paraphrased various sections of that in this exchange. Unless there is something you particularly want to add, we will move on.

Dr Carney: I will leave it there.

Q246 Mr Baker: Good afternoon, Governor. The Bill changes the situation of the PRA. I am mindful that in 2013 the Financial Stability Board warned that there was a danger of groupthink under the structures as they were. How does the Bill address that issue of the dangers of groupthink?

Dr Carney: I am not sure that the Bill specifically addresses issues of groupthink. There is a broader suite of measures, not least in terms of the transparency of our activities but also the structure of research, the forms of our communications and the way we are working as committees. I invite you to go to Bank Underground, trawl around a bit and see how much groupthink is going on.

Q247 Mr Baker: Perhaps it might be helpful if I just read out the particular phrase from that report. “Such an arrangement”—the one we currently have—“increases the potential of creating a ‘group-think’ mentality, particularly since a large scope of responsibility is vested in a small number of senior executives (primarily the Bank of England Governor and the Deputy Governor for Financial Stability, who serve on all of the”—you know the rest. In addition to being Governor, you chair the Financial Stability Board, you are a member of Court, and you chair of the FPC, the MPC and soon the PRC. We talked earlier about you chairing committees but chairing them, in a sense, with a degree of independence and separateness. Surely wherever you are acting within this wide-ranging framework you still bring the same paradigm with you to that role, do you not?

Dr Carney: I would not say I have a universal paradigm that encompasses the monetary implications of prudential decisions. A proper chair draws out the opinions of the members of the committee, ensures that there is proper challenge in the discussions of any

issue, and makes sure that the agenda is appropriately sequenced and prioritised so that that debate can be there and that the supporting materials promote that debate. The depth of expertise around the table at the PRA Board, particularly with the external members, is considerable and varied. As chair, whether it is me or someone else in that role, the responsibility is to ensure that those perspectives are fully listened to and those judgments are taken into account. We have quite robust discussions at the PRA Board. On a number of occasions, there has been material or an issue that has been sent back, effectively, that has not been ready for final decision or determination.

Q248 Mr Baker: Are you saying that this report was not correct in warning of the dangers of groupthink?

Dr Carney: It is warning of a concept. It is warning of a conceptual risk, and we are right to be alert to it. There are accountability mechanisms, including the appearance before this Committee of the members of the PRA Board.

Q249 Mr Baker: Do you believe that changing the status of the PRA has no effect on this phenomenon of groupthink in the context of what you are saying?

Dr Carney: Yes, is the short answer. There were some double negatives in there so I had better be careful. The change in the status of the PRC is a sensible tidying-up of the governance structure of the institution. It is one that permits us to operate more effectively in terms of value for money for taxpayers. It is one that appropriately ensures that no one would be in any doubt in terms of the equality of importance of the three committees of the institution, and it does nothing to undermine the very strong accountability mechanisms and independence of the existing PRA Board.

Q250 Mr Baker: But you would accept that the institutions are set up in such a way that they strongly depend on the Governor's capacity to act independently in different contexts.

Dr Carney: "Strongly depend" is too strong. If the Governor were to not act in that way, the institution would be less effective. If you have an ineffective chair, the board or the committee is less effective than it otherwise would be. It would become quite apparent very quickly to the public and certainly to Parliament if that were the case, given the accountability mechanisms that we have. I will give you an example. The FPC under statute is encouraged to take decisions by consensus but is not required to take decisions by consensus. In the situation that you are depicting, one would see that come out through the FPC record. I am not for a moment saying that the absence of consensus is an indication of *war*[12.27.29]. Some of these issues are quite complex, but—

Q251 Mr Baker: To touch on an issue that I know I have raised before with you but is relevant to this conversation, quite often when you appear before the Committee with colleagues, who are typically external members of the MPC, it is quite an effort for us to draw in those external members because you are such a dominant presence within the conversation and the spectrum of debate. Are you satisfied that you

receive adequate, robust challenge so that we can feel confident that the whole institutions are not exclusively dependent on your own thought?

Dr Carney: The first thing is whenever I and colleagues appear before the Committee we answer questions that we are asked. Most of the time when I appear before this Committee I am asked the majority of the questions. That is the reality. We are very much directed by you. That is not always the case. The last time I appeared there was a more equal distribution of questions asked. This is not a roundtable seminar where we just chip in; we are guided by your questioning.

Am I satisfied in terms of the discussions—let us take the MPC, for example—that there is a wide range of views robustly held and publicly argued? Absolutely. Just look at the public record in the last couple of weeks. That is very clear and that is very healthy. It is also the case that on the big decisions—any decisions, but especially the big decisions—that we have taken as the FPC, whether it is the decisions around housing, the design of the leverage ratio or upcoming decisions we need to take around the role of capital structure, those decisions are the product of quite robust discussion and different points of view, and they are true consensus decisions. In other words, they are not some pre-cooked idea that we have; it is a process and the process is better for it.

My last point, if I may, which is outside of this, is that is the reason for the moment why the FSB is effective: because different points of view are being taken into a true consensus decision, which ultimately then gets implemented.

Q252 Mr Baker: When Bradley Fried appeared before the Committee in his capacity as a member of Court, he assured us that the Court was there to clamp down on groupthink. Do you think the Court has gone about that? Has it accepted that it needs to do it and has it taken action, or has that not been an issue?

Dr Carney: I think they accept the issue. They accept that this has been an issue in the past. This is also an issue—and I am glad you are raising it—that is a perception-versus-reality issue. The perception about the continuance of groupthink is something that should be raised and we are responsible to answer it. As you are no doubt aware, a member of Court will attend every meeting of each of the policy committees. That is not just the big meeting where the final decision is being made, but all the preparatory meetings, from meetings where there are 100 people in the room for the first rounds of the slides through the various discussions on up. They have seen the entire policy process; they will have seen the discussions, they will have seen where there are differences and they will see the final fusion. That puts them in a position in order to make these judgments. It is for them to provide those judgments directly to you. That is the first point.

The second point is that the Chair of Court, as you would expect of the chair of a board, goes through an annual process of debriefing the external members of the various policy committees and boards as a cross-check to the day-to-day oversight responsibility. I will add that quite frequently the Chair of Court as well attends these policy meetings to inform his own judgment. You have met him. None of our external members of Court suffer from groupthink. All of them form their own judgments and they are all answerable to you.

Q253 Mr Baker: Could you conceive of circumstances within which, as a result of that process of review, the Court or the Chairman of Court felt it was necessary to, say, curb a Governor's authority or intervene in the conduct of meetings in order to ensure that there was sufficiently diverse conversation in other circumstances with other characters?

Dr Carney: Certainly on the latter. Could I conceive of circumstances? The point is that there could be circumstances. It is a mechanism that exists and therefore, if appropriate, they would provide that feedback. I am drifting into legal questions, but I am not sure that Court can curb the authority of the Governor; the Governor's authorities are given in statute.

I will put another point to it. We have implemented in the last two years—it was formally up last year; we are just completing the process now in our second year—a proper 360-degree review process. Every individual in the institution, including myself, is subject to a 360-degree review. In my case, that goes to Chair of Court. He will, as last year, sit down and say, “Here are the results. Here is where you come out on the spectrum. Here is what is bad; here is what is good. Let us focus on the issues to work on.” That supplements those more formal mechanisms, but appropriately so. If I may, the types of behaviour you are describing—this promoting groupthink—would be the types of things that would come out in those processes.

Q254 Mr Baker: The PRC can meet at any time. How often would you expect it to meet on a regular basis?

Dr Carney: We meet on average probably every two and a half weeks.

Q255 Mr Baker: Categorically the content of these meetings can be different to, say, the MPC, can it not?

Dr Carney: It is entirely different.

Q256 Mr Baker: Does this mean that there are implications for the structure of meetings and the role of the external members as they will be?

Dr Carney: Yes. An average PRA meeting will have mid-teens numbers of items on the agenda. I will come back to the PRA. The MPC has one item on the agenda, which is effectively where we should set monetary policy. There are a bunch of different mechanisms to make that decision. The PRA will have, as I say, mid-teens numbers on the agenda, some for information, preparing for future decisions, but seven or eight decisions and maybe more, depending on the time of year and the cycle. The preparation process for PRA Board meetings is quite intense, for external directors as well as ourselves. I find that the external directors in general will do additional due diligence in advance of the meetings. For example, they will sample from time to time the internal decisions of the Bank. There is a process, for example, called a PSM, which is the annual review for a financial institution that we supervise. If it is a major institution, the

supervisory decisions will come to the PRA Board. Quite often, external board members will have attended the internal discussion as observers, as a way to further familiarise themselves. I have never attended one of those internal discussions. I use that as an example in terms of the preparation.

Q257 Mr Baker: Is the consequence of these meetings being categorically different not that the level of public scrutiny that is possible is also categorically different?

Dr Carney: It is easier to judge MPC outcomes than it is to judge PRA outcomes. That is part of the reason, to go back to the earlier discussion, why I think we could do a better job—and we are in the process of trying to do this—of articulating our risk tolerance so we can judge ourselves and be publicly judged against that.

Q258 Mr Baker: If you are not able to attend the meetings, the chair would be taken by the Deputy Governor for Financial Stability or the Deputy Governor for Markets and Banking. Why not the Deputy Governor for Prudential Regulation?

Dr Carney: Because that provides a separation between a decision in which the Deputy Governor for PRA may have participated. It is an independence point.

Q259 Mr Baker: Why does that principle apply to that particular Deputy Governor but perhaps not to you?

Dr Carney: Because I would not have participated in any of the decisions.

Q260 Mr Baker: You are governing the whole Bank but you are participating in decisions on a range of committees, each of which you chair.

Dr Carney: I chair those committees when the decision is taken. I have not taken a decision prior or participated in the preparation of a decision prior in any differential way than any other committee member. I can assure you, Mr Baker, I do not have time to do that, because I am always chairing another committee.

Q261 Mr Baker: My final question is: are you satisfied that the externals will have sufficient capacity to ensure that the organisation remains independent?

Dr Carney: Yes. It is useful to have the attestation, if you will, on independence, and the process of the resources. We will have the accounts of the PRA and that allows a judgment in terms of adequacy of the resources, but it also frees them from the time that is spent as a director of a company board. Just to put it in context, about a fifth of our time as directors of the PRA is spent in conventional—on the board of a company that spends £300 million. We have a Court that is perfectly capable of discharging those responsibilities, and that is a fifth of our time, most of which—not all of it, because we still have to make those attestations at the end of the year—we could spend on judgment-led supervision.

Chair: Just to be clear, the externals on the PRA Board and the PRC will need to be reminded, perhaps, from time to time by this Committee and we will be expecting them to monitor that independence and provide evidence to us on it. We will be on that case before long.

Q262 Helen Goodman: I would just like to come back to the accountability point, please, Governor. The NAO will, as a matter of course, do a value for money inquiry into the sale of the RBS shares, not because you were involved but because they examine all the share sales. One of the things the Treasury relied on when justifying the sale of the RBS shares, which arguably means a loss of £7.5 billion to the taxpayer, which is a substantial sum, was a letter from you saying that this “would promote financial stability, a more competitive banking sector, and the interests of the wider economy”. Would you say that writing that letter was you acting with a policy hat on or with an operational hat on?

Dr Carney: It is a policy judgment. I was asked as Governor by the Chancellor for a judgment with respect to the potential sale of RBS shares, as you know, and the terms of the question are outlined in the letter. It was asked as Governor; it was not a question of the FPC or the PRA Board. It was not a question in terms of safety and soundness but in terms of the overall impact. I consulted with the Deputy Governor for Prudential Regulation and the CEO of the PRA, Mr Bailey, and did analysis in the team. The judgment was a broader question, which is whether continued Government ownership would promote financial stability in the fullness of time relative to returning a proportion of that ownership to the public domain, whether it was in the interests of financial stability that there would be a perception of a public sector backstop to an entity that was competing in the private sector—a public sector backstop that may not have been there if it were called upon—or whether it was better now that the institution had been stabilised to continue to move to a level-playing-field private ownership that would include bail-inable debt so that private sector bondholders would be the backstop of the institution, not the British taxpayer. As I made clear in the letter and as you would expect, it was not a judgment about precise timing of the sale and it was not a judgment about questions of valuation.

Q263 Helen Goodman: Thank you. You have given a very full answer, but we have not seen the team’s analysis. How would you feel if the Freedom of Information Act applied to the Bank of England so that people could just request this and have the information rather than relying on the alertness or lack of alertness of members of the Treasury Select Committee, which is a very thin, ropey and inadequate net?

Dr Carney: I was going to take the other side of that characterisation. As you would expect, as the supervisor of all major financial institutions, including RBS, there is regular analysis of their safety and soundness. Included in that is their capital position and their corporate strategy. They were one of eight institutions that were subject to a stringent stress test for whom we published the results of those stress tests, and it was a stress test that catalysed a private-capital-raising plan for RBS, which they have followed. That was all disclosed publicly. The analysis rested on the supervisory judgments, the input of the stress test and then the broader perspective of an institution that had been stabilised, was in public hands and, as long as it was in public hands, would be incapable of being put in a

position so that private capital bore losses, which is our objective across all major financial institutions in the United Kingdom.

In terms of the Freedom of Information Act and the ability to have FoI for specific information about a specific institution that competes, I fully understand the reasons why Parliament has chosen to give the protections it has, because this is commercial information about an institution that would be necessary—

Q264 Helen Goodman: I am not suggesting that we should have the FoI going into the assessment of the commercially confidential information relating to RBS, but I am putting it to you it would be reasonable that when you are writing letters advising the Chancellor of your view on a policy matter the analysis on which you are basing that should be in the public domain.

Dr Carney: I am afraid that the overlap between the commercially confidential information that we obtain as part of the discharge of our supervisory responsibilities of the PRA and the analytic is perfect. There is the logic of the financial stability, as you would expect. This is information about a single institution: the questions of the capital position of that institution; their strategy, much of which is confidential; the appropriateness; and the judgments that are made around that. It is cross-checked by a stress-testing process, which we conducted last year and published the results of in December of last year, and then put into the broader context of the reasons why RBS was originally taken into the public domain and to what extent—it is all outlined, as you can see, in the letter in front of you—those still pertain. Is it in the interests to have a public sector bank that has by that point been stabilised competing with banks in the private sector, and a public sector bank that by definition would rely on the public sector—the taxpayer—in the future if it had difficulties in the future, if the act, from a financial stability perspective, of not returning a globally systemic bank to the private sector would prevent the build-up of the capital necessary to ensure that the private sector truly bears the losses of that institution if it were to get into difficulty in the future? That is in the public domain.

Chair: Have one last quick go, Helen.

Q265 Helen Goodman: I just would put it to you, Governor, that we have £7.5 billion of taxpayers' money at risk. It might not be as much as that, but it might be as much as that. Do you not feel a little bit uneasy about saying that the justification for your advice should not be straightforwardly in the public domain?

Dr Carney: There is a basic justification of whether or not RBS, given its current capital structure and its business strategy, meets the so-called threshold conditions of the PRA—whether it has enough capital for what it is doing today and what it intends to do tomorrow, and whether it has a capital plan that is consistent with that. We make that judgment, effectively, on a daily basis. We review it periodically. Most proximate to the time of that letter, we had conducted a stress test of the eight major financial institutions, including RBS. We publicly disclosed that information. There was a capital plan associated with that. What is relevant is that judgment as a starting point. The next point is whether or not it is in the interests of financial stability for the Government to own RBS

in perpetuity. My judgement is “no” from a financial stability perspective, because it does not bring that institution into a position where private capital could truly shoulder losses and private capital therefore would discipline the management of that institution, as it would other private institutions with whom it competes. Those judgments, from the narrow perspective of financial stability in RBS and financial stability, suggest a return to private ownership. I was very clear in the letter, as you would expect, the timing of that and the valuation implications of that for the taxpayer are entirely decisions for the Government.

Q266 Chair: Governor, since we have strayed a little, I wonder whether we might just end by asking why you briefed the press and, indeed, why you are going to take this moment—which is on Thursday—to intervene in the Brexit debate. Can you tell us what Operation Bookend was really all about?

Dr Carney: Two things. We did not brief the press. Any time we make—

Q267 Chair: So this was a leak.

Dr Carney: What are you pointing to?

Q268 Chair: I have an article written by Chris Giles of the *Financial Times* saying in the first line: “Mark Carney is to make a dramatic intervention in the Brexit debate”. I do not believe everything I read—

Helen Goodman: Now, perhaps.

Chair: But I did note that headline and it crossed my mind I might ask you about it.

Dr Carney: Whenever a member of a policy committee makes a speech, we put out a press notice a few days in advance. This is important because it goes back to some events of the past. If we are producing a document—it could be about insurance or it could be, in this case, about Brexit—

Q269 Chair: Why have you chosen this moment to intervene?

Dr Carney: I will just finish, if I may. We offer journalists an opportunity to come into the deep vaults of the Bank of England—it literally is in the deep vaults of the Bank of England—and have a lock-in until the time that document is released to avoid any market-sensitive information—

Q270 Chair: I am not suggesting there was any commercially confidential information in your views on Brexit, but it was a nice digression and I am sure it is helpful we were all reminded of something you have told us on several occasions.

Dr Carney: That is the sum total of what allows somebody to write an article to that effect.

Q271 Chair: What I wanted to know was why you had decided to intervene in the Brexit debate just now.

Dr Carney: There is no precise timing for it. We had signalled—and we had this discussion—that given the Queen’s Speech and the intention to have an in-out referendum we would look at matters around this. We made the commitment that we would publish this analysis when it was completed. We have done the analysis. It is complete. We will release it, and we are open to discussions. I will be clear, though, just to calm the adjectives around this—“drama”, etc.—the analysis concerns the implications of EU membership on the ability of the Bank of England to discharge its statutory responsibilities: monetary stability and financial stability, promoting sound institutions and facilitating effective competition. It is a bit of a yawner.

Chair: Good. Thank you very much for giving evidence to us—it is now this afternoon. Both your session and Andrew Bailey’s before it have been extremely interesting. We are grateful to the Bank and it helps us form views on the legislation that is now before Parliament.