

Work and Pensions Committee

Oral evidence: Pension Protection Fund and the Pensions Regulator, HC 55

Monday 17 October 2016

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Members present: Richard Graham (Chair); Heidi Allen; Frank Field; Jeremy Quin.

Questions 3219 - 3256

Witness

[I:](#) Dr Ben Broadbent, Deputy Governor, Bank of England.

Examination of Witness

Witness: Dr Ben Broadbent, Deputy Governor, Bank of England.

Q3219 **Chair:** Deputy Governor, thank you very much for accepting our invitation to come and join us today. I should absolutely emphasise for the record that it was, as always with this Committee, purely an invitation, and we are very grateful that you are here.

I apologise first of all that our Chairman, Frank Field, is unavoidably held up. He is deep in a shipyard in his own constituency for the keel-laying of a ship building order where the Secretary of State is present, and he hopes to join us later. Can I also say that I think you have made a minor bit of Work and Pensions Committee history by being the first Deputy Governor to join us for one of these sessions? I hope some historian in the corner of Victoria Tower will take careful note.

Today we want to try to explore with you a little bit the role of the Bank of England and the effect of your policymaking on the savings world and pension funds, in particular. If I can just start by quoting the Prime Minister at the Conservative Party conference in Birmingham. She noted that, "While monetary policy with super low interest rates and quantitative easing provided the necessary emergency medicine after the financial crash we have to acknowledge there have been some bad side effects. People with assets have got richer. People without them have suffered. People with mortgages have found their debts cheaper but people with savings have found themselves poorer". My first question to start the debate today is how does the Bank of England look at the world of savings and pension funds when considering your wide remit for financial stability and growth?

Dr Broadbent: Pension funds are a central, if not the central vehicle, by which people save. Net financial assets of households are roughly £5 trillion, and roughly £2 trillion of those are held in pension funds. So they are hugely important as a means of channelling savings to productive investments.

Perhaps I can say something right at the start about the low level of interest rates. One thing I want to get across today is not to confuse the low level of interest rates with monetary policy. That may sound an odd thing to say, given that the MPC sets the official interest rate, but over long periods of time I do not think monetary policy sets the real rate of interest. To put it another way, the interest rate that we set, the interest rate that in the end is necessary for the economy to maintain a stable rate of inflation and a stable rate of growth, which is what we are interested in, itself changes over time. A lot of what we do can be understood in some ways as trying to match those movements in what you might call the underlying neutral real rate of interest. We are an effect much more than a cause of this inexorable trend we have seen



HOUSE OF COMMONS

over the last 25 years, of a decline in that interest rate. That is not due to monetary policy. Monetary policy has simply followed it down.

When I started my professional career, for example, if you look at one simple measure, the interest rate paid on a 10-year indexed bond was a little over 4.5%, in the late 1980s, early 1990s. By the end of the 1990s, it had fallen to a little below 2%. Even on the eve of the financial crisis it was lower still at 1.5%, long before the crisis, long before QE and then it fell further afterwards.

Even in a closed economy, I do not know how much bearing on forward real interest rates monetary policy—by which I mean pure independent decisions—the MPC can have. I do not think it has much on real variables over the longer run. In a globalised economy with open capital markets, the monetary policy of a small open economy like ours has very little. We were, in a sense, a price taker. These trends were caused by things other than monetary policy and the official interest rate was but one symptom of those forces. Economists were writing about those forces long before the crisis. An increased desire, for various reasons—demographic and others—to save across the world, a certain reluctance to invest, these were driving down that real neutral rate of interest. Monetary authorities around the world were following it. We were simply the last link in the chain. We were not the cause of low interest rates.

Since the crisis, those trends have intensified, driving down that neutral rate even further. If I can put it like this, one way to see this: if monetary authorities had failed to match that fall in the neutral rate of interest we would have been running overtight policy, inflation would have been that much lower, growth would have been that much lower.

To put it another way: if in the statement that somehow this is all monetary policy, within that there is an idea of some alternative universe in which everything else that matters—real growth, real wages, real equity prices—all that is unchanged, but we could somehow choose to have interest rates materially higher, I do not think such a thing exists. I do not think there is such a universe. If we had done that, all those real things would have been much weaker.

Even though we are that last link and even though it is the MPC that sets interest rates, it is not a realistic question—I do not think it is a realistic premise to say low interest rates are because of monetary policy. They are not; they are because of much deeper things.

Chair: It was not quite my question but, Jeremy, do you want to—

Dr Broadbent: Sorry, if I can pick up the question, I wanted to say that as a general statement at the beginning.

Nevertheless, we recognise that with a decision like QE we can have an additional bearing on those longer-term interest rates and we can thereby have an impact on the financial position of pension funds.



HOUSE OF COMMONS

As a general matter it is true that, if only at the margin, monetary policy affects at least the near-term interest rates and therefore the returns that borrowers and savers face. It is part of the way it works.

When it comes to pension funds and their positions and the impact of QE, we think about these things very carefully. We are concerned at the possibility that if QE increases the deficits of some pension funds—and it may increase the deficit, certainly of those that already run deficits—and if that then acts as a financial constraint on companies that affects their investment, their hiring and so forth. That we certainly look at closely. We did a lot of work both in the earlier phases of QE and ahead of the most recent decision in August.

Broadly speaking, we cannot find—we have looked for it—much evidence that that effect exists at the moment. We cannot find evidence, for example, that the cost of capital has gone up more for companies with pension fund deficits than for any others. We consult our Bank of England agents around the country and talk to businesses all the time. We ask them to ask businesses whether it is having any impact on their real investment decisions. We have not found any evidence of any material effect of that sort.

Having said all I said about the neutral rate of interest, we do a lot of work ahead of each decision, and certainly did ahead of August, to make sure that we are not causing material distortions that can affect corporate investment.

Q3220 Jeremy Quin: Deputy Governor, thank you for coming. I was going to bring you back to a number of points that you then covered in your rider, so we will get back to the main questions. But your preamble was so interesting. I would love to ask a question on that if I may.

The implication of the statement is that—you said it clearly and there has been a lot of work done on this—the overriding impact of monetary policy over the years of goods getting cheaper, and so on—that loop that has been created—you posited that the role of monetary authorities has been limited as a result. I wonder if we can explore that a little bit—it is probably for the Treasury Committee rather than us—because that would suggest that central banks were slightly helpless when it came to preventing the credit bubble. I assume you would say the FPC has a role in terms of restricting credit availability even if the ability of the Bank to increase interest rates against a global trend is—

Dr Broadbent: Let me be clear. We have the ability to change interest rates. That will have various effects. I will say a little bit in a moment about whether it would have helped contain a “credit bubble”. I do not want to deny there are effects. What I am saying is that we had no choice but to follow this decline in this neutral real rate of interest.

Let me put it another way. When the Monetary Policy Committee was created and the Bank was given operational independence over policy,



HOUSE OF COMMONS

most people would have said then of the new neutral nominal rate of interest—the kind of interest rate you would expect if the economy is a trend, we are not in the middle of some big cycle and inflation is a target and everything is looking fine—“Oh, it should be around 6%, 6.5%”. That is what they said. The number that delivers that stability today is lower and that is a fact that is external to us. We face that fact. It does not mean that what we do around it does not have an impact but it does mean that had we held the interest rate at 6% the outcome for the economy would have been a lot worse. That is what it means.

Now on the question of the “credit bubble”, my own view being that it would not have made much difference, certainly not in this relatively small economy had interest rates been materially higher in the last decade ahead of the financial crisis. It is a slightly different point, but the fact is that most of the losses of British banks were on their overseas assets, the big losses.

It may have been the case—at least with the benefit of hindsight—that tighter monetary policy in the United States might have made a difference. I am not sure tighter policy here would have made some. You are absolutely right to point out that one thing that was missing from the range of policies available—there is international consensus on this point, although only again with the benefit of hindsight—is the tools that the FPC has and certainly within this open economy those are much better suited to dealing with the stability of a financial system, including credit supply.

Chair: Thank you, Deputy Governor, for explaining the trend of interest rates but can we bring you back to the effect of the decisions you have been making on savings and pensions, which is two-thirds of the household assets? Heidi, can I bring you in at this stage?

Q3221 **Heidi Allen:** You mentioned in passing about how the MPC does consider—less perhaps for interest rates but more for QE—what effects that will have on savings and pensions. Can you talk to us a little bit more about how you go about it; what goes into the decision-making process and how you consider what the knock-on effect might be, and then how you monitor to see whether it has had that effect?

Dr Broadbent: We model what effect QE has on asset prices and we observe it more or less cleanly. These things always move around for other reasons as well, but we monitor it obviously after the event, and then we model what that does to the balance sheets of pension funds. We look for evidence by looking, for example, at differences in behaviour of and the pricing of companies according to the size of the pension fund liabilities and deficits they have. We talk a lot to our Bank of England agents. On the first point, I would point you towards a speech that my predecessor Charlie Bean wrote in 2012, which gives a good idea of the effects we think policy has on asset prices overall and thereby on the position of pension funds.



HOUSE OF COMMONS

Charlie argued correctly, and we probably expect to have had more or less this—for this to be true as well as the latest round of QE. I do not think QE has much of an effect on the balance of a pension fund that is already in balance. That is because the effect of pure monetary easing is—certainly of QE—to raise the price of bonds, so it pushes up the value of the liabilities, depresses long-term interest rates, but it also raises the price of their assets, assets like equities and corporate bonds. Once you take both into account, and certainly for a fund that starts in balance, the impact on the difference between those two is not that large. I would suspect—we have not gone through as full an analysis of the latest round—but my guess would be that would be roughly true this time as well.

It does have a bigger effect on the accounting deficits of funds that are already in deficit because obviously the effect on the liabilities, because they are larger, will itself be larger than the effect on the assets.

But what matters for us is not what happens to that accounting deficit but what effect it has on actual behaviour. What would be of concern to us, and what would be one of the costs of QE, is if there was sufficient increase in the deficits of those already in deficit to make them financially constrained, to push up the cost of their funding, push up the cost of their bond and equity funding, make them more nervous about making investments. So that effect is possible in principle and that is what we look for in empirical work. It is what we ask the agents to check for continually but particularly ahead of such decisions.

We have not, first order, found important effects of that sort. We continue to look for them but we have not yet found them. Which is not to say they could never exist, nor is it to say in principle that they could not be big enough to deter us from doing something like this if we think it is necessary. But one should recognise that that is the stuff that matters. One should recognise too that the counterfactual here is a world in which the economy performs less well. The economy performs less well, risky assets perform less well; it is not clear that that is an overall better outcome. Our judgment in August was that it would have been a worse outcome.

We do think about it a lot and examine it closely all the time, but particularly ahead of such decisions.

Q3222 Heidi Allen: Could I just ask one very quick follow up? On the back of that, you say the risk is or you need to be more aware of it, when pension funds are more in deficit. Does that mean this is something that is an increased area of vigilance for you? It seems to me that—forgive me, because you are the expert and I am not—but you seem very relaxed about this, “Well, we have not seen any effect so far”.

Dr Broadbent: It is not for want of looking.

Q3223 Heidi Allen: That is what I was trying to explore a little bit.



Dr Broadbent: That is my point. What I am trying to suggest to you is I do not think it is yet—we are not, as a matter of principle, saying we are not bothered. We are bothered. But obviously we have a duty to look at the evidence. Looking at it, our view is that it has not yet reached the level where the costs—we cannot see the material effects that would worry us, but we are looking for them, they are just not there.

Q3224 **Chair:** Can we just probe a little bit on that? Reading through the report of the last MPC meeting there is no very obvious reference to having looked at what the impacts might be of decisions on savings or pension funds. There is certainly no evidence that I have seen there or elsewhere about your earlier assumption that there was no premium on capital charged by lenders to businesses with pension funds. I wonder whether you have evidence that has not been presented.

Dr Broadbent: We did put some in the inflation report in August, which is the main place where we explain the decision in August. That is the place to look and there was a reference to it there. I am not entirely sure—I thought we had made a reference to this work on equity prices and the cross-sectoral differences.

Q3225 **Chair:** The only slightly different reference that I could see in the MPC minutes was that three out of five of the independent members voted against buying further government bonds.

Dr Broadbent: Yes, but that was mainly because of an assessment about what they thought the risks were about economic growth, not because of pension funds.

Q3226 **Chair:** That was not taken into account?

Dr Broadbent: I must come back to what I said originally. The danger here is thinking that because we have, I would say a marginal impact on pension funds, on a pension fund that is already in balance, the effect is small. It is a mistake to think therefore that this is the only influence on pension fund deficits. The big thing that has happened, the big thing that has caused problems for them over the last decade, is that the yields on their liabilities, the price with which they are valued have come down. The price has gone up—but the yield on their assets has not fallen as much. You have had this long period during which bonds have out-performed equities and other risky assets. That is what has caused the problem. That is not a question of monetary policy, which tends to move yields in the same direction. That is the primary cause of the problem.

Q3227 **Jeremy Quin:** I just wanted to test a little on the point that you make about seeing no evidence of the cost of capital of those companies with significant deficits rising, which should be priced in—the market should be pricing that in—and I wondered if you might hazard a guess as to why the market is not pricing that correctly? Is it because people think it is temporary or is it just too opaque? I will leave it at that, and there is another point I would like to come back on, if I may. Any thoughts as to why the market is not pricing it?



Dr Broadbent: The market may already have priced it in some sense. It is hard to say. What we are doing is looking for changes in the equity price costs, correlating that across firms and looking at whether there is any effect and we can detect any sense in which those with larger deficits have seen decline in the equity price, relative to those that do not have large deficits. But it may already have been in the price, but at the point at which we start that analysis. You would not necessarily expect to see it unless investors suddenly thought the deficit has got so big now that we start to worry about solvency. That is the point we care about, because that is the point at which the firm starts changing behaviour, starts reducing its investment. That is the point at which you would expect to see an effect. But it is not to say it does not price it. It may simply be that it prices it here and it prices it there, and the price is lower to that extent, but the extent to which it is lower than other firms' equity prices does not change over time.

Q3228 **Jeremy Quin:** One of the aspects, I suppose—this is anecdotal rather than empirical, but I think it is the case—is that a majority of those companies with significant deficits are not listed at all. You referred to equity prices and normal prices.

Dr Broadbent: Yes, that is possible.

Jeremy Quin: It is very hard for—

Dr Broadbent: That is possible and it is one of the reasons we ask our agents to go and talk to—our agents talk to a lot of businesses and many of them will be unquoted. We have a survey out in the field now. We will report the results of that in our next inflation report, which asks precisely these sorts of questions, asks about which things matter for your investment or what has changed your appetite to invest, where does this issue rank. We will ask precisely that question.

Q3229 **Jeremy Quin:** It is specifically included on your agents' questionnaire?

Dr Broadbent: It is and it has been before.

Q3230 **Jeremy Quin:** So the smaller family companies that have a long-term DB scheme would all be picked up over—

Dr Broadbent: They would be. Obviously we set policy for the macroeconomy. I will make the point again—broad, big picture point: one should not see, even to the extent it has been caused by monetary policy—and to begin with, I do not think that is a huge extent—the fall in these yields on the bonds on its own. What matters for the deficit is what has happened to the price of the asset. It is when this goes up more than that; that is the issue.

Q3231 **Chair:** The corollary to the question Heidi asked is partly leading towards a question about the appropriateness of investment strategy that might follow from looking at a deficit that is seen to be ballooning as a result of yields coming down and therefore valuations declining. That might



HOUSE OF COMMONS

encourage certain pension funds, just as it has been done arguably in a wider retail context of savings, for people to start ploughing into riskier investments on the basis that they are not only not paid to hold cash, they are being asked to pay to hold it.

Dr Broadbent: It raises a very big question.

Q3232 **Chair:** Since you said two-thirds of household savings are in pensions or related savings offerings, that surely could have a potential impact on financial stability if some of those riskier investments then turned out to go pear-shaped.

Dr Broadbent: I am going to make a bigger point here about what this does and whether it is desirable. You could argue it the other way round in some ways. I said a moment ago that the problem for funds has been not in and of itself a decline in the yield on the bond or the rise in the price of the bond, but the fact that the price of the assets have failed to keep pace. That has been a problem.

If you look for example—I will put it in yield space—if I look at the dividend yield in equities, it has fallen, but not that much. It is currently higher than it was in the five years leading up to the financial crisis. If I look at the rate of profit in the economy, that has not come down much. The problem has been that these yields on the riskier assets, which they hold as assets, has not fallen much while those on the funds have fallen a lot. That is the issue.

I suspect that one of the reasons for that is that the risk premium on these riskier assets has gone up. So the reward you get prospectively, the expected excess return from holding such an instrument relative to bonds has gone up. There is a question: if that expected extra boost you get from bearing risk goes up, should you hold more or less of the risky asset? You could argue the other way round. You could argue that the regulation is pushing these funds towards the low yield in a so-called risk-free asset to an excessive extent. I suspect, I do not know because—

Chair: Or you could argue both.

Dr Broadbent: You could. It depends on the—but let me—

Q3233 **Chair:** That is what happening institutionally but on a personal household basis the opposite is happening, both of which would have negative—

Dr Broadbent: I put it this way: individuals should be free to make their own choices, but I suspect it is true. We do not have very good data on the composition of defined contribution funds but I suspect it is the case that those funds have a higher proportion of equities than the DB funds. You could say that somehow households are choosing to hold riskier assets. You could also say, as I set out, that they are choosing to hold higher return assets. That is a judgment for each individual household to make. My guess is that the risk premium is higher than usual at the moment.



HOUSE OF COMMONS

Q3234 Jeremy Quin: I am just thinking through what you were saying, Deputy Governor. For a board of trustees, they are having to get their heads around fairly extraordinary times and all of us probably put our head in the sand a bit to say this is all temporary. People have come to the conclusion, which fits your narrative in your earlier statement, that this could be a long protracted period of monetary policy being what we would normally regard as abnormal perhaps being normal. If I can lead you in that direction, what do you think trustees should be thinking in terms of whether they should—

Dr Broadbent: Let me try to give you several things on that. I am not going to offer direct advice to trustees, but first, even in the short run these things can move around quite a bit. We issued in early 2014 a form of guidance, so-called, in which we spoke a little bit—I say “we”, I mean the Monetary Policy Committee—which was essentially the same point I made to you right at the start about “the neutral rate of interest”. What were the broad forces telling us we had to do to these interest rates? We wanted to make the point precisely that these things were going to look slightly different from in the past. At that time, you will remember, people were talking about rises in interest rates and we ourselves thought that would be the next move, but we wanted to make the point that, because of these forces depressing a neutral rate, any rises we had were unlikely to be as steep or as rapid as in earlier hiking cycles. We said, “Look, you should talk to businesses” at the time. They said, “Oh well, we know what is going to happen: the first time interest rates move they are going to go straight up to 5%”. We said, “Well, no, for various reasons that is unlikely to be the case”—not as a matter of choice but because we had no other choice but to follow this thing—the appropriate rate of interest is likely to follow a flatter path than in the past and we were thinking precisely of these deeper forces on the neutral rate of interest.

Now, at that time yields were higher than they are now. If anything, it has turned out to be even lower than we suspected. I might point out that if you look, on one measure, at the PPF section 179 measure, funds were in balance in aggregate at that time. If asset prices had followed and interest rates had followed the path, even though it is much lower than in the past and yields were much lower than they had been historically, there wouldn't have been much of a problem. There was a distribution across funds but in aggregate they were more or less in balance. Indeed, my guess is that you have seen the gilt yield moving up in the last two or three weeks. The PPF estimate of that aggregate got into a deficit shortly after the referendum of probably half a trillion pounds, they publish monthly, and that shrunk in September. My guess is if yields stay where they are now, it shrunk from 500 closer to 400 and probably closer to 300. So these things move around a lot even in the short run.

Now, if you ask me what the very long run prospects are, I do not know. I have been expecting this, I have to say. You know, my tendency is,



HOUSE OF COMMONS

how long can this stay the case? How long can it be true that bonds outperform equities? It just doesn't seem a reasonable thing to go on forever. Indeed if you look at the—

Q3235 **Chair:** But isn't this partly driven by repurchases?

Dr Broadbent: I think it is driven by these other deeper forces, by risk aversion, by fears of slower growth, by demographics globally. These are global trends. They are not local to the UK.

Q3236 **Chair:** You do not see quantitative easing having any impact on bond prices?

Dr Broadbent: Some, but remember my view is that quantitative easing moves asset prices in the same direction. It boosts equities as well as the price of bonds. The problem here is not things that go in the same direction, but things going in opposite directions. That does not seem to me to be the result of any independent decision on monetary policy.

The Bank of England has been around since 1694, as you know, and we have data on yields back to 1694. If I look at the ex-post yield, the yield—we didn't have indexed gilts back then—if we look back at the real yield on gilts, how much it is averaged over the whatever, 320-odd year period, it has been two and a half. If you ask me whether the yield in 20 years, the real rate of interest on Government bonds, is going to be higher or lower than it is now, I would put a large weight on higher. Indeed, I would put a large weight on the probability that equities outperform bonds over the next 20 years, but I would have given you the same answer three years ago as well.

Q3237 **Jeremy Quin:** From your earlier statement, the implications for the average person in work at the moment are that they should be working longer and saving more.

Dr Broadbent: There is a separate problem in this country, I have to say, that in aggregate we don't save enough. The net national saving rate—if you look at saving and you take away the depreciation of our capital stock—is negative, with the implication that our national wealth is falling, unless we get lots of capital appreciation. We have an ageing country. We know all this already and, faced with those choices, unless you get super high returns on assets, the only choices that you have are to consume—and I am talking about the aggregate picture—less now or consume less later or work longer.

Q3238 **Frank Field:** I know the Chairman has apologised for my lateness but we had the laying of a keel by Sir Richard Attenborough in our shipyard today; it is the most significant commercial order in the 37 years I have been MP.

Dr Broadbent: Fantastic.

Frank Field: The great man was there to lay the keel himself. So despite the attraction of having the Deputy Governor before the Committee, I am



sorry I am late.

Dr Broadbent: I can quite understand.

Q3239 **Frank Field:** May I start a contribution by following up on how you replied to Jeremy? We know that one of the reasons why pension funds—only one of them—are suffering deficit is an ageing population, yet pension funds have a duty to take into account the age profile of their fund members to try and offset the risk that some calamity could happen near a whole tranche of people's retirement. Wouldn't that be one of the forces that would have pushed people into bonds and against equities?

Dr Broadbent: Yes, possibly. Absolutely. For DB funds whose beneficiaries are approaching that age, they need to fix its number. I am not disputing with the regulation as it stands. I am just musing about the possible effects of it. These firms have made promises, those promises are defined, they are in some sense like the coupon on a bond you have written, and therefore, if you want to offset the risk of that entirely, whether it is longevity risk or something else, you have to hold the bond on the asset side. I am simply saying that regulation may not allow, rightly or wrongly, any flexibility to ask, "What about the future relative returns on assets?" If bond yields are low simply because there is a lot of risk aversion in the world, which side of that do I want to be on?

Q3240 **Frank Field:** I am not sure whether your previous answer is that, in a sense, if you had considered this, you dismissed it, but one of the, I think proper elements of the theme music from the Prime Minister is that her administration is going to look after those who, probably over a longish period, have had really rather a rough deal compared with other groups. One of those groups is clearly many pensioners. Given the proposals that the pension industry has put forward to try to link some of their assets directly to fund infrastructure projects, and the disappointing results of that, to what extent is the Bank doing any creative or new thinking in this area? Specifically lobbying on this, one way of actually compensating a very large group of people and to raise funds from pension funds that will be specifically linked to the returns the Chancellor can reasonably expect from some of the big projects he may well be backing very shortly, would be to issue bonds explicitly in the first instance for pension funds, which had clearly positive rates of return and may be linked to the returns in the market thereafter until their redemption date.

Dr Broadbent: That, in a sense, maybe this is stretching it, makes my point. If you want higher returns, you have to bear a little more risk. One cannot on the one hand—only to a degree can one do this—say, "I will absolutely fix the value of your liability and, furthermore, I am not going to allow you any risk in your asset base, particularly currently, when I would judge the gaps in these prospective returns are higher than average, if you are not going to bear any risk." The private sector under those forces, in aggregate as it were, has to a degree answered that question precisely by moving more and more people to DC funds.



HOUSE OF COMMONS

I do not disagree, having said that, that it would be desirable to have a broader range of assets and indeed to have some that are higher-return assets. I am simply pointing out that usually the price of accepting higher return is to accept some higher degree of risk.

Q3241 Frank Field: It could be this Government is more interventionist than Governments we have had for quite a long time. This could be a move to intervene on behalf of a group that at least the public, even if the Bank doesn't agree, perceive have been generally losers.

Dr Broadbent: No. We set aggregate policy, but certainly are not unconcerned with distribution effects any less than anybody else, and what has happened to the wider distribution of income. I might point out that the picture is somewhat nuanced with reference to the effect on inequality of wealth of some policies, including falling interest rates. If you accept—it is clear to me at any rate—that the broad trend has been this downward trend in bond yields that started 25 years ago, and that has been independent of policy—it has driven monetary policy rather than the other way around—that would have had two sorts of effects. It will have driven down the yield on saving for short-term interest rates over time. It would have pushed up the price of assets that look like bonds that have a relatively stable return, most obviously houses. So I think it is important to understand that the distribution effects have cut both ways. The group—if you want to call it this and it is not clear what the benefit means when you have to live in a house, after all you only get the capital gain if you move into a smaller one—but the group that has benefited the most from that trend are those that happened to buy their houses 25 or 30 years ago. The value of that house is now higher. Those that have lost out in some sense are those who want to buy a house, who do not have one.

Q3242 Frank Field: Does that mean that the Bank on this specific point, if it is looking at intergenerational losses—and that follows from teasing out a bit comments and questions that Richard was asking you earlier—is satisfied that one should not be making any huge exertions to try and compensate other groups who may now be losing out, like, for example, those wishing to enter pension schemes as younger people, who are clearly getting worse deals, and have not benefited in the way of intergenerational shift that you described and people like me have so benefited from because we are able to buy a house?

Dr Broadbent: What I was trying to get to was that there are big differences. This trend is a fact of life, first of all. It is not something we could have fought. It is a global force that is just there. There are big differences in the effect it has had on the distribution of wealth on the one hand and some of the effects on income on the other. So, if, for example, you happened to buy a house—you are of an age, the luck of when you were born—before that happened, the value of that house would have gone up a lot. The value of any fixed claim on the future and present value of that claim would have gone up a lot. The value of a bond, the value of a DB pension, have all gone up a lot.



But if at the same time you are reliant on interest income from a deposit account, that income would have gone down. So when one is talking about the rich getting richer, the group to whom that most obviously applies is simply those who happen already to own houses. When you talk about savers losing out, those are very often the same people. So there is no easy distinction here when talking about these distribution effects. The very same people might have gained on the one hand in wealth and lost on the other in income.

Q3243 Frank Field: I am interested to see where you might refer us to some work that you have done. Can I put the question a different way on this issue?

Dr Broadbent: Yes.

Frank Field: One thing the Committee has been looking at is that maybe the honouring of pension pledges more fully will result in job losses for those who, if they are lucky, might get a pension but nothing like the pension increases of the people who are putting them out of work. Has the Bank done any calculations on that and thought about what are the compensation measures that one should try and take within the market?

Dr Broadbent: We have not thought about the latter. We certainly, as a regular part of thinking about monetary policy decisions, think about the trade-offs involved and in particular what would happen to unemployment if we did not act. For many firms, even those that might be running deficits, I would not say the choice for those individuals is very material because, again, looking at the evidence, we don't see—we haven't found, despite looking, great evidence that these deficits are affecting their behaviour, whether it is over investment or other employment. It could do for some. It could do.

Chair: Deputy Governor, I think that brings us on to a question that Heidi had, because this compensation factor is quite an interesting one.

Q3244 Heidi Allen: This is around the balance point. How do you view the negative effect of the monetary policy on the assets of DB pension schemes but the trade-off being a positive effect on the ability of sponsor companies to invest more? How do you see that balance and how do you measure it?

Dr Broadbent: We think about what QE does to asset prices in general and that tells you what it does in aggregate, broad brush, to the position of pension funds. First, I don't think it damages the value of their assets; it pushes up the price of their liabilities. That is what happens when bond yields fall. The price of that bond and the present value of the liabilities go up. But it also pushes up the assets. I said earlier that if a pension fund starts in balance—Charlie gave a very nice exposition of this four years ago and I think the same reasoning would apply today—the increase in the value of the liabilities induced by more QE is pretty much matched by the increase in the value of their assets. I don't think it has a



HOUSE OF COMMONS

big first-order effect on the position of those pension funds. That is an important point.

It may push up the deficit of those that start in deficit. I will repeat what I said earlier. What matters for us there is: does the increase in that deficit get to such a point that it has a material bearing on the decision these companies take that affect the real economy, on their hiring, on their investment strategies? By investment, I mean their actual physical investment in productive capacity. That is what we would care about and that is what we look for. That is what we have not found much evidence of so far. We will continue to look for it because it continues to matter. As it happens, since the August decision—and if nothing else, it demonstrates that bond deals move around for reasons other than just QE—they have gone up a lot. My guess is that the deficits in aggregate have shrunk quite a bit over the last six weeks alone—

Chair: They have.

Dr Broadbent: —but it is not to say we don't have a duty to keep examining these effects and looking for them. What matters is not whether QE in and of itself reduces bond deals. What does it do to asset prices? If the effect of the first is bigger than the second, which it will tend to be for firms that already start with a deficit, is that effect big enough to mean some first order impact on the way firms are behaving in their hiring and investment decisions? That is what we are watchful for.

Q3245 **Chair:** That is very helpful, Deputy Governor. You made an interesting comment earlier about the impact on asset prices and the way in which, perhaps, some pension funds are almost derisking too much.

Dr Broadbent: Possibly.

Q3246 **Chair:** Therefore possibly not getting the long-term returns from doing so. I think there is some anecdotal evidence that the Pensions Regulator is telling schemes with significant deficits to derisk, whereas a bold investor in a different context might take a different approach. I think there is also some anecdotal evidence that some of our constituents with small amounts of savings, who are not necessarily home owners but have a trickle of income, may be investing in less appropriate instruments in order to try and increase the yield off which they are really living. So you have markets, perhaps moving in slightly different ways. What sort of questions, discussions, have you had with the Pensions Regulator about these issues and the financial stability of the 6,000 DB pension schemes?

Dr Broadbent: I have not had any direct conversations with the regulator, I have talked to individuals—forgive me.

Q3247 **Frank Field:** Has anyone in the Bank had those conversations?

Dr Broadbent: I think some people have met the regulator and also the PPF. Certainly the FPC is always interested in whether funds, households, are over-exposing themselves to risk. Their biggest concern in that



HOUSE OF COMMONS

respect in the last few years has been household debt rather than the nature of any household assets, but I certainly accept, as a matter of principle—I don't know how widespread or important from a macroeconomic, macro-financial stability standpoint it is—that the search for yield has the potential to force people or to encourage people into assets that may be riskier than they realise.

It is exactly that sort of trade-off that, for example, would have some bearing. It is exactly this two-sided question that comes back to what you are saying about infrastructure. What is the correct yield to compensate for any risk involved? Whether you are an individual investor or a pension fund, what sort of yield should one demand? What is the risk involved? Those are decisions for individuals and individual funds but there is some trade-off there between risk and return.

Q3248 Chair: There is, which in a sense brings us, if the Committee are broadly happy with this, to the last part of our questioning, which is a bit of future guessing. What we are seeing is the increased risk on the one hand to employers, who are doing the right thing by maintaining defined-benefit pension schemes, but are either having to pay more and more into the PPF, or put more and more into the fund in order to reduce its deficit, which prevents them from growing and employing more people. On the other side there is the risk of employers possibly becoming less scrupulous and trying to offload their schemes into the PPF and therefore not fulfilling the pension's pledge, which could give some people in their retirement significantly less income to live off.

Both of those in a broad sense are financial stability issues. The question, therefore is, what does the Bank think is likely to change in this scenario? How can a more positive outcome, both for employers and pensioners, be made possible? Is there anything that any of the financial institutions can do to try to prevent an increase in both these rather unsatisfactory solutions?

Dr Broadbent: In some sense the private sector as a whole has already answered that to some degree. You know, it is simply not possible—

Q3249 Chair: By closing the schemes?

Dr Broadbent: Yes. There is a position where contributions to DC funds now exceed those to DB funds. The average age of DB beneficiaries is getting older and older; the proportion already in retirement is probably, I don't know, around half, as far as I remember, if not more. That has been the result of the increase in the cost of providing safety, which is one way of describing the downward trend in the yield on bonds.

We talked about this trade-off between risk and return; it has driven people in aggregate away from those schemes.

Q3250 Chair: Doesn't that worry you a bit because the uncertainty of DC pension schemes, the inability to be able to plan because you don't know—



Dr Broadbent: Yes, but someone has to bear that risk. The alternative is to ask the shareholder to bear the risk, with the potential, as you say, for restraining the expansion of the company. So there's no free lunch here.

Q3251 **Chair:** So you see it as an inevitable trend that just has to be—

Dr Broadbent: It may be possible to tweak some of the regulation to the ends that Mr Field described earlier about whether you can allow high-yielding assets into these funds. I should say that there is not an equal distribution of these deficits or an equal distribution of these liabilities. So, I do not want to say it is inevitable that they have to die away completely because behind those aggregates there is quite a skewed distribution. The biggest numbers belong to those firms, as you would expect, that have a lot of ex-employees. So the aggregate may not describe the average position. All I am observing is that the trends in asset prices over the last 20 years have had that effect and it is not a terribly surprising one.

The difficulty here is, as a society, and given what I said earlier about probably there being too little saving in aggregate, it would be nice to imagine we could have a vehicle that, in a sense, forced people to do it, which is one way of seeing at least fully funded pensions, whether DB or DC. I think those are extremely valuable because it is not an easy decision to take. When you are younger, it is always something you want to put off, yet when you are older you will regret not having done it.

Q3252 **Chair:** How do you see auto-enrolment in that context?

Dr Broadbent: I think it is a helpful thing.

Q3253 **Chair:** It is something that should be encouraged, increased and built up?

Dr Broadbent: Yes. Yes. There may be other things that one can do, as you have described, Mr Field, to ensure the continued survival of the DB scheme.

Q3254 **Chair:** But, of course, the increase of products in the ISA range, which come out of taxed income and then are exempt at the moment they take them out and they can be mostly taken out at any time, even the LISA can be taken out fairly early, that does not necessarily encourage the trend of pension savings where the aim is precisely to have something for later, in retirement?

Dr Broadbent: Yes, at the margin it will help with that, but it probably also just helps having precautionary savings you can dip into at any point. I agree that, in some ways, odd though it may seem, people benefit from the opportunity to tie themselves, tie their own hands, as it were, and say, "I am going to set this amount aside and I am not allowed to touch it until I am retired". That was the benefit of these schemes and, of course, it was—I wouldn't call it straightforward, but it was more straightforward for companies to promise that when people didn't live as



HOUSE OF COMMONS

long, when real bond deals were four, not minus one or two, equities were performing better and people stayed at the same firm for longer and so on and so forth. But they did have that advantage of giving people a means of forced saving.

Q3255 **Chair:** Finally, what recommendations, if any, would you have for what this Committee might do to try to help the pension sector at the moment?

Dr Broadbent: Gosh, that is a—

Q3256 **Frank Field:** Should we have asked that at the beginning?

Dr Broadbent: Yes, I think I have run out of time. No, I am not going to give you any big—I have tried to describe how I see the economics of what we have been facing. I do wonder, and this is not a recommendation, whether, even if, at the same time at an individual level, these falling yields have encouraged people to take too much risk in some areas, the regulation isn't herding people to a situation where, even if the gap between the prospective returns on this thing and that thing is widening, you are being forced at the level of the system into this thing. That is an advantage at the margin for a Government issuing debt, but it may not be the right decision for society as a whole.

Chair: Thank you. Does anyone have any more questions?

Deputy Governor, thank you very much, we are extremely grateful.