HOUSE OF COMMONS

# Treasury Committee

## Oral evidence: Appointment of Elisabeth Stheeman to the Bank of England Financial Policy Committee, HC 758

Tuesday 6 February 2018

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Watch the meeting

Members present: Nicky Morgan (Chair); Rushanara Ali; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Mr Alister Jack; John Mann; Catherine McKinnell; Wes Streeting.

Questions 1 - 50

### Witnesses

I: Elisabeth Stheeman, Appointed External Member of the Financial Policy Committee.

Written evidence from witnesses:

– Elisabeth Stheeman CV

– Elisabeth Stheeman appointment questionnaire

# Examination of witness

Witness: Elisabeth Stheeman.

Q1 **Chair:** Good morning, Ms Stheeman. Thank you very much indeed for coming in for this evidence session this morning. We are going to be asking you some questions about your appointment to the FPC. Perhaps you could just introduce yourself for the record and for the benefit of those watching.

***Elisabeth Stheeman:*** I am Elisabeth Stheeman. I am to be appointed as an external member of the Financial Policy Committee of the Bank of England.

Q2 **Chair:** Thank you very much indeed. I wanted to start with banking culture and what role you thought that the culture in the banks had played in the global financial crisis. It is quite a broad question.

***Elisabeth Stheeman:*** It is a very broad question and I will touch on a few points. I am happy to go into more detail. Yes, culture is definitely something that I have been very interested in, especially from my governance work, both as a senior adviser at the PRA but also having been on boards. Having been in financial services during the financial crisis, I have certainly seen that the way culture works in an organisation makes a big difference. One part of the culture would be how the risk-taking is, in terms of how prepared people are to go up the risk curve. Another question would be what the dynamics are in teams sometimes and what the decision-making is. I have certainly seen that first-hand when I was on committees that would be thinking about how to make decisions on, say, where to invest money. It is always interesting to see how people deal with a process where you have to take an important decision.

Another point I would make on culture is certainly something on which both the PRA and FCA have been very focused. Culture also makes a big difference in terms of how boards behave. I know that is something has been a big topic globally. For example, the Federal Reserve Bank of New York has been very focused on that. I have been part of a working group looking at that as well. It is a really important topic and I am glad you raised it. For good reasons, there has been much more focus on culture in the last 10 years, since the global financial crisis.

Q3 **Chair:** Looking at the FPC's role in that and assessing financial stability, at what point does culture become a threat to financial stability and what role does the FPC have in monitoring what is going on and the culture in our banks and financial institutions?

***Elisabeth Stheeman:*** How the FPC would look at that, in particular, is in how lending, for example, gets decided in banks. It would, for example, tell financial services companies how broad they can be in terms of their lending limits. There are examples of when the FPC has given certain recommendations in terms of how high lenders can go up the risk curve and has taken decisions as to limiting that. One example would be the limit on lending in terms of the loan-to-income ratio, where lending has been limited to 15% for banks where lenders could not be over 4.5 times their loan-to-income ratio. The way that I would view it in terms of where the FPC gets involved is trying to find a way to keep the financial system safe and to ensure it puts certain limitations in place to avoid an excessive risk culture.

Q4 **Chair:** Do you think that the Senior Managers and Certification Regime that was introduced after the financial crisis is making a difference, in terms of a culture of responsibility?

***Elisabeth Stheeman:*** No doubt it has created higher responsibility for people. That is something that came out of the Commission on Banking Standards. I know it has taken quite a long time to put it into practice. I realise there was initially some scepticism about it, from firms and individuals, where people felt it takes more responsibility. At a non-executive director conference, which was jointly arranged by the PRA and FCA, this was discussed. It was discussed just after the Senior Managers Regime came in and then a year later, and it was interesting how the mood had changed. People realised that it actually makes a difference to decision-making when people need to take responsibility and when they have a very clear assignment of responsibility.

In my view, it has made a difference. As with all of these things, the proof is in the pudding. These are reasonably early days still, but from the research I have seen and the interactions I have had, when we have done governance reviews with a building society, for example, or another financial services firm, people take it very seriously.

Q5 **Chair:** In the most recent stress test, it was assumed that not only that there would be a severe macroeconomic downturn but misconduct fines of £40 billion. Is that figure a concern to you? Does that figure seem high or low?

***Elisabeth Stheeman:*** It is obviously a big figure. I would hope that it is not necessarily something that is a recurring theme. Clearly, over the last 10 years, misconduct fines have been awarded to a number of firms. I would hope it is not necessary for regulators just to use misconduct fines to improve regulation, so I would hope that regulations such as the senior managers regime you mentioned, and others, would improve behaviour. As always with stress tests, you would look at potential scenarios that might happen. The FPC's role specifically is to look at the tail risks, so the least likely things to happen. To answer your question, yes, it is a big amount. Do I think it is likely that it might happen? I would hope that the probability is relatively remote, but it is important to have a figure within the menu of the stress-testing scenarios, so to speak.

Q6 **Stephen Hammond:** Good morning, Ms Stheeman. Thank you very much for coming to speak to us this morning. I read your appointment hearing questionnaire, and I noticed your expertise in commercial property markets, both in the UK and in Europe. I also noticed your declaration that you are a member of a supervisory board of a bank and a German property company. It leads to this question. Given that is one of your areas of expertise and that you intend to recuse yourself from discussions of the commercial property market, perhaps you could say a little bit about where you think you might have to exercise that in discussions. Given that that is a key expertise and that you have also highlighted one of the issues that you see coming up in terms of financial stability being asset and property valuations, I wonder if you could tell the Committee how much you think you will be able to contribute to those areas, given what you have declared.

***Elisabeth Stheeman:*** Clearly conflicts were something I thought of very carefully before applying to this role. As you rightly point out, I included any potential conflicts in the questionnaire and discussed them, both during my hearing[1] and also subsequently, after my appointment, with the Bank's conflicts officer.

The way I see it working in practice is, first, before the first FPC meeting, I would send a letter to the FPC stating my various roles, just to ensure that there is no misunderstanding. Before each FPC hearing, there would be a conversation between the Bank's conflicts officer and the secretary of the FPC to consider what topics are on the agenda. There would only be a concern that I would be directly conflicted if there was a discussion where there might be an outcome that would directly affect a company whose board I am on, and then I would recuse myself. In practice, I hope this would not be something where I would constantly need to leave the room. If there was a specific discussion, say on the German commercial property market, then I would obviously leave the room, but in practice I hope it is the exception, rather than the rule.

Q7 **Stephen Hammond:** Does either the bank or TLG operate in the UK?

***Elisabeth Stheeman:*** TLG Immobilien is purely focused on Germany. It is the old Treuhand Liegenschaftsgesellschaft, which is a bit of a mouthful, the Treuhand being the East German participation of the German Government, which was privatised about five years ago and then taken public. That is purely focused on Berlin, Leipzig, Dresden and the former East German market, and has started to invest in West Germany as well. Aareal Bank is a global real estate lender, mostly focused on Germany, and also Asia and the US. They have a small branch in the UK and do mostly hotel lending in the UK, but it is not of any systemic importance to the UK.

Q8 **Stephen Hammond:** The Bank of England or the FPC at no stage

[1] Clarification from witness: "my hearing" should instead refer to "the appointment process with the Treasury"

suggested that it might be appropriate to come off the supervisory body of Aareal.

***Elisabeth Stheeman:*** We reviewed that ahead of the appointment, and the clear advice I got, both from the Treasury and from the Bank's conflicts officer, was that there would be appropriate measures put in place to ensure that I would not be put in a position where this could potentially be a conflict. I am personally very focused on it and want to ensure it does not put anybody in a difficult situation.

Q9 **Stephen Hammond:** After discussions with the Chairman of the Committee, perhaps it might be appropriate that the letter that you write to the FPC prior to appointment could be made public or at least sent to the Chairman. That would be extremely helpful.

***Elisabeth Stheeman:*** Yes, sure.

Q10 **Stephen Hammond:** Thank you. I also note from your written submission that you say, "I should add that the Treasury did not see my husband's position as a Treasury official as a potential issue". Would it be possible for you to tell the Committee if the Treasury set out why it did not see a potential conflict there?

***Elisabeth Stheeman:*** Clearly the Treasury would be able to answer this directly as well. My husband's role does not involve anything to do with anything the Financial Policy Committee makes any decisions on. He is the CEO of the UK Debt Management Office, which means he is involved in raising gilts for the UK Government. If, surprisingly, there was a situation where any decisions on the FPC might involve any discussions on gilts, obviously I would not take part in these discussions. Both the Bank's conflicts officer and the Treasury, having reviewed it, were of the opinion that this would not pose a conflict.

Q11 **Stephen Hammond:** I am grateful for that answer, but you can see why there may be some concern, or at least some perception of concern, given what the FPC's role is. Inevitably Government monetary policy will come up, and then potentially there is quite a significant issue for you, in terms of the number of discussions you may have to recuse yourself from.

***Elisabeth Stheeman:*** I would expect that there would be a similar type of procedure if a decision came up that might involve any discussion on gilt issuance or something. To give you an example, as you may have seen from my questionnaire, I am an independent member of the FMI board, the Financial Market Infrastructure board. As part of that role pre-appointment, it was reviewed how, to deal with any potential or perceived conflicts, there is a procedure in place where I would recuse myself if there was any discussion of anything to do with gilt issuance.

Q12 **Stephen Hammond:** I wonder if you could just say what you see as the purpose or the role of external members on the FPC.

***Elisabeth Stheeman:*** External members have a very important role to play, given that they bring external experience, having worked mostly in financial services and in academia, both in the UK and internationally. I would think that they could add very helpfully to the executive experience of the FPC. The Governor, the Deputy Governors and the Executive Director of Financial Stability are the other members, and then obviously the CEO of the FCA is a member and then the Treasury has a non-voting member. To me, where the external members can be really useful is when they think about risks that people who might sometimes be too close to the market may not be immediately aware of. I find that, sometimes, when you are very close to a matter you almost do not see the wood for the trees. It is quite good sometimes to have somebody who brings an external perspective.

To give you an example, one of the supervisory boards I sit on has somebody on it who has a very different background, as an insurance person. Quite often, he asks the question that nobody has expected, so that is certainly the way I would see the role of an external member: sometimes asking the question that may not be the obvious one. It could be a "stupid" question that nobody dares to ask.

Q13 **Stephen Hammond:** I would concur and I think the Committee will be heartened by that answer. You have obviously had a very distinguished career and, for the last three years, you have been an adviser to the PRA. One of the issues that a number of people are concerned about, and also presentationally concerned about, is the impact that might have on your independence, or the group-think concept affecting your mindset. Could you comment on how you think that may or may not have affected an outsider's perspective?

***Elisabeth Stheeman:*** It might be helpful if I could just give you a sense of what the senior adviser role entails. The idea goes back some number of years. Some of you might remember that, initially, senior advisers were called grey panthers. They are not allowed to call them that anymore. This goes back to the earlier days at the Bank of England and then the FSA. Really the idea was to bring somebody in with industry experience who brings an outsider's perspective, an independent perspective. I will give you some examples.

One example is, once a year, for the so-called Category 1 firms, there is something called the PSM, the periodic summary meeting. The supervision team would present all the work they have done during the year to a panel of independent people. Mostly they would be people whose full-time job is working at the PRA, chaired by the Executive Director for that area. They might be people from different areas, so it could be policy, resolution and different areas. There is always one independent adviser on that. The idea really is to challenge the panel, challenge the supervision team and ask, "Why have you done it this way?" and, coming back to your question, Chair, on culture, "What do you think of the culture? Why did you look at that?" That is one example where senior advisers play a role. It is not part of the executive hierarchy of the PRA or the Bank, but is really as an external.

Another one—and we also mentioned the Senior Managers Regime earlier—is when interviews are being held for senior management functions, so, for example, chair of a ring-fenced bank, chair of an audit committee or of other main committees, or the CEO of a firm. Again, a senior adviser would be part of that interview panel, so it is providing a practitioner's view but also an independent's view.

One other part has been mentoring or training people. It is not being in a role where you manage people or a team or something, but is very different to come in as an outsider. I have asked myself the question just to make sure I can have that independence, but I feel very strongly that, given the role I have had has been very focused on providing challenge and independence, in some ways it has been helpful to provide what I have learned on the supervision side of things and bring that into the work of the FPC. I would bring an understanding of banks' supervision, and what is important on liquidity and capital to keep the financial system safe.

**Chair:** We are now going to look at some of the risks to financial stability, Catherine.

**Catherine McKinnell:** We never get very far in this Committee without bringing up Brexit.

***Elisabeth Stheeman:*** I thought you might.

Q14 **Catherine McKinnell:** To be honest, I wanted to talk generally about financial stability, but you note in your questionnaire, "The FPC's value-added is to focus on outcomes that would most affect financial stability, and then take action to mitigate the risk or increase resilience". You highlighted a "disorderly" exit from the EU as a principal risk to UK financial stability. How likely do you think a disorderly Brexit is, at this stage?

***Elisabeth Stheeman:*** I wish I had a crystal ball. I am not sure anyone in this room does. I would answer this purely from a financial stability perspective and actually from a practitioner's perspective. Firms do not like uncertainty. If I was the CEO of a large bank operating globally, for example doing European business through a hub out of the UK, clearly I would want to have certainty as to what the outcome would be. The worst is the uncertainty of thinking there may be a cliff-edge scenario where, suddenly in March 2019, there may be a situation where I could not operate the business I used to do out of the UK. To me, that is the real risk. On the one hand, you do not know what the outcome is. On the other hand, there may not be an outcome where banks can not continue to do the business they have been able to do.

It is very hard to predict how it is going to come out, at this point. Nobody really knows for sure. What I would say is that it is very important to create some kinds of certainties for firms; otherwise, they may be pushed into taking decisions, and some people have suggested as early as March, so next month, when they have to pull the trigger on moving operations and asking for authorisations. You would have heard Sam Woods, the CEO of the PRA, saying to this Committee back in January that it takes about a year to authorise new firms, so that is an issue. Firms grapple with the issue that they are not exactly sure what end state to work towards.

Q15 **Catherine McKinnell:** It is not a fixed process. Therefore, assessing the risk and what needs to be done to mitigate that risk requires assessing how those risk factors are either increasing or decreasing. You have identified next month as potentially a key date. What measures would you put in place at the moment to seek to mitigate some of the risks that have already been identified?

***Elisabeth Stheeman:*** One mitigant from a firm's perspective would clearly be to have some certainty on the transition or implementation period, just to know that there might be a period in which they could implement changes to the business, when there were not too many changes to the banking regime. That would make a big change for firms, because it would create more certainty. Certainly the recent announcement by the PRA, back on 20 December, on the roadmap for authorisation for firms coming into the UK has been helpful. With my hat on as an independent member of the FMI board, creating some certainty on derivatives clearance would be very important. It is such an important business and it is a business that is predominantly executed out of the UK. It is a business that you cannot just move to another region overnight. Some of you may have seen just this morning—I think it was in the *FT*—that SwapClear has about €83 trillion in notional clearing, all done out of the UK. Eurex, their counterpart in the EU, has €2.5 trillion, so it is a huge difference: €83 trillion versus €2.5 trillion. There are so many big numbers involved that it becomes very hard. Insurance contracts is the other one that you would have had people who have testified in front of this Committee mention as a big risk, both for policyholders in the UK and for policyholders in the EU.

Q16 **Catherine McKinnell:** What sort of signals would you be looking for to indicate that a disorderly Brexit is becoming more or less likely?

***Elisabeth Stheeman:*** It is hard to know sometimes what is, as part of the negotiation, a little bit of scaremongering or showing a position. You could be trying to play hardball and, because it is part of the negotiation, you do not want to give anything away. It is quite difficult to know exactly what the right signals are or how they will eventually come out, because it is part of a negotiation. Some people refer to it as a divorce settlement; you just do not know where the different parties stand.

Q17 **Catherine McKinnell:** You must have been watching these negotiations over the last 12 months, at least. Would you say that a no-deal Brexit, which has been identified as a clear risk to financial stability, has become more likely or less likely over that period?

***Elisabeth Stheeman:*** It is an interesting question. I have asked this myself. I would hope it is not more likely. I would hope there is a way to find some common ground and that people will realise how important it is to find, both in terms of the types of agreements and in terms of the timing, the right outcome. In this case, from the perspective of what my personal opinion is, I would hope it is not more likely.

Q18 **Catherine McKinnell:** This is just a final question. Given that hope and looking at it from the other perspective, what do you think a disorderly Brexit, as you identified in your questionnaire, would mean for the UK economy?

***Elisabeth Stheeman:*** It really depends on exactly what form that would be, but, if it meant that financial services firms would not be able to do the business they used to be doing outside of the UK, it would create huge disruption in the financial services sector. That is something that the Financial Policy Committee would be concerned about.

Coming back to what I mentioned earlier about derivatives clearing, that is very important for the UK economy and, in fact, for the European and global economy. LCH.Clearnet, for example, does not just clear euros or pounds; it clears all kinds of currencies. That is where some of the disruption would come. For your constituents, somebody might have an insurance policy—household insurance or car insurance—with a European firm. There could be a real issue with that. Clearly there has been discussion in terms of what that would mean for jobs being moved to different locations to ensure that the roles that could not be done out of the UK anymore would need to be done out of an EU country. That again would create disruption. Those are just a few examples. I am happy to spend more time on it but I realise it is a big topic—

**Catherine McKinnell:** It is a big topic.

***Elisabeth Stheeman:*** It is a big topic that I know has been a big topic for discussion on this Committee as well.

Q19 **Charlie Elphicke:** One of the big concerns we have here is that the PRA often goes around telling boards and directors they need to challenge. We think, in the FPC and Bank of England, what are the non-executive directors doing to challenge. You took that great example of an insurance colleague challenging on one of your other boards. What do you think you bring to the party that will most enable you to bring challenge and add value to this organisation?

***Elisabeth Stheeman:*** In this case, do you mean the FPC specifically, because you talked about non-executive directors? One example is to think creatively about tail risks that the FPC might not have thought about. Obviously I have not attended any committee meetings yet, but there are certainly some topics I would hope and expect to see on the agenda. If they were not on the agenda, I would certainly ask for them to be on the agenda. One would be on operational risks and operational resilience, and related to that would be cyber. In recent Financial Stability Reports and records of the meeting, it is clear to me that that has had some discussion. I am also aware from my role on the FMI board that this is certainly something that the Bank is very focused on more broadly, so definitely operational resilience. This is just bringing up topics that the committee may not have thought about. Clearly something like cryptocurrencies and financial technology is another area I would expect the FPC to spend some time on. You may have heard the Governor mentioning that at the recent Economic Affairs Committee hearing at the House of Lords. Certainly cryptocurrencies would be on the agenda.

To answer your question, I would really be bringing an independent view and perhaps also challenging the common wisdom. It could be a situation where a certain topic may have been discussed in a committee including only people from within the Bank of England. I would think it really important that there are some practitioners who, either through their previous professional experience or being on supervisory boards, as in my case, are hearing about other things going on in different markets, bringing a different perspective, and then making sure that gets discussed.

Q20 **Charlie Elphicke:** You spent 20 years at Morgan Stanley, including before, during and after the credit crunch, the crash and the great recession, managing their entire real estate global business. What is it that you bring to the party from that experience, which you think would be particularly relevant to your work here?

***Elisabeth Stheeman:*** I sometimes joke that people should not necessarily follow what I did. While I was at Morgan Stanley, I moved to the so-called TMT sector, so the technology, media and telecoms sector, in 2001. That was just before the bubble burst. I moved to real estate in 2007. I think you get the theme. What I said to a group of graduates when I gave a talk about when I was in the real estate team is that managing through crises is an incredibly useful experience. I remember incredibly well when Lehman Brothers went down. The building was right next to Morgan Stanley at Canary Wharf. You saw people walking out and it really sticks with you. What that instilled in me is a certain scepticism to really ask why you are taking certain decisions. I have certainly seen afterwards how important it is to plan ahead and think about different scenarios to avoid that kind of crisis happening—for example, how important it is that banks are well capitalised and how important it is that you do not have the same type of loan-to-value ratios that you might have seen leading up to the crash.

Q21 **Charlie Elphicke:** Do you think that, having been a poacher, you might be a very effective gamekeeper, knowing the sorts of tricks that they all get up to?

***Elisabeth Stheeman:*** Having been a practitioner for many years or some decades, I would hope that would help to understand how some people, whether in real estate, financial services or other areas, might take decisions but also look out for potential warning signs. Obviously an important remit of the FPC is to ensure that things are put in place to keep the financial system safe and to foster the economy of the United Kingdom. To me, it would be important to keep that in mind and to also create the right balance between keeping financial services safe and also allowing banks to be able to lend.

Q22 **Charlie Elphicke:** Let us look at the risks facing the UK economy. Obviously we have Brexit, but let us say we leave Brexit without much of a deal or a very great deal. The FPC meeting record says that, if that coincided with a major global recession, it could result in more extreme circumstances than the stress tests to date. How seriously do you see the risk to the economy, in terms of where the economy is today? Is the current turbulence in the markets a hallmark of global growth and a return of inflation, or is it a hallmark of potential risks to the future of the global economy?

***Elisabeth Stheeman:*** Thinking back for a moment to the stress test and the way the scenarios were put together, they were very severe scenarios. You would have seen those in the report, in terms of commercial real estate values going down by over 40%, house prices going down by 33%, GDP going down by 4.7% and the sterling exchange rate going down by 27%, plus an unemployment increase to 9.5%. Those are pretty severe scenarios. The way I interpret the record of the FPC meeting is that the committee felt, having looked at those scenarios, it was severe enough with all those together. It was reviewed how banks would be financed if this would happen, and the view was that the banking system is adequately capitalised at the moment. As you are aware, for the first time since the stress tests were put in place, since 2014, no bank had to raise additional capital following the stress test.

Q23 **Charlie Elphicke:** Turning to this issue of fragmentation, increasingly voices say that the risk is not to us, but to the European Union. Philip Lane of the Bank of Ireland basically says that the risk seems to be to the European Union; so does the Governor of the Bank of England, who told this Committee that Brexit is no longer the biggest single risk to the UK's financial stability. The truth is, if we left with no financial services deal whatsoever, if I wanted to do real estate investment and lending into Germany and France, I would simply use a Luxembourg sandwich structure like all the American banks do. You would do structured lending instead and warehousing transactions through a Dublin conduit. Is it not the reality that the only losers would be the European Union, because it would increase its costs of capital? The City of London would still be the epicentre of innovation and lending of this time zone.

***Elisabeth Stheeman:*** There would be different people affected in that scenario. You talked about fragmentation. This fragmentation is specifically important in terms of the derivatives clearing and the economies of scale you have from being able to clear a huge number of derivatives transactions in one place. LCH.Clearnet now clears 90% of interest rate derivatives transactions. If you put that into half a dozen or more different locations, the economies of scale immediately get worse. That means that the cost would increase quite a bit. This would not just be for European companies; it would be for companies in other parts of the world and clearly also companies in the UK. It is important to realise that this would affect people both in the UK and in other economies. No doubt there will be people who will try to find solutions, but it is important to keep in mind that it would make it much more difficult.

Q24 **Charlie Elphicke:** Fundamentally, that sort of approach would be an act of economic self-harm, first and foremost, to the European Union rather than the United Kingdom, would it not?

***Elisabeth Stheeman:*** I would not necessarily put it that way, because it is very hard to say now exactly how much certain costs would increase. You say the biggest harm would be for the European Union, but it obviously depends on what type of transactions are involved, whether you look at how certain transactions are being done and where people are located. I would personally be careful of making a specific assessment at this point, one way or the other.

Q25 **Charlie Elphicke:** Very finally and very quickly, is the mature approach for Europe to take the same approach that the PRA has taken, which is to authorise branches of foreign firms and not play the protectionist game at all, because we all win if we all trade with each other?

***Elisabeth Stheeman:*** I do not know exactly what the thinking of the European regulators is.

**Chair:** That is called a leading question. The MPC is not responsible for EU policy.

***Elisabeth Stheeman:*** I certainly would not want to speculate on that. I would hope that different regulators take the same pragmatic approach that was taken with the announcement back in December. Ultimately, the objective is to ensure orderly functioning of the financial markets. Again, this is a personal view, but European regulators have an interest at heart in keeping the financial markets working.

Q26 **Rushanara Ali:** I am certainly all for pragmatism. I wanted to talk about asset valuations. You obviously have a great deal of expertise in this field. In your questionnaire, you stated that asset valuations should be an area of focus for the FPC in 2018. Do you think the risk of repricing is increasing?

***Elisabeth Stheeman:*** Do you mean real estate specifically?

**Rushanara Ali:** I mean generally and what the impact of CRE is on that.

***Elisabeth Stheeman:*** In commercial real estate there are different layers of complexity. If we just look at commercial real estate in the UK for the minute, it is really interesting to look at the valuation parameters over time. There is a very interesting chart in the last Financial Stability Report, which shows how valuations have changed both in London and outside of London. The view talking to market participants is that prices in commercial real estate, especially in central London and particularly in the West End, are very fully valued. Interestingly enough, if you look at recent transactions and where the money that has been invested in the UK has come from, a lot of it is foreign money and quite a lot from Asia. I have heard people who are more traditional UK real estate investors say that they have been rather cautious on the UK market for quite a while.

The interesting thing is to compare commercial real estate market prices to 2007. This is in the Financial Stability Report. In the UK as a whole, commercial real estate prices are 13% below the peak. You would think they have already changed but, if you just look at central London, they are still 20% above their 2007 peak. To me, that was really a wake-up call in the sense that they are very fully valued, to say the least. There was another statistic that I thought was really interesting, which was that the Royal Institution of Chartered Surveyors or RICS, which is the big society for real estate practitioners, recently did a questionnaire and 60% of the respondents said that real commercial estate prices are either expensive or very expensive. There is certainly a view in the market that commercial real estate prices are very highly valued.

That can have a secondary effect, just thinking about financial stability here, especially given that commercial real estate is very often used as collateral when small and medium-sized businesses ask for lending. If valuations go down, suddenly the loan-to-value goes up. That is exactly what happened in the financial crisis. That is why this is very important.

Q27 **Rushanara Ali:** If you were asked to rank this in terms of risk to financial stability, how high would it be in your areas of concern?

***Elisabeth Stheeman:*** You would have seen from my questionnaire that real estate valuations are towards the top end. Are they 10 out of 10? They are probably not. I would also hope that there are mitigants to this. One area that gives me some comfort is that loan-to-values have gone down quite significantly since the financial crisis. Where you used to have 90%-plus loan-to-value ratios, they are now at a much more manageable level, and banks and lenders are much better capitalised. They are almost three times as well capitalised as they were going into the financial crisis.

Q28 **Rushanara Ali:** The latest FSR notes, "Overseas investors accounted for around 80% of total investment in the London CRE market in 2017, compared to around 55% in 2007". Can you say a bit more about whether you think that makes us more vulnerable to shocks?

***Elisabeth Stheeman:*** It always important when you look at real estate valuations or investments to look at a very balanced portfolio. That is why a number of real estate investors have said they will not just look at one asset class, but spread the risk. One area, interestingly enough, that has done rather well recently is the logistics business. In a way, it is pretty obvious with hindsight, you could say. More people buy online and all the stuff needs to be sent somewhere, so they are going into warehouses located around airports. Different pockets of real estate have done better. Retail is an interesting one, because there are pockets of retail that have done fairly well. Prime locations, the Westfields and others of this kind, have done well, but some secondary and tertiary locations have not done quite as well. That is the other thing to keep in mind: there are different asset classes, lenders and real estate investors.

Q29 **Rushanara Ali:** I have a couple of questions on FinTech, in terms of your views. The Basel Committee on Banking Supervision estimated that the rise in FinTech and the emergence of new challenger banks could threaten up to 60% of retail banking profits. Are you concerned that this will make the sector less resilient to financial stability risks?

***Elisabeth Stheeman:*** One thing that is clearly important from a financial stability perspective is to ensure that both challenger banks and other new entrants to the market are supervised in the same way or have the same regulatory regime as established banks. In a way, and I think the Governor said this at a recent hearing, it could create some opportunities, in terms of making markets more efficient, if you think of payment systems and clearing. From my role as an independent member of the FMI board, distributed ledger technology, which is this blockchain technology, could create real opportunities.

In this case, I would not necessarily say it is all bad. I think it is important to keep an eye on it. That is why I am focused on ensuring that this would be one of the topics discussed at the FPC, to the extent that it is not already being discussed. As you may also be aware, not in the stress tests themselves but the biennial exploratory scenario, the BES, potential competition from FinTech was included. It is for banks to address how they would respond to increased competition through fintech.

Q30 **Rushanara Ali:** The Chair was asking you about culture earlier. What do you anticipate changing, with the increasing change through FinTech in the banking sector? What do you see as potentially positive, as well as potentially negative, in terms of how the sector and its culture will change?

***Elisabeth Stheeman:*** One obvious one is that it will probably be more entrepreneurial. It gives smaller companies the opportunity to enter into the market. Quite a large proportion of those might initially fail, but some will survive. It will create an opportunity for people who want to work in a more entrepreneurial way to do this. Interestingly, as part of one of my supervisory boards, I spend quite a bit of time in Berlin, which has become a real FinTech centre. In the UK you have this around Shoreditch, Old Street, et cetera.

**Rushanara Ali:** That is my constituency.

***Elisabeth Stheeman:*** Exactly, and I think that is terrific. Coming back to the question on culture, it has created an opportunity for people to work in a different environment. It is interesting; they may not want to work in an established way, where they have to put on a suit every day. One of the large four consultancy firms has a FinTech incubator somewhere in Clerkenwell or Islington, and it said it specifically had to move this outside of its headquarters, because the people who work there do not want to come in.[2]

Q31 **Rushanara Ali:** What about customers? A few years ago there were lots of concerns, which remain, that small businesses struggle when it comes to lending. Challenger banks started to enter the market, but can you say a bit more about whether customers could benefit and the conditions in which they could benefit, to ensure that that happens?

**Chair:** Could you be brief, because we need to move on?

***Elisabeth Stheeman:*** I will do that briefly. When FinTech first came in, one of the ideas was to increase liquidity in the market or increase lending so, when large banks were constrained by capital requirements, the peer-to-peer lenders, for example, would do that. They raise money from different investors and then lend back to small and medium-sized businesses. To answer your question—I know we need to move on—it is definitely an opportunity in terms of increasing lending into the market.

Q32 **Mr Jack:** I am going to try to shorten the questions, if you could shorten the answers, because we are running out of time, if that is okay. I am going to turn to consumer credit and mortgage lending, domestic meltdown rather than Mr Elphicke's global meltdown. One of the risks you highlighted in your questionnaire response was consumer credit. Do you think the FPC is sufficiently alive to the problem, or the potential problem?

***Elisabeth Stheeman:*** Looking at recent Financial Stability Reports, there has been a lot of focus on consumer credit and a lot of discussion. It has clearly been a concern for the FPC. Some analysis has been done on this. One specific piece of analysis on consumer credit was actually moved earlier, before the stress test results.

Q33 **Mr Jack:** You think it is alive to the problem.

***Elisabeth Stheeman:*** Yes, very much so.

Q34 **Mr Jack:** What do you think are the main factors that have fuelled the rise in consumer credit?

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[2] Clarification from witness: "come in to work in the main building, which is more formal."

***Elisabeth Stheeman:*** It is an interesting question in terms of why and how people use consumer credit. One interesting study was recently done by the FCA, and I have spoken to Andrew Bailey about it. Jointly with the PRA, the FCA looked at where the rise in consumer lending was coming from. The interesting outcome of that analysis was that the highest proportion of people who were borrowing through credit cards or personal loans actually had balances on their current accounts at the same time. Interestingly enough, initially people thought that consumer lending or people going up the risk curve would be from people who already have lots of different loans, mortgages and others, but actually the outcome was that it was not necessarily that group who would do their lending through consumer credit.

Q35 **Mr Jack:** Banks have started to curb unsecured lending and credit availability. In the last four quarters we have seen that falling away. Does that obviate the need for an increased buffer in the immediate future or not?

***Elisabeth Stheeman:*** Do you mean the countercyclical buffer?

**Mr Jack:** Unsecured lending and credit availability are falling away. You were pointing in your answers to consumer credit coming more from credit cards and overdrafts, rather than mortgages, which is the unsecured lending side of it.

***Elisabeth Stheeman:*** It is a mix, obviously. Household debt as a whole is a mix between the consumer lending side, credit cards and car lending, which is clearly another area that has grown a lot. On car lending, the difference is that, at the end of the loan, there is still the car. If the borrower cannot repay the loan, there is still the car or there could be a new loan coming up. I would not necessarily say that you would need to increase the buffer as a result. It obviously depends on how the lending could be done from other parts of the capital stack.

Q36 **Mr Jack:** Do you think it is the right approach to leave the PRA to handle the pieces that the FPC has not picked up on? The FPC has not used its policy tools to address this pocket of risk that is building around consumer credit and the PRA seems to be filling that void. Is that the right way, in your view?

***Elisabeth Stheeman:*** I would phrase it slightly differently. The remit of the FPC is somewhat different versus the remit of the PRA. Where the FPC has a view across the entire financial system and looks to ensure that, if there are any systemic risks to lending or any potential tail risks in the economy, there are mitigants in place, the PRA will look at firm-specific actions. For example, in the analysis I referred to earlier, it may look at household debt across a certain number of firms. Interestingly enough on this one, it was not just the seven or so largest banks in the UK that were looked at, but a broader group of banks. I would not necessarily say it is just picking up the pieces that the FPC did not want to deal with, but it has a different responsibility and a different remit. That is why it is important that the PRA will at it on a firm-by-firm basis, obviously ensuring that there is some co-ordination between different committees.

Q37 **Mr Jack:** What would prompt you to recommend the FPC employed its own tools to head off risks on consumer credit when you take up your role?

***Elisabeth Stheeman:*** It is certainly something the FPC could continue to have a close look at. As you know, the FPC would have various tools, for example recommendations to the PRA, the FCA or other parts in the economy, if it felt that there was a real risk to financial stability. At this point, it is hard for me to say whether I would ask for a very specific tool purely on consumer debt. I would certainly say that it is an area the FPC should continue to have a very close eye on and ensure that there is close co-ordination with the PRA or PRC.

Q38 **Mr Jack:** I am conscious of time, but in December we saw a downturn in the number of mortgage applications being approved and it was larger than was expected. Obviously you have some real estate in your background, albeit commercial rather than housing. Do you think that is a sign that the property market is cooling down and, if so, what are the reasons for that?

***Elisabeth Stheeman:*** There could be different reasons for that. It could be that borrowers find different ways to finance the acquisition of a new house. It could be that they delay decisions into the new year. I would not necessarily go as far as to say it is indicating that the entire market is readjusting. It may be a timing issue. People may just hold their decisions.

Q39 **Mr Jack:** You do not think they are going to non-traditional lenders. It is genuinely a downturn in the market, rather than finding others.

***Elisabeth Stheeman:*** I suspect it would be a combination of different things. One interesting statistic I referenced earlier was the loan-to-income ratio, where the FPC has made a recommendation to limit lending to households that are over 4.5 times salary. Actually, it has never got that far. It is only about 10% to 10.5%. That would give me an indication that it is not necessarily a squeeze in the market, but it may be that borrowers take decisions in a different way or perhaps the lending is done, as you say, from other institutions, which could be challenger banks.

Q40 **Stewart Hosie:** You told us earlier that you do not feel the FPC needs additional tools at this stage, but that further research should be undertaken on how best to employ its existing powers. Does this mean you see gaps in the way the FPC understands the toolkit it has at present?

***Elisabeth Stheeman:*** I do not necessarily think it is a lack of understanding, but there may have been more tools in the toolkit when the FPC was first created than have been used in practice. As I mentioned briefly in answer to Mr Jack's question, there is the tool of recommendation. For example, if there was a financial stability issue, the FPC might make a recommendation to the PRA or the PRC, the Prudential Regulation Committee. That is certainly the tool that has been used the most, by far. It seems that has been enough, in terms of having a focus on certain parts of the financial system. It depends on how the financial system develops over time, but also how the economy develops over time, as to what extent other tools may be required.

Q41 **Stewart Hosie:** When you spoke about research being undertaken about how to deploy the existing powers, where do you think that research should start? Should there be a review of the powers that the FPC has to decide whether they are usable, useful or should be put away? Is that where you would start with the research?

***Elisabeth Stheeman:*** It could also be talking to firms and finding out whether they get enough lending in the current environment. For example, one thing I mentioned in my questionnaire is that I have recently been involved in a senior advisory group for a review of the sterling monetary framework. One of the questions the working group talked about is to what extent liquidity, which the Bank of England provides to the market, is actually being used by firms. Sometimes there are certain areas that are available to the market, but may not be used as actively as we thought.

Q42 **Stewart Hosie:** I understand the contradiction of saying, on the one hand, businesses and individuals need credit facilities and, on the other hand, the economy needs stability. Surely, as an external member of the FPC, the focus within that committee should be simply the macroprudential and the systemic. The concern should not be, "Does this business have enough cash? Does this sector have enough cash?" It should simply be about the prudential condition of the economy overall, should it not?

***Elisabeth Stheeman:*** It would certainly look at the financial system as a whole and then review whether there was enough liquidity in the system. I certainly would not suggest that the FPC would get to a stage where it would look at individual lending by firms or at specific borrowers. That is the remit of the PRA or the PRC. I would definitely agree with you; it is a macroprudential focus.

Q43 **Stewart Hosie:** You said in your questionnaire that an important indicator for the FPC was the level of debt in the economy and in specific subsectors. You wrote, "Excessive levels of debt can make both lenders and borrowers more vulnerable to financial shocks". Can you define or put a number on what an excessive level of debt would be for the economy?

***Elisabeth Stheeman:*** I do not think I could speculate on a specific number. I would look at it more in terms of certain measures or parameters you would look at. One of the parameters I mentioned earlier was the loan-to-value ratio. The other one that is important to look at is the level of debt to GDP, if you look across the economy. That is also interesting in terms of international comparisons to other economies. The other one I mentioned earlier is the loan-to-income ratio. When you look at certain lending that is being done, how overlevered might households or companies be? Those are a few I would mention. It is important to look at different measures and I expect that is what the FPC does. It looks at how different parameters change over time and then makes an assessment of what kinds of measures might need to be put in place.

Q44 **Stewart Hosie:** At the national level, the debt-to-GDP ratio is something we all look at. That makes sense. At a personal level aggregated up, loan-to-income levels for mortgages, for example, make sense. Should there be a national version of that? Should a national-debt-to-GNI or debt-to-national-income ratio above a certain level trigger a response, for example?

***Elisabeth Stheeman:*** When you talk about debt-to-income, do you mean household lending or small and medium-sized business lending?

**Stewart Hosie:** I am talking about the whole economy now, so UK debt to gross national income. Should there be a UK version of that, as well as a personal version of that?

***Elisabeth Stheeman:*** It is an interesting question. I am sure lots of economists and academics would have lots of fun thinking that through. Just coming back to what the FPC's remit is, it is really concerned about the stability of the financial system. In that case, it would look at both borrowers and lenders, and certain parameters would give an indication of whether the levels are right. Its secondary objective is to ensure that the economy is functioning well and that it could support the economy. I would not necessarily go as far as saying it is the FPC's role to look at all the debt across the UK, because obviously that would include government debt and other areas, but it is definitely an interesting thought.

Q45 **Wes Streeting:** You come on an auspicious day today, because we are celebrating 100 years since the first women won the right to vote. It seems quite apt, as part of our women in finance inquiry, to ask you some questions that might be pertinent to that, as well as the process of your appointment. First, in terms of your experience of the appointment process, if you were sought out and actively encouraged to apply or was this something that you saw advertised and chose to apply for?

***Elisabeth Stheeman:*** I was contacted by someone in the Treasury and encouraged to put my name forward. I was aware of the FPC and I knew it as a committee that takes very important decisions on the role of the financial system. I was flattered when I was approached. I had not thought about it because, frankly, I just did not know that the FPC was adding to its members. I was directly sought out and, having thought it through, I thought it was a really interesting role and I could bring to it my experience having worked in financial services for many years. Having moved to more public sector type roles, I could also do more in terms of bringing something and giving something back. To me, that was really the motivation behind it. As I briefly said earlier, I could also bring some of the experience I have gained as a senior adviser, in terms of how the different areas interact with each other.

Q46 **Wes Streeting:** I am curious. Were it not for that tap of shoulder, is this something you would have applied for having seen the advertisement, or was that encouragement really important to provoke your motivation to apply?

***Elisabeth Stheeman:*** It was a bit of both. In terms of my longer-term career plan, it is certainly something that I would have considered at some point. Having said that, I thought it was very positive that the Treasury proactively went out and thought about who the people are, in the broad economy, who have that kind of experience and could bring something to the committee. Given that you mention the important day today and women getting the vote, it is also an opportunity to help spread the word in terms of the outreach of what the FPC and the Bank do.

I know your women in banking and finance review has also been very focused, for example when you interviewed Jayne-Anne Gadhia back in October and then I think you had three witnesses in January, on attracting people and especially young women to these types of roles. I would also see it as one of my roles to go out into the community, hopefully talk to some of your constituents, go out to schools and spread the word, in encouraging people that this is a career path that is worth taking. If you had asked me 30 years ago, would I have said, "I am definitely going to be a member of the FPC"? I am not sure I would have thought that far ahead.

Q47 **Wes Streeting:** You have answered my question about what you might do. There is one thing I just wanted to check quickly, because we have heard from the evidence gathering on the women in finance inquiry that job specifications have a tendency to be gendered in a way that might put women off from applying. Obviously you were not put off from applying, as you are sat in front of us, but I wondered if that was your experience of the application with the Bank for this role.

***Elisabeth Stheeman:*** It was not with this role.

**Wes Streeting:** Good, that is what we wanted to hear.

***Elisabeth Stheeman:*** I could not see anything in the job spec that would have put my off. I know there is a lot of research on this and I think Jayne-Anne Gadhia talked about that. If a man sees an advertisement—and apologies to the men present—they might know two or three things out of 10 for the role and think, "Oh yes, I can do this role". If a woman sees an advertisement, she might just focus on the one thing she is not sure about. There is a lot of research on that. When I looked at the role description, I thought, "Yes, I have done this" or "I can bring something to that".

Q48 **Wes Streeting:** Someone in the Bank's HR department is breathing a sigh of relief at that answer. You talked about what you might do in the role. I just wondered, from your perspective at this stage, if there are things that the Bank ought to be doing more than it is already on this agenda.

***Elisabeth Stheeman:*** Do you mean specifically on diversity?

**Wes Streeting:** For women in finance in particular, and women's representation at senior levels of the Bank or throughout the Bank at every level, is there anything that strikes you at this stage, before you enter?

***Elisabeth Stheeman:*** In fact, I was at the launch event that Jayne-Anne Gadhia did at the Bank. That was a big impetus, in terms of having that launched at the Bank. The Bank itself has a very active women in banking network and, I am pleased to say, has much broader networks in terms of all kinds of strands of diversity. It also has a mental health network, which is really important, and a carers' network. When I first came to the Bank I found that very interesting and reassuring: the Bank is very focused on having people bring their whole self to work and providing opportunities for people to talk to other people.

To answer your question: should the Bank do more? From what I have seen, over the last four or five years, the Bank has done quite a lot. Interestingly enough, when I joined as a senior adviser two and a half years ago, I was the only female senior adviser out of a group of about eight or so. I was thinking about this last night. Now it is almost 50/50, which I would not have predicted two and a half years ago. That may be a coincidence.

If you look across different sectors, and I can only judge by what I have seen, I have been heartened by what I have seen in terms of people coming through the ranks. Clearly there is more to do. Clearly it would be great to have more senior women represented in senior roles. Having said that, from what I have seen in terms of the recruitment process having gender–balanced panels, having gender-neutral language and encouraging people, a lot is being done. There is a very active external recruits network that is not gender-specific, but looks more broadly at how you can bring people into the Bank and help them deal with coming into a new organisation. I personally have done a lot of mentoring, both in terms of being assigned somebody and asked, "Can you deal with them?" and being proactively in touch with people.

Q49 **Wes Streeting:** Finally, last month Sir Tom Scholar told the Committee that it was difficult to find suitable women as candidates for seats on the

FPC, because the role demanded upwards of 30 years of experience in the financial sector. Do you think that is a reasonable concern? Related to it, I was struck by what you were saying about timing and your career. Sir Tom also suggested that a further barrier to appointing more women to the FPC is the restriction on holding roles in organisations that are subject to FPC scrutiny concurrently with membership of the committee. I wondered if there is a particular gender dimension to this. For example, women may be more reticent to disrupt their career in this way. There are other disruptions to their careers. I want, from your perspective, to unpack a bit what Sir Tom was warning the Committee about.

***Elisabeth Stheeman:*** I listened to some of his evidence online afterwards. I thought it was an interesting point. If the committee requires, as it does quite rightly, a long experience in financial services, it is hard or has been harder to find somebody who would have been in that kind of role for a long period of time. Frankly, 30 or 35 years ago, there were not that many women entering these kinds of roles and, most importantly, staying throughout their career. Thinking back to when I started in the 1980s, the intake was not that bad, but it thinned out quite quickly.

You could ask why that is. There were definite reasons for that. We could spend hours on this, but I would like to come to your next point. Does it turn people off? It needs a certain amount of drive and commitment, but for men and women that is no different. It is a challenge for anybody to continue in a career, especially if you have dual careers. That makes it even harder. It is difficult to find people who have the breadth of experience.

The other thing, and I suspect this is what Sir Tom was hinting at, is that if you are trying to attract people who have the experience in these roles but are not conflicted, coming back to some of the questions Mr Hammond asked earlier, there are a number of people who may be on the board of a bank or an insurance company, or may have been a CEO of a firm, who either are still in an executive role or have a non-executive career. If they are specifically in a PRA or FCA-regulated firm, that would preclude them from doing that role, so that is another dimension that makes it difficult.

The role itself, from what I have heard about it, is incredibly broad and interesting. It is having the combination of really long experience and not being in this situation where you are conflicted. Some people might say they would rather be in the private sector and perhaps earn more money. That could also be a consideration for other people. For me, public service is really important in this role.

Q50 **Chair:** Thank you very much. I have one final question. The committee aims to make decisions by reaching a consensus, rather than having a publicly recorded vote. I wondered if you thought that made it harder for members of the committee to challenge orthodoxies. Do you feel confident that you would be able to make a dissenting view known? It has been suggested that perhaps only the Governor should speak on behalf of the FPC. I wondered what you thought about that. You mentioned outreach and speaking to schools, for example. Is that something that you intend to do? Would you feel confident, if you were making a speech, to set out where you had perhaps disagreed in a recent meeting?

***Elisabeth Stheeman:*** I will start from your last question, in terms of outreach. I would definitely expect to go out to schools and other educational establishments, to explain the work of the FPC and the Bank more broadly. I am not sure, if I went to talk to some sixth formers, whether I would get into the detail of exactly who said what and who disagreed. That may be overstepping the mark a little. It is really important for people, including students at schools, at university and the public more broadly, to understand that the FPC's role is to keep the economy safe. That is a really important point. It is also to increase the understanding of the FPC.

To come to the first part of your question in terms of consensus versus voting, I thought about this ahead of my appointment, looking at the way the different committees of the Bank operate. It struck me that the FPC's remit is quite different, and the decisions the FPC make are quite different from other committees. Looking at tail risks, the least likely scenarios and what might potentially happen, and then thinking about potential mitigants, is a very different proposition from thinking about if the interest rate should remain the same, go up or go down, where you have a very clear decision point and a vote makes sense. For that reason, it makes sense for the FPC to reach an agreement on consensus.

Having said that, and as I laid out in my pre-appointment questionnaire, it is very important to ensure there is full discussion ahead of reaching the consensus. Looking at the records of some of the meetings, my sense is that there is a lot of discussion ahead of reaching a decision. Looking at the meeting schedule, it is not like you have lots and lots of very short meetings. There are longer meetings where you might just look at certain topics. Hopefully in a year or so, when you might see me again, I can give you a much better sense of what that means in practice, but I will certainly do my very best to contribute to a good and fruitful discussion, and to challenge.

**Chair:** I hope that we will see you again, because we like to see members of the committees, as well as the Governor, in front of us, to ask them what they have been up to and what they have been thinking. Can I thank you very much indeed for your time this morning? It has been great to hear your evidence. Thank you.

***Elisabeth Stheeman:*** It is my pleasure. Thank you very much.