



House of Commons  
Treasury Committee

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# Accountability of the Bank of England

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*Additional written evidence*

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## The Treasury Committee

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# List of additional written evidence

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(published in Volume II on the Committee's website [www.parliament.uk/treascom](http://www.parliament.uk/treascom))

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# Written evidence

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## Written evidence submitted by Intellect

### EXECUTIVE SUMMARY

As HM Government has set out in its recent Growth Strategy, “the private sector cannot plan for the future if it does not have confidence in the long-term stability of the economy”—the requirement for this growth strategy was, after all, a direct result of the failure of the financial system in 2008.

Since then, significant efforts have been made by regulatory authorities on a global basis to address the issues posed by the banking crisis. In the UK, HM Treasury, the Independent Commission on Banking, the Financial Services Authority, Bank of England and of course the Treasury Select Committee have all dedicated significant time and resource to identifying and addressing priority issues in order to reduce the possibility (and potential impact) of another crisis.

As it stands however, there is a crucial oversight in these ongoing reforms—specifically relating to systemic risk. The systems and processes for the Bank of England to collate the necessary information from Systemically Important Financial Institutions (SIFIs) that can then be used to identify the build up of risk across the whole of the financial system are not in place. If financial stability cannot be guaranteed because the means to spot the next banking crisis are not in place how, therefore, can long term economic growth be assured?

This inability to monitor systemic risk is one of the major contributory factors behind the massive public spending cuts that we are all now facing—it is why front line services are being cut for ordinary citizens and why a number of industries are facing very damaging reductions in their public sector revenues over the coming years. Simply put, banking institutions cannot be bailed out to the tune of £1.3 trillion without consequences. It is unlikely that in the event of another financial crisis, which given the current tools that are available for regulators will be again largely unseen before it is too late, such bail outs will be possible given the state of the public purse.

Therefore it is essential that the Bank of England be given the appropriate tools to undertake its crucial financial stability role.

In both the US and Europe, this gap in the regulators tool-set has been acknowledged and steps have been taken to allow regulatory authorities to build a single view of risk across the system, yet in the UK we are lagging behind, relying upon the assumption that such a system is already in place. As we still have the same system with the same lack of granular data as before the financial crisis, this is not the case.

Intellect, as the trade association for the UK technology industry, believes that the Bank of England therefore must firstly make an effort to identify what system-wide information would allow it to spot the build up of risk and intervene, before it is too late. Secondly it must advocate an industry-funded “systemic risk utility”—an early warning system—that would draw standardised and detailed data from across financial institutions and present it as a “dashboard” so the Financial Policy Committee can make the appropriate decisions to safeguard financial stability.

### 1. INTELLECT FINANCIAL SERVICES PROGRAMME

1.1 Intellect is the UK trade association for the IT, telecoms and electronics industries. Our members account for over 80% of these markets and include blue-chip multinationals as well as early stage technology companies, and play a crucial role in virtually every aspect of our lives. In the UK these industries together generate around 10% of GDP and 15% of trade, directly employing over one million people.

1.2 We are a trusted partner for Government, both in terms of policy development and policy implementation across numerous sectors. We look to ensure that all relevant engagement of policymakers and regulators with industry is both easy and as valuable as possible in order that the technology industry may play the fundamental role it merits in the success of UK plc.

1.3 Intellect’s Financial Services Programme brings together over 150 suppliers of information systems, services and consultancy to the financial services sector. After the public sector, the financial services industry represents the largest market place for many of Intellect’s members. From software companies to service providers, enabling trading platforms and payment processing, technology is crucial to the sector. As such, the industry’s regulatory regime is a key issue, as, in many cases, it will be our members working with the financial institutions to ensure compliance. Global IT service providers sit alongside many specialised smaller companies and all play an active role in imparting their expertise and experience to better inform the development of financial services policy at a cross roads in the industry’s development.

1.4 Many of Intellect’s members are heavily involved in providing the fundamentally important technology platforms upon which the UK’s financial services industry is built. For example, these members help facilitate the 5.7 billion automated payments that are made through the banking system on an annual basis. Indeed, through Intellect our members are working with the Payments Council to develop the future technology that will afford consumers and businesses alike more convenient, secure and efficient ways to conduct their

transactions. Similarly, the 40 million online bank accounts that are registered in the UK would not function without the technological capability that our members design and supply.

## 2. WHAT RESOURCES DOES THE BANK OF ENGLAND REQUIRE TO CARRY OUT ITS FUNCTIONS?

### *Systemic risk “early warning system”*

2.1 Intellect believes that there should be a much greater focus now on the tools required for the Bank of England to carry out its financial stability role and specifically relating to its newly designated responsibility to monitor the build up of systemic risk and act accordingly to mitigate it. As it stands, the Bank of England does not currently have the tools to undertake this role effectively and there is an assumption that the tools that are in place, are adequate. This is not the case—there is no early warning system in place to prevent the next financial crisis and this is a crucial resource that the Bank of England requires in order to fulfil its role.

2.1.1 HM Government has already stated that under the previous tripartite regulatory system, the Bank of England “while having statutory responsibility for financial stability, had only limited tools to deliver it” (P4, “A new approach to financial regulation: building a stronger system”, February 2011).

2.1.2 Three years on from the onset of the financial crisis and the systems and processes for the Bank of England to collate the necessary information from Systemically Important Financial Institutions (SIFIs) that can then be used to identify the build up of risk across the whole of the financial system, are not in place. This is despite the technology being available to establish such a “system” (see below). Equally worrying, there appears to be no acknowledgement amongst regulators of the requirement to put such a system in place, which is a direct result of a lack of understanding of the means to do so.

2.1.3 Indeed, up until the recent publication of HM Treasury’s proposals for the regulatory system (“A new approach to financial regulation: judgement, focus and stability”) on the 17 February, there was no one body taking ownership of this issue. Now the interim Financial Policy Committee will have responsibility for monitoring systemic risk but, as it stands, does not have the ability to do so and there appears to be an assumption amongst regulators and policy makers that such a system is already in place. It is not.

2.1.4 Intellect therefore believes that, for the good of the financial system, there needs to be a concerted evaluation by the Bank of England of the sort of information it needs to collate in order for it to identify risks that are building up across the financial system. A systemic risk “early warning system”, entrenched in the legislation required to enact the new regulatory system, can then be developed by both industry and the regulators. Such as the system is already being assessed for development by the Office of Financial Research (OFR) in the United States (a product of the recent Dodd-Frank Bill). The creation of the European Systemic Risk Board (ESRB) is also indicative of the importance that the European Central Bank (ECB) is attaching to this issue in terms of maintaining financial stability across the Euro zone.

2.1.5 European Systemic Risk Board (ESRB) and has been acknowledged by these institutions as essential for maintaining financial stability.

2.1.6 Whilst Intellect is the trade association for the UK technology industry, this is not necessarily a technology issue. Instead, monitoring systemic risk is about setting appropriate standards and oversight for a stable financial system. What is lacking is therefore twofold:

- Consideration of this issue alongside other “big ticket” regulatory reform issues such as capital and liquidity requirements, the potential split up of banks and bankers bonuses (amongst others) by policy makers and regulators. The impact that the lack of such a system prior to the financial crisis and the impact that another financial crisis would have on the UK economy makes this a political and regulatory priority.
- A mandate, preferably from Government, to build a set of standards and processes that can help identify risk right across the financial system.

### *Systemic risk—the current situation*

2.2 On a systemic level, the financial crisis exposed the weakness of the UK’s and US’s financial services regulatory framework and in particular the asymmetry of information between the regulators and financial services providers. HM Treasury and regulators across the global financial system have already stated this was a major contributing factor to the financial crisis.

2.2.1 The result was that the prudential regulatory system was not equipped to manage systemic risk. The information gap between the tripartite regulatory authorities and the financial institutions slowed the response to the financial crisis. Whilst the Government was able to step in and save RBS and HBOS, albeit at a high cost, this was undertaken without full knowledge of the risks that the banks faced, and an accurate, holistic assessment of what risk their collapse would have posed to the financial system as a whole.

2.2.2 In the U.S. where the regulatory system suffered from the same deficiencies, a slowed response time meant that the authorities could only act to save one of Lehman Brothers or AIG, and the rest is history.

2.2.3 The problem stems from the fact that the data that regulatory authorities currently have access to from financial services providers are neither in a uniform standard (making it much harder to collect, compare and

analyse what the data means) nor is it granular enough. I.e. this data is not of a sufficient standard to allow regulators to paint an accurate picture of the realities of the positions of individual SIFIs, and in doing so, of the financial system.

2.2.4 The complexity of the global financial services industry and the products within it have themselves provided something of an opacity which is directly responsible for complicating the task of viewing the whole of the financial services system, and assessing risk therein. There is currently very little motivation for financial services institutions to reduce this opacity as a lack of transparency is conducive to the development of complex and profitable products. In short, it is good for business. Other sectors, such as pharma, aerospace and the chemicals industry have all increased their own transparency through regulator-enforced modernisation—ie standardising the flows of data from individual companies to regulators. It is no surprise that as transparency of a specific industry is increased, the effectiveness of that specific regulator increases as well. If industries such as this can modernise, there is a strong argument for an industry as economically and socially critical as the financial services industry, to modernise as well. The financial services industry is also capable of the same modernisation of its data flows (precisely what is required for a systemic risk “system”), despite its protestations—this capability is already demonstrated on a daily basis through the vast amounts of trade data that is channelled at great speed between institutions operating in the capital markets (high frequency trading is a notable example).

2.2.5 On a UK level there is currently very little leadership on this issue and as a result the UK regulatory authorities (i.e. the Bank of England, and the Financial Policy Committee specifically) are in no better position to monitor the build up of systemic risk than it was before the financial crisis. If the next banking crisis were around the corner, the asymmetry of information between the financial service providers and regulators would be of a similar level to that in 2008 and there would, once again, be a tough choice for regulators to make as they had not been able to act sooner—i.e. to step in and bail out stricken banks, or let them fail with uncertain consequences for the rest of the economy.

#### *Implementing an early warning system—UK is lagging behind*

2.3 In the United States the OFR has been established within the US Treasury Department as a result of the Dodd-Frank Bill. Its remit is to improve the quality of financial data available to policymakers and facilitate more robust and sophisticated analysis of the financial system. In effect, the OFR is permitted by law to demand data from financial companies including banks, hedge funds, private-equity firms and brokerages. It would be able to track information such as counterparties for credit-default swaps and would, crucially, afford regulators the sort of system-wide overview (including darker parts of the market) that will allow it identify when and where there is a risk to financial stability. All this, and the fact that the OFR has recently started defining reporting standards for the financial community puts it way ahead of the Financial Policy Committee in terms of establishing tools to head off the next financial crisis.

2.3.1 On a European level the ESRB was established, again by law, in December 2010 under the auspices of the European Central Bank and has a similar function to the OFR. Whilst it is not yet as advanced as the OFR in terms of its use of data, it is also still way ahead of the UK as it has acknowledged that data standards that will allow it to collate information from 75 different member organisations (including the ECB, the EU national central banks and EU national regulatory authorities amongst others) are not sufficient to allow it to undertake its role effectively.

2.3.2 That the both these institutions have acknowledged that current data standards are insufficient to afford regulators the necessary systemic risk early warning systems, should Intellect believe, be heeded by the Bank of England and acted upon now, whilst the regulatory system is being reformed.

#### *What would a systemic risk early warning system look like?*

2.4 In order to carry out its role of maintaining financial stability by monitoring systemic risk and stepping in to mitigate where necessary, the Bank of England will need to implement an overarching “systemic risk utility” that will collate information from individual financial institutions and present it in a way that it can be analysed and interpreted by the FPC. It is envisaged that, ultimately, the front end of this system could represent a “dashboard” that could inform and alert the Bank of England.

2.4.1 Advances in computing power, data storage and analytical techniques mean that the creation of this utility for the entire financial system is now a viable proposition. Systemic risk (macro) analytics aim to quantify risks relating to the broad-scope, long-term dynamics and dependencies of major markets and players, and are associated with significant shifts in market state. By contrast, market and credit risk (micro) analytics have a narrower scope, make linear extrapolations from recent market trends, and assume localised shifts in aggregated market parameters.

2.4.2 Such a system would require the following components:

Reference Data (including standard legal entity identifiers):

- A means to gather, cleanse, organize public reference data for end to end cash flow risk analysis.

“System of Systems” Approach:

- Reuse of existing components in an open and extensible architecture.

Collaborative Analytics:

- Establish a secure, collaborative analytic tooling for risk valuations and analytics across the financial system.

Data-driven Stress Tests and Interventions:

- Support for stress-testing and targeted intervention driven by actual position and counterparty data.

2.4.3 However, it is worth noting that the burden of developing this “system of systems” should not fall wholly on the Bank of England. It is the collection and use of non-standardised data within individual financial institutions that poses the fundamental challenge in detecting and mitigating the build up of systemic risk and which made it near impossible for the regulatory authorities to identify risk signposts in the lead up to the recent financial crisis and intervene before it became necessary to bail out financial institutions.

2.4.4 Therefore it is envisaged that the bulk of the cost of such a system should be borne by the industry, who dedicate millions of pounds per year into developing commercially orientated low latency IT systems that contribute significantly to their performance in financial markets and have significant profit making capabilities.

2.4.5 As a result of such a system, the entire financial industry will benefit from central provision of clean reference data instead of the current situation with each enterprise having to cleanse and maintain its own. This could save the industry millions of pounds per annum as well as reducing the chances of bank failure and increasing market certainty.

*In the short term ...*

2.5 Measuring systemic risk will be iterative and a multi-year effort, however pragmatic steps can be taken to start now. Initially better data management can help consolidate existing data and systems for better analysis and insight, and will define the minimum set of data standards and reporting requirements to allow cross-firm and cross-market analysis. Data models can be developed to analyse data gaps currently impeding systemic risk measurement, to aggregate and link data across a large number of financial institutions and markets, identify important data that is currently inaccessible, and define consistent data “tags and identifiers” for securities attributes and legal entities. Alongside the models data analytics will measure different dimensions of systemic risk to develop automated processes for continual stress testing, standardise approaches for gathering normalised data from multiple institutions, and develop forensic and “what if” scenarios and simulations. Overall this will enable the development of macro prudential regulatory and systemic risk tools that can run scenarios and simulation techniques to further support the transparent monitoring of the financial system.

*Security of data*

2.6 What does also fall upon the Bank of England regardless of what means it uses to monitor systemic risk, is the requirement to ensure that the data it collects and houses from across the financial system, is secure to the appropriate level.

2.6.1 Given the sensitive nature of the data that is collected, the negative impact upon individual banking institutions and the economy as a whole would be significant if this data were to be compromised. Consequently there would need to be formalised and independent oversight in place to ensure that data security standards were constantly maintained and evaluated—in keeping with the same standards and oversight that all other public sector institutions are obliged to maintain. There are currently 6 Impact Levels relating to information held by public bodies ranging from IL 1 (unclassified) through to IL6 (top secret). The Bank of England would need to determine just how sensitive the information it holds is (and the impact if it is lost/compromised) to determine the appropriate Impact Level. It is envisaged that the Bank of England would have to work with CESG (the information assurance arm of GCHQ) here to determine what level (and what safeguards) were appropriate for which processes.

2.6.2 That the Bank of England is taking on more responsibility in this area under the proposed reforms to the financial system requires it to apply greater resources to information assurance.

3. ARE THE RESPONSIBILITIES OF THE COURT OF THE BANK OF ENGLAND CLEAR AND APPROPRIATE?

3.1 Given that the Court of the Bank of England is responsible for:

- Ensuring the effective discharge of the Bank’s functions.
- Ensuring the most efficient use of the Bank’s resources.
- Reviewing the Bank’s strategy in relation to the Financial Stability Objective.

3.1.1 ... it is therefore the Court’s duty to ensure that the FPC has the tools in place to measure the build up of systemic risk and, as outlined above, to evaluate what information it needs to receive from financial services institutions across the system, so that it can adequately discharge its responsibility to monitor systemic risk.

3.1.2 Intellect would urge the Court to play close attention to the work being undertaken by the OFR and the ESRB to this end to ensure that the FPC has the appropriate tools and to work with the ICT industry as early as possible to ascertain what the Bank's requirements will be, what is possible and how to undertake this task.

#### *Achieving Value for Money*

3.2 As part of the IT systems required for the new regulatory system, Intellect would also urge the Court of the Bank of England and other relevant bodies responsible for ensuring that value for money is achieved in the procurement and implementation of IT systems for the new regulatory environment, to involve industry as early as possible to seek advice and work with those suppliers that will ultimately be rolling out the required systems anyway. On a wider level, there is a strong argument for the proposed regulatory authorities to involve industry as early as possible in its deliberations for new initiatives, so that costly regulatory proposals can be evaluated, with duplication of effort and unnecessary expenditure (for government, regulators and financial service providers) kept to a minimum.

3.2.1 The case of the FSA's approach to implementing the Single Customer View (SCV) as part of the Financial Services Compensation is an example of how not to do this. It was estimated in an independent feasibility study for the FSA, that the cost of adapting bank's IT systems to accommodate this new regulation was in the region of £1bn. A commercially-focused SCV has been the goal of established banks for some time now, in order to manage individual customers' "touch-points" and allowing a more personalised service. There is a strong argument that if the FSA had sought to involve the technology industry at an early stage to determine how to adapt existing SCV capability, rather than re-inventing the wheel, the result would have been quicker and easier to implement; and significantly less expensive. At a time when there are two state owned banks that need to deliver value for money, it makes little sense for regulation to "re-invent the wheel" when there are systems already in place within banks that can be adapted to achieve the same result.

3.2.2 Intellect already partners with the Office of Government Commerce, HM Treasury and the Cabinet Office amongst other government departments to ensure that such situations are avoided and it would seem logical that the Court consider this path as well.

*March 2011*

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### **Written evidence submitted by Aviva**

#### **POLICY FUNCTIONS WITHIN THE BANK OF ENGLAND**

1. It is important that the relevant supervisory authority has responsibility for engaging in and determining the policy relating to the prudential supervision of regulated firms. This means that the Prudential Regulation Authority (PRA), not other parts of the Bank of England (the Bank), should be responsible for micro-prudential policy and engage with stakeholders as appropriate.

2. The PRA, not other parts of the Bank, must represent UK insurers' interests with the European Insurance and Occupational Pensions Authority to ensure a credible approach to EU negotiations is maintained, provide the industry with clarity and enable constructive engagement in the process of developing future regulation.

#### **MEMBERSHIP AND ACCOUNTABILITY OF THE FINANCIAL POLICY COMMITTEE**

3. The membership of the Financial Policy Committee (FPC) must have identifiable expertise to cover all financial sectors. The selection process for appointing members to the Committee should be transparent. This process should aim to ensure that expertise covers all financial sectors and is not overly focused on banking. We would strongly welcome the appointment of members with experience of insurance and members with experience of asset management.

4. The expertise of the membership of the FPC should be subject to scrutiny by the Treasury Committee.

5. We note that the FPC will be accountable to the Court of the Bank of England. We welcome HM Treasury's proposal for this to be supplemented by Parliamentary scrutiny. We believe that the TSC should review the performance of the FPC and take evidence from the Chair.

6. The FPC should consult and publish a cost-benefit analysis for each of the tools it has aimed to address systemic risk. This information is very important to ensure that the FPC is both effective and efficient in its actions and able to make informed regulatory decisions.

7. Overall, the additional powers that are proposed for the FPC (and the Bank) mean that it should be subject to greater levels of transparency and accountability than apply to the FSA.

#### **MEMBERSHIP AND ACCOUNTABILITY OF THE BOARD OF THE PRUDENTIAL REGULATORY AUTHORITY**

8. The membership of the Board of the Prudential Regulatory Authority (PRA) must have identifiable expertise to cover all financial sectors that it supervises. The selection process for appointing members to the



Board should be transparent. This process should aim to ensure that expertise covers all financial sectors supervised by the PRA and is not overly focused on banking. We would strongly welcome the appointment of members with experience of insurance and members with experience of asset management.

9. The expertise of the membership of the Board of the PRA should be subject to scrutiny by the Treasury Committee.

10. We note that the PRA will be accountable to its Board, HM Treasury and the National Audit Office. We welcome HM Treasury's proposal for these forms of accountability to be supplemented by Parliamentary scrutiny. We believe that the TSC should review the PRA's performance and take evidence from its Chief Executive and Chair.

11. The discipline of attending these sessions would focus the minds of the Board and executive management team on their roles, objectives and challenges to delivery. This would provide a form of accountability and oversight of the PRA's governance.

31 March 2011

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### **Written evidence submitted by the British Bankers' Association**

#### INTRODUCTION

1. The British Bankers' Association welcomes the opportunity to give evidence to the inquiry by the Treasury Committee into the accountability of the Bank of England. We represent 220 banks from 60 countries and have 40 associate firms within membership.

2. The Treasury Committee has separately inquired into the reform of the regulatory structure. Under this, the Financial Services Authority (FSA) will cease to exist in its current form and will be replaced by two new bodies: the Prudential Regulation Authority (PRA), a new subsidiary of the Bank of England (Bank) focusing on the regulation of banks, deposit-takers, insurers and certain investment firms; and the Financial Conduct Authority (FCA), which will be responsible for the regulation of conduct of business for all firms and wholesale markets, as well as the prudential supervision of investment firms not supervised by the PRA. A new Financial Policy Committee (FPC) will also be made responsible for macro-prudential policy and will sit alongside the Monetary Policy Committee (MPC) within the Bank of England.

3. In response to the earlier inquiry, we explained that the BBA is supportive of the broad structure of the new UK regulatory framework, including the emphasis to be placed on financial stability and the intention to establish a firmer linkage between the micro-supervision of individual firms and the additional macro-prudential regulation intended to enhance systemic stability. But we also highlighted certain areas requiring further attention, in our view, including the concern that the breadth of the Bank's new responsibilities gives rise to questions concerning the adequacy of the checks and balances within the system. We are therefore pleased to see the Treasury Committee conduct its inquiry into the accountability of the Bank.

4. The proposed reform to the regulatory structure involves a very considerable extension to the mandate of the Bank, which becomes responsible for: financial stability, including macro-prudential policy; monetary policy; oversight of micro-prudential policy; prudential regulation of key financial infrastructure, such as payment and settlement systems and central counterparties; the resolution of failed or failing banks under the special resolution regime; and the provision of liquidity insurance to the financial sector.

5. In addition to this expansion in scope of the Bank's responsibilities, it can also be seen that with the expansion in its role in respect of financial stability, and the assumption of tools enabling it to direct regulatory action, the nature of the Bank's responsibilities can be said to have expanded considerably. We view this as giving rise to a number of interrelated governance and accountability issues that we do not believe have been fully explored in the consultation papers on the reform of the UK regulatory structure issued so far by the Treasury

#### EXECUTIVE SUMMARY

6. In this submission we explain that we:

- Are unsure that the potential socio-economic impact of macro-prudential tools has been fully appreciated and whether the arrangements for democratic accountability are as robust as they need to be.
- Believe that the enhanced role of the Bank necessitates a review of its governance arrangements including the processes and responsibilities of Court.
- See a case for reviewing whether the policy-making of the FPC, in keeping with to the MPC, should be scoped out of the Court's responsibility and so establish that, through the Chancellor's remit letter, its accountability is to Government, Parliament and the public.
- Appreciate that financial regulation will be more resource-intensive than in recent years but believe that relevant activities should be drawn into a single budgetary process under the auspices of the National Audit Office.

- Express concern about the concentration of power and ask whether sufficient thought has been given to how potential conflicts of interest are to be resolved.
- See a case for a firmer commitment to the governance arrangements for the Bank and other authorities being made consistent with the UK Code on Corporate Governance, including the provision for external performance review to be reported upon publicly on a periodic basis.

#### KEY PROVISIONS ON FINANCIAL STABILITY

7. The BBA is in the process of preparing an industry response to the Treasury consultation paper “A new approach to financial regulation: building a stronger system” and will forward a copy to the Treasury Committee upon completion as this will explore related issues of interest.

8. From our initial analysis, we can see progress in terms of the Government attempting to answer some of the concerns identified by the industry in response to the earlier consultation. There are, however, many questions that remain unanswered and with additional detail come additional questions. Taking financial stability as an example, we can piece together the different sources of the FPC’s authority and aspects of the regime intended to ensure that the Government can provide appropriate direction and for the committee to be held to account for its actions variously by the Court, the Treasury and Parliament. Key provisions on the exercise of macro-prudential tools and aspects of their accountability include:

- The FPC will be responsible for exercising its functions with a view to contributing to the achievement of the Bank’s financial stability objective and we are told that the FPC, as a policy committee of Court—the governing body of the Bank—will be accountable to Court for the contribution that it makes to the Bank’s financial stability objective. (Treasury consultation paper, paragraph 2.1.)
- The Government will legislate to give the Treasury a discretionary power to provide the FPC with guidance in the form of a remit and this will provide that the Chancellor write to the FPC to provide greater clarity on the overall approach the FPC should take in pursuit of its objectives. The FPC will be required to respond to the remit, setting out how it has taken the Government’s views into account, and both the remit and the reply will be published and laid before Parliament. (Paragraphs 2.22 and 2.23.)
- The main functions of the FPC will be to monitor the stability and resilience of the UK financial system with a view to identifying and assessing systemic risk; and to use the levers and tools at its disposal to assess those risks, with the FPC able to decide what action would be most appropriate. (Paragraphs 2.24, 2.25 and 2.26.)
- It is recognised that external channels of accountability are needed and so the legislation will provide that there be a twice yearly Financial Stability Report containing an assessment of potential and actual risks to financial stability, and action taken by the FPC (including a description of the FPC’s activities in the period since its previous report and an assessment of their effectiveness), with reports submitted to the Treasury and laid before Parliament. (Paragraph 2.82.)
- When the PRA or FCA take action to tackle systemic risks on the basis of a recommendation from the FPC, the decision will be taken by the regulator within its own statutory framework, and subject to its own accountability and transparency mechanisms, such as consultation or cost-benefit analysis, but “shorter consultation periods may be necessary” and “both the PRA and FCA will have the ability to waive consultation requirements”. (Paragraphs 2.90 and 2.92.)
- The Treasury which will legislate to set out the FPC’s toolkit in secondary legislation, to specify for each tool: whether the FPC should publish and consult on a policy statement in advance of using the tool and whether the existing PRA and FCA procedural requirements should apply when implementing that tool. (Paragraph 2.96.)
- We are advised earlier in the document that “the Government will legislate to ensure that, in urgent cases, the Treasury can amend the secondary legislation containing the FPC’s toolkit immediately, with approval by Parliament required in the following 28 days” but that in practice “the Government believes this mechanism will rarely—if ever—need to be used”. (Paragraphs 2.74 and 2.75.)
- It is confirmed that an interaction with sustainable economic growth will be built into the objectives for the FPC, albeit in muted terms, such that the FPC’s statutory objective for financial stability would not require or authorise “the Committee to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term”. (Paragraph 1.21.)
- There will also be a regular twice-yearly update from the Governor to the Chancellor on developments in prudential regulation and financial stability and this high level interaction will form the central point of the bilateral relationship between the Bank and the Treasury in the event of a crisis. (Paragraph 2.138.)

9. So it is clear that significant thought is being given to governance and accountability mechanisms planned for the new regime. We find ourselves struggling, however, to gain a real understanding of who does what and

when, and whether these mechanisms will be effective, particularly in the event of a new crisis breaking or an element not working as envisaged.

#### SPECIFIC CONCERNS IN RESPECT OF THE FINANCIAL STABILITY PROVISIONS

10. We are concerned that the potential socio-economic effect of the application of macro-prudential tools has not been fully appreciated and accordingly believe that the objective, governance and accountability mechanisms should be further reviewed in this light. To begin with, it is clear that the application of these measures have the potential to have a significant effect on economic growth. The Treasury consultation paper links the FPC's objective into the Bank's existing financial stability objective and in the process adds that this linkage "does not require or authorise the Committee to exercise its functions in a way that would *in its opinion* be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term". Our reading of this is that the need to take proper account of the potential for adverse impacts on medium or long term economic growth has not been embraced with particular enthusiasm. This is therefore a subjective test and, since growth is placed on a lesser footing, the FPC will be obliged to err on the side of caution so as to ensure they hit their stability objective. If it later becomes clear that they made the wrong call, FPC can always hide behind plea that *in its opinion* at the time, measures taken were appropriate.

11. It further needs to be appreciated that the impact and effectiveness of macro-prudential tools will also depend upon the effectiveness and stability of monetary and fiscal policies as well as micro-prudential regulation and supervision. It is not sufficient in itself to compensate for failure to act in these areas with measures against the financial sector. We are therefore of the view that a much more deliberative process is needed at the heart of Government and Parliament to ensure appropriate oversight and direction of these different, but fundamental strands of macroeconomic management of the economy.

12. As explained above aspects of the regime intended to instil a sense of accountability include provision permitting them to be sidelined or curtailed. This includes the proposition that the FPC should have the power to adopt a tool in an emergency and direct the PRA or FCA to take action, with Parliamentary authorisation for the use of the tool following within 28 days. Whilst we note that this power is not intended to be used to make a firm-specific intervention or to override the PRA, we remain to be convinced that the power would not be used with this effect, particularly in a market where there are a small number of significant players. At the very least, this power does not sit well with the suggestion that macro-prudential policy should be focused on the medium to long-term.

13. We therefore believe that further thought needs to be given to macro-prudential tools and their exercise before conclusions are drawn on the need for such emergency powers. At this point in time we are inclined to draw a very different conclusion, namely that because of the potential socio-economic effect of the application of these tools, and their medium term horizon, that their use should be subject to full consultation and the explicit authorisation of the Chancellor and that there should be no need for emergency powers if the tools are to be used in accordance with their stated objective.

#### THE RESPONSIBILITIES AND PROCESSES OF COURT

14. The Court is currently responsible for managing the Bank's affairs—other than the formulation of monetary policy—and this includes determining the Bank's objectives and strategy and ensuring the effective discharge of the Bank's functions and the most efficient use of its resources. Since the 2009 Banking Act, the Bank has had a statutory objective to "contributing and enhancing the stability of the financial systems of the United Kingdom" and the Court, consulting with HM Treasury and on advice of the Financial Stability Committee, also formed under the Act, was given responsibility for determining the bank's strategy in relation to the financial stability objective.

15. It is clear that with the expanded responsibilities of the Bank now planned that there will be a commensurate increase in the duties placed upon the Court in the discharge of its obligations. In view of the changing nature of the Bank's responsibility for financial stability, the establishment of the FPC, and the nature of its powers, we see a case for responsibility for the policy set by the FPC being scoped out of the Court's responsibilities in the same way as for the MPC. This would establish that the FPC, through the Chancellors remit letter, is accountable for its policy decisions to Government, Parliament and the public. This would be consistent with the Court being responsible for the governance of the Bank of England, but not the delivery of its statutory functions. This would seem a more appropriate form of accountability for the FPC given the potential socio-economic effect of the macro-prudential tools at its command, the potential trade off between financial stability and the capacity of the financial sector to contribute to economic growth and possibly fiscal policy.

16. Given the nature of macro-prudential tools and their intended effect, it is also clear that there is an increased prospect of pressures upon the Bank to opine on discussions previously seen as being more in a political domain. This is also something that the Court will need to be much more alive to in the fulfilment of its oversight function. The Court will also need to be much more sensitive to the need to ensure that the Bank remains independent and objective in its engagement in the public debate on financial stability issues.

17. It would therefore appear to us that there is perhaps a need for a more open account of the responsibilities and processes of Court and that these need to be catalogued in a fuller account that will give much greater transparency into the workings of the Court and the way it discharges its responsibilities.

18. It is interesting to note that the recent evidence session with the current Chair of the Court constituted the first time he had appeared before the Treasury Committee despite his appointment almost two years ago. It must therefore be a consideration as to whether the Court should be invited to report to Parliament on meeting its oversight functions on a more regular basis. It may even be that the Treasury Committee should seek to institutionalise within legislation a more regular dialogue with the non-executive members of the Court.

#### THE BANK'S RESOURCES

19. We are not best placed to comment on the resources needed by the Bank to carry out its functions. What we would say however is that the banking industry has been supportive of the substantial increase in the cost of the regulatory authorities needed to make the shift towards enhanced supervision. We appreciate that the further changes envisaged are also likely to come with a need for a further increase in resources, not least to fund engagement with the European Systemic Risk Board, but would press for all aspects of financial regulation to be drawn into a single budgetary process under the watchful eye of the National Audit Office.

#### THE CONCENTRATION OF POWER

20. While we fully appreciate that the intention is to break with the Tripartite arrangement and that the intention is for the Bank to have prime responsibility for financial stability within the financial system, it must be questionable whether the concentration of responsibility places too heavy a burden on too few individuals and whether this brings concurrent risks for sound policy-making. It may also be arguable that there may be a conflict of interest between some of the component parts and that how to address these needs to be considered more fully. This would include the Governor's chairmanship of the PRA in instances where the issue in hand concerned the PRA determining how to act upon a recommendation from the FPC within the PRA's statutory framework, and the PRA making an assessment of whether to trigger the special resolution regime (as opposed to the Bank's determination of which of the resolution tools to use).

21. The Treasury paper briefly explores the interaction between monetary policy and macro-prudential policy and suggests that cross membership and the careful sequencing of FPC and MPC meetings will be sufficient to manage these interactions and avoid potential conflicts. While we see the logic in the MPC being the "last mover", adjusting its analysis to take account of the likely impact of the most recent action taken by the FPC, this is an area which may require further thought.

#### A NEED TO TAKE A STEP BACK

22. Notwithstanding checks and balances explained in the Treasury consultation paper, we feel no more assured that the governance and accountability arrangements will work in practice. While it is clear that there is not a vacuum in this regard, we are finding it hard to piece together the separate strands. This in turn makes it difficult to assess whether or not the arrangements have been viewed from a strategic perspective with the objective of ensuring that each of the different elements work both individually and as a collective whole. This is central to ensuring that the process of accountability will stand up in the event of a significant difficulty emerging in respect of a particular activity for which the Bank or one of its major committees has responsibility.

23. What perhaps is needed therefore is for the Government to take a step back and to explain in more holistic terms the way in which the different governance and accountability mechanisms are meant to work, and the way in which they interact, in respect of the full range of the Bank's new and existing responsibilities. Only when we see this will Parliament be able to obtain a real sense of whether it believe the arrangements need only updating to reflect the Bank's new responsibilities or whether the breadth and nature of the new tasks warrant more fundamental change.

24. The answer most likely lies somewhere in the middle in that it is highly likely that those directly engaged in individual processes have a sense of how they are meant to work and are clear as to the levers and mechanisms to pull if something goes wrong. This, however, is very difficult to assuage looking in from the outside. The question for the Government therefore is both whether the governance and accountability mechanisms are as robust as they need to be and whether they are sufficiently visible so as to inspire confidence in their workings. As matters stand, it is unclear as to the circumstances in which key individuals or committees would be held to account by the Court, the Treasury or by Parliament—or all three for differing purposes—for their policies or activities.

25. A specific recommendation would be that the Treasury Committee request that the governance arrangements for the Bank and the other authorities be set out in terms fully consistent with the UK Code on Corporate Governance. This would include their being subject to the type of external performance review provided for by the Code and reported upon publicly on a periodic basis.

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## Written evidence submitted by the Forum for Stable Currencies

A Response from the Independent Perspective of a Systems Analyst and Online Activist.

### 1. EXECUTIVE SUMMARY

1.1. The Committee is invited to go beyond the accountability of the Bank of England by looking at its main function: the supply of money to the UK's economy which consists not only of the financial, but, above all, the real economy.

1.2. Furthermore, this text widens the scope of the inquiry by defining "financial stability" as one of the responsibilities of the Bank of England. As a solution to the complexity of the situation, it proposes a number of software tools and macro-prudential indicators.

1.3. Finally, the Committee is alerted to the rising "global political awakening" and how it manifests in the UK. It poses the ethical challenge whether the Bank of England is accountable to the global money elite<sup>1</sup> or the UK electorate. Does it want to maintain credibility into the system of well paid organisations and committees—despite more and more *Victims of White Collar Crimes*<sup>2</sup> which even include state kidnapping<sup>3</sup>? Please note the book *FLEECED: How we've been betrayed by the politicians, bureaucrats and bankers—and how much they've cost us.*<sup>4</sup>

### 2. AN INTRODUCTION TO MINDSET AND CONTEXT

2.1. First-hand knowledge of creating and distributing private currencies has been available thanks to the *Christian Council for Monetary Justice*<sup>5</sup> since the 1960s and experiences of LETS (Local Exchange and Trading Systems)<sup>6</sup> as well as commercial barter companies<sup>7</sup> since the 1980s.

2.2. The creation and management of public currencies through central and other banks is thus well understood and many positive models exist for consideration, if only the global money elite were well intentioned. The realities that we have encountered, paint a different picture.

2.3. Eg *victims of white collar crime*<sup>8</sup> are part of the wide network of citizens and Parliamentarians, independent of party, religion or other affiliations, long before our meetings began at the House of Lords in 1998.

2.4. Since then, internet and web technologies are greatly contributing to the spread of knowledge and information pertinent to the accountability and responsibility of central banks in general and the Bank of England in particular.

### 3. THE ADVOCACY OF THE FORUM FOR STABLE CURRENCIES

2.1. *Economic Democracy*<sup>9</sup> through *Freedom from National Debt* is our tagline. The blog *Public Debts for Vested Interest Payments*<sup>10</sup> spells out in detail what the problems<sup>11</sup>, solutions<sup>12</sup> and challenges<sup>13</sup> are, as well as the metrics<sup>14</sup> that could be used as macro-prudential tools that the Government wants to define as part of its proposal.

2.2. The author is not only the national co-ordinator and web promoter of the *Forum*, but also a mathematician and software diagnostician, formerly at the *European Centre for Nuclear Research* (CERN) in Geneva. Having invented software methods that allow for the layering of complex data<sup>15</sup> and forecasting time series,<sup>16</sup> she has alerted the Bank of England as well as the Treasury to this innovation which would add great value to the analytical and interpretative processes in place.

### 4. THE GLOBAL POLITICAL AWAKENING AND THE NEW WORLD ORDER<sup>17</sup>

4.1. The article with this title appears on the website of the highly renowned Canadian *Centre for Research on Globalization*.<sup>18</sup> Covering the technological revolution and the future of Freedom, it concludes: "The

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<sup>1</sup> The Forbes 400 vs. Everybody Else: <http://www.michaelmoore.com/words/must-read/forbes-400-vs-everybody-else>

<sup>2</sup> <http://victims-unite.net/2010/12/04/victims-of-financial-exploitation-and-legal-oppression-blog-and-report/>

<sup>3</sup> <http://bit.ly/dLyBqF>

<sup>4</sup> [http://www.amazon.co.uk/Fleeced-betrayed-politicians-bureaucrats-bankers/dp/1849012865/ref=pd\\_sim\\_b\\_2](http://www.amazon.co.uk/Fleeced-betrayed-politicians-bureaucrats-bankers/dp/1849012865/ref=pd_sim_b_2)

<sup>5</sup> <http://www.ccmj.org/>

<sup>6</sup> <http://www.letslinkuk.net/regions/uk-map.htm>

<sup>7</sup> <http://bartercard.wordpress.com/>

<sup>8</sup> <http://victims-unite.net/>

<sup>9</sup> [http://en.wikipedia.org/wiki/Economic\\_democracy](http://en.wikipedia.org/wiki/Economic_democracy)

<sup>10</sup> <http://publicdebts.org.uk/>

<sup>11</sup> <http://publicdebts.org.uk/problems/>

<sup>12</sup> <http://publicdebts.org.uk/solutions/>

<sup>13</sup> <http://publicdebts.org.uk/challenges/>

<sup>14</sup> <http://publicdebts.org.uk/new-metrics/>

<sup>15</sup> <http://3d-metrics.com/wordpress/our-offers/software-methods/layering-complex-data>

<sup>16</sup> <http://3d-metrics.com/wordpress/our-offers/software-methods/forecasting-time-series>

<sup>17</sup> <http://www.globalresearch.ca/index.php?aid=19873&context=va>

<sup>18</sup> <http://www.globalresearch.ca/index.php?context=home>

*technological revolution has led to a diametrically opposed, antagonistic and conflicting geopolitical reality: never before has humanity been so awakened to issues of power, exploitation, imperialism and domination; and simultaneously, never before have elites been so transnational and global in orientation, and with the ability to impose such a truly global system of scientific despotism and political oppression. These are the two major geopolitical realities of the world today. Reflect on that. Never in all of human history has mankind been so capable of achieving a true global political psycho-social awakening; nor has humanity ever been in such danger of being subjected to a truly global scientific totalitarianism, potentially more oppressive than any system known before, and without a doubt more technologically capable of imposing a permanent despotism upon humanity. So we are filled with hope, but driven by urgency”.*

4.2. The “global political awakening” was advocated by co-founder with David Rockefeller of the *Trilateral Commission* and regular *Bilderberg* attendee Zbigniew Brzezinski at a *Council on Foreign Relations* speech in Montreal in May 2010.

4.3. *PrisonPlanet*<sup>19</sup> publishes: “Zbigniew Brzezinski’s much feared ‘global political awakening’ has arrived<sup>20</sup> and is in full swing”: “We are seeing a global revolution, the age of rage is falling upon us like dominoes reaching to every corner of the planet. Whether or not the outcome will topple the current global hierarchy, as Zbigniew Brzezinski fears, remains to be seen, but it will surely depend upon who controls the new governments that will replace the ousted rulers—the people who started the process of change, or the World Bank, IMF, NGOs and the rest of the global elite who are desperate to save their world government agenda from being derailed”.

## 5. THE ETHICAL CHALLENGE REGARDING THE DEMOCRATIC DEFICIT AND SYSTEMIC LOSS IN CONFIDENCE

5.1. The UK has always played a special role between the US and the mainland Europe in the globalisation and institutionalisation of Anglo-American capitalism. In its preliminary consideration of the Government’s proposals, the Committee mentions the democratic deficit and asks the key question: *who shall guard the guards themselves?*

5.2. But what are the guards guarding? What is “the need for secrecy” that the Committee mentions in its Summary? Might it be that banks create “money” from thin air?<sup>21</sup> Is the need for maintaining public confidence the constant camouflage of banks creating credit from thin air, selling it at interest and especially as “national” or “public” debts?

5.3. Is the systemic loss in confidence in political and economic processes due to the increasing awareness of the unaccountability of central bankers running the world, no matter what governments are in power with no end to their publicised huge bonuses?

5.4. In 2005, the Forum presented a human rights lawyer with the 17-page report *Sovereignty and Seigniorage*<sup>22</sup> outlining how the legal privilege (sovereignty) and financial mechanism (seigniorage) of nation states are being undermined by banks issuing credit as “money”. We were advised to “go for Parliamentary scrutiny via the Treasury Select Committee”, which has become the tagline for our website *Forum for Stable Currencies*<sup>23</sup>.

5.5. Since this took place at the time of the Stern review of the previous Treasury Committee, we submitted *Green Credit for Green Purposes*<sup>24</sup>, recommending to *Change the Cash: Credit Ratio of the Money Supply to Ameliorate Climate Change*.

5.6. Everybody uses a computer to get Cash, but nobody has any data about the loss of value of this Cash. The German/Swedish lawyer *Dr. Henning Witte*<sup>25</sup> who often represents banks in legal actions, has defined six levels of devaluation through debt-based money creation.<sup>26</sup>

1. the shift of assets from the real economy to banks;
2. pension contracts and savings lose their value through the effect of inflation;<sup>27</sup>
3. taxes have to be increased regularly;
4. “system relevant” banks (too big to fail) are bailed out with taxpayers’ money;
5. nation states are rescued with taxpayers’ money; and
6. currency reforms, such as from DM to Euro, ensure the loss of value.

5.7. The Government is aware of the need for cleaning up politics.<sup>28</sup> But is it aware of citizens, i.e. voters and taxpayers, publishing sites such as *Political Cleanup*?<sup>29</sup>

<sup>19</sup> <http://www.prisonplanet.com/>

<sup>20</sup> <http://www.prisonplanet.com/brzezinskis-feared-global-awakening-has-arrived.html>

<sup>21</sup> <http://www.guardian.co.uk/commentisfree/2008/mar/20/jamesrobertsonmoneyfromthi>

<sup>22</sup> <http://greencredit.files.wordpress.com/2008/01/sovereignty-and-seigniorage-report.pdf>

<sup>23</sup> <http://forumforstablecurrencies.info/>

<sup>24</sup> <http://greencredit.files.wordpress.com/2007/01/green-credit.pdf>

<sup>25</sup> <http://www.witte.se/>

<sup>26</sup> <http://publicdebts.org.uk/problems/>

<sup>27</sup> See *Pillaged: How they are looting £413 millions a day from your Savings and Pensions*

<sup>28</sup> [http://www.conservatives.com/Policy/Where\\_we\\_stand/Cleaning\\_Up\\_Politics.aspx](http://www.conservatives.com/Policy/Where_we_stand/Cleaning_Up_Politics.aspx)

<sup>29</sup> <http://political-cleanup.org/>

5.8. Politics can't exist without funding. Cleaning up funding, the creation and supply of money and the maintenance of its value ought to be the responsibility of the Bank of England, but who cares about the maintenance of long-term monetary and financial value when short-term interest payments fit the bill?

5.9. An ethical Bank of England, in the spirit of the writers of the Bank of England Act in 1694, would compensate for the every repossession, every bankruptcy, every pensioner who's been defrauded and every miscarriage of justice that has taken place. When will that be?

#### 6. ACCOUNTABILITY TO THE FINANCIAL OR THE REAL ECONOMY?

6.1. The Committee acknowledges that the Government's proposals talk about financial stability, as if the financial economy existed for its own sake: "*it's not all about banking*"! If it is accepted that the purpose of the Bank of England is to supervise the services provided by banks to the real economy, a different profile of responsibilities and accountabilities would arise.

6.2. In theory, the accountability of the Bank of England lies with *voters and taxpayers*. In practice that means Parliament as the mother of democracy.

6.3. But in a truly enlightened and progressive "big society", key economic, monetary and financial indicators could be made available on-line and instant voting and polling could take place—not just by the financial and political elite, but, above all, by concerned voters and taxpayers in the real economy, so that democratic procedures evolve into smart online technologies.

#### 7. THE BANK OF ENGLAND ACT 1694 AND ITS ENFORCEMENT

7.1. The Bank of England was founded with the Bank of England Act 1694, establishing the first National Debt of £1.2 million at 8% interest. The writers had the intention to avoid any "oppression of Their Majesties' subjects".

7.2. In particular, Section XXVI spells out that the "Corporation is not to trade" and that there is a Punishment, should it happen anyway.

7.3. Nowadays, this punishment means not only treble the value of national debts, but all other trades that the Bank of England is conducting and proudly presenting on its website. But Section XXVII spells out "in what Things they may nevertheless deal".

7.4. The Bank of England makes money out of money—just as all other financial institutions. In Islam, making money out of money is called "*riba*"<sup>30</sup>: a deadly sin. Whilst counterfeiting Cash is a crime, the creation of Credit from thin air<sup>31</sup> is not treated as counterfeiting nor money laundering the western financial world.

7.5. To raise awareness about the noble intentions of the writers of the Bank of England Act 1694, Early Day Motions to enforce it were tabled in April 2009<sup>32</sup> and in July 2010<sup>33</sup> and signed by 13 and 14 MPs respectively.

7.6. Furthermore, the blog [www.edm1297.info](http://www.edm1297.info) was started in June 2009 and has been viewed by over 19,000 visitors since.

#### 8. The Creation and Supply of Sterling for the UK's Economy

8.1. Responding to *What kind of decisions should be made by each body within the Bank?*

8.2. Questioning the accountability of the Bank of England in the context of supplying money to the UK's economy, means the following:

1. The *Court of Directors* addresses the degree to which the Bank is accountable to its global playing partners or the UK's electorate, which, after all, is losing interest in voting.
2. The *Committee of Court (NEDCO)* studies the ratio of the financial economy to the real economy, in terms of number of employees and GDP.
3. The *Monetary Policy Committee* monitors not only the interest rate, but also the Cash : Credit ratio in the money supply. Since WWII,<sup>34</sup> this ratio has changed from 47% Cash and 53% Credit to 3% Cash and 97% Credit!
4. The share of the Government's budgets as part of the total money supply is monitored as an indicator of who guards the economy as a whole.
5. As long as "financial stability" means financial institutions not collapsing, the *Financial Stability Committee* monitors the accounts and reserves of financial institutions.

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<sup>30</sup> <http://en.wikipedia.org/wiki/Riba>

<sup>31</sup> <http://www.guardian.co.uk/commentisfree/2008/mar/20/jamesrobertsonmoneyfromthi>

<sup>32</sup> <http://edmi.parliament.uk/EDMi/EDMDetails.aspx?EDMID=38435&SESSION=899>

<sup>33</sup> <http://edmi.parliament.uk/EDMi/EDMDetails.aspx?EDMID=41554&SESSION=905>

<sup>34</sup> <http://forumnews.wordpress.com/public-interest-article/2-what-is-the-cash-crumble/>

6. When “financial stability” means the maintenance rather than loss of financial value, price stability within the country and exchange rates with respect to other currencies need to be monitored.
7. “*Financial Stability Indicators*” should thus be the pre-eminent tool for this Committee.
8. Price inflation is measured on such a short-term basis that it never reflects the loss of value that people experience in their life time.
9. Gold and the metals used to mint coins have gone up and up in value, while “money” has gone down. As part of the political awakening, the *Gold Anti-Trust Action Committee GATA*<sup>35</sup> has been questioning the Fed for many years and even taken legal actions.
10. Creating bailout money for banks, imposing spending cuts and refusing a *Robin Hood Tax*<sup>36</sup> to its over 80,000 supporters, makes the agenda of the financial elite obvious, while turning moves towards credibility and maintaining confidence into a farce.

## 9. THE GROWTH OF WHITE COLLAR CRIMES

9.1. Pointing at the effects of a poor financial system, we have brought the plight and grievances of *Victims of Financial Exploitation and Legal Oppression*<sup>37</sup> to the attention of the Committee.

9.2. White collar crimes are also carried out by national authorities such as *HM Inland Revenue, HM Customs & Excise, HM Court Services*, Insolvency Practitioners and any number of solicitors, barristers and judges as well as those in positions of trust in commercial companies.

9.3. Any discussion about the accountability of the Bank of England as the ultimate guardian of the money that banks create for the financial and real economy of the UK, needs to take into account the Government’s plan for an *Economic Crime Agency* that should also address the kinds of white collar crimes that we have been witnessing for some twenty years.

9.4. The Government and the Committee need to be aware of an electorate that is increasingly aware of the *Money Masters*<sup>38</sup>, *Dishonest Money*<sup>39</sup>, the *Money Scam*<sup>40</sup>, *Money as Debt*<sup>41</sup> the *Lost Science of Money*<sup>42</sup> and the *Web of Debt*<sup>43</sup>, published by increasingly popular American authors and specialist researchers.

9.5. In the UK, *Money as Debt*<sup>44</sup> *Public Debts*<sup>45</sup> are similar blogs *In the Spirit of the Forum for Stable Currencies*<sup>46</sup> Furthermore, *Debtonation*<sup>47</sup>, the *Money Reform Party*<sup>48</sup> the *Global Table*<sup>49</sup> *Prosperity UK*<sup>50</sup> *Positive Money*<sup>51</sup> *One Good Cut*<sup>52</sup> and the *Robin Hood Tax*<sup>53</sup> are gaining more and more support.

9.6. The Government’s call for *judgement, focus and stability*, combined with the Committee’s call for slow but appropriate regulation need to be balanced with an electorate that is growing in terms of political education and ability to use technologies for effective communication.

## 10. FURTHER SPECIFIC QUESTIONS BY THE COMMITTEE

10.1. *Discussion focuses on the MPC (Monetary Policy Committee) and FPC (Financial Policy Committee) but are there other policy functions within the Bank's remit which deserve attention?*

It seems clear to the Committee that the City in general and the Bank in particular need to take the real economy into account. A “Liaison Committee” that is representative of employers and employees, of large corporations and SMEs, of Trade Unions and the *Federation of Small Businesses*, the *Institute of Directors* and other representatives of the real economy might add to a “political face lift” for the Bank.

<sup>35</sup> <http://www.gata.org/>

<sup>36</sup> <http://robinhoodtax.org/>

<sup>37</sup> <http://victimsunite.files.wordpress.com/2010/12/victims-of-financial-exploitation-and-legal-oppression1.pdf>

<sup>38</sup> <http://themoneymasters.com/>

<sup>39</sup> [http://dishonestmoney.com/dishonest\\_money.html](http://dishonestmoney.com/dishonest_money.html)

<sup>40</sup> <http://forumnews.wordpress.com/2011/01/30/the-money-scam-alex-jones-says-it-in-59-slides/>

<sup>41</sup> <http://www.moneyasdebt.net/>

<sup>42</sup> <http://www.monetary.org/lostscienceofmoney.html>

<sup>43</sup> <http://www.webofdebt.com/>

<sup>44</sup> <http://moneyasdebt.wordpress.com/>

<sup>45</sup> <http://publicdebts.org.uk/>

<sup>46</sup> <http://forumnews.wordpress.com/>

<sup>47</sup> <http://www.debtonation.org/>

<sup>48</sup> <http://www.moneyreformparty.org.uk/>

<sup>49</sup> <http://www.globaltable.org.uk/>

<sup>50</sup> <http://prosperityuk.com/>

<sup>51</sup> <http://www.positivemoney.org.uk/>

<sup>52</sup> <http://www.onegoodcut.org/>

<sup>53</sup> <http://robinhoodtax.org.uk/>



10.2. *To whom should the Bank be accountable? Are different accountability mechanisms needed for different functions?*

Different INDICATORS are required as the basis for different decisions that affect different layers of the economy for different lengths of time.

Paragraph 8 spells out the following indicators as areas of responsibility and accountability:

- The ratio between Cash and Credit in the money supply.
- The share of the Government's budget in the money supply.
- The cash flow and risk of bankruptcy of financial institutions.
- The loss of financial value in terms of.
- Price inflation—as the increase of prices—with a difference between baskets required at different life stages, since the financial needs for young people differ from those of the elderly—over short-, medium and long-term intervals.
- Monetary inflation—as the increase of the money supply over short-, medium and long-term intervals.

10.3. *Are the responsibilities of the Court of the Bank of England clear and appropriate?*

Yes: to manage the Bank's affairs, which includes determining the Bank's objectives and strategy, ensuring the effective discharge of the Bank's functions:

- But the question remains: how is financial stability defined, monitored and managed?

10.4. *Are the members of the Court of the Bank and the arrangements for its members' appointment and dismissal appropriate?*

Yes. Hence it would have been nice to use my innovative software methods to analyse what the Governor repeatedly calls "complex", especially as he also has said that "of all the banking systems possible, we have the worst".

10.5. *What resources does the Bank of England need to carry out its functions?*

It can invent all the money it needs at any time.

The modus operandi of all central banks and banks has the effect of creating a scarcity of money that is artificial: creating credit or "broad money" without creating "interest money". People thus have to borrow from Peter to pay Paul all the time.

This practice is not sustainable and this attitude does not need spreading, compared with the stability and sustainability that private currencies are demonstrating.

30 March 2011

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**Written evidence submitted by the Building Societies Association**

INTRODUCTION

1. The Building Societies Association (BSA) is pleased to take this opportunity to contribute to the Treasury Committee's inquiry into the accountability of the Bank of England.

2. The BSA represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

EXECUTIVE SUMMARY

- The BSA observes that the debate about the framework for the new regulatory architecture is now largely settled and will vest very much more power in the Bank of England than is currently the case.
- Parliament should consider how it holds to account a more powerful Bank. There is a case for a dedicated, well-resourced, select committee to shadow the Bank.
- With the division of responsibility for macro and micro prudential regulation—between the FPC and PRA—under the overall control of the Bank, the Bank has a crucial coordination role, identifying and managing the interdependencies between the new regulatory bodies.
- Clarity around the FPC's role, and targets, in securing financial stability is essential. Financial stability is not an absolute—and needs to be balanced if economic stagnation is to be avoided.

- The PRA needs a culture of consultation—as part of this, it should seek input from practitioners on developing EU initiatives, so as to inform its negotiation strategies in Brussels.
- The FPC should comprise a majority of external members, several of whom have direct and recent experience of working in financial services.
- Among other accountability mechanisms for the FPC, assessments are needed of the unintended and spill-over effects of the use of its macro-prudential tools, several of which are relatively untested.

*What kind of decisions should be made by each body within the Bank?*

3. The current proposals would bring responsibility for all aspects of financial stability together within the Bank group, the Bank of England having ultimate responsibility, as follows:

- The Financial Policy Committee (FPC), as a committee of the Bank’s Court of Directors (its governing body), will be responsible for delivering systemic financial stability through macro-prudential regulation;
- The Prudential Regulation Authority (PRA), as an operationally independent subsidiary of the Bank, will be responsible for oversight of the safety and soundness of banks, insurers and other prudentially significant firms; and
- other parts of the Bank of England will be responsible for:
  - crisis management, including the resolution of failed or failing banks under the special;
  - resolution regime;
  - regulation of key financial infrastructure such as payment and settlement systems and central counterparties; and
  - continuing to provide liquidity insurance to the financial sector and, where appropriate, emergency liquidity assistance, as part of its central bank responsibilities.

4. The BSA observes that the debate about the framework for the new regulatory architecture is now largely settled and will vest very much more power in the Bank of England than is currently the case. The division of responsibilities between the FPC and PRA on, respectively, macro and micro-prudential lines should enable the bodies to focus on their own key responsibility, under the overall management of a single institutional structure. In principle, this should help avert a repetition of some of the fundamental problems experienced with Tripartite in the past.

5. However, the need for co-ordination remains, so it will be essential for the Bank to identify interdependencies between the different elements in the arrangements and manage them effectively. The importance of effective management by the Bank and proper coordination between the new regulatory authorities is identified in *A New Approach to Financial Regulation: Building a Stronger System* (especially see chapters 1 and 2).

6. We also agree with the Treasury Committee that, if the FPC is to be given lead responsibility for securing financial stability there needs to be clarity about what such stability means. Whilst this is by no means an easy matter, more detailed examination is necessary, including how success will be measured and what tools will be used to achieve it.

*To whom should the Bank be accountable?*

7. Taking a broad view of the proposed arrangements, there is still a risk of the emergence of an excessively powerful Bank of England unless robust accountability and transparency provisions are put in place. The new arrangements, as proposed, will mean that the Governor of the Bank of England will be Chairman of the MPC, the FPC and the PRA, as well as having oversight of the FCA, and the bank resolution regime.

8. We welcome the Government’s recognition of the need for strong accountability, with mechanisms and controls to be put in place, as set out in *Building a Stronger System*, such as publication of FPC meeting records, a twice-yearly financial stability report, certain accountability mechanisms for the FPC’s use of directions and toolkits, audit of the FPC and PRA by the National Audit Office, a Treasury power to order independent inquiries into regulatory power, further governance and accountability arrangements for the PRA among others.

9. We believe that the proposed arrangements could go further, without diminishing—but, indeed, reinforcing—the importance of financial stability. In UK financial services, and banking in particular, systemic risk is concentrated in relatively few institutions—a fact acknowledged by the Independent Commission on Banking. The combination of this concentration of systemic risk and the concentration of power in the Bank of England means that it would take only a very few people to make wrong decisions at critical times for a future financial crisis to be dealt with in a sub-optimal manner. Checks and balances on the Bank are required to mitigate this risk and certain specific suggestions are set out below.

## PARLIAMENTARY ACCOUNTABILITY

10. Key among the accountability mechanisms to which the enhanced Bank will be subject is accountability to Parliament, principally via the Treasury Committee. There would appear to be scope for the formal functions of the Treasury Committee to be enhanced; for example by routinely interviewing new appointments to the board of the new regulators. Given the importance of ensuring appropriate levels of political accountability, it would seem now to be the right time to assess whether the Treasury Committee is properly resourced. The BSA understands that the Committee has very few support staff, certainly compared to the Bank of England and other regulatory agencies; given the high profile of its work, the range of inquiries it undertakes, and the reports it publishes, it may well be appropriate for the Treasury Committee to have additional resources.

11. Moreover, arguably, the concentration of power in the Bank of England, and the very wide range of subjects already covered by the Treasury Committee will be such as to warrant a dedicated select committee to provide adequate oversight of its activities. Typically select committees cover the areas that are particularly the responsibility of a Department of State; however, we would support moving away from this model, with the creation of either a Financial Regulation Select Committee, or a Bank of England Select Committee.

12. The financial crisis of the last few years has had, and is having, a huge effect on the structure of the banking industry in the UK, and on the structure of regulation. On the face of it, it would be odd if the arrangements for Parliamentary oversight of regulation of the finance industry were not even discussed. (That said, for the purposes of the remainder of this submission we assume the current arrangements continue.)

### *Are different accountability mechanisms needed for different functions?*

13. The BSA's view is that certain accountability measures should apply across the board, but that other measures should vary from one regulatory body to the other, taking into account their differing objectives.

## PRA

14. The BSA believes that the PRA should be subject, essentially, to the same statutory accountability provisions as the FSA. The BSA also believes the PRA should have regard to the primary objectives of the FPC and Financial Conduct Authority (FCA). Financial stability is overriding, but it is imperative that the three organisations liaise closely and that one does not cut across what the others are doing.

15. In respect of "have regards" under the principles of good regulation, we adhere to the position set out in our response to *A New Approach to Financial Regulation: Judgment, Focus and Stability* —

"Why should the PRA not be expected to use its resources in the most efficient and economic way? Why should it not have regard to the responsibilities of those who manage the affairs of authorised firms? Why should the PRA be entitled to disregard the principle that a burden that is imposed on a person should be proportionate to the benefits that are expected to result?"

16. We welcome the decision, referred to in *Building a Stronger System*, that the new arrangements will recognise corporate diversity. Particularly welcome is the Government's decision that both the PRA and the FCA will be required specifically to take account of mutuals in relation to cost-benefit analyses.

17. The FSA has a culture of consultation because of the requirements, prescribed by the FSMA, to consult on prospective rules and guidance. The Bank of England has not been subject to such requirements and it will be important for the PRA to develop relevant approaches to the consultative process.

18. While it would not be appropriate for the PRA's day to day supervision of firms to come under government control (and thereby responsibility), nevertheless there needs to be some mechanism whereby the PRA's micro-prudential policy initiatives should also have regard to wider economic and social policy imperatives. Otherwise there is the risk of measures that may appear justified in a narrow regulatory context but which are clearly suboptimal, or even undesirable, when viewed against the wider context. Micro-prudential regulation is not an end in itself—it should serve wider societal objectives.

19. It also needs to be recognised that much, perhaps most, micro-prudential policy (eg on capital and liquidity) is now settled at EU level with the UK having less and less room for independent manoeuvre. So—in future—at least as important as consultation on actual rules/guidance will be consultation on the agreed outcomes that the UK should seek from current and future EU regulatory initiatives, which will then inform the UK negotiating strategy.

## FPC

20. We recognise that the position of the FPC, as a body with high-level responsibility for financial stability, is substantially different from that of the PRA, whose primary responsibility is the prudential regulation of individual businesses. Nevertheless, it would be appropriate to examine whether the FPC, like the FSA currently, should be required to have regard to good corporate governance in managing its affairs. Arguably, it should also be required to have regard to the views of the statutory panels.

21. Macro-prudential decisions are essentially about seeking an optimum combination of financial stability with growth in the wider economy, as is implicitly recognised in the FPC's objectives. Too much stability may be accompanied by economic stagnation, and too much credit growth may endanger stability. But this shows that financial stability is not a good that can be pursued in isolation, but is inevitably connected with wider economic matters, and indeed with several aspects of social policy which are the preserve of the elected government—such as access to housing and access to credit. It may not be possible therefore for the FPC to be as explicitly independent of government influence as the MPC.

22. There is also the specific interaction between monetary policy and macro-prudential regulation. Co-ordination is the key, incorporating such matters as cross-membership (of the MPC and the FPC, with the Governor as chairman of both) and sensible sequencing of meetings. We agree with the Treasury Committee that, so that policies on financial stability can be coordinated more effectively, provision for joint MPC/FPC meetings may be required.

23. The independent members of the FPC will play a very important role but, whilst the MPC has four external members out of a total of nine, the FPC would have four external members out of eleven. We agree with the Treasury Committee that a better balance between internal and external members of the FPC could be achieved by increasing the number of external members on the FPC to, say, six. Further, to aid the achievement of the FPC's statutory objective of not having a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy, it would be beneficial to appoint more external members with direct and recent experience of working in the financial sector. In the interim FPC, just one out of the four external members has such direct experience.

24. In addition, it is not yet clear which tools the FPC will favour, nor how it will use them, and this will depend on the risks it identifies. Accountability of the FPC must incorporate an assessment of the spillover effects and unintended consequences of its macro-prudential tools, many of which are relatively untested at present. We accept, of course, that it would not be appropriate or desirable for the FPC to consult prior to each use of one of its macroprudential tools. However, it would be appropriate for the FPC to be obliged to engage in consultation on the tools available to it and how it would envisage these being deployed. This will help to develop understanding of how macro-prudential tools affect the wider economy, and therefore also have an impact on the achievement of the MPC's objectives.

*What resources does the Bank of England need to carry out its functions?*

25. We are not in a position to assess the appropriate level of resources required by the Bank of England to carry out its macro-prudential and supervisory roles. It is though self-evident these need to be adequate. However, we would see certain key principles that need to be met. First, we would expect the Bank to be required to operate with efficiency and economy. Second, cross-subsidy between the various regulatory bodies must be avoided. This means that the PRA and the FCA should not be subsidised by the Bank (which in turn derives its financial resources from, *inter alia*, interest-free cash ratio deposits from building societies and banks—there is a strong case, by the way, for the group of institutions required to make such deposits to be widened.) Equally, the Bank should not have access to the financial resources of the PRA or the FCA. Third, to underpin the first two, there is a need for greater transparency than at present around the resources the Bank has at its disposal and how they are deployed.

March 2011

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### Written evidence submitted by the Financial Services Consumer Panel

#### EXECUTIVE SUMMARY

1. The Financial Services Consumer Panel (“the Panel”) is a statutory body established under section 10 of the Financial Services and Markets Act 2000 (FSMA). The Panel advises the FSA on the interests and concerns of consumers, and reports on the FSA's performance in meeting its objectives in the regulation of financial services. It also looks at the impact on consumers of activities outside, but related to, the FSA's remit.

2. The Panel's interest in this issue arises from the proposals for regulatory reform in splitting off the regulator's current prudential function to a Prudential Regulation Authority (PRA) located within the Bank of England, and in the formation of the new Financial Policy Committee (FPC), also situated within the Bank of England's governance structure. Our submission to the inquiry will focus on the need for greater accountability and broader representation in the FPC and PRA.

3. Stable financial markets are vital for consumers, but they also have a strong interest in retail markets which are transparent, which deliver good value and which treat consumers fairly. In the proposals for a new regulatory system there is a danger that the link between prudential issues and systemic risk on the one hand, and conduct issues and maintaining confidence in the market on the other, will be weakened. The Panel believes that to strengthen the links between macro-prudential, micro-prudential and business conduct regulation and to ensure that the broader issues and trade offs that impact on financial stability are taken into account, there is a need for broader accountability of the new bodies within the Bank of England structure than allowed for in the current proposals.

*To whom should the Bank be accountable? Are different accountability mechanisms needed for different functions?*

4. The regulatory system should be accountable to citizens and consumers, government and industry for the decisions it makes, the actions it takes and the impact these have.

5. Accountability can be provided through a number of means:

- In being held to account ex post facto by, for example, reports to the Parliament and to the public such as business plans and annual reports, minutes of meetings and reasons for decisions, and through complaints mechanisms.
- By securing good, evidence-based inputs from key stakeholders, through dedicated research, analysis and monitoring, and being responsive to the external environment so as to make better informed decisions.
- By improving the quality of decision-making, ensuring that institutions have an appropriate mix of skills and experience amongst executive management and non-executive members on their boards.

6. The current proposals lack operational detail, but the Panel is concerned that the boards of both the FPC and the PRA have an overly strong Bank of England basis and we would like to see a more diverse and representative structure. We would not want to see the supervision of business conduct downgraded and a failure to adequately consider the possible negative impact on citizens as a result of the structural changes.

#### THE FINANCIAL POLICY COMMITTEE

7. The FPC will use its macro-prudential tools to contribute to the achievement by the Bank of its financial stability objective. It will be required to take account of the effect of its actions on the growth of the UK economy, but there is no requirement, either in taking account of growth issues or in a broader sense, to consider the impact of its actions on consumers' welfare. For example, instruments, such as loan-to-value caps or increasing the cost of capital to manage an emerging asset bubble in the housing market may be effective in stabilising the financial system but could impact consumer confidence and therefore have adverse consequences for the growth of the economy. It is not clear that the constitution of the FPC will provide adequate breadth of experience and independence to provide effective governance for an activity which will have a much broader remit than the MPC.

8. The FPC will be a sub-committee of the Court of the Bank, chaired by the Governor of the Bank. In addition, a majority of the members and the Chairman will be drawn from the executive management of the Bank. The Board of the PRA will also be chaired by the Governor and have majority Bank membership. In our view this does not provide the necessary checks on the decisions taken by the Bank's executive management. We would like a majority of members to be from outside the Bank. These non-Bank executives should be appointed in a transparent way, properly supported and resourced to guard against the phenomenon of "group think". In normal circumstances this will provide the necessary independence to review actions proposed by the Bank, the PRA and the FCA and decide on the best course. In the case of a crisis we think it is extremely unlikely that the independent members will overrule the advice of the bank's executive. In that respect experience, once the recent crisis crystallised, has been reassuring.

9. The Monetary Policy Committee (MPC) provides an example of greater transparency and accountability of operations within the Bank of England and, allowing for the different functions, could be a model for the FPC.

10. The MPC goes to great lengths to explain its thinking and decisions. In addition to the publication of the minutes of meetings and the discussion leading to decisions it also records the votes of the individual members of the Committee. The Committee has to explain its actions regularly to parliamentary committees, particularly the Treasury Committee. MPC members also speak to audiences throughout the country, explaining the MPC's policy decisions and thinking. This is a two-way dialogue. Regional visits also give members of the MPC a chance to gather first-hand intelligence about the economic situation from businesses and other organisations. We would encourage the FPC to adopt a similarly transparent and accountable approach in its engagement with stakeholders.

11. The FSA Panels have traditionally had a worthwhile dialogue with the FSA Board, providing information and particular perspectives, and we propose that this ongoing dialogue should continue with the FPC. We believe that the relationship proposed between the Panels and the FCA would be a useful addition to the governance arrangements of the FPC and PRA. This could be achieved as part of the MoU between the FCA and the FPC and PRA.

#### THE PRUDENTIAL REGULATION AUTHORITY

12. The decisions of the PRA and its supervisory work have the potential to impact significantly on consumers, because of the interactions between conduct and financial stability (eg the decisions taken to deal with an asset bubble), the potential for anti-competitive practices to be endorsed in the name of financial stability (eg in a PPI type situation where the business model is common to all) and the power of veto over

conduct regulation. It is vital that consumer interests are represented in its discussions. The presence of the chief executive of the FCA on the Board is not sufficient in our opinion.

13. We would like to see the Panels having a relationship with the PRA Board, as now with the FSA, which would enable us to be aware of forthcoming items on their agenda and the ability to submit observations and comments on issues which are being discussed where the experience of the people on the Panel may be relevant. This has been achieved through the requirements in sections 10 and 11 of the FSMA for the FSA to establish and consult Panels of consumers and practitioners and, for the panels to be able to raise issues formally with the Board and require them to respond. This process has never had to be used formally but, through the MoU under which the Panels operate, it has been possible to discuss issues and provide advice which has improved the debate on the Board.

14. Regulatory intervention undertaken by the PRA may also have a damaging impact on competition. Concentration or a preference for larger, possibly sounder, institutions raises concerns about barriers to entry and the spectre of too big to fail. It is no doubt easier for a regulator to regulate a small number of firms with a similar operating model. If the PRA only focuses on financial stability it may lose sight of long term impacts on the market.

15. The elevation of competition to a primary PRA objective could lead to muddle and industry gaming of the regulatory rules. We believe that a competition check is required on the PRA's activities. The existence of the FCA provides a primary check, but the power balance between the two organisations as proposed would not produce satisfactory consumer outcomes. Therefore, as one of a number of measures necessary to produce a more balanced power relationship between the PRA and FCA, the Panel urges that the PRA's functions be subject to the former general duty to have regard to:

“the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions”.

#### THE PRA'S POWER OF VETO

16. The availability of a PRA veto could constitute a restraint on FCA exercising its consumer protection functions and may result in significant detriment to consumers. Financial firms may use the existence of the veto to game the system, seeking regulatory forbearance on exaggerated grounds of instability risks. We are not convinced that the proposed Parliamentary scrutiny would avert these potential deficiencies.

17. The PRA is able to intervene where it considers FCA actions are likely to lead to disorderly failure of a firm or firms, or wider financial instability. We accept the need for a veto in certain limited and well-defined circumstances; it is not in consumers' interest that the disorderly closure of firms disrupts the supply of vital financial services or threaten financial contagion. But we question whether the PRA should be permitted to exercise its veto on grounds of “wider financial instability”, a macro-prudential consideration for the FPC to decide, and remain concerned that the industry will have a large incentive to game the rules even in cases where the risk of instability is limited.

18. The Panel proposes that if there is a role for a veto in circumstances where actions proposed by the FCA create a risk of wider financial instability, the decision to deploy the veto should be with the FPC rather than the PRA. The FPC have no direct relationship with the firms involved and, if the composition and issues under consideration by the FPC are more broadly based, should be able to better balance competing issues. The FPC already has a role in providing advice and expertise to the regulators and in advising on disputes where matters could have material financial stability effects.

19. Ultimately if the PRA has to use its veto it is a strong indication that it has failed in supervision and the required interventions have not been made earlier. The veto should be seen as a last resort.

#### CO-ORDINATION AND COMMUNICATION

20. The proposed split of supervision and conduct functions between the PRA and FCA should be supported by strengthened communication and a commitment to consistency. This will be a challenge between two bodies with completely different objectives. The duty to co-ordinate must result in co-ordination and therefore there is a need for oversight and regular monitoring.<sup>54</sup> The Panel proposes that some of the necessary scrutiny of co-ordination and communication could be provided both through regular internal audit and also through the Special Supervisory Unit, an independent unit within the current FSA which reviews how supervisors are dealing with relationship managed institutions.

21. In addition, we propose the following mechanisms to achieve a more even balance between the PRA and FCA:

- Annual reporting by the Treasury Committee on how the FCA and PRA are co-ordinated.
- Bi-annual reports by the FCA to BIS and HMT, comparable to the bi-annual stability reports by the Governor of Bank of England.

<sup>54</sup> The Australian twin peaks model has separate prudential and conduct regulators in addition to the Central Bank who all have representation, along with the Treasury on an overarching Council of Financial Regulators.

- A relationship for the FCA Panels with the PRA and FPC, similar to that in sections 10 and 11 of the FSMA to strengthen the governance of both organisations.

22. The exchange of information from PRA to FCA will be paramount to FCA properly performing its functions. There is some concern that because of the commitment to financial stability that prudential supervision will lose its focus on conduct issues and unfairness and that even if information is passed on to FCA, the information will not be adequate. Incentive structures are required to encourage sharing of information rather than just requiring information exchange.

#### ROLE OF THE PANELS

23. The role of current FSA Panels has been recognised as a critical and effective component of governance and accountability and an important part of the FCA going forward. The Consumer Panel currently plays a role within the regulator in relation to both prudential and conduct of business issues and also provides advice on matters applicable to both such as consumer and stakeholder engagement. The Panel advises and challenges the FSA from the earliest stages of its policy development to ensure the FSA takes the consumer interest into account. Members of the Panel encompass a broad range of relevant expertise and experience. Formal recognition of the Consumer Panel and its representations, through an MOU with the PRA and FPC, would enable early input and identification of possible consumer impacts of prudential regulation.

March 2011

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### **Written evidence submitted by the Financial Services Practitioner Panel and the Smaller Businesses Practitioner Panel**

#### EXECUTIVE SUMMARY

1. This is a joint submission from the Practitioner Panel and the Smaller Businesses Practitioner Panel. The Practitioner Panel is a body set up under FSMA 2000 as an independent Panel to represent the interests of practitioners to the FSA. The Smaller Businesses Practitioner Panel (SBPP) was set up by the FSA to represent the interests of smaller firms and is due to become an additional statutory panel of the Financial Conduct Authority under the current Government proposals. Details of the role and remit of both Practitioner Panels are at Appendix 1.

2. As Panels with a remit to represent the interests of regulated firms, we will confine our comments in this Inquiry to the areas of the Bank of England which will be taking over responsibility for the regulation of financial services firms in the Government's current proposals. We do not have experience of interaction with the Court of the Bank of England and so we will not comment on this part of the Inquiry.

3. Our concerns focus on the lack of structured practitioner level engagement in the decision-making processes at the Bank. We believe it is vital to have some system for engagement—probably linked to the new FCA Panels—for the PRA, which will be a subsidiary of the Bank. We also believe it should be considered for the FPC, and a link to the FCA Markets Panel for the systemic infrastructure which will be supervised by the Bank.

4. We also question whether it is practical for the Governor of the Bank of England to have responsibility for so many different aspects of the new regulatory system, in addition to the duties which he has already.

#### TREASURY COMMITTEE QUESTIONS

*What kind of decisions should be made by each body within the Bank?*

5. In our response to the Government's ongoing consultations on the proposed new UK regulatory structure for financial services, and in our evidence to the Treasury Select Committee's previous Inquiry into regulatory reform, we highlighted the concentration of power in the Bank of England.

6. In the new system, decisions which impact on the regulation of firms are split between a number of different bodies within the Bank. However, the Governor provides a common role of chairing all of these bodies—FPC, PRA, Bank and other bodies such as the MPC. Although we appreciate the desire for coordination through this model, we question the potential conflicting objectives and other conflicts of interest inherent in this structure. One particular example is the concept of the Governor chairing the PRA when deciding if a firm should go into the Special Resolution Regime, as well as chairing the Bank, FPC and acting as Governor of the Bank which will take on this responsibility. Not only are we concerned about conflicts, but also the capacity for a single person to hold so many significant roles effectively.

7. For the FPC, we see that its decisions could have a huge impact not only on the financial stability of the UK, but at a detailed level, ultimately on the way that firms are run. We question the dominance of membership of the FPC by the Bank. We are also concerned that the independent members of the FPC as announced in February 2011, do not have recent direct experience of running financial services firms. We think that this experience is important to be added to the mix for appropriate decision making by the FPC. We would like to

suggest that a specific requirement of the independent members of the FPC is that at least one has recent and senior executive director level experience in a financial services firm.

8. For the PRA, its decisions will mainly be in the context of implementing regulations as set by international and European regulatory bodies. However, it will be vital that the PRA plays a key role in representing UK interests in the debates within the EU structures. We believe that there should be a structured debate with practitioners on the UK's interests as they play out for firms. This is another argument for the engagement with practitioners through a cross-sector representative panel for the PRA as well as the FCA.

*To whom should the Bank be accountable?*

9. We believe the Bank should be accountable to Government and Parliament. However, we believe there is a clear role for engagement with the industry in respect of the functions of the FPC, PRA and the regulation of systemic infrastructure by the Bank.

10. In our responses to the HMT consultation published in February 2011, the Panels will argue for engagement with representatives of the Practitioner, Markets and Smaller Businesses Practitioner Panels as a means of ensuring effective regulation of financial services firms.

11. We believe that the Panels should provide structured practitioner-level engagement with the PRA. This is necessary to enable debate on any unintended consequences of regulation, as well as the most effective implementation of regulatory priorities. This is not only necessary for the PRA's work in supervising UK firms, but also in its work in representing UK interests in European negotiations: we believe there should be a system of ongoing dialogue with relevant firms to assist the PRA with its negotiations in Europe and internationally. We also believe that there should be some opportunity for debate on the cost effectiveness of the PRA itself, which is funded by the industry. To have a system of Panels, which publish annual reports on their activities, would provide the opportunity for structured debate and transparency and clear reporting of the debates which have taken place, in line with the government's wish for greater transparency overall.

12. For the FPC as well, we would like some consideration of a formal system of dialogue with the Panels. The FPC's control of macro prudential decisions and tools, means that their decisions could have major impact on firms and some significant socio economic consequences, which firms would need to take into account, and possibly adapt their business models from a wider perspective than first thought. We believe that the Panels could provide a useful function in dialogue with the FPC.

13. We would also like to suggest that the new FCA Markets Panel should represent the interests of those firms covered by the systemic infrastructure of the Bank. Whilst we recognise the rationale for the movement of the supervision of systemic infrastructure to the Bank, this split between the Bank and FCA in the regulation of markets introduces a weakness in the system. The ability for the Markets Panel to engage in dialogue with the relevant section of the Bank of England should work to assist in ensuring effective regulation of these essential functions.

14. For all of these areas of dialogue, it may be worth considering if the Panel should also be given powers to engage with the Bank, possibly through a similar power as that given to the current FSA Panels in Section 11 of FSMA<sup>55</sup>.

*What resources does the Bank of England need to carry out its functions?*

15. We believe that the addition of access to a group of practitioners would provide a significant and worthwhile resource for those parts of the Bank of England whose work impacts directly on the regulation of firms, as set out above.

16. We will be suggesting in our response to the current Government consultation that, as a minimum, there should be a joint representation of the Practitioner Panel, Smaller Businesses Practitioner Panel and Markets Panel, which engages with the PRA and possibly FPC on a six monthly or quarterly basis.

*April 2011*

<sup>55</sup> Financial Services and Markets Act 2000—Section 11 **Duty to consider representations by the Panels.** (1) This section applies to a representation made, in accordance with arrangements made under section 8, by the Practitioner Panel or by the Consumer Panel. (2) The Authority must consider the representation. (3) If the Authority disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.



## Written evidence submitted by the Association for Financial Markets in Europe

### INTRODUCTION

1. The Association for Financial Markets in Europe (AFME)<sup>56</sup> welcomes the Treasury Committee's (the Committee's) inquiry into the accountability of the Bank of England (the Bank), which is designed to focus on the "greater and more operational role for the Bank in the financial system" that arises from the Government's proposals for reforming financial regulation.

2. AFME represents European capital market participants and although keenly interested in ensuring strong and well regulated London markets, seeks to analyse issues from a European, rather than a national, perspective. This has implications for the extent to which we are in a position to respond to the specific key questions identified by the Committee on the internal governance of the Bank, which require a detailed understanding of the Bank's wider operations. Given the importance of the Bank in the new regulatory framework, we are, however, able to focus on a number of the issues and concerns that our members have raised as regards the future role of the Bank in financial regulation, as set out in the February 2011 HM Treasury consultation document (condoc): *A new approach to financial regulation: building a stronger system*. In sum, these relate to:

- the governance of Financial Policy Committee (FPC);
- the transparency and accountability of the Bank's Court of Directors (the Court);
- transparency and accountabilities re macro-prudential regulation;
- the management of "key man" risk; and
- perceived conflicts of interest.

3. We hope that our observations, albeit limited to a financial regulatory perspective, will assist the Committee in its inquiry.

### EXECUTIVE SUMMARY

4. The Bank is a unique and historic institution and to understand the wider impact of the decision to bring macro- and micro-prudential regulation under the overall responsibility of the Bank, one has to have a detailed understanding of the Bank's internal structure, governance arrangements and wider operations; in particular, financial stability and monetary policy. It is also difficult to make direct comparisons between the Bank and a corporate entity—for example, in relation to governance structures and their effectiveness and the management of "key man" risk—and there is a question about whether it is appropriate to do so given the Bank's functions.

5. Whether it is due to less transparency, less frequent interaction with the industry and/or its complex and evolving role and history, it appears that, generally speaking, our members do not seem to have the same level of understanding of the Bank's overall internal governance and operating structure—for example, the role and day-to-day work of the Court—as they do in respect of the Financial Services Authority. We believe, therefore, that there is a need for enhanced communication between the Bank and the industry, including the publication of additional detail regarding the Bank's internal procedures: we note in this regard, that there is a general understanding of the Monetary Policy Committee's (MPC's) operations, reflecting the transparency of its work.

6. As we will also explain in response to the HM Treasury condoc, despite the significant and welcome, developments in policy since the July 2010 consultation, and the greater detail that is now available, we still have questions as to whether sufficient checks and balances will be in place to counterbalance the concentration of power that the reforms to UK financial regulation will create within the Bank. Our concern is not necessarily the concentration of power in the Bank *per se* but whether, in particular, there will be appropriate levels of transparency and due process, proper accountability to Parliament—including whether the extent to which the FPC and the Prudential Regulation Authority (PRA) have met their objectives is capable of being assessed, measured and audited—and effective procedures to manage perceived conflicts of interest. We agree that these issues warrant further, detailed exploration by the Treasury Committee.

7. The new framework will need to recognise the breadth of the responsibilities that will rest with the Governor of the Bank (the Governor). In addition to executive management of the Bank—including responsibility for the Special Resolution Unit (SRU), the regulation of payments systems and the provision of liquidity insurance to the banking sector—currently, the Governor chairs the MPC and the Financial Stability Committee (FSC) and has been appointed as the Vice-Chair of the European Systemic Risk Board (ESRB) for a five-year term. In the new regulatory framework, whilst the FSC will be removed from statute, the Governor will also chair the FPC and the PRA and be responsible for the direct regulation of settlement systems and central counterparty recognised clearing houses. In addition, the Deputy Governor, Monetary Policy and the Deputy Governor, Financial Stability will each sit on the MPC, the FPC and the PRA.

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<sup>56</sup> AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information please visit the AFME website, [www.AFME.eu](http://www.AFME.eu).

8. Hence we continue to believe that further consideration needs to be given to addressing the perceived conflicts that may arise and managing the “key man” risk in the new framework. Given the demanding nature of the Governor’s role going forward, the Bank’s senior management team will be critical in providing support for the additional responsibilities. However, as noted above, the Deputy Governor, Financial Stability and Deputy Governor, Monetary Policy—two members of the Bank’s Executive Team—will also have enlarged roles given that they will also be members of the FPC.

9. We believe that further consideration should, therefore, be given to addressing the implications of the responsibilities of the Governor and, in particular,—notwithstanding the check provided by the majority of non-executive directors on the PRA Board and the independent members of the FPC—to the scope for measures that could be introduced when a conflict (whether perceived or actual) is likely to arise between specific roles.

#### DETAILED COMMENTS

10. We highlight below a number of detailed observations, which the Committee might wish to consider during its inquiry.

#### *Governance of the Financial Policy Committee*

11. Given the important role to be exercised by the independent members of the FPC, we remain concerned as to whether—whilst the focus should be on quality rather than quantity—the ratio of external to internal members of the FPC is sufficient to provide independent challenge.

12. As we will explain in our response to the condoc, whilst we accept the Government’s view that the ratio of 4:5 is similar to that of the MPC, we do not believe that the Chief Executive of the Financial Conduct Authority (FCA), who is counted, in the condoc, as one of the 5, should be regarded as wholly independent. The MPC also has a more linear remit than the FPC. The FPC’s responsibilities will extend across the UK financial system and members will have to analyse sector-specific risks and determine the most appropriate macro-prudential tool from the FPC’s toolkit, mindful of the impact the (possibly untested) tool could have on the wider economy. Hence, we believe that the FPC would benefit from having access to as wide a range of expertise as possible, without making its decision-making unwieldy. At a minimum, though, we feel that the FPC should have *at least five wholly independent members excluding the FCA’s Chief Executive*.

13. As the external members of the FPC will be: “*appointed by the Chancellor and recruited in a similar manner to the current external membership of the MPC*”,<sup>57</sup> we assume that there will be appointment hearings by the Committee.

14. The condoc states that the FPC will be established as a committee of the Bank’s Court (we assume the FPC will, like the current FSC, technically be a sub-committee of the Court), whereas the MPC is a committee of the Bank. This distinction is important given that the Court has different responsibilities in relation to the FSC and the MPC; we wonder if this is appropriate or whether the FPC should, to enhance its independence, also be a committee of the Bank.

#### *Transparency and accountability of the Court*

15. We believe that the intended relationship between the FPC and the Court needs clarification; in particular, the oversight to be provided by the Court. We note that, as a result of the changes introduced by the Banking Act 2009, in particular, the Bank’s new financial stability objective, five non-executive directors (including the Chairman) were appointed to the Court to, inter alia, provide the right mix of skills to enable the Court to: “*determine and review the Bank’s strategy in relation to the [Bank’s] Financial Stability Objective*.”<sup>58</sup> If the Court assumes responsibility for the FPC—and the nature of this responsibility would, as noted above, benefit from further clarification—it will be important to ensure that the Court has the appropriate macro-prudential expertise to carry out this oversight role effectively. The Committee would be well-placed to monitor, possibly at regular hearings, the effectiveness of the oversight provided by the Court.

16. In addition, given the Court’s increased responsibilities in the new regulatory framework, there is also a question about whether changes should be made to the transparency and accountability of the Court.

#### *Transparency and accountabilities re macro-prudential regulation*

17. We believe that the Committee should have a key role in scrutinising the FPC. We note that the ESRB will publish an outlook on key systemic risks after each of its (quarterly) General Board meetings and question whether the FPC should do likewise, referencing the ESRB’s outlook as appropriate.

18. We understand that the FPC’s Financial Stability Reports will include action taken by the FPC and the assessment of its effectiveness. Given the possible effects of macro-prudential tools—intended or otherwise—on the wider economy, Financial Stability Reports—and, in particular, the socio-economic effects of macro-prudential tools—could be subject to scrutiny by the Committee at regular hearings.

<sup>57</sup> Paragraph 2.78 of the HM Treasury condoc

<sup>58</sup> Section 2A(3) of the Bank of England Act 1998, introduced by section 238(1) of the Banking Act 2009.

19. Whilst we recognise that any direction to use a macro-prudential tool given by the FPC to the PRA and/or the FCA will be copied to HM Treasury and laid before Parliament (after the fact), we also wonder whether, given the potential impacts on the economy and economic growth, HM Treasury should have a greater and earlier role in the process e.g. by approving the use of a macro-prudential tool.

#### *Management of “key man” risk*

20. As discussed above, under the proposals the Governor will have a formidable range of roles and responsibilities and whilst we recognise that the Executive Team will be vital in day-to-day delivery of the Bank’s objectives, we still wonder whether sufficient thought has been given to the administration arrangements necessary to ensure that unrealistic expectations are not being placed on one individual, particularly in times of crisis. Notwithstanding the operational separations further down the Bank’s organisational structure, the demanding nature of the Governor’s new responsibilities when coupled with the existing responsibilities, must be recognised and consideration be given to the need for additional procedures.

21. Certainly, when making public pronouncements, it will be vital to have clarity with respect to the capacity in which the Governor is speaking, particularly if the FPC decides to communicate concerns through public speeches.

#### *Perceived conflicts of interest*

22. The PRA will be responsible for the micro-prudential supervision of, inter alia, banks and for “pulling the trigger” and placing a failed bank in the Special Resolution Regime (SRR). The Bank’s Special Resolution Unit is responsible for the operation of the SRR. We note HM Treasury’s view that “*the potential for conflict to arise is limited...because the roles and legal responsibilities are clear, and because, as set out in Chapter 3, the PRA will be operationally independent of the rest of the Bank.*”<sup>59</sup> However, we remain concerned that, as the Governor is ultimately responsible for a firm which has reached the end of its viability as well as a firm which is a going concern, there may be a perceived conflict of interest notwithstanding clear legal responsibilities.

23. As a result of changes made by the Banking Act 2009, which strengthen the Bank’s corporate governance and accountability, there is now a division of responsibilities between running the Court (a role performed by a non-executive Chair appointed by the Chancellor) and the executive responsibility for the Bank (which rests with the Governor). This leads us to wonder whether it would be appropriate for the Committee to consider whether the Governor should serve as an *ex officio* member of the PRA Board, rather than taking on the responsibility of Chair (which could then be filled by a non-executive director). At a minimum, however, there should, as discussed above, be robust procedures for conflict management eg the Governor could be absented from any PRA decision that involved placing an individual bank within the SRR regime or considering an FPC recommendation.

#### *Independent input and challenge*

24. We believe that the FPC should consider the merits of establishing an advisory group of independent academic and industry experts—similar to the ESRB’s Scientific Advisory Committee—to contribute to, and possibly challenge, its work.

April 2011

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### **Written evidence submitted by Professor Forrest Capie, Official Historian, Bank of England**

This is my response to your invitation to provide some historical perspective on the Bank of England’s approach to its duties.

#### **EXECUTIVE SUMMARY**

I set out briefly the essential elements in the Bank’s and the banks’ history that show the route to financial stability and monetary stability. The Court’s role in this was limited at most and accountability was equally murky. I conclude that the payments system should be separate from the rest of the system and that the simpler the regulatory system is the better. And the owners of the financial institutions should accept responsibility for their institutions. The Bank must play a central part in financial stability. A lot of weight would be put on simplicity, clarity, and transparency.

1. The Bank has long had a mandate from government to protect the value of the currency. From the eighteenth century when the Bank had become the centre of the monetary/financial system protection of the currency or words to that effect has been its principal function. In the early days that was done by protecting the gold reserves. Later its focus was the exchange rate and most recently has become the inflation rate.

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<sup>59</sup> Paragraph 2.152 of the HM Treasury condoc

2. It became clear in the course of its development that financial stability underpinned monetary stability which in turn underpinned macro stability more generally. (None of that language was used.) That was learned in the nineteenth century following several financial crises. The solution to the crises was for the commercial banks to learn prudence and the Bank to behave as a lender of last resort. The climate of the times—the age of *laissez-faire*—meant that an increasingly lightly regulated system emerged.
3. The commercial banks found their own way to the appropriate reserve/asset, liquid/asset, and capital/asset ratios that were consistent with an acceptable level of profitability. (This resulted in the banks being criticised for being overly conservative over the next 100 years. The criticism frequently took the form that they should become more adventurous in lending to industry and more like their continental European counterparts the universal bank.) The Bank of England slowly learned its part, how to behave as a lender of last resort injecting the necessary liquidity into the market as a whole whenever there was a shock—and not bailing out individual institutions. And this was all done in a light and informal regulatory environment.
4. The system that evolved had several component but quite separate parts. Retail banking was separate from wholesale banking and from the discount houses, and other financial organisations.
5. The Bank then became expert in the money markets and extremely knowledgeable about City institutions and the financial instruments in use. The Principal of the Discount Office within the Bank became the governor's eyes and ears in the market. Nothing moved in the City without his and the Bank's knowledge. It was convenient for the banks to leave balances with the Bank for settlement purposes. And they could always get cash when needed through the operations of the discount houses in the bill market. The governor's eyebrows thus became powerful. And a useful element of anonymity was bestowed by means of the working of the discount market.
6. After these elements were in place 100 years of stability obtained from around 1870 to 1970, across a period when there were wars, different exchange-rate regimes, slow and rapid economic growth, and so on.
7. It reached a point after the Second World war that financial stability was taken as a given and it was not discussed. That happened to coincide with a time when the importance of money was being downplayed. Within a couple of decades things on both the inflation and the financial stability fronts began to go badly wrong. The 1970s were then the worst decade in Britain's monetary and financial history up to that point.

*What part did the Court play in this system?*

8. In the modern history of the Bank the Court has never had a significant role to play in the main business of the Bank. It has been concerned with the everyday running of the institution but not policy. That was always the preserve of the governors, senior advisors, and executive directors. After Nationalisation the Court was asked to look after the "affairs of the Bank", again interpreted to be the day-to-day running of the organisation. There were frequent complaints from members of Court that they had no role and were simply observers or rubber stampers. I believe this has changed somewhat in the last decade and they have had work to do.

*How was the Bank made accountable in this regime?*

9. In the world after 1946 the Bank was responsible for, among other things, the currency and the affairs of the City. It was accountable to the Treasury and more generally to government. But there were few formal rules. The aim of some of those behind the setting up of the Radcliffe Committee (1957–59) was to see the Bank's power diminished and see it become more openly subservient and answerable to the Treasury. But apart from the Bank publishing a Quarterly Bulletin that explained what some of its activities were to a wider public nothing much changed. Nothing resulted from the Committee's Report that changed the nature of the relationship with government or the Treasury. So for example, when the secondary banking crisis flared up in the 1970s the Bank was left alone and expected to sort it out.

10. After that crisis more focussed supervision was put in place, and then legislation passed (1979) that regulated some of the activities of banking. That regulation was seen to be faulty within a couple of years as problems arose within the clearing banks. New legislation was prepared and passed (1987) but within a few years fresh problems had blown up in the small banks crisis of 1990–92.

11. A greater stress on accountability followed that crisis which coincided with the failure to remain in the new exchange-rate arrangements of the ERM. From 1992 the more open discussion between the Bank of England and the Treasury (the publication of minutes etc) of the pursuit of an inflation target was a step on the way to the operational independence, and clearer accountability, that came in 1997.

12. The mandate remained more or less the same as it had long been, protection of the currency though now the focus had changed to an inflation target. But the Bank was also given explicit responsibility for financial stability. That was not defined in any way and it was nowhere spelled out what would be expected of the Bank in regard to financial stability. A view seems to have developed that financial stability was not a serious issue—always a dangerous sign.

## CONCLUSIONS

13. My inclination, based on a reading of this history and on the principle that taxpayers should be called upon to bail out banks in extremely rare circumstances, and further on the belief that complexity and great detail in regulation only gives people incentives to devise means of circumventing the rules, would be the following. The payments system should be protected—kept separate from the rest of the financial system—and the remainder of the system allowed to do whatever it wishes. There should be a reasonably large number of banks in the “payments” sector so that the failure of any one of them did not expose the system to much risk. There should be competition for customers and ease of movement for customers. (That said, I should prefer to avoid prescription of any kind.) In other words there would be as little regulation as possible, with two provisos. There would be as much transparency as possible and it would be easy to read a financial institution’s balance sheet. That should be easily achieved for the clearing banks which would have deposits for liabilities and short-term government securities and loans as assets. But clarity of the balance sheet should apply to other institutions as well. There would be a heavy stress on the quality of assets.
14. In addition there would be a special resolution regime that would be able to move quickly to wind up an institution that did not comply with some well-accepted principles of financial behaviour and adhere broadly to keeping within some close distance to some simple indicators of good health. That regime would be situated in the Bank (the institution performed that role quietly behind the scenes in the past), but since there is the risk of taxpayers’ money being involved the Treasury should play some part.
15. Perhaps there are some areas of the financial sector in which the restoration of unlimited liability might be useful too.
16. How then can the Bank make a contribution to financial stability? It would do what it used to do in relation to the payments system. It would stand ready to supply liquidity to the market when some unforeseen shock hit. This is not protection of institutions and does not increase moral hazard. So long as banks held appropriate assets for discount they would not be in danger. If they did not they would fail and be wound up by the resolution regime in the same way as any other institution. It would monitor the health of the rest of the sector and take action when needed.
17. If the rules are clear and as simple as possible and set out in advance, the behaviour of the participants should be improved and the risk to the taxpayer ideally eliminated, but certainly hugely reduced.

*June 2011*

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