HOUSE OF COMMONS

Treasury Sub-Committee

Oral evidence: Re-appointment of Sir Jon Cunliffe, HC

Wednesday 17 October 2018

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Watch the meeting

Members present: Nicky Morgan (Chair); Mr Simon Clarke; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Wes Streeting.

Questions 1 - 44

Witness

I: Sir Jon Cunliffe, Deputy Governor for Financial Stability at the Bank of England

Written evidence from witness:

– CV, Covering Letter

Examination of witness

Sir Jon Cunliffe

Q1 **Chair:** Good afternoon, Sir Jon. Thank you very much for being here this afternoon for your reappointment hearing. We are going to dive straight into the issue of the day on Brexit, you will not be surprised to hear, and particularly looking at the recent statement issued by the Financial Policy Committee, which was widely interpreted as an escalation of the committee's appeals to EU authorities to take steps to mitigate risk to financial stability in the event of a no-deal Brexit. It was not quite, "What the hell is the European Commission playing at?" You found more delicate language. Things were pressing and timely action was needed. Is that what you are saying, which is an attempt to put pressure on the EU to get around the table and discuss?

Sir Jon Cunliffe: Chair, it comes back to the point you made: time is pressing. If the private sector cannot deal with some of these issues, and it seems to us clear in some areas that it cannot, or there is legal uncertainty for the private sector, the time available to put that right has become shorter. The checklist shows that there has been some progress in some areas on the UK, but there have also been discussions with the EU and I think some of these issues are better understood now than they were.

Certainly, in one particular area around cleared derivatives there is private-sector action available. It is not anything that any clearing house or any firm would want to do but, to put it simply, if one were on the board of a UK clearing house and there was uncertainty as to whether your European members could perform against their contractual obligations on 1 April and there was uncertainty as to whether you would be facing sanctions, civil or, in some jurisdictions, potentially criminal, if you continued to offer clearing services, and you have the ability within your rulebook to ask members to leave the clearing house, for a member of the board of one of these firms, which are designed to manage risk, you put them in a position where they have to take that action. That action would be disruptive and it would be expensive, but the alternative is allowing us to get to a position where for clearing houses, which are supposed to absorb stress in a crisis, you have a sizeable number of members where there is uncertainty as to whether they can meet obligations. We were just trying to point out that time is going.

Q2 **Chair:** For the FPC this was an escalation, again very well phrased, in the sense that it was an attempt to make it clear that frustrations still remain and actions are needed.

Sir Jon Cunliffe: I think that it was an attempt to say this has to be dealt with. The timetable for this is around the timetable for clearing houses if they wanted to take that action, and also, of course, the FPC will not meet again before we pass this date, so this was its opportunity to make those points.

Q3 **Chair:** Is there any further action? You mentioned obviously the clearing houses; that will be quite a nuclear option, one assumes, for them. Is there any further unilateral action that the UK can take in relation to some of these outstanding matters? You mentioned derivatives, but I think there are also issues around insurance contracts, for example, which may not be so relevant to the FPC. Or is it now really that EU action is needed?

Sir Jon Cunliffe: Subject to one caveat, I would say we have taken or set in train all of the unilateral action. By "we" I include the Treasury. I am including Parliament as well because the temporary permissions regimes that we have for banks, insurance companies and clearing houses—

Chair: Will need to come through us.

Sir Jon Cunliffe: The SIs are coming and they will come in quite a rush. The Treasury is drafting them. Some are now before Parliament; some will come. If we can put in place all of the legislative measures that are in train and with the other action that is taken, and crucially with the use of the stress test to see that the core banking system in the UK could withstand a very disorderly cliff-edge Brexit, I would argue that we have pretty much done all that we can do unilaterally.

The caveat is that we scanned all these issues with the financial sector a year ago. We have repeated that, but we keep doing that and it may be some new issue pops up that is not on that checklist that we have not worked on. I would say we have pretty much done what we can.

Q4 **Chair:** What about the firms obviously activating contingency plans as a result? First, how are you monitoring any contingency plans? Secondly, what do you think the long-term consequences of that are going to be?

Sir Jon Cunliffe: If I can distinguish between the inbounds or domestic firms and the outbounds, for firms that are catering to the domestic UK retail market everything they need to do on retail—and there are not many—is in hand. For the big ones like Santander, for example, their subsidiaries are here anyway.

On the wholesale market, European firms that need to come into the UK, the PRA has engaged with them. The process of authorisation that we will need to do for post-Brexit if there is no other arrangement is under way with some of them but, of course, that is where the temporary permissions regime comes in. It takes a year or two to authorise a branch of a large wholesale bank. If that cannot be done in time, that is covered.

As far as outbound services are concerned, the big firms have put an awful lot of money and good people on establishing the entities in Europe that they would need to deal with a loss of the passport. They are in negotiations with European supervisors. It is difficult for me to comment on how well prepared European supervisors are for that. My assessment would be that for the large firms I think they will be able to operate without discontinuity of service after Brexit. What the impact of that will be in terms of jobs, the number that you would normally hear is around 5,000. That is not just banks; it applies to asset management and insurance as well.

We do need to have in place going forward memoranda of understanding between us and the European supervisory agencies and the national competent authorities. That is not a particular Brexit thing. We have memoranda of understanding with the US, the Swiss and the Chinese. That is how you co-operate on cross-border services. Work on that needs to start quite soon because that has not happened.

The long-term question I find more difficult to answer. My own view is it would be wrong to assume that those day one effects that I gave you will be the effects after a number of years. One would expect over a number of years more European-related business to transfer out of the UK into the European Union. There is an Oliver Wyman estimate out that everybody uses, which you have, which estimates 35,000 jobs from the financial sector and then maybe the same again from related legal, consultancy and audit professions. I do not have a better number than that at the moment, and that will depend very much on post-divorce negotiations on the end state.

Q5 **Chair:** Stephen is going to ask about post-Brexit in a moment. I have one further question on this, then I want to ask about something else, and then we will move on.

Obviously, the Bank has been clear about the importance of having a transitional period, and this Committee certainly has published a report before Christmas about that. In your opinion, would a lot of what we have just talked about in terms of no deal be resolved or made much easier if we have a transition period? Therefore, should that not also be something that the FPC is also making clear, that a transition period is very, very desirable?

Sir Jon Cunliffe: The FPC has made that clear and it is in the checklist. It is one of the things we check progress against. Clearly, all of that disruption around 1 April that we have been talking about and preparing for goes away if on 1 April the same conditions apply as at the moment, which is how we understand the implementation period or transition period—the nomenclature changes—is going to work.

I would make the obvious point that if all that happens is that when we come to the end of that period, which at the moment is the end of December 2020, we have not reached agreement on any of these things, then we are just pushing the problem forward. Yes, if you have an implementation period of the sort that is set out in the agreement between the UK and the Commission, then these disruption problems over the Brexit date will go away.

Q6 **Chair:** Yes. I cannot tell you how excited we will all be to carry on debating all this for the next few years, but we will return to that.

I want to ask you about something completely different, which is the bullying and harassment story in the Bank of England that was reported last week. It was reported that there has been an increase in the number of bullying cases being investigated at the Bank in the last five years. Could you comment on that? Could you shed any light on any underlying causes?

Sir Jon Cunliffe: I did have a look at that. We did not keep records before 2009 is my understanding, and the number of cases before I think 2013 fell below the rules about what numbers you can release. Looking at it, my sense is that on a like for like basis it is about the same and it has stayed about the same. When I say like for like, the Bank is about twice the size now than it was beforehand because it took on the PRC and everything.

One wants no bullying cases. One does not want to have any, and we are trying to work in a number of areas, particularly around the wellbeing programme and respect programme, to try to deal with it. That is a priority for our Vision 2020. I am not saying nothing having changed is a good outcome, but I think you can say it is pretty small numbers for 4,500 people. The law of small numbers affects this a little bit as well.

Q7 **Chair:** I am very conscious in asking this that, of course, the House of Commons is also in the light on this this week, but I think that it is important for all of us to ask these questions. As Deputy Governor, how has this been discussed by senior management at the Bank? Where do you see your role as Deputy Governor working with other senior management on tackling these issues?

Sir Jon Cunliffe: It has been discussed. This comes up in a number of areas and it comes up in a broader form than specific bullying cases. It is really about the empowerment agenda, which is something that the Bank has been working at since I joined. Central banks do tend internationally towards being quite hierarchical and formal places. The modern world of work is not like that, and I have worked in a number of different organisations across the public sector.

Some of this is about how we empower people. One of the things we do is we ask questions in our annual survey about, "I am treated with respect. I feel I can speak up without fear of consequence". The scores for that have gone up over the last five years and they are high. I think that they are high relative to outside organisations, but I have to check against the benchmark.

A lot of the Vision 2020 agenda is designed to try to empower. "Author in the room" has been one big policy at the Bank over the last few years. If you are the author, if you have done the work, et cetera, you should come into the meeting and you should speak. I know that it may sound as though that should have been happening automatically, but there have been a number of policies on that. I would be very happy to write going forward.

I am a member of the senior management team, so I was involved in how first we took forward the strategic plan, not just the hard bits around the organisation but the soft bits around one bank, diversity or whatever. I take responsibility with the other governors for taking forward Vision 2020, which is our next iteration.

Q8 **Chair:** Finally, how often does this get discussed, this issue, the survey, the results and other issues, formally by the executive team at the Bank?

Sir Jon Cunliffe: Quite a lot. The progress against the strategic plan, the development of Vision 2020 and progress against it comes to the governors' committee on a regular basis. I do not have an exact number but it would certainly be more than four or five times a year. Probably about every two months we look at one aspect or some aspect of this. It comes to the court of the Bank as well. The court monitors it and they monitor the metrics pretty carefully. That comes to the court—I am going by memory—once every two meetings or once every three. We also have regular meetings with a broader management set that involves the executive directors, and this is discussed there as well. It is something we spend a lot of time on.

Q9 **Chair:** If there is anything you were able to write to us about, certainly in terms of the number of times it is on the agenda, both with the executive team and the court, but also whether there is any sort of breakdown of the numbers of complaints, particularly in relation, obviously, to gender and ethnicity, it would be helpful.

Sir Jon Cunliffe: Yes.

Q10 **Stephen Hammond:** Sir Jon, good afternoon and thank you for coming to give evidence this afternoon. I wanted to ask a bit about financial services, the White Paper and the plans going forward through Brexit and beyond.

The White Paper does not give very much detail at all on financial services, but it sets out that the Government want an expansion of the existing frameworks. It then says that is, "to reflect the fact that equivalence as it exists today is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision", which basically asks three questions, to my mind. First, if the regime as it exists, or what potentially is there at the moment, does not reflect sufficient scope, then why did we not go for a mutual recognition scheme? Secondly, it is not clear in a number of areas at the moment what the Government mean by enhanced equivalence, and I wonder if you would care to set that out. Thirdly, you are probably one of the UK's most experienced diplomats around the European circuit and in Brussels.

What hope do you think we have of achieving that?

Chair: Three simple questions.

Stephen Hammond: I have the easy ones later.

Sir Jon Cunliffe: Yes, that is fine. I think that the last question has an error of fact in it at the end because there are a lot of people who have been involved in this world in Whitehall. I will answer the questions, but I think that the Treasury will want to be able to explain, and if I were in the Treasury, I would want to, because this is a ministerial decision.

Q11 **Stephen Hammond:** Sure, and I take that point. It is, but I am assuming that the Bank was heavily involved in the preparation of the White Paper.

Sir Jon Cunliffe: We have given the Treasury advice, as you would expect.

On the first point, what does enhanced equivalence mean, the EU equivalence regimes were not developed consistently across different guises. The existing regimes are different between the one that is in MiFID on the market investment instruments, and EMIR is the other one, the market infrastructure regulation. They are different, and then equivalence is used completely differently in other places where it means the capital treatment that you give to assets in different countries.

The first thing is that the equivalence regime in the EU—and I hope Michel Barnier will not object to me saying this—is a bit of a patchwork. It developed in negotiation in the European legislative process. The first thing is that it is not consistent. The second thing is that it does not cover the range of services covered by the passport. There is no equivalence regime, for example, for corporate banking. If you are an investment bank in the UK offering corporate banking services to Siemens in Germany, one would no longer be able to do that. There is no equivalence regime for that. There is an equivalence regime for trade repositories and CCPs. There is an equivalence regime for some investment banking services, but it is not comprehensive even in the MiFID area. Then there are other areas like insurance where it means something else.

I think the first thing that the Treasury meant was can we have a comprehensive equivalence regime. It could be done in separate parts but that covers the sectors that are not covered at the moment and where there is potentially more consistency. Secondly, if you have a relationship that is as deep as the relationship the UK has on financial services, while remaining autonomous, so each side takes its own decision, the arrangements for deciding that a jurisdiction is equivalent and, within that, a firm is equivalent—because in some cases you need both—need to be predictable, transparent and objective. The arrangement for deciding, if you ever did decide, that something had changed and you wanted to remove equivalence has to be an understandable process. I think that in the Treasury's conception that is done unilaterally, but you would know and it would have a phase-out period so you would not be suffering a series of mini cliff edges, if I can use that. That is the enhanced.

If I can make one last point, the European Union also talks about enhanced equivalence, but they mean a different thing.

Q12 **Stephen Hammond:** They mean a different thing, yes. They mean quite a different thing to what we mean and, therefore, it seems materiality, divergence and, as you point out, the phasing or putting out or putability of the option or withdrawal period look to be pretty difficult negotiations. Are you surprised or was the Bank consulted on its view whether a mutual recognition scheme might have been a more appropriate regime to put in place?

Sir Jon Cunliffe: The judgment to start for equivalence rather than mutual recognition—and, by the way, I would never have called something a mutual recognition scheme.

Stephen Hammond: Or using a code word then.

Sir Jon Cunliffe: No, mutual recognition has a history and a meaning in the European DNA around these issues that suggests something that I think would have been quite difficult to be accepted. The decision that that was where you put the negotiation was a political decision and that was really for the Treasury.

Q13 **Stephen Hammond:** In December, the Bank obviously introduced the temporary permissions regime with the hope that we would see some reciprocity. That has not happened. Should we take it that negotiations on that particular angle have completely stalled or do you think there is some hope that we might still see that?

Sir Jon Cunliffe: My guess is we will see some action. In the area that I mentioned, cleared derivatives, there have been statements from some of the European regulators—Steven Maijoor at ESMA—and some of the national regulators—BaFin in Germany, I think Robert Ophele in France—that said nobody wants the dislocation around the existing stock, around the legacy, not about the future, and we will need to handle it. My guess is something will be done.

Q14 **Stephen Hammond:** Around clearing but not around things like asset management or—

Sir Jon Cunliffe: Asset management does not need changes to the law. It just needs the existing delegation regime that is applied in Europe to, say, the US to be extended to the UK with memoranda of understanding. Data is an area we have highlighted, which I think will be dealt with in the divorce agreement but it has to be dealt with horizontally. On some of these issues, my hope anyway is that something will be done. Our discussions with the EU have not finished. We are still talking to the ECB and the technical groups.

Q15 **Stephen Hammond:** At the moment, for asset management, for instance, the delegated management regime or rules cover professionals, capital, et cetera. There are still some issues if we do not sort out a further expansion of that about what is going to be sold into what place, which has been raised directly by the asset managers. That was what I meant by their passporting regime. I think there are still clear issues with that.

In your questionnaire response to us about financial stability, what you said was, "Whatever the outcome of negotiations ... the FPC has made clear that it will remain committed to the implementation of robust prudential standards in the UK." I have a couple of questions in that area. First, I will take it, and could you confirm, that that means the Bank has no plans to reduce the current strength of regulations or alter the regulations re financial stability post-Brexit?

Sir Jon Cunliffe: First, post-Brexit we are importing the acquis so that is the starting point. I do not know what the arrangement will be with the EU. In terms of the resilience, we are implementing international standards. We said in 2016 that we thought the European legislation in the main implemented those standards well and we need those standards.

Q16 **Stephen Hammond:** Fine. That is helpful. One of the questions that it was suggested that I ask you—we have excellent advisers here—is: are there any rules imposed upon financial services based in the UK from the EU that the Bank would seek to remove? That is a very good question, but the real question, having spoken to major investment banks, clearing banks, asset managers and major wholesale financial insurance firms in the last month, is not that. The actual question is: is the Bank alive and alert to the concerns of the industry that in far too much European regulation it is overembellished by the FCA? Commission sharing, AMS, CFD, and I could go on. The industry is not concerned about rules it can take away. It is actually concerned that the FCA is likely to make the regime much less competitive in the UK. Is that a fear that the Bank is alert to?

Sir Jon Cunliffe: On this, we have to look at our remit and our responsibility. From a financial stability point of view, on many of the things you have mentioned—and when we come to asset management as well—I look at things as to whether they are going to be financial stability and systemic risk. Then on the prudential regulation, because I sit on the PRC, again we look at it from a prudential—

Q17 **Stephen Hammond:** You were very clear with us a moment ago about the financial stability and the prudential regulation. I understand that you do not have direct responsibility, but the Bank has a relationship with the FCA. I am just wanting to understand whether or not the senior management team at the Bank are alert to what every aspect of financial services is currently saying.

Sir Jon Cunliffe: We talk to the industry. We hear what the industry says. I have to say that is not endorsing a particular view of the FCA, and if the UK authorities as a whole—and in that I include the political authorities, the Treasury or Parliament—felt that something was there that should not be there, then one would look at it. We have enough on our plate, I think, with the prudential and the systemic.

Q18 **Chair:** You are not looking for more work?

Sir Jon Cunliffe: I was not, no.

Q19 **Stephen Hammond:** Sorry, I just want to ask one last question, but before I move on to that, you are aware, of course, that this Committee recommended that the Government relook at the competitiveness as opposed to the competition aspect of Solvency II, for instance, in terms of the regime that was in place and potentially looked at that as a recommendation for a secondary recommendation?

Sir Jon Cunliffe: Yes. The FCA, I think, and Andrew would be delighted to—

Stephen Hammond: Yes, we will ask him about that, but I just wanted to make sure that the senior management team—

Sir Jon Cunliffe: On a lot of these issues—and I was involved in the negotiation of a lot of European legislation—there are things in European legislation that we do that do not really have much relevance to the UK. A lot of it is about process. If you are trying to run a rules-based system for 28 nationalities, you need a lot of returns and data. If we were not in the European Union and we were not lining up with those rules, there would be a lot of things that are done just to make it possible to have a system for 28 that you would not need to do. There may well be some requirements that in the UK do not really address any particular risk and cause problems. I am not saying the acquis is the acquis and one would never look at it again. One would certainly look at it to make sure that it was fit for UK purposes.

Q20 **Stephen Hammond:** There are some areas that we could probably all agree—

Sir Jon Cunliffe: There are, and the risk margin in Solvency II, and I went through the negotiations on that, is something we would look at.

Q21 **Stephen Hammond:** I have one very last question, a short question, at the risk of irritating my colleagues even more than I have already because I have taken too long.

Sir Jon Cunliffe: It is the answers.

Stephen Hammond: Well, I hope the answer is not no, actually, because the question I was going to ask you is: using your vast experience of EU, what do you think the EU's willingness is to compromise in financial services regulation post-Brexit?

Sir Jon Cunliffe: I am trying to think of a short answer. I don't know. The EU is not homogenous; there are many different voices. There are many in the EU, particularly in the industry and the real economy side but also on some of the political side, that recognise that they depend on the UK for our scope and complexity of financial services that they would not be able to replicate or they could only replicate at a higher price. They do want to make sure that risks being imported into the EU are controllable in exactly the same way that I want to make sure that risks being imported into the UK are controllable, but they would like to find some way of doing that. I think there is room to negotiate.

There are others in the EU who take a more political view, and some of this is that the euro area should have its own capital market, that they should not be dependent on an offshore financial centre for their complex financial services and that they want to bring home, to legislate into being, a kind of regional financial jurisdiction. That of course cuts you off from the rest of the world. The other objective that President Juncker mentioned recently that we want the euro to be an international currency, a reserve currency, to have the US runs against the idea of ensuring that it is only ever traded and used onshore. There are different things put even within the commission. But a lot of people in the EU do want to have a constructive relationship and access to some of the services provided here. It does not mean everything stays here, but it does mean there is potential when we get there for those negotiations, but I could be proved completely wrong.

Q22 **Wes Streeting:** You are never annoying on Brexit, Stephen. Just lots of other things. Turning to global financial stability risks. Argentina and Turkey have come under severe financial stress lately. To what extent do you view these as idiosyncratic cases against a more systemic problem across emerging markets?

Sir Jon Cunliffe: At the moment, my internal majority view is they are idiosyncratic but they have the ability to become more widespread. The reasoning behind that is judged on fundamentals, where we are now, many of the other emerging markets do not have the vulnerabilities that Argentina and Turkey have. They are extreme in that sense. But also, they have taken policy action to prepare for the tightening of global financial conditions for the last four or five years. If investors look at each one on their merits then the chance of this turning into some more general contagion is limited.

That said, there has been some general contagion. There has been some general movement in exchange rates and in yields. Some other countries—South Africa, Brazil—where there are political or other difficulties, come in scope a little bit. Some of the indices that you use as spillovers are ticking up.

A very large amount of capital went into emerging markets for the last five years. The inflow has doubled. It went up by about $5 trillion. Many of those are just long-term investors in emerging markets so they want to hold emerging markets to hedge against advanced economies and other things. But some of those are investors who would have been in the US investments had yields been higher and they were searching for yield. When financial conditions tighten, when interest rates go up in advanced economies, that is always a time of stress for those capital flows.

The last thing I would say is the US started tightening monetary policy at the end of 2015 but monetary conditions did not start tightening until the beginning of this year. It is not a question of are we out of the woods yet with the tightening cycle. We are just going into the woods, if I can put it that way.

Last year, financial conditions loosened so we are just seeing that tightening happening. We have seen a lot of preparation happen. We have seen the weakest, most exposed, at the moment but there is further to go in that global tightening cycle.

The only consolation is this is a risk we have been talking about—snapback risk—and thinking about for the last five years and now we are getting into that period when we will have to see whether the kind of precautions taken have been adequate.

Q23 **Wes Streeting:** You have answered my question about the impact of Fed rate rises and that trajectory and led me neatly into the other question I had, which is precisely about the extent to which our financial system could be exposed to border stress. You mention this as an anticipated risk and one that you have been mitigating against. Do you see any particular danger points ahead that we should be concerned about or particularly alive to?

Sir Jon Cunliffe: On emerging markets specifically on this general type?

Wes Streeting: Yes, general stress across the emerging markets but if you have views on the wider side of things as well.

Sir Jon Cunliffe: There are three channels by which an emerging contagion and emerging market stress would come to the UK; one is the trade channel because this would affect trade with emerging markets. About 20%, 25% of our trade is with emerging markets, if you include China in that.

The second is we have financial institutions that have large exposures in Asia, some in Latin America. I think it is in the FPC statement today that exposure to emerging markets as a whole, including China, Hong Kong, is about 330% of banks CET1, so those are sizeable exposures that come through that channel.

But the channel that is most difficult and maybe most worrying is the impact on global risk sentiment, and how that communicates. To give an example, when there were problems in the Chinese stock exchange in 2015 that moved through immediately into the S&P 500 in New York, although there is no—China is a pretty closed financial system, but that change in risk sentiment could make quite a difference as well.

That is why the stress test that we did in 2017—and we are repeating that scenario—has a large global stress; a drop in GDP of nearly 2.5% in the world as a whole and the recession in China it dropped down to 1.4%, had problems in the euro area. Then those feed through to trade and assets and also the Bank's portfolio of investments in emerging markets to see that they have the capital to weather that shock. That is part of it. Then there is a big UK specific shock as well.

There are trade financial sectors that have gone through those channels. We cannot influence what happens in emerging markets but we can try to ensure the core banking system is resilient to the worst case.

Q24 **Chair:** Turning to the IMF global financial stability report, they suggest there is a 5% chance over the medium term of portfolio outflows of $100 billion from emerging markets. Is that an analysis you agree with and how do you think the UK would be affected in such a scenario?

Sir Jon Cunliffe: That is the generalised emerging market contagion crisis that I was talking about. I have not calibrated the IMF's capital flow sustainability exercise specifically against the stress test but I am pretty sure it is incorporated within the sorts of market price movements and economic movements that I talked about.

The IMF is trying to do something, which is very valuable, which we have been trying to do, which is to change the way people think about financial stability and risk. The FPC is a bit of a dismal Committee because it is always thinking about what could go wrong rather than what is likely to happen. We are dealing with tail events, like the financial crisis. Something that is improbable but is very bad when it happens.

This IMF technology of GDP at risk from a financial crisis, capital flows at risk, which is how they have pushed together, is an interesting way of presenting to people how something—you have moved into that higher risk range of the distribution of risk. That scenario of the big capital outflows I would not necessarily validate the—it is 5% or something else. There is a lot of econometrics, a lot of judgment in there.

But the fact that there is a tail event, with a big outflow, and we are nearer that tail now than we were a year ago. It was just a good way of presenting it.

Q25 **Wes Streeting:** One final thing I wanted to pick up from your questionnaire response is particularly around the indirect financial stability risk to the UK where a US/China trade war complicates Chinese efforts to reduce debt. In previous evidence sessions, you and other Bank of England officials, suggested the direct threat to UK growth from a trade war would be relatively limited. In terms of that indirect financial stability risk is there something that is playing a greater role in your thinking? How concerned should we be about it?

Sir Jon Cunliffe: A little bit. China has been increasing credit in the economy substantially since the financial crisis. It has now growing roughly in line with nominal GDP, which is what you would want to see, but there is a period where it has been growing much faster. As a result, Chinese debt to Chinese GDP ratios have gone to levels, and gone there quickly, where other countries have already had crises in the past.

We have had worries about the Chinese financial sector and the correction of this for a while. The FPC has been talking about it for a while. To be fair, the Chinese authorities the last couple of years have taken quite a lot of action to push down on some of those shadow banking problems, the wealth management products, and the like. But it has been a risk that has been out there.

They have been trying to manage that down but also the Chinese authorities balance growth against other things. Increasing credit is one way of stimulating growth. The worry is that if there is a bad impact on China from a trade war, Chinese policy makers are now trying to balance an extra thing. They were trying to balance growth and get into a more sustainable financial systemic position. Now they have to deal with the impact of growth and other impacts from a trade war. They also need to think about the currency. 2015 you saw capital outflows from China.

It just becomes a more complicated problem for them. If you do one thing then you cause a problem somewhere else. It is not to say that it is turned a risk that has been there. It is a large risk into an immediate and pressing risk but it makes it more likely and it makes the whole situation more difficult. It is not a quantified response but that is how we think about it. That this adds a complication to something that is a major risk.

China is a very large part of the world's economy. It is a large part of emerging markets, production chains, and the like. We have large exposures but just the confidence—I gave the S&P 500 example—the confidence impact, there is something going on in China.

The technocrats, the Chinese politicians, have managed these risks and they are aware of them, but they have now been given an extra complication.

Wes Streeting: One to keep an eye on then, in that case. I have to go to another meeting so please do not think I am walking out in protest about anything you have said.

Q26 **Charlie Elphicke:** Can I ask you about debt? I read a report in the excellent *City AM*—it was an outstanding newspaper—on leverage loans. The Financial Policy Committee had discussed this in the minutes. The new lending to already debt-burdened borrowers has parallels to the subprime lending of the global financial crisis. What are doing about it?

Does it represent a new crisis?

Sir Jon Cunliffe: If I talk first about what it is and then what we propose to do. I will just put it under a total heading. As far as the corporate sector as a whole is concerned their credit is growing roughly in line with GDP, about 5%. More of that is coming from market than banks. If you look across in aggregate at the corporate sector in the UK there is not a sense that credit is increasing at a very fast rate.

But in this sector of leverage loans, highly indebted or firms, there is no one definition of firms that are not investment grade. Borrowing or lending has been growing pretty fast. We say it got to 38 billion at 2018 and it is already at 30 billion this year. This is not lending, in the main, by banks. This is lending coming from the markets and a lot of it is coming from abroad.

It takes two forms. The interesting one is high yield bonds but increasingly it is leveraged loans, which banks make and then they sell on and they get packaged or sold on. About half of them are winding up in collateralised loan obligations. As I start to talk about banks selling on loans that get packaged into—the echoes start and also true for the Committee.

The things that are similar are size and fast rate of growth. Secondly, we are seeing a weakening in underwriting standards. These loans are essentially so-called cov-light, light covenants. The other similarity is this packaging and distribution.

There are some big differences. First, this activity is not being funded by short-term borrowing, as it was for the financial crisis. There is no repo market, as there was with subprime. There is a lot of differentiation between countries, so we were not trying to say it was subprime. We were trying to say that this is something—the US position has grown far more so it is more of a global thing as well. What we are trying to say is there is something here that is growing fast, which is developing, and it is now 20% of corporate borrowing in the UK, with highly indebted companies coming through some of these routes.

We will do a number of things. First, even though banks are not holding this, they do hold it while in the pipeline—about 90 days—so the stress test is going to look at what happens if you stress what is going through the banking pipeline. Also banks may have other loans to these companies, which are not in this form, but if the company was to get into trouble that would be an issue. We will look at the core banking system. That is always the first place we look because of the importance to the economy.

Secondly, we do not know where these are winding up. A lot are winding up abroad. But if the companies themselves were to get into trouble would that have an impact, not on the financial sector but on the economy and could that impact then come back to the financial sector?

The analogy there is the way we looked at highly indebted mortgages, but people pay their mortgages and the banks do not take losses. But in a crisis everybody cuts back on consumption and then the banks take losses because the whole economy worsens. Is there a link like that? We are going to do more work to look at that link.

The FPC said it was concerned, it did not say it was concerned at the point where it would take action. To the extent that this is not coming through the banking system, it is coming from abroad, one would not necessarily want to restrict companies' access to credit. But we thought it was worth highlighting it and bringing it out, and just making some of those comparisons. I am not saying it is subprime, I am just saying I wish I had thought about subprime a long time before we did think about it.

Q27 **Charlie Elphicke:** The other day the IMF toted up and said there is a hidden debt mountain of 2 trillion of government debt—more than 100% of UK GDP—and the only country that seems to be worse is Portugal. What is your view on this massive hidden debt mountain and are you concerned there is a bit of cooking the books going on in national finance.

Sir Jon Cunliffe: I think the OBR has set out their view in their long-term sustainability report. This is a long-term issue that they are looking at and other liabilities. Our focus tends to be much shorter term than that. There are many things out there in the future. One can think of pension liabilities, pension provision, and the like, which will need to be dealt with but they are not approximate financial stability risks. When I read the OBR long-term report—and I have not dived into the IMF and whether it is different or not—there are issues there and we know there are long-term obligations that all governments have taken on, which cause strain on long-term debt sustainability. But my recollection is the OBR did not say there was a danger on long-term sustainability.

To be clear, our focus is on things that are within our horizon and likely to go wrong within our horizon. This was not one of them for me.

Q28 **Charlie Elphicke:** It is all very long term and nothing to worry about, it is all fine. But the IMF does not quite agree with that because they say, there is a risk from the Treasury's love of issuing index-linked debt. Because you have been busy doing quantitative easing it means more of our debt is short term, a lot of our debt seems to be index-linked, and the IMF warn about the risk of that if the inflation picture changes. Is the Treasury being irresponsible in the pursuit of its policy in the short term as much as the long term?

Sir Jon Cunliffe: I do not think so, and also I did not say there is nothing to worry about. I just said within the things that we worry about on our time horizon this was not one of those things.

I used to do debt management in the Treasury. I have not done it for a while but my recollection is when you think about the debt portfolio there are always risks, so if you issue a lot of index-linked debt then you have the risk that if you get no growth and high inflation, stagflation, that debt becomes a problem. But index-linked debt protects you and protects the Government in other ways. My recollection is the portfolio was balanced between indexed and non-indexed, and also that it was balanced between the maturity buckets of short, medium and long.

I certainly know that when we did QE in the UK we did not do what the Americans did, which is just buy the long end. The Japanese just bought long debt. We bought evenly across the curve. At the moment on QE we are reinvesting, and we are reinvesting evenly across the curve. I do not think QE has changed or the reinvestment of QE has changed the debt profile of the UK at all.

Q29 **Charlie Elphicke:** You used to be the UKREP. What sort of analysis on how the Brexit negotiations are going, and if you had been advising the Government with your years of expertise, what do you suggest they do different?

Sir Jon Cunliffe: I am doing the job I am doing now. If I could give you the answer perhaps I have given you—

Charlie Elphicke: Is it that bad?

Sir Jon Cunliffe: It is not a spectator sport, I hope I can put it that way. I do not know what is happening—and nor should I. There is no reason why I should know—inside those negotiations. The sorts of insights that you have from being able to read that, it is difficult to say. It is easy and it is sometimes a habit of ex-officials—I count myself as an ex-official—to comment on their successors, but it is not helpful to their successors. I did not find it so when I was doing the job.

Q30 **Charlie Elphicke:** Would you let them get away with all this backstop nonsense?

Sir Jon Cunliffe: It is a question you are going to have to ask the Brexit Secretary.

Chair: Mr Elphicke is channelling his inner-Jeremy Paxman. Sir Jon, you are channelling your inner politician in not answering. Shall we move on?

Q31 **Mr Simon Clarke:** On that uncontentious note, stress testing, which I hope does not follow from Brexit, but it is obviously a matter of ongoing systemic concern about whether we have the requisite degree of stability. I was reviewing your answers to the questionnaire, which were commendably thorough, and they point out that you instigated the annual system-wide stress testing in 2014 of the banking sector. You did not set out what those tests showed. What additional details could you provide on the trends you have identified in the last four years?

Sir Jon Cunliffe: A few points. One point, if I could just elaborate a little bit on what I said to Mr Streeting. We started the concurrent stress test in 2014. The first time that had been done in the UK. But we changed it in 2016 to basically make the test tougher when the financial sector was getting stronger. The basic philosophy there is the higher things are the further they have to fall. That was a development—

Mr Simon Clarke: Is that an ongoing state of affairs?

Sir Jon Cunliffe: We look at it every year. Every year normally the FPC looks at the scenario and it says where are asset prices, where are house prices, equity prices, a number of different ways you can measure them.

Where do we think we are in this difficult to identify beast called the financial cycle? But to the extent that asset prices is the easier, to the extent they have gone up over the last year, we keep the point to which they could fall the same. So the peak to trough fall the banks are being tested against is greater. Then we would do the opposite in a period after a financial bust. When house prices are very low there would be a smaller fall.

One of the reasons within a period immediately after the crisis a lot of asset prices were depressed, yet you were then assuming another crisis similar to the one that had come from the top of the boom. That is one way we try to deal with this. That has been one trend that we have used.

There have been trends over the period. The biggest trend is when we started doing it. A number of banks were asked or volunteered to adjust their capital plans. In other words, they had to put in more loss absorbency and they did that in the year following. Last year—I think it was the first year—when no bank had to do that so one important trend.

Tier 1 capital is just under 17% now. Some of that is a management buffer they hold voluntarily above our buffers but some of that has come precisely because of the stress test and the trends. We have asked them to do it and they have done it.

We may discover in future, as the test gets stiffer, as the financial cycle goes into an upswing, we may find one has to do that again. But at the moment that is where we are. The tests are pretty—some of the numbers are in the FPC's record, they are pretty severe.

There have been other trends. We have picked up things. First, the quality of submissions has got better and the boardroom control, the governance around the quality of submissions, has got better. Part of what we ask the banks to do is to give us their loan books, their portfolios, and then they stress them first with their own models. Then we subject them to peer-to-peer test and sometimes use our own models on some of them as well.

What some of the banks have realised is they need to check the submissions and think very carefully before they send them back to us, and the quality has to be there because they do not want to be arguing afterwards that, "No, we did not mean that". So quality has gone up. Our expertise has improved.

We have identified some other things that—despite the risk of getting into the weeds here—are quite important. Some banks use models that are calibrated on what happens through a business cycle. Some banks use models that are calibrated at a point in time. What tends to happen is the ones that are calibrated at a point in time are more volatile in one of these stresses, because the model is based a lot on what is happening at the moment when times are good. You get to when times are bad, and it changes the model. A model that is calibrated through the cycle says, "Okay, times are good at the moment, but let us just calibrate this bearing in mind that it has to be the whole cycle". That is more stable in the stress because you have already taken some of that into account, but it is slower moving.

One of the things we learned in the stress test in the early years is some of the volatility in banks' results and losses came from this process and there have then been some changes in the way—PRA changes in the guidance to banks and how they model. There have been a number of technical issues that we have learned. Sorry, that is—

Mr Simon Clarke: No, that is—

Chair: We are quite relieved you are getting into the weeds.

Q32 **Mr Simon Clarke:** As a taxpayer, it is encouraging that you do. I would much rather that than the other. In terms of how that—would you say we have now established—this is not boastful but we are at gold standard levels now in terms of making sure that bank capitalisation is as robust as it can realistically be expected to be.

Sir Jon Cunliffe: Because bank capital costs, so on the one hand you need the resilience for times of crisis, which is why this IMF work about thinking not just about the cost today but the cost of a crisis in five-years' time is so important. But it does cost and it does have an impact on the economy and it does affect banks' abilities to lend. You do want to get capital of the point where you think you are resilient to a tail event, and resilient does not just mean they do not fall over. It means they are not in such a life-threatening position, that they can continue to lend. They do not see the sort of credit crunch that just made the last crisis so much worse. We are in the zone.

The stress test, it is the risk-weighted capital, the 16.8 I mentioned, and it is also the leverage ratio, which we brought in now. Those three things keep us in that zone, I hope.

Q33 **Mr Simon Clarke:** This is slightly off topic but obviously the Italian banking system is under enormous strain at the moment. Is it that they just have failed to respond to the financial crisis or is it they have been unable to? How are we still seeing these crises in Europe given obviously the Basel requirements that we are uniform, and all the rest of it. I do not quite understand how this sector is still in such a woeful condition.

Sir Jon Cunliffe: The capital standards have gone up in Italy as well and they are subject to the same EU regulation. The bigger banks now are under the ECB, under the SSM, the smaller ones are managed locally. But capital standards have gone up in Italian banks. They have made progress in non-performing loans.

The first thing I say about Italy is one of the reasons banks get into trouble is because their loans go bad, and the Italian economy, particularly since the euro crisis, has been grinding along at pretty low levels, and they have seen lots of non-performing loans and the like. They have not been able, or maybe they have not wanted to, get rid of those loans because you have to take big losses when you do. You get into the zombie bank thing, so there is an issue about whether they had been fast enough to deal with some of the problems that come from the economy.

The other thing, Italy has a lot of banks and there has not been much bank consolidation in Italy. In part, because it is difficult to get the cost savings because you cannot—they are very connected to local regions and you cannot streamline them or move their headquarters out of the region. There is a consolidation in Italian banking. I am going to get interesting e-mails from my Italian colleagues now. But it is a consolidation in Italian banking that has been waiting to happen that is quite difficult.

Q34 **Mr Simon Clarke:** I am trying to understand whether it is a systemic failure in terms of the ECB and wider EU regime or whether it is particular to Italy. It sounds as if it is quite particular to Italy, although Spain—

Sir Jon Cunliffe: Spain is an example where they have a lot of the same problems as the regional banks and they have the same problems with loans going bad. They had those problems before the higher capital standard had come in. They acted in a different way. They were financed from the ESM. They consolidated a lot of their banks, their regional banks, and set up a bad bank to take on assets. The Italians have done some of that. The Italian picture has been more complicated.

The last thing I will say about Italy is a lot of Italian bank debt was sold to retail investors. I do not know if anybody will ask me about "to big to fail" or resolution but part of resolution is basically paying people to be victims in resolution. You get paid a bigger spread for lending under those terms, but you know that if a resolution happens you get bailed in as a bondholder.

One would not sell that to retail investors who might think it is exactly the same protection as a deposit. In Italy a lot of bank debt has been held by retail investors, which complicates a resolution because you are then wiping out real people. They still have them in Spain and there are some court cases and some people are in jail in Spain because of it. You have seen that problem in Italy.

Q35 **Mr Simon Clarke:** That testifies we can quiz you on any country in the EU. I will take us back to the UK before I finish, which is in June the minimum requirement for own funds and eligible liabilities, the MREL, was published as part of the resolution strategy. How have those requirements been met in terms of the responsive industry and when you say that banks are well on their way to meeting their 2022 target, which is up from 25 towards nearly a third, how has that been measured? Are we confident that they are going to meet those targets?

Sir Jon Cunliffe: The resolution requires a number of things. One of the things it requires is this loss absorbency, these people who can be bailed in basically without creating problems if the bank gets into trouble. The UK banks, particularly the big ones, have got on with the job of issuing MREL, probably a little faster than I was expecting. It is different for different banks and we will report publicly on this.

They need to get to about 28% of list quoted assets and they are nearly at a quarter in aggregate. A lot of this debt has been issued and the financial resilience—we are not pleased because one is never pleased as a resolution authority, but reassured that that is happening. It needs to continue.

In the point of if there was a resolution now would there be bondholders—not just shareholders but bondholders—who could be, which we could not do with RBS and we could not do with Lloyds, and the taxpayer had to come, and the answer is yes. Are we where we want to be? No, not yet.

The second point is even if the financial resilience is there for a resolution you need a lot of other things. You need to be able to value. One of the things you learn in the crisis is the valuations that the bank gives you, as it is going into failure, are very different from when you opened the bond. You start to look and you find it is a lot worse than you thought.

We need banks to have the ability to value on a resolution basis quickly. We need them to be able to identify the portfolios and have the loan information we need in resolution. We need them to separate out their service functions so that you do not discover a part of the bank has gone down but you have to keep it going because the rest of the group depends on the computer systems or the service companies or whatever. A lot of that has happened with ring fencing but these operational things could make a resolution more difficult. They are not as easy to deal with as a financial, and that is what the resolution assessment framework that we are bringing in over the next couple of years is designed to do so that we can get to a point where we can make a judgment. The bank has to make a judgment on whether it is resolvable and then we will make a judgment on the bank. We will publish that.

It will never be absolute, like bank capital resolvability is a risk judgment, but we hope we are going to be able to lay out what we have done where banks are.

Mr Simon Clarke: When will that all be in place?

Sir Jon Cunliffe: We will have it all in place by 2022. That is the end point.

Mr Simon Clarke: All of this including the understanding of what is under the bonnet?

Sir Jon Cunliffe: The kind of metaphor I would use is resolution is not a bridge. With a bridge, you cannot use it until you have both ends and everything in place. Resolution is not like that. The things you put in place on the way improve the position in stages. 2022 is when we hope to be in that position but a lot of the things that are happening can be used now.

Q36 **Stewart Hosie:** Your questionnaire response said that there remains heightened uncertainty of the supply side of the economy. In particular, the prospects for pay. How do we square that with the fact that the bank voted to raise the base rate, the bank rate, in August, which was a unanimous decision?

Sir Jon Cunliffe: I voted for that. First, there is always uncertainty. I have said before that monetary policy makers complaining about uncertainty is like sailors complaining about the sea. You live with it all the time. The uncertainty I was talking to is a bit different. When you are uncertain about some of the key relationships in the economy around supply side, about the model economy you have in your head and it is not doing what it should be doing for a long time, then that is a different sort of uncertainty.

What you can see in the economy is supply and demand coming into balance. So there is not much slack left in the labour market at the moment and there is not much spare capacity in firms.

We are not growing at the sorts of rates we grew before the crisis—about 1.6% now—but on the other hand we thought the economy could grow at 2.25%, 2.5% before the crisis—at the Treasury it was 2.5%—without generating inflation pressure. Now we think it is 1.5% because of lower productivity.

Even at 1.6% there is not much spare capacity and slack left. Normally for a monetary policy you say, “If supply and demand are in balance or close to balance, and I can forecast ahead, that demand is going to exceed supply” that is going to be inflation pressure and you would raise rates.

The forecast that we have does not require very much pay growth in order to be met, so we had in our forecast pay going into the 3s next year and establishing itself in the high 2s, and it was broadly doing that. But my concerns on the first rate increase, and there still are things that kind of form how I think about this, was that we have had so many fall storms on paper and we had an unemployment approaching now at 4%, which, with my memory, should be generating much more inflation pressure, and it has not done that so something structural has changed.

The bank is not forecasting the inflation pressure at these levels of unemployment that it would have forecast 15 years ago. Nonetheless, even with the forecast we have, there is just a bit more uncertainty.

My view was if there is a bit more of that sort of uncertainty, if we think we are going to generate domestic inflation pressure but it has not quite happened over the last few years in the way you would have expected, then you do not say, "Okay, I will stick where I am forever" but you say, "Okay, I may look for a little more evidence. I may want to wait to see whether pay is establishing itself above 2.5%. By the time we got to August there was evidence that we had seen pay in that 2.5% to 3% range in a steady established way rather than what had happened in 2016 and 2014; it got up there and dropped back again. I was happy to make the next move.

I share the forecast of the Committee that if it evolves the way we have said we will need to move further but at each stage I just want to be sure, and just maybe a little more sure than I would have been pre-crisis, that the evidence is there to justify it.

Q37 **Stewart Hosie:** Let me be sure about something. The Governor has previously said that he wanted to see interest rates rise before he began to unwind QE so it could be cut because it gives an immediate stimulus. I just wanted to make sure in my own mind that that has no bearing on the decisions taken and that it is all genuinely data dependent.

Sir Jon Cunliffe: No, that has no bearing on the decision. I agree with you entirely. I said this publicly a few months ago. You do sometimes hear that central banks need to get interest rates up to a certain level so they would have ammunition in the future. I do not think that is a view that is held in the Bank. To my mind, it is always a slightly strange view because to hold that view you must believe there is no impact on putting them up but you are going to get an impact of releasing them. So you can afford to put them up when you do not think it is justified by the economy in order to have the room to release them later. So no, that is not part of the thinking.

What the Committee has said is as far as QE is concerned we do not want to start considering the unwind of QE until interest rates are in a position where we can use them as the primary instrument because what you would not want to do is to start unwinding QE, then discover you had to loosen monetary policy, you did not have enough room on interest rates and you have to start QE again. QE is a more cumbersome instrument to use than interest rates. I think the Governor's point was, "Before I think about starting the QE unwind", which will be a long-term process, you do not want to have it jerkily moving around, "Before I start thinking about that I want to know that a primary instrument monetary policy is at a point when I could do that".

Q38 **Stewart Hosie:** Forgive me, I must have paraphrased that slightly differently. I thought that is what I said. Let us move on. To what extent is the exchange rate figure or factor in your thoughts in terms of setting of monetary policy?

Sir Jon Cunliffe: We do not have an exchange rate target, we have an inflation target. It is pretty established that you try to have one target and one instrument and you cannot meet the two at the same time. But the exchange rate makes a huge difference to inflation and it makes a huge difference to activity. We saw post-referendum the depreciation has a number of effects. One effect is it has squeezed real income through 2017 and dropped consumption. Then we have to think about if it is an externally generated inflation pressure, we know it is passing out of the system, to what extent with a 2% inflation target can we say, "Okay, we will try to look through that" and to what extent do we have to say, "No, inflation is above target"? We have to act but we can only act on the domestic economy, we cannot act on the exchange rate. We have to act to push domestic demand down to accommodate this.

Where the exchange rate goes with inflation of the exchange rate is a big issue. How the exchange rate affects the export and import side of the equation is a big issue as well. It moves around a lot and at the moment it has been driven by the negotiations on Brexit and the like. We just have to make a conditioning assumption about it every time.

Q39 **Stewart Hosie:** Given the impact it can have, how vulnerable is sterling given the current level of uncertainty about the economy to a risk of a sudden devaluation?

Sir Jon Cunliffe: I think the current exchange rate has within it just about all the possible expectations you can have on Brexit. It is not bimodal, it is multimodal. In there is a disruptive no-deal Brexit, in there is that we get a deal and there is a transition period, and probably a number of different things in between. Of course, all those states of the world cannot come to pass. At some point when the true Brexit is revealed and the path to it becomes clearer—that may happen as a single event but will happen quite clearly—then I am pretty sure you will see the exchange rate move.

I cannot tell you the extent to which pessimists dominate optimists in the exchange rate. When you look at the way people are protecting themselves from a fall, or trying to take advantage of an increase, in general—it has changed a little bit recently—there has been more people trying to protect themselves from a fall. That suggests if a bad Brexit outcome happens we will see something on the exchange rate. We saw it drop 15% from the 2015 peak to the leave vote. I think the peak drop was over 15% after the referendum. Arguably there is more pessimistic expectation in there now than there was at the referendum but you could see a big fall.

Q40 **Stewart Hosie:** You would suggest that pessimistic market expectation is already reflected in the sterling value, to some extent?

Sir Jon Cunliffe: The sterling value is the combination of hundreds of thousands of people's view. Yes, there are going to be a lot of people who take a pessimistic view.

Q41 **Stewart Hosie:** Given that the Bank has its own forward currency reserves that can be used to support the monetary policy objective, when in your opinion should they be used; is it a level against the euro, is it a level in sterling against the dollar, is it general sentiment or is it world fluctuation? When would foreign currency reserves be used in a substantial way to help the monetary policy objective?

Sir Jon Cunliffe: The main foreign currency reserves are held by the Government, not by the Bank. The Bank has a small, I think £5 to 6 billion, pool of reserves that is never used. Certainly, in my personal view, currency intervention to maintain an exchange rate and particularly currency intervention to support your exchange rate when you are using reserves of foreign currency, is not something that is particularly effective in modern markets. Generally, none of us thinks about currency intervention to stabilise the exchange rate and the like. It is conceivable that in very disorderly markets you might, the old market disorder. However, intervening in the exchange rate is not really part of my thinking and has not been since the early 1990s really.

Q42 **Stewart Hosie:** I would probably agree. However, in relation to your last answer, is it more accurate to say there is a potential argument for using Bank or Government foreign currency reserves for general financial stability, to try to assuage disorder rather than to support a currency?

Sir Jon Cunliffe: Yes. If it turned out there was a shortage of foreign currency, for whatever reason, then you would want to do that. You would want to ensure liquidity is there.

If the exchange rate is moving down because people have changed their view of the UK's economic prospects and they think that is what the UK is worth, then I do not think currency intervention would do anything. However, if you discovered there was a shortage of foreign currency then we would try to make that available. We do that through swap lines in the main, not through the reserves. That is what we did in the Financial Crisis and conceivably you could do that as well.

Q43 **Chair:** I have a final question that follows on from something Stewart Hosie was asking. I think this has already been probed with the Committee before; it is about members of the committee giving their own view on issues.

In the questionnaire you talk at one point about the risk of groupthink, and that the arrangement whereby you and most of our fellow Deputy Governors and the Government all sit on the MPC, PRC and FPC raises the risk of group think. You say the risk is mitigated by the external members of each committee. Are there any particular examples you were thinking of when you wrote that, where those who are permanent employees of the Bank tend to coalesce around one view and the external members provide a good challenge?

Sir Jon Cunliffe: I was not such thinking of examples, I was thinking about the way it works in practice. This is my explanation of the structure. The structure was put in place before I arrived.

Chair: Yes, of course.

Sir Jon Cunliffe: It is the way I think about it. Very often we will have things that run across committees. I will know I am going to have to say something in the FPC but I may be chairing the PRC the next day with the same thing.

There are two ways you can think about that. One way you can think about that is—I understand it, but it is difficult to do—that it is perfectly right for me to take two completely different views on Monday and Thursday because I have different objectives. That is fine but it is hard to actually compartmentalise like that.

There may be a tendency for all these trade-offs to happen. The Governors meet pretty much every day. We discuss issues and there may be a tendency for that to happen. What keeps us honest—if I can put it like that—is I know I have to go to the PRC where there are people who only have one objective, they do not have that trade-off, and I may have to explain why I have made the trade-off. They may say, "Okay, I understand that" and, given it matters a lot somewhere else and does not matter very much here, we do it that way. However, what I cannot do is not expose that there are different things here.

What I was thinking of when I said it is the number of times you have reached views with one. Resolution is a good example. It is not actually another committee, it is done by the Bank. There are tensions between going and non-going concern policy. The supervisor wants to keep the firm alive, the resolution authority wants to make sure you pull the plug while there is still something left. Those two things pull against each other. So if you have a resolution case—we did not have one with the Co-operative but we got close—those two things pull. Then it is important to know, "I am going to have to explain this in the other committee in a different way".

That structure is quite important because if we did not have the externals then, in the end, we would make the trade-offs ourselves. Having these committees linked is important because I see in other jurisdictions, where they are separate, an awful lot of effort is expended in what the American's call inter-agency stuff. I hesitate to say it is the best system but it tries to achieve a balance in that way.

Q44 **Chair:** In answer to something Wes Streeting was asking, you talked about the internal majority view. I appreciate it is hard when you are sitting here, both as yourself and also as a Deputy Governor of the Bank of England. However, like for the interest rates, you are making clear, "This is my view and the rest of the committee had a different view".

Sir Jon Cunliffe: Everything I have said on monetary policy is clearly my view because there I vote and I have to vote. However, on financial policy I think in my evidence I have footnoted a couple of records, particularly around where we set the countercyclical buffer, which sets out some of the differences of view. I will have to stand by that everything I have said is my view today.

Chair: Absolutely. Thank you very much indeed for your evidence this afternoon. We wish you well. Well done for avoiding the hardest of the hard Brexit questions, we will save those up. I think you are back before us on 20 November, which I suspect could be a busy time in terms of the Brexit date, so no doubt that will come back as a question then. For now, thank you very much, Sir Jon.

Sir Jon Cunliffe: Thank you.