



Treasury Committee

Oral evidence: [Reappointment hearing of Dame Clara Furse and Richard Sharp](#), HC 895

Wednesday 9 March 2016

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

Questions 1-79

Examination of Witnesses

Witness: **Dame Clara Furse DBE**, External Member, Financial Policy Committee, Bank of England, gave evidence.

Q1 Chair: Thank you very much for coming in. We have asked you a set of questions and you have kindly answered. One of the questions was about the main risk to financial stability. You have listed several, among them the fragility of market-based finance, the level of corporate gearing and the difficulty that businesses are having obtaining capital. There is no mention there of Brexit. Why not?

Dame Clara Furse: I was framing my answer in the context of the committee's day-to-day work, and clearly there are domestic risks.

Q2 Chair: I have not really understood. Is it not the day-to-day work of the committee to look ahead to try to identify domestic risks?

Dame Clara Furse: Yes, so political risk is not what I would call a day-to-day risk.

Q3 Chair: I am afraid I do not really follow that either. I would have thought political risk would be very high on a list of things that might cause financial instability.

Dame Clara Furse: I agree.

Q4 Chair: Did the Governor not suggest yesterday that the sterling market may have moved partly in consequence of a bit of political risk introduced by Boris Johnson?

Dame Clara Furse: I am not saying that political risk is not a risk. Clearly it is. I am trying to explain that I was framing my answer to that question in the context of our day-to-day work. Obviously there is political risk; last year we had significant political risk around the Scottish referendum. This year obviously we have got an EU referendum. When we look at domestic risks, the uncertainty around an EU referendum vote that might take us out of the EU is clearly a domestic risk.

Q5 Chair: But not one in your list. It does not even make the grade, does it? It does not even come in fifth.

Dame Clara Furse: I clearly should have thought more carefully about my written answer.

Mr Baker: Is it okay for Brexit not to be a risk?

Q6 Chair: Hang on—you will come in in a minute. Your view is that basically if you had your time again you would write this slightly differently.

Dame Clara Furse: No, I am not saying that. I am saying that obviously the committee is trying to assess future risks. Political risk is obviously part of that, but political risk is not constant. It is occasional. When I framed my answer, I framed it in the context of what I think of as our day-to-day risks. I am sorry to keep repeating myself.

Q7 Chair: I have to admit I am as confused as I was when I started. Could you possibly have another go at answering the first question that I asked? Why did you not include Brexit among your list of domestic risks to financial stability?

Dame Clara Furse: My context for thinking about the answer was a different one. That is not to say I do not think it is a risk.

Q8 Chair: Could you explain what the context was, and what the context might now be? I am sorry to persist with this, but it did form a large part of our hearing yesterday, and we do need to get to the bottom of this.

Dame Clara Furse: If the question I am being asked is, “Do you believe it is a domestic risk?” the answer is, “Yes, it is a risk that the FPC needs to look at because of the uncertainty around a potential change of our relationship with the EU”.

Q9 Chair: In which case, why was this not in your answer? There was an omission. I am only trying to help with suggestions, but we do need an answer.

Dame Clara Furse: I shall think more carefully next time I put in a written submission.

Q10 Chair: Has your view been influenced by the fact the Governor of the Bank has given a view?

Dame Clara Furse: No, it has not. It is clearly true that any significant uncertainty is likely to create disruption, and that disruption creates risks. It also creates opportunities, but it creates risks. In the short term, that seems to be the case.

Q11 Chair: I just want clarity on a much narrower point. I think you have given me the answer. Would you have written exactly the same list had you heard the Governor's evidence before you wrote it?

Dame Clara Furse: Yes.

Q12 Chair: The reason I ask that is one of this Committee's concerns is that the FPC is operating by consensus and there may not be enough independence of mind. This is certainly going on in the way that it operates, and the fact that it does not publish proper minutes but only summaries does not assist us in forming a view about whether our concerns are warranted. Do you have anything you could put on the record for us now that can demonstrate independence of mind on your part?

Dame Clara Furse: I would say, and I think I have said this in my answer to the question in the questionnaire, that there is a consensus-building process. In my view, that is not easy, and I have had to consider my position on certain issues throughout that process. However, it is important we achieve consensus, because a predictable environment is one in which business investment is more likely.

Q13 Chair: That is an interesting answer, but it is not the question that I was asking, which is whether you can show us evidence of independence of mind.

Dame Clara Furse: We have had a number of very robust discussions on certainly all of the main issues. In December we had a long discussion about whether or not we should trigger the CCyB, the countercyclical buffer. That discussion was slightly complicated by the fact we wanted to ensure there was no overlap between anything we might do and something that the PRA had already done in response to stress tests. It appears that the PRA has already ensured some provision against cyclical risks. We are just beginning to see the PRA come back with their findings on what that means for a potential future decision on whether we trigger the CCyB. I was in a position where I felt very uncomfortable about potentially triggering the CCyB. I felt there were not enough signs of momentum in credit growth and in the financial cycle to suggest an upswing in credit growth that might worry us.

Q14 Chair: You were agreeing with the mainstream position in saying that, were you not?

Dame Clara Furse: No, I certainly was not.

Q15 Chair: You were in a minority?

Dame Clara Furse: Yes, I was in a minority.

Q16 Chair: Was it a small minority?

Dame Clara Furse: Yes, a very small minority.

Q17 Chair: Therefore, this is a good piece of evidence of independence. Do correct me if I am getting this wrong: you stood out against early implementation of the CCyB.

Dame Clara Furse: I stood out against the decision in December to increase the CCyB. Obviously as time goes on we will have more evidence about the rate of credit growth and pockets of risk in the domestic economy that might change my perspective. Certainly at that point I would have been extremely uncomfortable.

Chair: That is very helpful evidence. Thank you very much.

Q18 Wes Streeting: On a similar theme of questioning, the Monetary Policy Committee has been criticised for groupthink, and there has been criticism that there is very little dissension from the Bank view in terms of the airing of issues at MPC meetings. Would it be fair to accuse the FPC of something similar? You have given an example where there was a clear difference of views and you found yourself in a minority. I am wondering to what extent there are regular disagreements, or whether that was a one-off.

Dame Clara Furse: I would say we have pretty intense discussions about just about everything that matters. When we were looking at the macroeconomic costs of the capital framework that we made public in December, we certainly had a discussion around the assumptions behind the number that took us to an optimal level of 11%. I believe that the transitional costs associated with relatively high levels of capital are greater than some of my colleagues thought. That was a part of the discussion that we had. I think we landed in the right place. Therefore, I am happy to be part of the consensus and I am happy to respect the consensus. We did a lot of work together there.

Q19 Wes Streeting: Let me frame the question in a different way. Are your colleagues guilty of groupthink and you happen to find yourself outside of the consensus on a number of occasions? Alternatively, is it the case that there are times when you disagree with the consensus view but there are similarly occasions when other members would find themselves in a similar position to the one you found yourself in?

Dame Clara Furse: There is a range of views on the committee, and that is a very healthy thing. The Governor does invite us to contribute, and we do.

Q20 Wes Streeting: How close does the committee come to having a vote to reach a decision?

Dame Clara Furse: That might have been a possibility in December, regarding the CCyB.

Q21 Wes Streeting: Thinking about the membership of the committee, do the independent members of the committee demonstrate noticeably different views from one another and the committee as a whole?

Dame Clara Furse: Yes, definitely. We all have quite different views.

Q22 Wes Streeting: There was the December example, but generally speaking it is fair to characterise from your answers so far that the FPC achieves regular consensus on issues. Do you think, from this Committee's point of view, we should be pressing the Bank to draw more widely in terms of its membership and to look for differing views? Is it the case that there is so much consensus that the committee could do with an injection of some radical or different thinking and different perspectives?

Dame Clara Furse: There is a balance between the independent members of the committee and the executive members of the committee. The key is obviously to ensure there is a wide range of views and experience among the independent or external members.

Q23 Wes Streeting: The *FT* described the FPC as a more secretive body than the MPC, in that it does not publish full minutes of its meetings but only a record. Is that an accurate description?

Dame Clara Furse: No, I would not say that we are secretive. We try very hard to produce a flavour of the discussions that we have before we reach the decisions that we reach. Obviously we are able to redact certain discussions and certain elements where we think that might undermine financial stability. We have to be free to have discussions about events that might be disruptive if they were in the public domain. However, obviously the process ensures that we have to review those on a regular basis and put them into the public domain. That is what we do.

Q24 Wes Streeting: Do you not think it would be in the broader public interest for full minutes of these meetings to be produced and published?

Dame Clara Furse: It depends what one means by full minutes. The minutes do reflect what happens at the policy meetings and do a good job of reflecting that.

Q25 Wes Streeting: Is there not a distinction between the approach that the MPC takes and the approach that the FPC takes? When we look at records of your discussions, we will perhaps only get an overview.

Dame Clara Furse: We have quite different discussions. They have a relatively narrow remit and ours is very broad. We are examining future potential risks, which is quite different from what the MPC do.

Q26 Wes Streeting: As an independent member, would the publishing of more accurate minutes of these meetings prevent you or any of your colleagues from expressing a full and frank exchange of views? Would it make you more reserved in putting forward concerns or differences of opinion?

Dame Clara Furse: If we had a blow-by-blow account of every single issue that was raised and every single point that was made, that would not necessarily be helpful. I agree with the recommendations of the Warsh review on this—that we should have the freedom to have open and robust discussions on potential risks that might be destabilising if we communicated those publicly.

Wes Streeting: We should think of similar approaches for PLP and 1922 meetings, should we not, Chairman? I think my questions are done.

Q27 Chair: From what I can see, 1922 Committee meetings seem to take place in the public domain anyway, but I do not know about the PLP. I have one more question following up on what Wes said. You said that the records, and they are called records not minutes, were very full. You used “minutes” to describe them—twice, I think. You said that these records are very full. Of course, as a Committee we understand that there will be commercial information that cannot be divulged, and on occasion there will also be things you would want to avoid having in the public domain, for fear that it might trigger what you are trying to avoid. You may be looking at something that has not been given much prominence in the markets yet and which you are trying to forestall. Beyond that, what possible reason is there for not publishing minutes fully, in real time?

Dame Clara Furse: It is a record of what we discuss and the decisions that we reach in our policy meetings.

Q28 Chair: That is the question I just asked you. I am asking you, if that is correct, why do we not just publish full minutes, call them minutes and operate them in the normal way, with the two riders I have just given you?

Dame Clara Furse: I do not think it would be constructive to produce a blow-by-blow account of every conversation within a policy meeting.

Q29 Chair: Even the MPC minutes do not provide that. I am trying to get to the heart of the issue. You say that it would not be constructive, and obviously we do not want to encourage you to do something destructive, but I want to know what it is about lifting the veil that would be so destructive.

Dame Clara Furse: The point about financial stability is to try to create an environment in which we can improve the potential for economic growth. That is not assisted by discussions about future potential risks that might not materialise. We are trying to be

predictable and build confidence in a way that will underpin economic resilience and the potential for growth. We achieve that through the way in which we manage the record.

Chair: I am very confident I understand that last point. I am still unclear as to why, but I am going to give up and move on.

Q30 Helen Goodman: Good afternoon, Dame Clara. Thank you for coming. In your speech in February you wrote quite a lot about lessons from history. You chose two particularly benign examples, in Venice and Holland. I wonder whether the way London and the British economy are developing at the moment is rather more like 17th century Spain. There is a lot of investment in assets and less in productive capital. Do you not think that is part of the reason we are seeing the opening up in our productivity gap?

Dame Clara Furse: I agree there is not enough productive investment taking place. I would like to see more credit growth in the corporate sector generally, which is one of the points that I made in the questionnaire. It is something that I worry about and that is on our agenda. Coming out of the crisis, we have been through a process of repair, which means that credit growth is only just beginning to pick up. If it continues to pick up, which I hope it will, we should have more productive investment.

In relation to asset investment, we have had reasonably good markets until fairly recently, when we have seen some pretty major corrections. If one looks at asset valuations, it is difficult to conclude that they are overvalued, particularly if you take into account the level of rates today.

Helen Goodman: Which rates are you talking about?

Dame Clara Furse: Interest rates.

Q31 Helen Goodman: Do you not think it is significant that UBS say we are in a housing bubble and that the FPC has had to make recommendations for controls on domestic housing finance? This has pushed the Chancellor into taking fiscal action. Do you think that whole housing bubble issue is sorted out now, absolutely fine and not to be worried about?

Dame Clara Furse: When I think about productive investment, I think about investment in equities. My comments were about equity markets in particular. In relation to the housing market, it is clear we have had some very strong growth in house prices, but that is tailing off a bit. A lot of that is focused on London and the regions around London. This is why one of the recommendations that we made last year was to ensure there is a flow limit on high LTI mortgages. We are very aware of what is happening in the housing market and very sensitive to that.

Q32 Helen Goodman: I had the same kind of concept in mind for productive investment, just to clarify that. You also say in that speech: “We would lose the benefits of agglomeration and there must be a risk that decentralisation would induce a destructive trend to deep fragmentation”. Do you think that the

Government's encouragement of fintech might be the source of our own destruction, in that that might encourage this process of decentralisation?

Dame Clara Furse: I really do not want to speculate on that. Fintech does have the potential to make processes significantly more efficient, certainly banking processes, and that must be a good thing. Anything that improves efficiency, reduces cost and improves reliability of service must be a good thing. Obviously there are lots of aspects to fintech and lots of potential avenues for growth, but clearly there are changes afoot. One of them, which is the point I try to raise in my speech, is that the concept of centralisation and what a hub might look like is changing and could change. That is an opportunity as well as a risk to London.

Q33 Helen Goodman: What sort risk do you think it is? Why is it a risk to financial stability? You could say it is an economic risk because we will lose jobs to Frankfurt or Dublin or whatever, but why do you think it is a risk to financial stability in particular?

Dame Clara Furse: If you look at historical trends, it is clear that financial deepening and financial integration have not only improved resilience but underpinned the potential for growth across the world. Clearly any move away from that or any fragmentation would risk reversing that process.

Q34 Helen Goodman: I am going to flip back to the questions that the Chairman was asking. This is regarding what you described as the political risk of Brexit and whether you have looked at whether Brexit might hasten the loss of financial institutions from London and the implications of that.

Dame Clara Furse: I quite specifically did not write my speech with an eye to the EU referendum.

Helen Goodman: That is fine, but I am asking you what you think today.

Dame Clara Furse: I do not know what would happen. As I say there are risks around any major change but there are also opportunities. Obviously I cannot speak for the strategic plans of firms that are currently involved in business in the City of London. It must be clear that, if you can run a business more efficiently because you are in a hub to which you can draw the talent pool that you need, that is likely to produce a better quality of service at a lower price. That is a general concept that I think is pretty uncontroversial.

Helen Goodman: I think it is. Thank you.

Q35 Chris Philp: I have some very brief questions, because I have to go to a report stage of a Bill in a moment. Dame Clara, welcome. You mentioned you are keen to see more credit growth, which is something I agree with entirely. Do you think raising the tier 1 equity requirement for the banks over the last four or five years has helped or hindered that?

Dame Clara Furse: In theory it should definitely help that. The whole point of improving resilience in the core banking sector is that the core banking sector then gets to

a point where it lends more freely and comfortably. Clearly we are still in a transition, and that transition has probably taken a bit longer than we would have liked. However, we are beginning to see credit growth increasing.

Q36 Chris Philp: Sorry to interrupt; I need to leave quite soon. Would you agree that further increases, an increase or the introduction of the countercyclical credit buffer carries with it a risk of choking off that very nascent credit growth we are seeing?

Dame Clara Furse: That is a possibility, which was why I was uncomfortable about any decision to increase the CCyB at our meeting in December. I would like to see further evidence of sustained credit growth, in particular in relation to the corporate sector and the SME sector.

Q37 Chris Philp: I completely agree with your views on that point. My colleague Helen Goodman mentioned the potentially quite highly valued property market. There has been a growth in buy-to-let lending recently. It is now a higher proportion of mortgage originations than it ever has been before. Do you believe the Government should give the Bank of England powers of direction over buy-to-let lending, as it currently has over owner-occupier lending?

Dame Clara Furse: Yes, we have requested that. We should have it. The point about powers of direction is obviously that you get greater transparency, you consult and it tends to suggest that the decision or the direction is reviewed at some point.

Q38 Chris Philp: I believe there is a consultation currently under way. Finally, were such powers to be granted by the Government, would you be in favour of using those powers to impose perhaps slightly higher lending standards and restraints on the buy-to-let mortgage sector, rather as we did with owner-occupier mortgages a couple of years ago?

Dame Clara Furse: We are obviously looking at the evidence. There is a period of change taking place right now, because there is lots of activity this quarter in the run-up to the tax changes. We need to see how they play out before we make any decision. It is something that we are monitoring quite closely, as we said.

Q39 Chris Philp: That will be towards the backend of the calendar year, as it will take a quarter or two for the changes to filter through.

Dame Clara Furse: I do not want to run ahead of the committee on a timeline or anything else. I am just saying that we clearly have a lot of change taking place in this market. It is something that we are looking at because the rates of growth are quite high. However, I would feel more comfortable if we could see how those tax changes impact the market before we act, which we may or may not do.

Chris Philp: Thank you, Dame Clara. Chairman, forgive me for leaving. I am keen to get to the report stage of the Enterprise Bill.

Chair: That is all right.

Q40 Mr Baker: I will just try to reconcile some of the things that you have said. I am sorry to return to this point about Brexit. If it is the biggest domestic risk to financial stability, is it not extraordinary that it was missing from your submission?

Dame Clara Furse: I have tried to explain it. I can repeat myself if you like, and obviously my answer is inadequate, for which I apologise. I do not think one can get away from the fact that something that creates uncertainty is bound to create risk. If you look at the other domestic risks, first, we are looking at an increase in commercial property prices. Most of that is now equity funded; these are overseas investors, and so this is not a risk to the UK banking sector. Secondly, we have the current account deficit, which improved quite markedly in December to 3.7%, which might even be considered a sustainable level for the current account deficit. Finally, we have household debt, and household debt remains relatively subdued. Debt service ratios are actually declining. In that context it is clear that something that is likely to create a lot of uncertainty is going to be a risk.

Q41 Mr Baker: I am just trying to concentrate on the operation of the committee. It is about 17 years since I was professionally employed to do risk management on aero engines. I understood the likelihood and severity of any particular problem, and I can remember now what the top risk was on the Adour gas turbine and the engine fitted to the Harrier, which I cannot remember the name of. I could easily remember what the top risks were, and I am just a bit surprised that you and the Governor would not come up with the same answer at the same time, when you are both managing risks to financial stability. What is it about the operation of the committee that has made it possible for the two of you to give quite different answers regarding financial stability risks?

Dame Clara Furse: I do not think it is a comment on the operation of the committee. I was answering questions and, as I tried to explain earlier, my frame for doing that was what I think of as the day-to-day, bread-and-butter work of the committee, rather than occasional political risks.

Q42 Mr Baker: I will pick on that thought. Bearing in mind I have sat here and watched the Governor search his mind for perhaps the right words to use, knowing that it would be headlines, it feels as if as a committee you have not given a great deal of thought to what the risks are from a potential Brexit vote. The Governor had to choose his words very carefully and you did not write anything about it. Even today it feels like it is more of a search for consensus than a really serious risk that has been occupying a great deal of your time.

Dame Clara Furse: I do not think that is right. We obviously have discussed it. We had a briefing last week. We had some time on the document that the Bank produced in relation to the EU referendum a few months ago. Therefore, that is not right.

Q43 Mr Baker: Do you agree with what the Governor also said yesterday, which is that the global risks to financial stability are greater than the risk from Brexit?

Dame Clara Furse: The external risks are increasing. That is quite clear. Geopolitical risks and risks relating to global growth are increasing. Both the IMF and the Bank have reduced their forecasts for growth from emerging markets. We can see that the financial outflows from China have been great and continue to increase. There are obviously issues around currency, not just the Chinese renminbi but other currency factors influencing the global economy. Yes, that is a very big risk.

Q44 Mr Baker: In your speech on capital markets in February, you made three points: first, that increased use of the capital markets might help move businesses away from their reliance on banks; and secondly, that investment banks play a vital role in maintaining liquidity in these markets by acting as market makers. Yet, you also said investment banks have moved away from these low margin areas as a result of higher capital requirements. Could you explain what your direction of travel is with those three points? It feels like perhaps you are advocating the Bank of England becoming a market maker. I would just like to understand what your thinking is in this direction.

Dame Clara Furse: Certainly not. Obviously the Bank can be the market maker of last resort, but we would not want to go there, for very obvious reasons. That is certainly not what I am advocating. I was advocating then—this was a year ago—that we had to pay attention to the fact that market fragility was an issue, was increasing, and that has in fact happened. We see that markets are becoming less liquid and that repo markets in particular are under pressure. That obviously has an impact on the functioning of not just government bond markets but importantly corporate bond markets, which are priced off government bond markets.

In our response to the remit letter from the Chancellor last summer, we did say that we would look at the cumulative effect of regulatory initiatives on market liquidity in particular. The Bank is doing that now.

Q45 Mr Baker: Given the range and scope of questions that we end up putting to all of you, and in particular to the Governor, that seems to imply a very large role for the Bank of England. Could you explain some of those obvious reasons why you would not want the Bank of England to be a market maker as a matter of course, just for the record?

Dame Clara Furse: As I said the Bank can be a market maker of last resort, if it needs to be. Clearly we would want the market to function well. Asset managers need to be able to adjust their portfolios in an orderly market. Corporates need to be able to raise new issues at different tenors and in a variety of markets. We also need to ensure that we reduce the risk and interconnectedness of the banks. It is making those three things work in a wholesome way that is the challenge.

We have seen a very urgent move towards a significant change in the regulatory framework. That has some transitional costs attached, and they seem to be playing out in markets. We

are examining what is happening and whether there have been perhaps some unintended consequences of regulation in markets. Having said all of that, we should recognise the fact that the core banking system is much more resilient. We have had two very extreme stress tests that have underlined that.

Q46 Mr Baker: Let us not get on to the stress tests again today. I hope you will forgive me for putting it in these terms, but I am trying to lift some of those wallpaper words like “clearly” and “obviously”. I understand you to have said that you do not want the Bank of England steering markets. You want markets to function; is that correct?

Dame Clara Furse: Yes.

Q47 Mr Baker: That implies it is a bad thing for the Bank of England to unduly direct markets.

Dame Clara Furse: It is a last resort event, which we would obviously want to avoid.

Q48 Mr Baker: What are the long-term real effects of sustained easy-money policies such as we have not only in the UK but around the world?

Dame Clara Furse: I do not know what you are referring to. Did you say “real money”?

Chair: We will read it afterwards.

Q49 Mr Baker: My view, which I have been absolutely clear about throughout my time in Parliament, is that the greatest risk to our economy and particularly to financial stability is easy money—artificially suppressed credit rates. What is your view? I have some literature here, which I am not going to read into the record, given the Chairman’s entreaty, but it is from Hayek and implies very much the same. I am concerned about the framework through which the committee approaches questions such as Helen Goodman’s about credit growth and productive investment. I do not think the committee even uses a framework that allows you to consider the long-term real effects of credit growth and sustained easy-money policies on the real economy and what it means for financial stability in addition to the real economy and real jobs. I am trying to tease out why you think more credit growth implies more productive investment rather than higher asset prices and inflated housing prices, which people increasingly cannot afford.

Dame Clara Furse: I do not think money is easy. Interest rates are low but that does not mean we have easy money. We do have an increase in the availability of credit but from a very low base. Credit growth in aggregate is only running at about 2% above the previous year, which is hardly ringing alarm bells. Having said all of that, a low-interest-rate environment does carry risks, and macroprudential policy gives us the opportunity to take those risks off the table. That is precisely the sort of discussion we are having around the countercyclical buffer.

Mr Baker: I will yield to another colleague, Mr Chairman.

Chair: We will leave it there. Thank you very much, Dame Clara. We will go straight on, if we may, to the next evidence session with your colleague.

Examination of Witness

Witness: **Richard Sharp**, External Member, Financial Policy Committee, Bank of England, gave evidence.

Q50 Chair: Thank you very much, Mr Sharp, for coming to give evidence to us this afternoon. Can I begin with you where I left off with Dame Clara? In your case, for the same question, in the domestic area you listed government debt, the balance of payments, spillover effects from abroad and a number of things, and the local macroeconomic environment. You also mentioned a couple of other things. Again, though, Brexit did not feature in this list. Why not?

Richard Sharp: In addressing this question I considered the medium-term and longer term risks that trouble me in terms of the potential sources of financial instability for this country.

Q51 Chair: That is exactly the opposite reason from the one given by Dame Clara, which was that she was listing what she called the day-to-day work of the committee.

Richard Sharp: Yes.

Q52 Chair: It is a slightly odd situation that one of you did not list this because it was not day-to-day and the other did not list it because it is day-to-day.

Richard Sharp: I remain of the view in the longer term that it is not an issue of financial stability as far as I am concerned, one way or the other. There is clearly short-term volatility, and I distinguish that from what I regard as fundamental financial instability. The FPC was established because of the failure to assess some of the macro environment appropriately, with respect to major sources of financial instability. There are clearly issues around the Brexit situation. We have seen some of those manifest themselves in the foreign exchange market. But I do not consider them to be fundamental financial stability issues for this nation.

Q53 Chair: Do you disagree with, would you have described differently or would you have qualified in any way what the Governor told us yesterday?

Richard Sharp: The Governor said yesterday that in the short term it is a domestic issue. In fact, when you questioned him, he said that in the long term, if the issue is not resolved, we would find a way to stability one way or the other. Do I think there will be short term issues? Yes, I do. Do I think they will be reflected in markets? Yes, I do. Do I think it is a long-term financial instability issue? No, I do not.

Q54 Chair: That is helpful and a little clearer. When you submitted evidence, and again in your evidence most recently, disarmingly and self-deprecatingly you have said that you are on a steep learning curve. You have come from one very commercial environment to another public sector role. We have all noted that round this table. What have you learnt on the learning curve so far? I might prompt you with a few further questions following this, depending on what you say.

Richard Sharp: Obviously for me this is not just an issue of the central bank; it is an issue of being involved in the public sector as such, with the different level of accountability—and this meeting is part of that. I would not have normally expected this in the commercial world in quite the same way. The requirement for the record, which you touched on, for example, struck me as quite startling. A lot of time is taken up in drafting and going over every single word in the financial stability report and our announcements. Before I joined the FPC, I thought we would spend a much higher proportion of our time discussing all of the issues. However, getting the drafting, the public record and public accountability absolutely correct takes up a considerable amount of time.

Secondly, as I flagged in my comments, I have been quite disappointed about the pace with which national and supranational bodies, in seeking to co-operate, work. At one meeting I characterised it as almost like postal chess. I am more familiar and more comfortable, when there are issues to address, with people being able to get together and solve them more nimbly. As I have been exposed to the intricacies of central banks and central banking supervisory relationships, I can see why these things take so long—because of the consensus required over multiple jurisdictions with many different entities. That has also been a learning curve.

The third area, which is the most difficult, covers many of the areas I flagged three years ago to do with the intricacies of bank capital, the numerous buffers, the regulatory processes, the stress tests involved and the intricate requirements involved to make sure that the public purse is protected with respect to banking risks. This was really quite startling to me.

Q55 Chair: Do you think we could do business better in the public sector with respect to the second of the three that you listed, which was the time it takes to get a decision out of anybody? If so, have you got any specific suggestions? There is no reason you should, however.

Richard Sharp: The short answer is no. The reason I say that is because to me the leadership at the Bank of England is full of outstanding individuals. In addition we have the benefit of not just the leadership position that the Bank of England has but the Governor's position on a number of other relevant boards. I am satisfied, given the

realities of having to deal with many other institutions, we have pushed things as fast as we can.

Q56 Chair: Do you think we could do more on this transparency problem that we were discussing earlier? Perhaps we could have fuller records and something more akin to minutes, albeit with some form of redaction for the two primary sources of concern, but you might want to add to that list.

Richard Sharp: I would certainly add one other source of concern. We have to deal with tail issues, and some of those tail issues have political implications. When the Bank of England records its concern about a particular tail issue with a particular jurisdiction, country or market, we should have the freedom to really discuss and debate this—and in fact we have done so—without it then becoming a lead item in *Bloomberg* that the Bank of England is concerned about x, y and z.

Q57 Chair: I just wonder whether this concern is overdone. When I was in the Treasury in the 1980s there was tremendous amount of secrecy about the matrix by which other countries' risk was assessed. This was carried around in bundles with so many "secret" stamps and so much red ink on it that it was very difficult to read what was underneath. Finally, after a lot of toing and froing, it was decided that the matrix should be published, and it is published. The sky did not fall in as a result.

Richard Sharp: The risk is that, in some way, whatever the Bank says through the FPC gets politicised. That is not our objective. Our objective is to really address financial stability issues. As far as the FPC is concerned, I am certainly in favour of having the freedom to discuss matters. In addition, one of the things you are concerned about is the groupthink. There is more opportunity to challenge groupthink in private than there is where things can be polarised by a public dispute.

Q58 Chair: I agree. I will pose my question to you in a slightly different way. The very reason that you are saying it needs a bit of secrecy is to deliver us what we say we want, which is the avoidance of groupthink. But we want the evidence to support the view that groupthink is not a problem after all. Have you got a suggestion for tackling this paradox?

Richard Sharp: No, I do not. I do not have a solution for that. That is an issue. Unfortunately transparency can have unintended consequences.

Q59 Chair: I wonder whether it might be an idea to ask the externals on the FPC to go away and think about that issue. Perhaps you can set your own exam paper. We have just framed it in a little exchange between ourselves now. It strikes me that, as a new body, the MPC also had some teething problems and changed its rules after a few years. They did not change things a great deal, but they changed their rules and increased their transparency and the speed at which material is made public. I realise that we cannot follow the MPC route for various reasons. I am wondering if we can do something with the FPC.

Richard Sharp: There is one other actor in this situation, which is the court and the scrutiny. To my mind an independent chairman and an independent court—which does scrutinise, and the Chairman and court sit on each of our meetings—are in a position to judge the nature of the discussions to some extent on your behalf.

Chair: You know they are there because of the pressure from this Committee.

Richard Sharp: Yes, I do.

Chair: Five years ago we argued vigorously for the court to be turned into a proper board and we were met with a wall of resistance. We fought it tooth and nail and eventually ended up where we are now, with a Bill that is about to come to the Commons. This Bill broadly speaking gives the court those statutory powers. That can certainly make a contribution and will enable us by proxy to cross-examine the court on how they are doing their job. It would help if they were called a board, because that is what they are, so that people who are not steeped in the history know what people are talking about. However, that is a secondary issue. But there may be other things that the FPC could do. Perhaps I could ask the externals to give that some thought?

Richard Sharp: Yes, I will take that back.

Q60 Wes Streeting: In your written evidence you wrote, “I am pretty sure the broader public has no idea what the FPC does or is”. I knock on enough doors to know that I am very rarely going to be asked about the FPC, and I do not think people across the country are lying awake at night concerned that they do not know enough about what you are doing. Should we be more worried that the public may have no idea what the role of the FPC is and yet banks may blame the FPC when they constrain credit or increase the cost of credit, which directly impacts on their livelihoods, their businesses or their personal incomes?

Richard Sharp: What is the question?

Wes Streeting: Should we be more worried? I am being quite blasé saying that nobody across the country cares, but should we be more worried?

Richard Sharp: I do not think so. I am happy to change my mind on that. The Bank of England is probably what the public appreciate as playing an important role. A lot of the restructuring that took place after the crash was precisely to create accountability within the Bank of England across a number of areas fulfilled by the MPC and the FPC.

I have thought about this. With the US, the Chairman of the Fed is probably more visible. As far as the FPC itself is concerned, to expect a pure public profile as opposed to a professional profile is a different matter. We should ultimately be known by the professional community and they should understand what we are about, what our point of view is and what we are there for. I am not troubled by the fact that a taxi driver does not know what the FPC is.

Q61 Wes Streeting: Regarding mortgage applicants who have had their applications turned down as a result of 3% interest rate stress testing, do you think it is important they are aware of the reasoning behind it?

Richard Sharp: Yes it is. We take account of the fact that, when we intervene, we are intervening between a willing borrower and a willing lender. We can affect people's lives if they cannot obtain finance to fulfil their desires to obtain credit in order to live. We are having to make judgments about stability in the future that do that. It is right that they should know why that is.

At the same time we also understand that we have got to deal through the FCA or the PRA, but the FCA in particular. A lot of people in a low-interest-rate environment can risk taking on credit that subsequently they cannot afford to pay. Therefore, we felt that in putting in an interest rate test we would ensure people were forced to understand, because a whole cohort of borrowers taking on credit that they could afford now but not at a higher interest rate would be problem both for stability and for themselves. In essence what we did was to test them and give them a communication about why we did what we did.

When it comes to the amount of the mortgage that is a high loan-to-value issue, and if they get turned down on a high loan-to-value basis, we probably have not communicated that. That is to do with the fact that we are concerned about the banks themselves moving the market on a competitive basis and across their balance sheets on a very high loan-to-value basis, in an asset class that is vulnerable. We have not communicated that and maybe we need to.

Q62 Wes Streeting: That ties on to my supplementary question. Is it not the FPC's role to explain to the public why such stress testing takes place or to highlight some of the wider risks both personally and for the economy of levels of indebtedness? If it is not your role, who is best placed to do this?

Richard Sharp: We do this through the FSR and we have done that. The FSR suffers from not being something that people want to communicate. I have certainly heard a comment from some of the executive that maybe we need to be more imaginative with what we put on the Bank of England's website, including videos or other things that communicate more easily than a rather dry FSR with a box in it that contains the explanation.

Q63 Wes Streeting: Do you think we should be doing more around financial education both in schools with young people and more broadly?

Richard Sharp: Yes, absolutely.

Q64 Wes Streeting: I am now going to pick up the earlier theme. I know you were in the public gallery before, so the theme will be familiar. It is around the nature of decision-making within the FPC and the issue you were picking up with the Chairman around groupthink. I was really interested when you said you wished to give more speeches in your second term, and that having had the experience that you have already accumulated on the FPC you feel more

comfortable being able to communicate FPC matters without risking breaching the requirements to respect the consensus. I found that interesting, as it makes me wonder if the requirement to respect the consensus of the FPC is stopping you or any of the other members of the FPC from saying what you really think.

Richard Sharp: We make judgments about the future, and many of those judgments are not black or white and are based on data that we have, our own analysis and our own individual experiences. We want to be able to make those judgments free from lobbying, free from a sense that there are factions within the FPC, and we also want to communicate stability. A lack of investment has taken place globally; that is affected by confidence. To my mind, a critical aspect of confidence is that the FPC and the Bank should speak on important issues with one voice and without it seeming like a cacophony. That was why I felt at the outset that I did not want to make any speeches at all. After a discussion here I then understood more clearly why, given that we have real power in the FPC—we are not elected, whereas you are—the individuals have a duty to communicate where they are coming from: because they have power over people's lives. I could see why that point was made in this Committee that communication should take place.

However, as this Brexit discussion has illustrated, it is also highly treacherous, because it can be politicised. That is not where we want to be. That is the issue that I wrestle with. There are some issues that interest me, such as fintech, the evolution of banking and some other broader issues that are uncontroversial and I now feel more comfortable about stepping into.

Wes Streeting: I was going to say; when you have cracked how you can have a good, robust and rigorous intellectual debate internally and then present a united public view, you might come and run some masterclasses for some of our leaders around here.

George Kerevan: Name names.

Q65 Wes Streeting: I do not need to; you can read it all on the internet, George. Finally, regarding speeches, I would like to think about that responsibility to set out views and explain your thinking. What sort of audiences do you have in mind for those interventions?

Richard Sharp: Quasi-professional is the answer. I gave a talk to a chamber of commerce in Nottingham, for example; it is that kind of communication. I also gave a talk at the LSE; it is for those particular audiences. I do not think the general public is as interested as we all may be in some of these issues.

Q66 Wes Streeting: Finally I just want to pick up the same theme that I picked up with Dame Clara in the previous session. This is around the way in which the FPC publishes records of its meetings. You have heard the earlier exchange about this. You have given some pretty clear indications as to what your views are. I may have some sympathy with them, but it is an important question for us to come back to. Would you like to take this opportunity to set out your view about whether the current system is appropriate and whether you support it or wish to see some changes? If you do think the system requires change, what

would the downsides be? If you think the system should remain the same, again, what are the downsides of that?

Richard Sharp: Unfortunately I think the system is appropriate. I do not have anything to add. We have probably reached the right point to give the flavour of our discussions. We have the capacity to have a vote if there is disagreement on certain key issues, which would then be recorded, but we also have an element of privacy so we can debate fundamental issues and challenge each other without necessarily putting disagreement in the record.

Q67 Wes Streeting: Can you give an example where your view as a member has been significantly different from the rest of the FPC?

Richard Sharp: I had a difference of view in the leverage ratio discussion we had. Going into that discussion, I felt that I would prefer 4% as the number. We had a robust discussion; I was not the only one with that point of view. I then understood that, in the context of the availability and the intention at some point to have a countercyclical capital buffer, we could address that. That is an example of where I went in with one view, listened to the facts, looked at the issues, understood the view and was prepared to move.

Q68 Chair: We have not got that buffer in place, have we?

Richard Sharp: We have the capacity; it is at zero at the moment. It may be a philosophical issue about whether it is a buffer if it is at zero.

Q69 Chair: You seem reassured by zero is what I am getting at, Mr Sharp. You are on a very big point here: 4% was the recommendation, because much higher than 3% was the conclusion of the Parliamentary Commission on Banking Standards, which I chaired. You are supported by a wealth of other people as well. Are you confident that the buffer can work as a substitute?

Richard Sharp: Yes. When I look at the whole capital stack, I am comfortable we are heading in the right direction.

Q70 Chair: When do you want to see that zero turned into a number? You might argue that nought is a number, of course.

Richard Sharp: We are going to have another meeting, we will have a discussion and we will come to a conclusion. I will be bringing my thoughts to that.

Q71 Chair: That was extremely informative. We have learnt a lot in a short space of time.

Richard Sharp: Let me give you a bit more information then, which will help you. I believe the non-resting state for the countercyclical buffer cannot be zero. We are on record as saying the normal state should be 1%. In addition, it takes a year to implement, so we have to wrestle with a number of issues in thinking about the right time to impose it.

As Dame Clara indicated, we do not want to impose it when it is going to be damaging, but at the same time we want to get to a point where we have capacity to release it, having got there.

Q72 Chair: Do you think that the lobbying rats have got at this? Do you see evidence that the banks have been pressing vigorously?

Richard Sharp: No, I have not seen any evidence of that.

Chair: I am not asking you a leading question.

Richard Sharp: No, I have not.

Chair: I am posing something that is frequently posed, to see if you could identify it. A couple of colleagues want to chip in.

Q73 Stephen Hammond: Good afternoon, Mr Sharp. I have two very quick questions on your written evidence to us. In response to question 6, which was about the risks to financial stability, you spoke about the unresolved balance-of-payments deficit and clearly made the point about the deflationary spillover. I take all of that. Could you give the Committee some sense of how significant that risk is and what you think the MPC can do about it?

Richard Sharp: We reached a level at 5% where, if we had gone further, we were getting to a significant level where we would require support from external capital flows in order to fill it. You would have seen that in the last quarter it went down. Whilst it has gone down, that does not mean it is on a path of future decline, so it is not a resolved issue.

One of the things we have tried to do is ask the economic side of the Bank of England to isolate the components of that. You will see in our last FSR we discussed some of those components, which were also to do with investment income. There was also an answer to the Treasury Select Committee, regarding Mr Baker's concern about the paper written by a particular professor in terms of companies in other nations.

Persistence is an issue, but fortunately the nation is very well funded externally in terms of the duration of the national debt and other sources of capital. It is not a short-term instability issue but it is a longer term issue, which could have some effect. There are other issues that are going to be brought to bear such as foreign exchange movements and our adjustment mechanisms to some extent. History has shown that certain countries can have balance-of-payments deficits for very long periods of time. Ultimately it means that we are dependent on external sources of financing, so we need a robust economy to provide an attractive source of capital. It is not good to be in a state of deficit permanently or long term.

Q74 Stephen Hammond: Is the UK economy perfectly capable of funding that at the moment?

Richard Sharp: Yes.

Q75 Stephen Hammond: The financial stability report in December said an effective resolution regime has been established, yet your written evidence to us suggests you are at variance with that. You are saying there is still work to do. First of all, are you at variance with that? Secondly, can you explain where you think the causes of the variants would come from? Is it the banks being obstructive and dragging their feet? What is preventing, as you see it, the effective resolution regime being put in place?

Richard Sharp: This goes back to the earlier conversation in terms of the pace of connected supranational and national entities. That comment in December referred to the November agreement of the FSB, which is the first step in moving towards the whole resolution regime in terms of TLAC. The implementation of that is going to take another two to three years. That is the frustration. To a common-sense person, if we think about when the crash was, the fact we have not yet fully resolved or completed too big to fail eight years later is a source of frustration. It is not what I would have anticipated before I came here. I am certainly hoping that will be completed by 2019.

Q76 Mr Baker: On this issue of the risk of a vote to leave, it is perfectly obvious it is a crucial issue in the campaign. In the last 24 hours or so we have had three opinions. It is fair to say that the Governor was drawn, at the end of a session, into saying what he said about it being the biggest domestic risk. Dame Clara omitted it from her questionnaire and has now said she should have included it. You have excluded it and given your good reasons why you have excluded it. I am just trying to behave myself and look at the operation of the committee. Would you forgive me if I said it looks like the committee is at sixes and sevens over what is one of the biggest questions of the moment?

Chair: I do not think it is the committee; it might be the witnesses.

Richard Sharp: Dame Clara will obviously have to speak for herself in terms of the longer term issues, which I do not think you touched on. My position as far as I am concerned happens to be, and these are judgment issues, entirely consistent with the Governor's. We have short-term volatility and short-term issues that manifest in markets. Regarding the medium and long term, either being in or out is not a significant source of stability, compared with some of the other external threats we face, in terms of priority.

Mr Baker: It is a consistent view then. Thank you very much.

Q77 George Kerevan: I was fascinated by a phrase in your written evidence where you say that the FPC needs to retain enough bandwidth to remain alert to tail-risk events. What does the committee have to do in order to maintain that bandwidth?

Richard Sharp: It goes to the stages that the FPC has been passing through in terms of having to spend an extraordinary amount of time in dealing with the banking system. As I mentioned, we spend an extraordinary amount of time on issues like drafting, to get our measures right. There are some fundamental issues of concern out there. We have to be aware of the fact that global debt has grown since the crash. We have to be aware that secular stagnation may be an issue in the euro economy. We have to be aware of the

spillover effects of a zero-rate bound in terms of asset bubbles. We also have to look at connectedness, which can give risk to shocks, as we are seeing in places like the commodity market.

As we have a vision of some of the bigger issues right in front of us, such as the fragility of the financial system and restoring that, we have to make sure that the tail issues, which are by definition significantly less probable but contain a risk of a shock, are ones that we devote enough time to, given our work load. That is really what I expressed. What do we have to do to change this? I seek to raise those issues and ask the Executive to come back to me with an analysis. For the FPC as a whole, making time to discuss them can be quite challenging.

Q78 Chair: Does it concern you, as some are concerned and have written about it, that in trying to make assessments about that bandwidth, the banks having recourse increasingly to modelling and modelling risks, which by definition tends to define them in a certain way, risk failure to capture part of something at the far ends of the fantail?

Richard Sharp: Yes and no.

Chair: You are getting very good at this public evidence.

Richard Sharp: The no part of it is because financial markets are inherently unpredictable, which is why so few active managers consistently make money. The entire mining and energy industry did not see the collapse in commodity prices. Modelling would not necessarily have produced it, or else they would have seen it. That is the issue; analysis will only get you so far. At the same time, we then look at resilience and try to understand transmission mechanisms. You can put too much faith in modelling as an academic exercise and as an engineer looking backwards and thinking that gives you solutions for going forward. The real world does not work that way.

Q79 Chair: Do the externals devote much time to thinking about the shortcomings of modelling?

Richard Sharp: I do. I have discussed that at meetings. We have to model a number of issues. For example, we have to model the housing market here. You will see from the fantails that the Bank of England has adopted and its own critique of its own modelling that it recognises how hard it is to provide the kind of accuracy that clairvoyants would require.

Chair: That is a very interesting point to make there, which we might take forward in other evidence. You have very kindly said you will go away, together with other independents, and think about the accountability issue. As you come fresh to it, perhaps you are very well placed to help pull those thoughts together. Thank you very much for coming to give evidence to us this afternoon. The Committee will now go into private session.