

Treasury Committee

Oral evidence: Appointment of Charlotte Hogg as the Bank of England's Deputy Governor for Markets and Banking, HC 1039

Tuesday 28 February 2017

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

Questions 1-135

Witness

I. Charlotte Hogg, Deputy Governor, Markets and Banking, Bank of England.

Written evidence from witnesses:

- [Charlotte Hogg - CV](#)
- [Charlotte Hogg – responses to questionnaire](#)

Examination of Witness

Charlotte Hogg.

Q1 Chair: Good morning and welcome to this pre-appointment hearing. I should begin by saying that I have, over the years, as I have got older, got used to doing business with people who are the sons and daughters of people I used to work with, particularly in the Treasury, not least for example the current Permanent Secretary of the Treasury, but it is very unusual—and in fact I think this is a first—that I can say that I used to have lunch with your grandfather in the Members’ dining room. I will put that by me and move straight on to some questions.

You wrote in your questionnaire that you have a detailed understanding of how households and businesses make financial decisions. Can you explain what you mean by that and how you think that is going to help you understand MPC decisions?

Charlotte Hogg: Yes, of course. Over the last decade or so, I have been responsible for managing three different consumer businesses, predominantly in financial services. The first one was running a credit card business through the financial crisis and, as part of that, understanding the details of how people get into financial distress and what you can do to try to restore that. Much of what I did there was also making sure I spoke to customers, read their letters and really understood what was causing it. You cannot run a consumer business without really understanding what your customers think and feel.

Subsequently at Experian, we ran a direct consumer business advising people around their debt, which is called CreditExpert, but we also had a whole range of understanding of customers and consumers around credit, which supported a whole range of businesses. In fact, I used to say to our colleagues that we did everything from help our banks lend money appropriately to solve teenage pregnancy, because the data that we used was so varied and could help solve such a range of problems.

Lastly at Santander, I was responsible for the branch network and I would spend a good day every couple of weeks in all of our branches talking to colleagues there, but also talking to customers. I also made sure that I read all of the executive letters that came to us every week to understand what had happened to customers, why they were in the situation they were in and how to think about managing through it. That is quite relevant, because the other thing you understand is that, as you make decisions around products, pricing and after all interest rates, you are in a sense part of the transmission mechanism, which is the phrase people use for how interest rates are passed through to consumers and what the responses are. I might be unique on the MPC as being part of the transmission mechanism in my past, as well as thinking about how it might affect customers.



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That is really why I hope I bring a slightly different point of view with an understanding of how households and ultimately how businesses might think about any changes or policies that we might make.

Q2 Chair: Have you ever had a job that requires you to think through how the MPC is arriving at its decisions?

Charlotte Hogg: Both in the credit card business and in the retail banking business, you are constantly making pricing decisions. What price should we set on mortgages? What price should we set on credit cards? What is the right rate for our savings products? All of those factor in a range of things including what the interest rate is going to be and how we are going to fund ourselves as a bank. Whilst obviously I have not made policy decisions before, those policy decisions have been very relevant to decisions we have had to take in a business context and, therefore, we thought about them fairly deeply but from the outside.

Q3 Chair: The reason I ask that question is that the majority of people who gravitate to the MPC job are people who have done that and who have been thinking professionally, for a long time, about the factors that go to make those decisions. You do not have that experience.

Charlotte Hogg: I do not, and I think it is a plus because, as we know, the MPC is made up of nine people, all with independent votes. Everything one learns about decision-making is that you want a difference of views and a difference of experience coming into those decisions.

Chair: We can look to you to break down groupthink.

Charlotte Hogg: Groupthink is not alive and well at the Bank anyway, but it certainly helps to have a different set of cognitive experiences and a different set of careers, serving the same objective and the same mission.

Q4 Chair: It was certainly alive and well a decade ago, and we spent our time trying to exercise vigilance to ensure that it does not resurface. You are giving us confidence that, on the basis of your experience, there is not groupthink, are you?

Charlotte Hogg: What I can talk best about is what we are doing more broadly in the Bank to make sure that we have a diversity of thought and a willingness to include all sorts of different views. I obviously have not been part of the MPC yet or any of the policy committees, so I can only observe what I have seen over the last three and a half years. We have worked very hard, and I think quite successfully, to change the way that we reflect the people of the United Kingdom and to include those views. In our staff survey this year, the aspect that went up the most was the one about inclusion and people feeling that they are included and allowed to speak up. That is quite good evidence that the Bank is changing and I would think that would ripple through to all the committees.



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Q5 Chair: What we are trying to assess, as I am sure you appreciate, is whether we are returning to an over-mighty governorship again. Now that you are coming into this post, which is arguably the most important and pivotal deputy governorship of the lot, being on so many of the key committees, we are looking for your capacity to challenge the Governor and, if necessary, to be seen to be challenging the Governor publicly. Do you think you are up to that?

Charlotte Hogg: I do. One of the reasons I put in my questionnaire a sort of personal history of the decisions that I have had to make is to give you a sense of the fact that I always try to be very clear about the objectives I am there to serve and then my desire to serve them irrespective. The example I gave you, which was a very difficult one, comes from when we spun Goldfish off from Morgan Stanley in July 2007. We were securitised; we were conduit-funded so, come the crisis, we were in a situation where we might not have been able to serve customers or our shareholders for the indefinite future.

I took the decision that we had to sell the business, which was an incredibly hard decision knowing that it was potentially going to impact at least 1,000 people's jobs, particularly up in Cumbernauld. It took a while for me to persuade all our senior leadership back in Chicago that that was the right thing to do, but I give it to you as an example of being prepared to do things that are pretty painful and very difficult but that you think are in the interests of the objectives that you have been given to serve. I could give you others, but I hope that will give you some comfort.

Chair: Let us stop there for now. Others might come back to this point.

Charlotte Hogg: I am terribly sorry—can somebody do something about the light?

Chair: I am very sorry about that. We have the blinds down. Maybe you could move one seat along. Is that better?

Charlotte Hogg: That is much better, thank you.

Q6 Kit Malthouse: On the point of challenging the Governor, what is he doing wrong at the moment?

Charlotte Hogg: I have challenged him more in my pre-existing role as COO. There have been circumstances when, in my responsibilities, we have disagreed. They tend to be around staff issues or particular parts of the organisation, and sometimes I have ended up agreeing with him and sometimes he has ended up agreeing with me, but I can think of a number of examples when we have not been absolutely in sync at the beginning.

Q7 Kit Malthouse: Are you able to give us one of those?

Charlotte Hogg: I do not really want to give you examples of staff issues, if you will forgive me.



Q8 **Kit Malthouse:** Was that purely on the staffing decisions?

Charlotte Hogg: It was on all the things that I am responsible for. I am responsible for HR, technology, finance and fintech.

Q9 **Kit Malthouse:** I understand, but I meant in terms of the new responsibility. What do you think of forward guidance, for instance?

Charlotte Hogg: It seems to me quite an abused phrase but, if you unpick what it means or what it means to me, it means to me that a central banker should be clearly communicating what it is that they are thinking about and why they are thinking about it, because the last thing you want businesses to have is uncertainty as to how a central bank might react; you do not want a surprise. It is also to recognise that that communication is contingent on events that may or may not occur. If I think about the things that are probably thought of as forward guidance at this point, it would be things like how we might move out of QE, where the MPC has said that we need to get bank rate to a level where we can flexibly raise it or lower it. That seems sensible to me. Alternatively, we have talked about the importance of, if and when bank rate moves, moving it in a limited and gradual way. Both of those seem sensible when you think about the underlying rate of interest. That is how I think about forward guidance.

Q10 **Kit Malthouse:** When the Governor appeared here last week, he effectively said that there was no forward guidance at the moment. Is that right?

Charlotte Hogg: As I say, it is a much-abused phrase, but the things that are very relevant to my new responsibilities are what the MPC has clearly stated about exit from QE and this point about moving in a limited and gradual way. Both of those are guidance about how we might react in the future.

Kit Malthouse: Those are general intentions, rather than forward guidance.

Charlotte Hogg: Clear communication and contingent events is how I would translate it.

Q11 **Kit Malthouse:** On that, what do you think are the consequences of this low-interest-rate environment for the UK?

Charlotte Hogg: This is a global phenomenon, not just a UK phenomenon. The factors that have caused it are global factors, such as people growing older and needing to save for their retirements. That is pushing down the global rate of interest. It is structurally lower at this stage, but the view is that it will begin to increase slowly, as some of those dynamics move and some of the debt overhang from the financial crisis moves off. It is a structural phenomenon; it is not purely a reflection of what we choose to have as the bank rate.

Kit Malthouse: You do not think it is cyclical; you think it is structural.



Charlotte Hogg: There are structural elements to it, because the demographic element of more people ageing and needing to save for retirement is a structural one.

Q12 **Kit Malthouse:** In terms of your general direction of thought when you join the MPC, your baseline will be that this is a structural change and rates will effectively be permanently lower than the previous norm.

Charlotte Hogg: They will be lower, but the expectation is that they will slowly begin to increase, which is why the MPC has said that any movements would be limited and gradual, in effect to replicate that.

Q13 **Kit Malthouse:** Back to my earlier question then, what do you think the consequences are of this permanent structural change?

Charlotte Hogg: I think that the job is always be mindful of the risks that might emerge from it, and they can be things like the search for yield, which could cause some market volatility. There are obviously questions that you are all thinking about in terms of distribution questions and pension questions. What happens to pension liabilities? I do not think that they are a result of the bank rate choices or even of QE. They are potentially a result of having a lower equilibrium rate of interest.

Q14 **Kit Malthouse:** One of the issues that we have discussed a few times here is effectively the forecasting errors, in particular in relation to inflation. One of the suggestions that we have put to the Governor and that he has bridled about is that part of this is that everybody in the MPC thinks the same way. Effectively, they all come out of the same educational establishments, the same banks, the same backgrounds and all the rest of it. Notwithstanding what you said earlier about your experience and your willingness to challenge the Governor, do you think that your fantastic CV, although it is fairly glittering, is any different from any of the other people on the MPC? There is quite a lot of Oxbridge representation. Obviously you have worked in all the major banks that are already represented on the MPC. I guess what I am looking for is why you think that you would be in a particular position to challenge or change that kind of groupthink that the Chairman referred to.

Charlotte Hogg: There are a number of things bound up in your question, if you will forgive me, Mr Malthouse, so tell me which one you want me to hit first. I am guessing it is the one on consensus views. I do think I have a different career. I have worked in both the US and the UK. I have worked in consumer businesses. In that respect, I have probably travelled more around the country than any of them. I have led quite big organisations—organisations of 10,000 people, 3,000 people and 1,000 people. That makes me different. A lot of my work has been around risk management. Experian is an extraordinary business in terms of helping you to understand risk management, and risk management for businesses as well as for consumers.

Do I believe that the Bank of England should reflect the people of the United Kingdom? Yes, I do. We have done a lot to improve and we still



need to improve our diversity over the next few years but, if you look at the movements we have made, particularly in all of our senior leadership, we are now nearly 30% women and we were barely 20% when I joined. We are pushing hard in terms of our ethnic diversity. The Governor has just made a speech about inclusion. The whole journey towards reflecting the people of the United Kingdom, which we should do as a public institution, is well under way and we are wholly committed to it.

- Q15 **Kit Malthouse:** That is an interesting question, because you are obviously talking about diversity in terms of DNA, rather than diversity in terms of experience. One of the things that I have put to the Governor is that I cannot see anybody on the MPC who has had recent experience of small business. There is nobody there from the north, for instance.

Charlotte Hogg: I know we can debate the north, but I very strongly count myself as someone from the East Midlands. In terms of diversity, you are right to say, and we believe, that diversity of facts is not as important as inclusion, and you always want to have an environment where people can speak their mind, feel included, feel respected and bring a different point of view. As I said, our staff surveys are showing that the Bank has become much stronger on that over the last couple of years.

In terms of small business specifically, one of the things I most enjoyed at Experian was that we probably had the richest database of small business—built by an amazing entrepreneur I am very fond of—and we used that database to really understand where there are small businesses that can generate employment in this country and how to begin to project that. I have had small businesses as my customers and I have had a lot of small business data. I agree with you that it is now probably five years out of date, but it is an area in which I am particularly interested and it is also why, in my questionnaire, I focused so much on the importance of looking at business investment and the degree to which that is growing or declining and where there is consistency. One of the things I am really looking forward to is getting out and going around the country again, being able to talk to businesses, because it is a little bit of my background and I very much look forward to it.

- Q16 **Kit Malthouse:** After the next person is recruited to the MPC, what sorts of extra skill sets would you be looking for, do you think?

Charlotte Hogg: That is really a question for the Treasury and not for me, but I am sure we will want to continue to think about the range of cognitive experiences that you bring to a decision. We have nine people who can bring differences of view, but it is a decision for the Treasury.

- Q17 **Kit Malthouse:** One final thing from me is that you have declared some conflicts of interest. Obviously you have family connections in the industry, so what measures have you agreed with the Bank to manage those?



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Charlotte Hogg: My only connection at the moment, which you are referring to, is my brother, who is part of Barclays' strategic planning group. He has been for a number of years. I do not discuss work with him and he does not discuss it with me. We mostly talk about his children.

Q18 **Mr Rees-Mogg:** Good morning, Ms Hogg. Like the Chairman, I have met members of your very distinguished family over the years, including your grandfather, who kindly came to speak to me when I was at Eton. I remember him speaking in Greek on the steps of my house. It was a most impressive display. Thank you for coming before us. You are not going to speak to us in Greek; that is a relief.

Charlotte Hogg: No, I promise I will not.

Chair: Could you, if you needed to?

Charlotte Hogg: No, I could not.

Chair: That is a step forward, many people would say, except for Jacob.

Charlotte Hogg: I think he was disappointed in me.

Q19 **Mr Rees-Mogg:** It sounds like modernity, but never mind. To come on to monetary policy and your role on the Monetary Policy Committee, do you think too much is being asked of monetary policy, we have to be more realistic about what it can do and that it cannot do absolutely everything for the economy, at all times?

Charlotte Hogg: Yes, I do. I think it was Mark's quote that central bankers are coming to the end of their 15 minutes of fame. I have heard other descriptions of it. I do think important questions as to the future of the country, and how we reduce disparities in society and how we ensure long-term economic growth, are questions for the Government, and their policies are the ones that we should vote for.

Q20 **Mr Rees-Mogg:** Would you like to go back to stricter inflation targeting or do you think it is a bit further than pure inflation targeting, but not as far as overall economic activity?

Charlotte Hogg: I like to think of the role that the Bank plays as part of three things. There is the remit that is set for us by the Government. They phrase that in the way that they will. At the moment, it is phrased to require you to focus on an inflation target but to allow for some short-term volatility in output, to think about the aggregate and, as a secondary, to think about the economic policy of the Government. Our part of that is to, in an independent way, fulfil that remit, and your role is to hold us accountable. For me that triage works well. Clearly, if the Government wanted to change its remit it could, but we have had a history of that particular set of circumstances and combination working well, so I would be careful about moving away from it.

Q21 **Mr Rees-Mogg:** Do you feel that the MPC is under some pressure,



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without a formal change in its remit, to be doing more?

Charlotte Hogg: I am not aware and of course I am not privy to that just yet, so I do not think I can comment on that effectively.

- Q22 **Mr Rees-Mogg:** Do you have any concerns about the independence of monetary policy, partly in relation to the expectation that has built up of it doing more? If it does more, it is at risk of being more political, and that makes the questions of independence perhaps more prominent.

Charlotte Hogg: Our understanding of how the three balancing acts work is that Government set the remit, we have operational independence and then we are held to account. That is how we see our independence and I do not think that is under threat.

- Q23 **Mr Rees-Mogg:** You were not worried about the Prime Minister's speech at the party conference in October, which some people thought might be indicating a push against the independence of the Bank of England.

Charlotte Hogg: No, and I think she subsequently reinforced her support for the operational independence of the Bank of England.

- Q24 **Mr Rees-Mogg:** In terms of within the Bank, one of your replies used insights from the FPC in relation to what you are doing on the MPC. Do you think it might be better if those two committees were one, so that it could be brought together? There is some conflict between the effort to create stability and the effort to ensure that the economy is going. Sometimes you have a sort of pushmi-pullyu: the FPC is pushing policy in one direction and the MPC is pushing it in another.

Charlotte Hogg: I have not seen that happen. What is strong about the three committees is that they are pretty clear as to what their objectives are. Once you start to muddle objectives, life becomes more complicated. The MPC's remit is very clearly around inflation targeting. The FPC's is around financial stability and the PRC's is around safety and soundness, and protection of policyholders, in the financial sector. That clarity is incredibly important, and everything I see from the outside, not the inside right now, suggests that it is working well. We also have to bear in mind that both the FPC and, as of tomorrow, the PRC are relatively young and they have come a long way in the last few years. I would not be for tinkering with it.

- Q25 **Chair:** Let us go back to an answer you gave to Kit Malthouse a moment ago. You said that, with respect to conflicts of interest with your brother, you do not discuss business with him and that that should be enough to allay concern of any conflicts with your work on the PRC particularly, which has direct responsibility for regulating Barclays. Have you discussed the reply you just gave with the Governor?

Charlotte Hogg: I have always declared, from the moment I joined the Bank, all of my potential conflicts of interest. I would be more than happy to discuss it with Mark if he wants to. I am pretty sure he is aware of it.



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Q26 **Chair:** I was just thinking about the specific reply. Now you are going on to the PRC, have you discussed that reply?

Charlotte Hogg: No, I have not discussed it with him directly, but I have shared all my conflicts and my response with him, clearly, so he is aware of it, and I have discussed it with our company secretary. Frankly, I did not know what my brother did—I mean, I knew he worked for Barclays, but I did not know what he did—until I asked him, so I could fill in the questionnaire. That gives you a sense of how little we discuss it.

Chair: I am sure you understand that it is not that I have any reason to disbelieve you.

Charlotte Hogg: I totally understand the point, of course.

Q27 **Chair:** It is that we need these conflicts of interest not only not to exist but to be seen not to exist. Did you discuss it at all with the Court and the Chairman of the Court, who has overall responsibility for corporate governance in the Bank?

Charlotte Hogg: To be honest, I cannot recall whether I have, but he has also seen the response to my questionnaire.

Q28 **Chair:** Neither the Court nor the Governor was consulted before you came to the conclusion that it should be adequate to say that you and your brother can just agree not to talk about Barclays.

Charlotte Hogg: I have not discussed it with him, but I am in compliance with all of our codes of conduct. I know that; I helped to write them. I have discussed it with the company secretary and I have declared it on my questionnaire. I am happy to go back and discuss it with them.

Chair: That is for your current job. We are talking about for your future job.

Charlotte Hogg: Yes, and they saw it in relation to my future job, but I will always declare it as a conflict at the beginning of any PRC meeting. I am happy to go back and discuss it with them.

Q29 **Chair:** You must have thought carefully about that question, given it is on the questionnaire and given, as you say, you then went back to your brother to find out about this. Before you came to that conclusion, did you consider whether you should recuse yourself from any discussion of Barclays when those take place on the PRC?

Charlotte Hogg: I have not sat on the PRC yet. It is certainly a possibility that I could recuse myself, but I would not do it without discussing it with the Chairman. I am happy to go back and do that.

Q30 **Chair:** Sorry, my question was: before you decided that just saying, "I won't discuss it with my brother", was a sufficient answer, did it go through your mind that perhaps the right answer to this would be that



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you should recuse yourself?

Charlotte Hogg: My honest answer is that, because I have never discussed it with him, it had not yet come up, but I am sure it would come up as I started to see the first sets of papers, because it is a natural question.

Q31 **Chair:** It did not occur to you prior to this hearing, but it is occurring to you now and it is certainly going to start occurring to you when you attend your meetings and see Barclays' detailed commercially confidential information in front of you.

Charlotte Hogg: You have certainly raised it as an issue and I will go back and discuss it with the Chair, the secretary and the Governor.

Q32 **Helen Goodman:** Good morning. I am not sure; when did we send out this questionnaire? How long did you have to fill out this questionnaire from us?

Charlotte Hogg: I think it was about 10 days.

Chair: It is a very standard questionnaire though, so since the date of your appointment the Bank will have known that something very like this is going to appear.

Charlotte Hogg: I did not start completing it until I received it.

Q33 **Helen Goodman:** In response to the questions on QE, you have written, "I would note that, over the period since the early 1990s, the distributions of income and wealth in the UK have been relatively stable and have actually declined since 2007". That is not true.

Charlotte Hogg: The factor I am referring to is that the proportion of income earned by the 1% and the top 10% has declined over the last couple of years. The 1% has gone down from 15% to 13%, and the 10% has gone from 8.5 times to 7.5 times. That was the basis on which I was making that comment.

Q34 **Helen Goodman:** It is true that income inequality has declined over that period, but it is not true that wealth inequality has declined over that period. Were you aware of the fact that wealth inequality has increased since 2007?

Charlotte Hogg: What I was referring to was that the Gini coefficient for income and wealth inequality has been relatively stable since the 1980s but, if I have got my facts wrong, then obviously I will come back and check.

Q35 **Helen Goodman:** You have written that income and wealth inequality have actually declined. The Gini coefficient for wealth has gone up from 0.61 to 0.63. For example, the share of the top 10% has gone up from 51% to 54%, so that is not true. Are you conscious of the paper that the Bank of England wrote in 2012 about the effects of QE?



Charlotte Hogg: Yes, I have had some briefing on it.

Q36 **Helen Goodman:** What the Bank found was that the top 5% saw an increase in the value of their assets to the tune of £185,000. You say that monetary policy is not the tool to address inequality, nor is it intended to, and that this is part of what you call the benefits of the clarity of the remit, but I wonder if you can think in the real world—the real political world in which we live—of a policy that we could introduce to take £185,000 away from the top 5% of people who have benefited from the effects of QE up to 2012.

Charlotte Hogg: The way I have thought about it is that if you believe, as I do, that the monetary policies over the last decade have helped to increase growth and employment beyond the levels that would have been expected—and I think people talk about 1.5 million in additional jobs—and if you believe, which I do, that the bulk of income comes from earned income, then I would say that the benefits in terms of growth and employment, in line with the remit to drive aggregate growth, are the ones that we should and did adopt. It is not for me to determine the fiscal policies of the Government, but it is for us to look at aggregate output and growth. That has been positive, and therefore positive for distribution overall. I would prefer to have people in jobs than not.

Q37 **Helen Goodman:** Of course that is true and I agree with you. Of course it has been good for incomes; it has been good for growth; it has been good for employment levels. The question was about the drawbacks of QE. Would you not say that this impact, this increasing of wealth inequality, was a drawback?

Charlotte Hogg: No, because, on the balance of the strengths of QE, which was to drive ultimate growth, drive income and drive jobs, that is the option I would always have gone for.

Helen Goodman: You do not think that the increase in wealth inequality is a drawback to the policy.

Charlotte Hogg: I think that we were given our remit, we have performed our remit and it has not damaged income inequality. That is a preference in the end. As a citizen and as someone who cares deeply about society, yes, of course I care about distribution effects and I also care about the distribution effects between generations, as well as wealth levels. But that is a thing I think about when I vote, and it is a thing that I look to the Government to begin to address.

Q38 **Helen Goodman:** When house prices go up, people have to spend more of their income on rent or mortgages, so the impact on levels of income after housing costs is negative from doing this. Do you think that very neat and tidy distinction between income and wealth is at all misleading?

Charlotte Hogg: No, I do not think it is misleading. One also needs to remember that house prices have gone up because there is not enough supply of houses in this country. I think we all welcome the increased



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housebuilding that is going to come. I do not think that one can point to QE and say that that is the only reason, in fact even the major reason, why house prices have gone up.

Q39 Helen Goodman: No, nobody is saying that, but the Bank of England itself did the analysis that showed that the impact on the wealth holdings of the wealthiest people had gone up. £185,000 is a very significant amount. Let me ask you about something else. In your CV, you have talked about what you did at Santander and your responsibilities there. You say you were accountable for various things, including offshore private banking facilities. What are offshore private banking facilities?

Charlotte Hogg: At the time, we had a couple of branches in Jersey and the Isle of Man, which were supporting mainly UK and international customers in terms of their deposit holdings. All they pretty much did with us was savings, in my recollection.

Q40 Helen Goodman: What lessons did you learn? Did you think that the rules of the game with respect to offshore private banking facilities were okay, needed any reform or that we should look at them?

Charlotte Hogg: As I said, my recollection of what we were doing was predominantly deposits and savings. As far as I can recall, it was not wealth management to a broad degree. We were also of course going through that period of understanding what citizenship everybody had, very importantly, because that was important for all of our tax reporting. If the question you are getting at is a concern about taxes, I am very confident that Santander was very alive to these issues and very focused on making sure that, if people had bank accounts in Jersey, there were very good business reasons for it.

Q41 Helen Goodman: Obviously the prudential regulation responsibilities that you will have are primarily about the stability of the banking system, and there are always difficult and tricky judgments to make about how much and to whom the institutions should lend. Do you think the Bank has any role at all in improving financial inclusion in this country?

Charlotte Hogg: If you will forgive me, I will answer it a little bit differently, which is to say that I really welcomed the steps that we took on housing specifically to put some limits on lending to customers whose loan-to-income was over 4.5. I do worry, and I have always worried, about where people are close to the edge in terms of what they can afford and where they stretch too much. From the basis of my experience as well as from the basis of financial stability, I really welcomed those changes in underwriting standards. That thinking, where the financial stability objective is in play, but which will ideally have the benefit of making sure that the right people are gaining affordable mortgages, is something I would welcome. That is where we should aim.

Q42 Helen Goodman: That was not quite what I had in mind when I was talking about financial inclusion. I was really talking about people who are way below the income level for buying a house and what banking



services are available to them. Perhaps you think that that is not something that falls to the Bank to think about.

Charlotte Hogg: I do not think it strictly does. The other thing I would say is that I have been doing a lot of work on fintech recently, which is potentially very powerful in terms of enabling different kinds of banking services for a much broader range of customers, because we are seeing a different range of banking providers emerging. I know we have authorised a number of them. You are seeing potential benefits from the API moves for banks, which allow them to reach more customers. The ability to use many different channels, rather than require people to always physically go to a branch, is a big opportunity, as are the initiatives around digital identity. I think all these fintech opportunities are potentially quite positive, and the Bank has been very clear that, when we think about the risks of fintech, we should also think about the opportunities, the ability to increase our banking services and the competitiveness of that.

Q43 **Chair:** I do not think your questionnaire response on conflicts of interest mentioned your mother's non-executive director role at the FCA.

Charlotte Hogg: I referred you to her *Register* at the House of Lords, I think it is called.

Q44 **Chair:** Is that something that needs a bit of thought?

Charlotte Hogg: Everyone is always aware of it. It has always been disclosed: it has always been disclosed on her record; I have disclosed it on the questionnaire. I do not see it as a conflict, but again I am very happy to go back and discuss it further with the Chair.

Q45 **Chair:** The *Register of Members' Interests* was, but the specific issue is the fact that she is sitting as a non-executive director, where one of her crucial jobs is to keep an eye on the work of the chief executive, who will be sitting alongside you on the FPC. Again, I do not think this is a question of my suggesting that there is some conflict of interest, but there is a perception issue here, though it is perhaps less serious than the Barclays issue. That is maybe something that needs a bit of thought if he ends up taking a line that is very different from the majority, perhaps you and the Governor, conclude would be appropriate for the FPC. Does it occur to you that that might cause a perceived conflict?

Charlotte Hogg: On that issue, I am struggling to think of a scenario where there would be a conflict, but again there is good awareness of her role and I am happy to discuss, if I think that scenario emerges, how best we handle it, but it has not emerged.

Chair: I think this exchange might help, and that is why I decided, although it is a much less substantial issue than the one with a commercial aspect, which your brother's has, that it should be put on the record.



Q46 **Mr Baker:** Good morning. You previously noted something said by the Bank: "The MPC has previously stated that it is unlikely to reduce the stock of asset purchases until bank rate has been raised to a level from which it can be cut materially, judged to be around 2%". Are you happy that that is the right level from which to consider unwinding QE?

Charlotte Hogg: The important part of that is the first part of it, which is to get it to a level where it could be raised or lowered, effectively. They have judged that to be around 2%. That is the contingent part. The important part is to have the flexibility of bank rate to be able to use it as a primary tool.

Q47 **Mr Baker:** You will be part of reaching the right judgment of when the right moment has come, so how will you reach that judgment?

Charlotte Hogg: Clearly bank rate will be quite a lot higher than it is today and we will be looking at a large number of factors, most importantly what the remit is and how close we are to our inflation targets. It is probably quite a long way off in the future. In all the predictions of where bank rate might be at the moment, the markets are implying a rise somewhere in 2019.

Q48 **Mr Baker:** Are you saying that you will not need to make this decision and therefore it is not important to consider how the decision might be made? I am trying to understand on what basis you will decide that the moment has come to unwind QE.

Charlotte Hogg: We will be in a position where bank rate will have become the primary tool and will be able to be the primary tool effectively, so we will be in a very different economic environment and we will be looking at many of the factors that drive that. It is quite hard to predict a scenario in the future and to say that you would judge it in any way differently from how you would judge any decision, looking at the evidence at the time, and the facts and data that are in front of you.

Q49 **Mr Baker:** Andy Haldane came to the Committee. It was reported in the *Telegraph* on 12 June; I am not sure of the date of the hearing. The quote is: "We have intentionally blown the biggest Government bond bubble in history". Do you think that bubble has burst or otherwise deflated?

Charlotte Hogg: I am afraid I do not recall his speech but, if you are asking me if I think that there is a problem in the gilts market as a result of QE, I would disagree. Clearly the Bank balance sheet does hold a large number of gilts, but there are 200 billion more gilts in the size of that market since we started the QE programme. We own around 20% of the total gilts in their entirety. We have had some quite volatile periods recently without any real stress in the market, and we have taken steps to make sure that, when needed, we will repo our gilts out via the Debt Management Office. I do not see that I agree with his comment at that point.



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Q50 **Mr Baker:** Which part of his comment do you not agree with? The Chief Economist was very clear in what he said. "We have intentionally blown the biggest Government bond bubble in history". Which bit of that was wrong?

Charlotte Hogg: I do not see evidence that we have a bubble at the moment, nor do I see evidence that it has burst. What I see is a reasonably functioning and effective gilts market.

Q51 **Mr Baker:** Have you discussed with Andy Haldane why he said that?

Charlotte Hogg: As I did not know he had said it until you said it to me, no, I have not.

Q52 **Mr Baker:** Do you accept that QE does change the price of bonds and their yield?

Charlotte Hogg: It has had a very limited effect, as I said, because we still hold a relatively small part of the market, because we still see evidence that the markets are functioning effectively, because the volume of gilts has increased and because we have weathered through some bumpier periods recently and not seen great evidence of that. We have recently just completed some of our operations to reinvest and we have been able to do it at a very effective rate. I do not see evidence of that.

Q53 **Mr Baker:** Would you mind explaining what you think the transmission mechanism of QE is? In what way does it affect the market? What is the point of it?

Charlotte Hogg: One of the ways in which it affects the market is to move through into asset prices. As Ms Goodman said, we have seen some increase in house prices. We have also, most recently, seen benefits in terms of company funding rates. We have seen the benefits from the corporate bond programme as well. We are seeing it feed through into asset prices. What I said was that I do not see a dysfunctional gilts market as a result.

Q54 **Mr Baker:** I am trying to get you off the horns of a dilemma here, because I think you have told me that the transmission mechanism of QE is asset prices. You are saying that the bond market is not dysfunctional, but you are accepting that bond market prices do change as a result of QE.

Charlotte Hogg: Real gilt yields have come down. If that is what you are referring to, then they have, but for that I would refer you back to my earlier answers about the real rate of interest, because that is what fundamentally has also come down.

Q55 **Mr Baker:** What I am trying to drive at is: what has QE done? How will it be unwound and how will you make decisions about these enormously important issues, which are still experimental, to a large extent? Do you accept that some of the questions are poorly defined and the answers to



them are as yet unknown? Would you accept that and, if not, what do you think is the state of theoretical understanding of unconventional monetary policy?

Charlotte Hogg: It is still a relatively early tool, but everything we know suggests that it has been effective, much in the way that bank rate has been effective, in terms of driving output and employment, in an environment where inflation has remained stable. Clearly, exiting from it is going to be a very important issue to think through carefully, because you would want to make sure that we do not cause any disruption in the gilts markets as we do that.

At the moment, the thinking is that we would do it through a series of either preannounced sales or failures to reinvest. We would work very closely with the DMO operationally. We would clearly have to monitor the markets very closely to understand what the impact was. We all have some of the lessons learned from the Taper Tantrum in 2013, so there is no question that it is an issue that will need to be managed incredibly thoughtfully and carefully, and got right operationally.

Q56 **Mr Baker:** Since you mentioned the operational need to get things right and you mentioned the Taper Tantrum, what do you think were the factors at work that caused the Taper Tantrum and how would the Bank avoid them?

Charlotte Hogg: I suspect that some of the factors at work were surprise, which is why we have emphasised the importance of communication and pre-announcement and, as I said, communication more broadly, going back to an earlier answer. I know that, as the Bank, we are trying much harder to be as clear as we can be as to what actions we might take, under what circumstances. Communication will be an incredibly important element of this.

Q57 **Mr Baker:** You have given economic expectation, but have you given much thought to the scholarship of economic expectation and where you might look theoretically for research and understanding about how economic expectations shift markets and, therefore, how you as an MPC member could take that scholarship into account in reaching your decisions?

Charlotte Hogg: Sorry—do you mean expectations in general?

Q58 **Mr Baker:** You have mentioned that surprise was one reason for the Taper Tantrum, so that points to the body of scholarship around economic expectations. I wonder where you would look in that body of scholarship when you, as an MPC member, need to reach decisions about how QE is unwound without producing market disruption.

Charlotte Hogg: That is a great question. I will certainly be asking my colleagues but, on the question of expectations in general, we live in a really interesting time. One of the things I have put in my questionnaire, as you may have seen, is that what you learn from consumer businesses



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is that people can move fast and surprise you. One of the things we are going to look at very much more is what data sources there are that could help us to predict those very quick shifts. I will not say I was scarred, but I am very mindful of a period in my life when I was working at Santander and we were downgraded. The communication and the consumer expectations moved very fast over two days and impacted our deposits quite quickly. I have seen that kind of behavioural move accelerating, certainly in commercial businesses, over the last few years.

Q59 Mr Baker: We all appreciate your very practical experience at a very senior level. Nobody doubts it. I appreciate that you are not a monetary scholar but, if you needed to refer to monetary scholarship, are there a couple of scholars that you would think of looking up, a couple of scholars of monetary theory whose work you would turn to, to understand the conversation that was before the MPC?

Charlotte Hogg: Ironically, the thing I would come back to is some of the work on behavioural economics I first saw when I was at Oxford with Sir John Vickers. He is one of the scholars I enjoyed very much at the time, and I have had the pleasure of working with him since.

Chair: You should have replied Kevin Dowd and Kevin Dowd.

Charlotte Hogg: I should have done, should I not?

Q60 Mr Baker: Just to check that I was asking a fair question, I scribbled a list of scholars earlier in the meeting, but I am not going to sit here and read them out. How is money ordinarily created in the economy?

Charlotte Hogg: Money is created initially from the reserves that banks hold with the Bank of England and then through lending and deposit activity.

Q61 Mr Baker: How is the majority of money created?

Charlotte Hogg: The majority of money is created through lending and banks' maturity transformation.

Q62 Mr Baker: When you say maturity transformation, what do you mean by that?

Charlotte Hogg: What I mean by that is that banks take deposits in the short term and lend them out in the long term.

Q63 Mr Baker: Forgive me, but I do just want to press on this point, because I rather regretted not doing similarly in a previous similar hearing. What is a bank deposit?

Charlotte Hogg: A bank deposit is a record of a customer holding of the money that they have.

Q64 Mr Baker: It is a liability of the bank to the customer. Is that right?

Charlotte Hogg: A deposit is a liability, yes.



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- Q65 **Mr Baker:** How would you lend out a liability?
Charlotte Hogg: You would create an asset from it, which is a loan.
- Q66 **Mr Baker:** You are saying that there is a direct connection between the deposits that the bank takes and the loans that the bank makes.
Charlotte Hogg: Historically there has been. Clearly lending far exceeded deposits running up into the period of the financial crisis. I think you are interested in 100% reserve banking; am I right?
Mr Baker: I have an interest in a wide range of scholarship, but I am sitting on this side, not that side.
Charlotte Hogg: I will refrain from questioning. I am sorry; where did you want to go to?
- Q67 **Mr Baker:** The point I was asking you was about how money is created. I am not trying to repeat your evidence; I am trying to understand how you think money is created. I think you have given two different ways. You have mentioned bank lending creating money and you have also pointed towards a connection between bank deposits, which you understand to be liabilities of the bank, and what banks lend, so what do you think is that connection between deposits and lending?
Charlotte Hogg: It is the ability of the banks to think about the risks they want to take and the reward that they might make, and the degree to which their assets are ultimately backed by stable funding, whether it is real notes and coins or whether it is reserves at the Bank of England.
- Q68 **Mr Baker:** What is the ultimate limit on credit creation by the banks?
Charlotte Hogg: Wise credit standards and good decision-making. Ultimately in our world, it is the degree of capital they have to hold against it.
- Q69 **Mr Baker:** That is a different answer from the one in the Bank of England's paper *Money Creation in the Modern Economy*, which says, "Monetary policy acts as the ultimate limit on money creation". I will not read any more of it. You do not need to put numbers on it, but could you characterise how the stock of money has changed since the crisis and how it had changed in the decade leading up to the crisis?
Charlotte Hogg: I am more familiar with the recent period where, just over the last nine months, we have seen money quite volatile, with quite a large increase over the first few months post the referendum and then it has stabilised and slowed down since.
- Q70 **Mr Baker:** In broad-brush terms, how did the stock of money change in the decade leading up to the credit crunch?
Charlotte Hogg: I am afraid I do not know. I can come back to you.
- Q71 **Mr Baker:** That is all right. I can broadly tell you that it tripled from



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£700 billion to £2.2 trillion and then, since the crisis, it has been broadly stagnant. Do you think that there is an important monetary phenomenon at work here that is categorically different before and after the crisis and, if so, what is that categorical difference?

Charlotte Hogg: My understanding is that we went through a period of trying to target the money supply and discovered that it was volatile and not as effective a tool as targeting the inflation rate, hence the move to inflation rate targeting in the late 1990s and through that point. I know that we keep very mindful of what is happening to the money supply in the subsequent period. It just reaffirms our belief that the inflation rate is a better tool for targeting than the money supply perhaps is.

Q72 **Mr Baker:** We have been through this with the Governor in some detail. I think it was in response to Mr Malthouse that the Governor broadly said—and I am not quoting literally—that the connection between monetary aggregates and inflation was non-existent. I am looking at *Money Creation in the Modern Economy* again and, at the bottom of the first page, it says, “The Bank of England aims to make sure the amount of money creation in the economy is consistent with low and stable inflation”. The Bank’s own papers by their monetary analysis directorate seem to establish a connection between the amount of money creation and low and stable inflation, so what do you say is the connection between the stock of the money and the level of—

Charlotte Hogg: In this instance, I would be agreeing with the Governor, since I already have.

Q73 **Mr Baker:** Will you be taking up this issue with the authors of this paper, who seem to assert that there is a connection?

Charlotte Hogg: No is the answer, because the great strength of the Bank is that our economists and our researchers should be able to write and think very broadly. We should always have an open mind to all different topics. That is why we started Bank Underground. The thought of me going back and tut-tutting one particular researcher, who has probably put a lot of thought into this, would not be helpful to our culture.

Q74 **Mr Baker:** There are three, but the point I am making is that these are the basic fundamentals of how money is created and destroyed, the role of the Monetary Policy Committee in ultimately determining the stock of money and whether it is or is not connected to the price index. To conclude, would you take a moment to tell us what you think your approach will be to these fundamental issues: the connection between money in its creation and indeed destruction, QE and the need to unwind it, and where the MPC’s policy will go in the future?

Charlotte Hogg: I would go back to the remit, which is that our job is to focus on a low and stable inflation target. That is the primary job. I can echo the Governor in saying that it is not to focus on the money supply. Clearly we will continue to monitor it, as an important indicator of the



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economy. Again, it is not directly connected to how we will think about unwinding QE and the balance sheet of the Bank. We will be focused on the degree to which we need to use both bank rate and QE as a reflection of monetary policy and, when we have the flexibility to move primarily to the bank rate, I believe we will move that way.

Q75 Chair: On QE, just going back to the question of what to do in the long run about the consequences of unconventional monetary policy, on balance do you think we would be better off unwinding it or letting it run off?

Charlotte Hogg: I do not see the distinction between the two, to be honest. The average duration of gilts at the moment is about 12.5 years. At the point at which we decide to unwind, I am sure it will be slow. There is a limited difference between just ceasing to reinvest and actively selling. That would change if the Monetary Policy Committee wanted to reduce the balance sheet much more aggressively, and then you would need to sell.

Q76 Chair: A large slug of the stock, a little under half but certainly over 40%, is at the short to medium end—less than five years—so, while the 12.5 figure can be slightly misleading, these are going to be very big and very tough decisions when they come. Do you think that the DMO might be an appropriate place to seek advice on how to execute this policy, since that is their bread and butter?

Charlotte Hogg: The choices around the balance sheet and unwinding of QE are and have to be seen to be solely the choices of the Monetary Policy Committee and independent.

Q77 Chair: Why? They are quite unlike any other aspect of your balance sheet. After all, they are underwritten by an indemnity.

Charlotte Hogg: Yes, but they are a reflection of monetary policy choices.

Q78 Chair: That is itself a controversial statement, is it not? Many would say that they also have a fiscal element.

Charlotte Hogg: They are a result of the choices that the Monetary Policy Committee has made, under the terms of its remit.

Q79 Chair: If I may interrupt a third time, this is Bank theology we are coming out with, at the moment, if I may say so. This is the doctrine that was created under Mervyn King to assert the supremacy of the MPC on all aspects of QE, which has been carried over. I am not saying it is wrong; I am just saying that you do seem to be supplying it lock, stock and barrel this morning.

Charlotte Hogg: I come back to this point that it is for the Government to set the remit, the Bank to have operational independence and for us to be held accountable. I do think you have to be careful of blurring those lines. You asked me if we should seek advice from the DMO. Where I



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was getting to is we will certainly discuss with them the operational issues of how we effectively do it, but it has to be the choice of the MPC.

- Q80 **Chair:** You have taken the decision in the MPC on the terms that you have just set out, where nobody else interferes with that decision. Let us suppose that for a moment. I think that that is highly unlikely, given that politicians created this policy and they are probably going to take a great interest in its unwinding, but we will let that pass. When we get to this operational issue, do you not think that the DMO has heaps more experience than the Bank in how to handle the markets aspects to the unwinding of QE?

Charlotte Hogg: The DMO has lots of very valuable experience and we would absolutely go and talk to them about how to most effectively do this.

Chair: The question was whether they have much more experience.

Charlotte Hogg: I find that hard to judge. I can look at the teams within the Bank that are effectively implementing, week after week, gilt auctions, bond auctions and, yesterday, the foreign bond support on foreign exchange.

- Q81 **Chair:** There has been criticism of their approach, has there not? You would have seen a paper published last year by the Bank for International Settlements.

Charlotte Hogg: I am actually not aware of that, no. Apologies, I will go and read it. If I look at the effectiveness of what we are doing, the rates that we are getting and the cover that we get for our auctions, it looks to me like we are working fairly effectively, but I am sure we can continue to improve. We are also looking to do an IEO report, possibly on the sterling monetary framework, which will also help us.

- Q82 **Chair:** What we are looking for in this hearing is a challenge to the conventional wisdom—not necessarily that it is all wrong but evidence that this is being challenged. I am not necessarily saying, “Why are you not saying the opposite to what the Bank is saying?” I am looking for evidence to suggest that you have had a go and, in that exchange, I have not found it yet.

Charlotte Hogg: As I said at the very beginning, I really do try to serve the objectives I have been given. That means that, if I agree, I will agree but, if I differ, I will differ.

- Q83 **Chair:** On a not entirely unconnected subject, certainly with respect to the early questions of Steve Baker, before Steve took you on a tour of monetary theory, you should know that Kevin Dowd is a—

Charlotte Hogg: Yes, my apologies for not mentioning him.

Chair: You always need to get Kevin Dowd in when talking to Steve about this.



Mr Baker: He will be so happy.

Q84 **Chair:** We have very recently discussed the decision to move from an estimate of NAIRU, although it is now called something else, from 5% to 4.5%. Are you a 5% woman or a 4.5% woman?

Charlotte Hogg: I could not tell you what I was, at this stage, because I was not part of the group. What I will do instead is what I always try to do, which is to look at the rationale that they have given for lowering it and the evidence to determine whether or not it holds true. The rationale for lowering it is around the ability of the long-term unemployed to come more actively into work, the sense that we are all going to be working a lot longer and therefore more of our lives are going to be spent attempting to be in employment, and higher educational attainment. The middle one of those feels particularly strong for me. I do think we are all potentially going to be working longer.

How are we going to determine whether this is right or not? One of the things we are going to look at is the degree of wage pressure and wage inflation. At the moment, it is running at about 2.6% overall and about 2.8% in the private sector. In the public sector it is about 1.6%, I believe. If that starts to accelerate more than is predicted, you have to begin to question whether the right rate is 4.5% or something closer to 5%.

Q85 **Chair:** What was your answer to my question then? On the basis of the exchanges you would have seen last week and the material that was presented, are you a 5% or a 4.5% woman?

Charlotte Hogg: I was not in all of the discussions that they were able to reflect.

Q86 **Chair:** All the material you need to form a view is now in the public domain and it is a very current and lively debate, on which there is a vote, which no doubt will come round very shortly, so I hope you feel that it is a reasonable question.

Charlotte Hogg: It is a reasonable question. I would be lower than the 5%, because of the rationale that seems compelling to me, but I will reserve my judgment on exactly where it is until we see the evidence pan out, particularly around wage inflation.

Chair: On the basis of the evidence, you are not a 5% woman and you might be somewhere near a 4.5% woman.

Charlotte Hogg: Indeed.

Chair: Okay—we got to the answer.

Q87 **Chris Philp:** Good morning. I notice, if I read the job description correctly, that your new role as a deputy governor, and as a member of the MPC, FPC and PRC, is in addition to your current responsibilities as chief operating officer. Is that correct?



Charlotte Hogg: That is right.

Q88 **Chris Philp:** You will be doing the jobs of two people in effect.

Charlotte Hogg: I do not think of it that way. I thought pretty hard about it, before thinking that these two things can be combined, so a couple of things have been done to make this work really effectively. First, at this moment in time, the kinds of responsibilities and priorities that the deputy governor for markets and banking has and I have as COO are quite similar, the most important of which is the rebuild of the real-time gross settlement system. That is the most important operational project we have, which has real impact on the real economy, and that requires very close collaboration between the technology areas that I run already and the banking areas that manage this. That is one point.

We have also reallocated some of the responsibilities of both roles. For example, the international directorate, which used to report to the deputy governor for markets and banking, is now reporting to the deputy governor for financial stability and monetary policy. Equally, some of the direct responsibilities I had for implementing the second strategic plan have been delegated to others, so we have effectively gone through—and it is very much in line with what we are trying to do at the Bank to delegate and empower—and reallocated responsibilities, delegated them or moved them into different areas.

I should say that there are also some areas where I overlap with Minouche, for example attendance at Court, the Audit and Risk Committee and in Chairmanship of the Executive Risk Committee. She and I both attended that. That is how it has been put together in a way that can be done effectively.

Q89 **Chris Philp:** Moving on to your very important new role as a member of the Monetary Policy Committee, you have not attended a meeting yet. Is that right?

Charlotte Hogg: I have not.

Q90 **Chris Philp:** When is your first meeting?

Charlotte Hogg: It is next week, I believe.

Q91 **Chris Philp:** You will be doing a lot of preparation ahead of casting your vote, no doubt. We have taken evidence before from members of the Monetary Policy Committee and read articles and speeches that they have written, saying that there are limits to how far you can tolerate above-target inflation. Do you think that those limits are likely to be reached in the next one to two years?

Charlotte Hogg: I think I wrote in my questionnaire that I have no tolerance for a lack of credibility in the path back to the inflation target. For me, some of the most important evidence that I will be looking for is that around inflation expectations. At the moment, if you look at both



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surveys and markets data, in the short term you can see a ticking up in terms of inflation expectations. They are still not yet above historical levels. The longer term ones are comfortably within historical levels, and the market implied rate is also around historical levels.

- Q92 **Chris Philp:** The Bank's own forecast, published in its most recent document, going out to 2020 has a central case in 2020 of around 2.5% as the CPI forecast. That is obviously above target. Given the Bank's own forecast right to the end of its duration is above target, do you see a credible path back to target?

Charlotte Hogg: At the moment, because inflation expectations seem to me to be well anchored and below historical levels, I believe in the credibility of the path.

- Q93 **Chris Philp:** What is the path, given the Bank's forecast to 2020 does not show it? What is the path back to the target?

Charlotte Hogg: The point I am probably making rather inarticulately is to say that, if consumers and businesses cease to believe that the 2% target is a real target and their inflation expectations go way beyond historical levels, you would start saying that there is no credibility of path back. It is the expectations I am looking at, less than the end of the forecast.

- Q94 **Chris Philp:** Given that the Bank's own forecast does not show us getting back to 2% within the forecast period, when do you think inflation will get back down to the 2% target, given the current monetary policy approach?

Charlotte Hogg: When you are asked to balance these two things, the output in growth in the economy versus inflation, you are allowed to look through the impact of the sterling depreciation on the figures. I would say that, if we did not start to see the impact of a sterling depreciation begin to diminish over the two-year period or clearly over four, then you would have more concerns. I come back to whether people expect inflation to be at 2%, at historical levels, or do they not expect that? If they cease to expect, then you really have to worry about the path.

- Q95 **Chris Philp:** Effectively you are setting monetary policy based on mass psychology, rather than fundamental economic analysis, are you not?

Charlotte Hogg: No. These data points are not just survey points; they are also markets.

- Q96 **Chris Philp:** Then you are outsourcing monetary policy to the markets, are you not?

Charlotte Hogg: No, I do not think so. If you find evidence that people do not expect the inflation target to come back, then you would believe that the credibility of the path has been damaged. The other thing you are of course looking at is the flow-through of sterling depreciation into pricing. You look for that effect to begin to taper off. The expectation is



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that that will be one to two years. If it looks much more systemic than that, again you would have more of a question about the credibility of that path back.

Q97 Chris Philp: Just to be clear, do you think the Monetary Policy Committee's method for hitting a 2% inflation target is to look at market expectations and massage them such that market expectation is 2% or, alternatively and mutually exclusively, to perform your own fundamental analysis of a variety of factors, which might include money supply, employment and the strength of the economy, and reach your own view of what monetary policy is required to hit the target?

Charlotte Hogg: You are perhaps not reflecting my point of view or perhaps I am not reflecting it correctly. There are clearly a number of factors you look at in determining monetary policy, and the ones you have mentioned are all valid. If you ask me what indicator I am particularly interested in, given what I wrote in my questionnaire about the credibility of the path, that is one of the indicators. It is not the only indicator, by far.

Q98 Chris Philp: CPI inflation has gone from effectively zero last summer up to probably 2% in February, 1.8% in January. What proportion of that increase do you attribute to the movement in sterling and what proportion to domestic inflationary pressure?

Charlotte Hogg: We believe that at the moment the vast majority of that is import prices flowing through in the depreciation of sterling.

Q99 Chris Philp: Okay, thank you. Moving on to the countercyclical credit buffer, it was reduced recently to zero and I think it will get reviewed in June. Had you been a member of the relevant committee when that decision was taken—I think it is the FPC—would you have concurred or dissented?

Charlotte Hogg: I would have concurred, and there are a couple of reasons I would have. One is that it is supposed to be used when you think there is potential for risks crystallising, effectively as an insurance. There was a perception that risk had crystallised. The second reason is a slightly different one, which is that, if you create a policy tool and then do not use it, you have a lack of credibility in that tool. Again, I referred back to a different experience, where you end up sitting in a commercial institution putting buffers on buffers, because you never quite believe in the clarity of the capital structure. It is important to have tools that can be used and can be used credibly. For both those reasons I concur.

Q100 Chris Philp: Could you countenance the possibility of a negative countercyclical credit buffer, if things got really choppy in the next year or two?

Charlotte Hogg: If you did that, you would be eating into some of the Pillar 2A buffers or the Pillar 2A portion of the capital stack. Given that they reflect supervisors' judgment on how to balance the quantitative



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metrics on Pillar 1 with all the different aspects associated with Pillar 2, it would be very hard at the moment, because you would effectively be discounting your own supervisory judgment, which would be a very awkward place to be. That would be my instinctive response to that.

- Q101 **Chris Philp:** There has been recent press discussion and possibly even a formal announcement about looking at the various ways risk-weighted assets are calculated in different kinds of institutions. You will obviously be sitting on the committee that has responsibility for that. Can you comment on your views on that topic?

Charlotte Hogg: The big issue, which I know Sam raised over the last couple of days, is this question about the risk weighting of assets under standardised models for mortgages, so that you have all of the relatively lower risk and lower loan-to-value mortgages under standard models being charged at 35% whereas, on they are much less on the internal-ratings-based models. That does seem to me to be an area that you would want to look at, because you would never want to discourage lending of relatively low-risk mortgages, particularly when you think that it tends to be the smaller banks and the challenger banks that are in that space.

- Q102 **Chris Philp:** Do you think that the smaller banks that do not use IRB risk-weighted models are being unfairly disadvantaged by the current regime?

Charlotte Hogg: Yes, we think that it is an issue at the moment.

- Q103 **Chair:** Do you agree with the criticism there has been about RWAs, which has been considerable, not least through the G20?

Charlotte Hogg: The question of what is the right RWA for different types of assets has been going on since I have been in the banking industry and probably much longer. It is important to have a model where you have some quantitative metrics, which ideally you continue to calibrate over time, as it is obviously not just the risk-weighted assets but things like the risk margin and the insurance side, plus supervisory discretion. I would be less supportive of any models that are purely quantitative and have no discretion.

- Q104 **Chair:** My question was a bit more precise. RWAs are more or less self-policing and the banks are expected to work out the value of their assets themselves and then invite the regulator in to take a look now and again. Broadly speaking, they do their own. It was discovered that banks do this in wildly different ways, leading to dramatic differences in RWAs for the same asset, when an analysis of that was done in Basel and eventually in the G20 process. Do you think that we should set much store by them?

Charlotte Hogg: You use a range of factors, and the leverage ratio is obviously the one that is the backstop to that.



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Q105 **Chair:** That is why I am asking the question, because your answer appeared to suggest that we should be placing more emphasis on RWAs, not less, and that the leverage ratio was going to drive people into higher risk assets, which is the standard criticism of its use.

Charlotte Hogg: No. The point I was purely trying to make is that RWAs, particularly for mortgages and small banks, can have—

Q106 **Chair:** Okay. If we create a separate regime or imagine that a separate regime has been created for a tier of banks that are unlikely to pose systemic risk because they are quite small, and we accept the argument about size for the moment, we can take them out of the argument. Now looking at the big banks, could you answer my question? Do you think we could rely on RWAs or do we need to lean heavily on the leverage ratio, given that we are dependent on the banks for most of the information to find out whether the RWAs are meaningful?

Charlotte Hogg: I would answer by saying that we need the four things that we probably have, which is a mixture of the capital ratios, the leverage ratios, supervisory discretion and high-quality liquid assets.

Q107 **Chair:** That is the same issue as before. This is a crucial issue and there was a big debate about whether to give the Bank the leverage ratio as a tool. This Committee and the Banking Commission, which I also chair, pressed vigorously for this to be taken out of the hands of politicians. Now it is in the hands of the Bank, we need to see this thought through very carefully, and I am just exploring the steps that you have taken to look at it. Can I just ask one more question in a related field? You made a very interesting remark in passing, a moment ago. You said that, when you were in the private sector, you never quite believed in the clarity of the capital buffer.

Charlotte Hogg: This is a long time ago in an institution that was based in the US and regulated by several different states, at the time. Just to be clear, it was way before the current capital regime, where we had as a broker-dealer multiple different regulators imposing different kinds of buffers. In order to make sure we were safe, we always just added a buffer to a buffer.

Q108 **Chair:** Do you believe in the clarity and credibility of the capital buffer now?

Charlotte Hogg: The capital regime we have now is infinitely clearer—and infinitely clearer than what I was living with when broker-dealers were regulated very differently in the US.

Q109 **Chair:** Do you agree with the Governor—I will be astonished if you do not, but let us see when I get to the end of the sentence—that we are a long way from resolution? That is, we are a long way from being able to resolve a major bank.

Charlotte Hogg: We are well down the path, but we are clearly not there.



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Q110 **Chair:** When do you think we are going to get there?

Charlotte Hogg: We will be in a much better place by 2022, when the minimum required equity and liabilities are in place to the level that we need them.

Chair: That is 15 years after the crash. In your view we will be there by 2022, barring accidents.

Charlotte Hogg: That does not mean to say that we are not in a better place now than we were.

Chair: I am accepting that. I am just seeking clarity on whether you think we are going to get to resolution by 2022.

Charlotte Hogg: I would hope so.

Q111 **Chair:** What is your answer to the Bank's criticism that this ring-fencing is a bureaucratic nightmare and that we might have done better just to go for increased capital? Actually, it is the same question.

Charlotte Hogg: Yes. We are well down the path at this point on structural reform and ring-fencing.

Q112 **Chair:** Would you start from here?

Charlotte Hogg: I might not start from here at this precise moment in time.

Q113 **Chair:** What would you start differently?

Charlotte Hogg: My point is that we have a banking industry that is in the middle of implementing ring-fencing and is also thinking about what its structures are going to be and what its business models are going to be, as the arrangements with Europe become clearer. That is quite a lot to do at the same time.

Q114 **Chair:** Were you a supporter of Vickers at its inception?

Charlotte Hogg: Yes, I was. Having lived on both sides of the fence, I was.

Q115 **George Kerevan:** Good morning. Could you tell me what the median disposable household income is in the UK?

Charlotte Hogg: Yes. It is around £27,000.

Q116 **George Kerevan:** You have reassured me. One of the worries the Committee has is not about your technical expertise but whether you are simply another member of the banking establishment. Could you reassure me further on that point?

Charlotte Hogg: I will certainly try to. There is no question I have been incredibly lucky with the family that I was born into. But I have also cared very much, throughout my career, about the importance of



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broadening the diversity and inclusion of the institutions I have been in and of building my own career, and not relying on what I was lucky enough to be given. I have also chosen to do consumer businesses. To be effective in a consumer business, you really do need to understand the different demographics and the different kinds of people in different parts of the country.

Whilst as you can see from my questionnaire I have rarely published, the topics on which I have published speak to that very much. The thing I was most interested in when I was in Experian was understanding where low-skilled employment was coming from in the country and whether you could begin to identify small businesses that were able to generate employment in a way that big businesses increasingly were not. That came from some initial work we did in Nottingham to think about the economic resilience of Nottingham through the recession, and then we tried to develop an understanding of whether you could predict which small businesses could generate employment, where they might be and what sectors they might be in.

Whilst you are making a very fair point, I hope, through the evidence of how I work, the engagement with customers and consumers and where I have done work off the back of businesses that I have run, it has been very much around how we create sustainable employment in this country.

Q117 George Kerevan: Let me move on from that specific topic to something that we have broadly not touched on yet, which is Brexit. What do you think would be the risks to monetary and financial stability if, at the end of the two-year negotiating period, the UK left without a trade deal and had to default to WTO rules?

Charlotte Hogg: First and foremost, the decisions on the negotiations are clearly a question for the Government. I want to think about this in terms of how we do the job that we have been given, which you are right to say is monetary stability, financial stability or, when you get to micro-prudential supervision, the safety and soundness of the institutions that operate here. Each one of those has to look at different aspects of this so, on the monetary policy side, I am most interested in what is happening to business investment and the degree to which businesses are continuing to invest or hesitating to invest. There is some evidence from our agents that people are holding off and capital decisions are big ones.

Q118 George Kerevan: Is that universal across the UK?

Charlotte Hogg: No, I would say it is anecdotal evidence from our agents, at this point, that some businesses may be holding off on investments. Speaking as someone who has made big decisions around capital investments, you do want to understand the framework in which you are operating as much as possible, but businesses are very resilient, so I am sure they will figure out a way through.



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On the financial stability side, there is this question about what happens particularly to funding and financing markets across Europe. We come back to this point that London is responsible for the vast majority of trading in FX and a good chunk of half the investment banking. There is this question about how banks change their business models and what kind of operational risk is involved with that.

If I was running a bank, if I had to move my business models around, there is a lot of operational risk in it. Where are the people who are properly talented? Where do you have systems that are going to work? How do you put the risk controls in place? How do you do a transition? What are the legal requirements? There is quite a lot of logistical, difficult, operational risk involved with that, and our job is to make sure we understand the ramifications for our system here in the UK and the management, safety and soundness of that system, which is what the PRA does all the time, but obviously on a different scale.

Q119 George Kerevan: I am obviously not asking you to take a stance on the Government's negotiations or what the Government are seeking to do but, in order to have some parameters that guide monetary policy in the medium term, I will press you. If we ended up coming out simply on WTO rules, would that produce specific monetary and financial risks to stability that the Bank would have to take account of?

Charlotte Hogg: On the monetary side, my understanding is that the forecasts assume a slightly less open economy than we have had in the past and they also assume sterling flowing through. If either of those two things were wrong, you would have to rethink your policy around that. On the financial stability side, the things to worry about are the risks of banks changing their business models and also any particular shocks to the financial system. Stress testing should give us all some comfort that we have sufficient capital liquidity to be able to make it through a number of shocks, and we have tested the equivalent through stress testing, but you have to be mindful that things can move quite quickly and be prepared for those. Those were the two things that we might think about.

Q120 George Kerevan: What do you think is necessary in the way of transitional arrangements for the financial system that might flow after the two-year negotiating period?

Charlotte Hogg: Again, I come back to what it takes to move a business model. What does it take in terms of hiring people or moving people? What does it take in terms of setting up the risk controls? It takes time. It always takes time to move business models and, in most of the regulatory changes we have made, we have had time—perhaps too much time in places. I would agree with colleagues that some level of transition makes sense just because, if I were sitting in the shoes of institutions that need to move their business models around, I would need time to plan that. We are very blessed in London at the moment



that we have such a richness of talent, people and systems that we can rely on that does not necessarily exist elsewhere.

Q121 **George Kerevan:** What length of transitional arrangements do you think we need?

Charlotte Hogg: Let me give you an example. When Goldfish was spun off from Morgan Stanley, we were given six months to list on the New York Stock Exchange. That was incredibly fast. In that period, we had to create our own brand, our own set of terms and conditions and our own bank charter, and we were a small institution of 1,000 people. Six months felt very short. When we talk about periods, you have to be looking beyond that into the 12- to 18-month period, just from my experience of having done something vaguely similar in the past.

Q122 **George Kerevan:** Is that a couple of years?

Charlotte Hogg: It is 12-18 months at least.

Q123 **George Kerevan:** Is that beyond the two-year negotiating period?

Charlotte Hogg: It is beyond the point when certainty is reached.

Q124 **George Kerevan:** When he last appeared before the Committee, the Governor suggested that Brexit was no longer the immediate number one risk factor for financial stability. Do you agree with him?

Charlotte Hogg: The way I would answer it is that stress testing has given us a way of testing a whole range of different scenarios and seeing if the banking system can continue to lend through them. It is true to say that some of the scenarios we have used are similar to an exit from the European Union. If I had to think about the future risks to financial stability that we have not yet fully tested and we are still on the journey on, I would come back to things like operational resilience and cyber, because those are risks that are not fully envisioned in our current stress tests and we are still on the journey of developing. That would be where I would go.

Q125 **George Kerevan:** That is interesting. You think cybersecurity has been understated.

Charlotte Hogg: No, I do not think it is understated, but we are still on the journey of how we develop the ways of thinking about it and the risks to mitigate it, where stress testing already factors in a range of different economic and market scenarios.

Q126 **George Kerevan:** You said we are on a journey on taking cybersecurity issues into account regarding stability. Where are we precisely on the journey?

Charlotte Hogg: The things that we have done, first, are really around penetration testing and response planning at the moment. The CBEST tests that we started a couple of years ago and have now done for about 30 institutions are a way of doing penetration testing that is



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intelligence-led, so they look to the specific threats to an institution and push against that. That has given the firms themselves and us in aggregate a very good picture of where they are in terms of the development of defences and detection from cyberattacks. The other thing that is so invaluable, which is kind of a stress-test mentality in a way, is to run a series of incidents with the different institutions and the different regulatory bodies to test what our response would be like. The one thing we know about cyber is that, if you think about it purely as "Keep them out of the perimeter", it is not even half the story.

Q127 George Kerevan: Where do you think British banks are in terms of international standards with their cybersecurity?

Charlotte Hogg: We do have not the stress testing. We do not have the CBEST comparisons for the rest of the globe. The things that we all know in terms of reinforcing defences against cyber come out pretty clearly from this. Things like having a good network segregation, things like having very good user awareness, and things like patching and hygiene always come out very strongly as some of your better defences.

Q128 George Kerevan: Just to go back to round off the discussion about Brexit, let us assume, on the other hand, that negotiations go well with the European Union. What sorts of arrangements would you like included in a deal, in order to maximise financial stability on the one hand and the performance of the City on the other?

Charlotte Hogg: Our job is financial stability. I think we have said very clearly, and again I believe, that we should not weaken our regulatory standards to try, in some way, to become more like the wild west. We would all be in favour of strong financial services that are prudently managed and regulated, and therefore continuing to adhere to international, consistent standards for the institutions that we regulate here and around the world would be a good outcome.

Q129 George Kerevan: Narrowing that, where do you stand on securing equivalence for UK financial institutions operating in Europe?

Charlotte Hogg: In the end, the exact relationships with Europe are for Government to determine. Do I believe that we benefit from international standards to which we have substantially contributed? Yes. Do I think that we would largely want to maintain the standards we have today? Yes. Do we believe that all the institutions that operate in the UK should be appropriately managed according to the PRA's special conditions? Yes, they should be. They should meet that.

Q130 George Kerevan: In terms of prudential regulation, post the UK leaving the EU, do you see any changes that you would make?

Charlotte Hogg: There are changes we have spoken about and I know colleagues have spoken about. There are changes to things like the risk margin on Solvency II. There are changes to some of the specifics around risk-weighted assets, but 80% of what we do today is broadly



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equivalent. Some is at our discretion, and maintaining that part of discretion is important.

Q131 **George Kerevan:** For instance on Solvency II, you think that some of the capital requirements for the insurance companies might be reduced.

Charlotte Hogg: It is some of the impact of the risk margin. It seems to me odd to discount liabilities at one rate and then revalue them at a different one, and the two do not move in sync. That seems like an odd way to do the valuation.

Q132 **George Kerevan:** In terms of other immediate risks to financial stability, leaving Brexit aside, I am looking at your written evidence. You suggested that conduct costs could be so large that they presented a prudential risk. Would you say, for instance, that the Department of Justice has been fining banks in Europe too much?

Charlotte Hogg: No. What I was trying to do in my questionnaire was to say what risks are pretty fully encompassed in all the stress tests and which ones are not, because they cannot be, because it is hard to predict all the different scenarios for conduct risk, although some elements of conduct risk were put into the stress tests. That is why I particularly highlighted operational resilience and conduct, because those are two things where you could imagine scenarios that we perhaps have not fully encompassed in the stress tests.

Q133 **George Kerevan:** You had made the point in your written evidence that the conduct costs can be quite major. We have at least RBS facing a potentially quite significant Department of Justice fine. What I am probing is whether you feel that the potential legacy costs are so great that it is time that we moved away from imposing those costs on the banks.

Charlotte Hogg: No, I would not agree with that. I can envision scenarios where the conduct costs are high and they do have a direct effect on the capital strength of any particular institution. That is as far as I would say. I do not think I would ever agree that people should not be held accountable for wrongdoing.

George Kerevan: We could hold individuals to account rather than fining banks.

Charlotte Hogg: It depends on the wrongdoing, so I would not go there.

Q134 **Chair:** Do you think these hearings are a good idea?

Charlotte Hogg: Yes. Do I enjoy them? Not terribly.

Q135 **Chair:** Why do you think they are a good idea?

Charlotte Hogg: If you believe at all in my model that Government set the remit and the Bank is operationally independent, you have to believe in the accountability piece, otherwise the three are really not in balance—you do not have a coherent system. You have to believe in



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accountability; you have to love accountability. These hearings are absolutely a good idea.

Chair: That is a very helpful final reply. Thank you very much for coming to give evidence to us. It is still this morning. That was a very interesting hearing and we will be giving careful consideration to the answers you have given. Thank you very much indeed.