House of Commons

Treasury Committee

Bank of England November 2012 Financial Stability Report

Oral and written evidence

15 January 2013

Sir Mervyn King, Governor, Andrew Bailey, Executive Director and Managing Director of the Prudential Business Unit, Andy Haldane, Executive Director, Financial Stability, Robert Jenkins, and Michael Cohrs, Members, Financial Policy Committee, Bank of England

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The Treasury Committee

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Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk

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Taken before the Treasury Committee

on Tuesday 15 January 2013

Members present:

Mr Andrew Tyrie (Chair)

Mark Garnier	Mr George Mudie
Stewart Hosie	Mr Brooks Newmark
Andrea Leadsom	Teresa Pearce
Mr Andrew Love	Mr David Ruffley
John Mann	John Thurso

Examination of Witnesses

Witnesses: **Sir Mervyn King**, Governor of the Bank of England, **Andrew Bailey**, Executive Director and Managing Director of the Prudential Business Unit, **Andy Haldane**, Executive Director, Financial Stability, **Robert Jenkins** and **Michael Cohrs**, Members, Financial Policy Committee, Bank of England, gave evidence.

Q1 Chair: You have brought quite a large team this morning, Governor.
Sir Mervyn King: You invited us to bring a large team.
Chair: We are very happy to see you all. It looks a strong team.
Can I begin by asking you on liquidity in the GHOS work that was announced only last week? In a nutshell, is this a grubby compromise or is this something you would like to see referred to as part of your legacy?
Sir Mervyn King: The latter. I worked very hard over six months or more to try to shape the agreement and in particular what I was very keen to do was to ensure that the liquidity requirements would not impede the ability of banks to finance a recovery. In this context there is a real difference between liquidity and capital requirements. Liquidity requirements mean holding assets—i.e. on the asset side of the balance sheet and for a given size of the balance sheet, liquid assets are a substitute for lending. So if you force banks to hold more liquid assets for the given size of the balance sheet they will be able to afford to do less lending.
The same is not true of capital requirements. That is merely a statement about precisely how the bank should finance itself, how it should structure its liabilities side of the balance sheet and in that sense does not have any automatic trade off with lending. The two things we were very keen to achieve are, first, not to introduce this too quickly. At present many banks have lots of liquid assets because of the expanded size of the balance sheet of central banks. That may well go away before 2019 and indeed I hope it does. In that case it would not be sensible to have a regime of liquidity requirements that constrained the ability of the banking system to finance the recovery, so we wanted a long transition. The other thing we wanted to do, which reflected very much our experience here in this country, was to make absolutely clear to everyone—the markets, regulators and banks—that the liquidity coverage ratio provided a buffer of liquid assets that was there to be used in times of stress. The great fear was that people around the world thought that this liquidity coverage ratio was a minimum and you could not ever fall below it. If it was a minimum it could not possibly carry out its function of being a buffer available in times of stress, so banks were building up buffers on the buffer in order to give themselves something that could be used. We said, "This is pointless. This can be used as a buffer and can be used in times of stress".
So, far from being a grubby compromise, to use your words, I am very pleased that we have this agreement and it was reached pretty quickly, 10 days ago, at Basel. Unanimously around the table, everyone signed up to this.

Q2 Chair: Have we cracked the stigma problem?
Sir Mervyn King: It is hard to be entirely certain about it but I think we have gone a very long way towards it, and I think the fact that we have an agreement that will apply around the world will certainly help that.

Q3 Chair: We can take heart from this liquidity agreement that we will have more lending?
Sir Mervyn King: I think it removes the uncertainty about what the regulation of liquidity would be, and in itself I think that is a very good thing, and we have removed the uncertainty by implementing the LCR in a way that should not constrain the ability of banks to finance a recovery.

Q4 Chair: One of the aspects of what you have done is to widen what you are accepting as collateral all the way down to triple-B minus on corporate bonds, subject to a haircut and, what is more, in order to do that—as indeed you have had to do in the past—you will be relying on risk rating agencies to do the assessments. How confident are you about their work?
Sir Mervyn King: That will depend on which authority you are talking about. At the Bank of England we have gone a very long way to saying that we do not rely on rating agencies.

Q5 Chair: Why is that?

Sir Mervyn King: Because we are not confident that the ratings are ones that we would, ourselves, want to trust so we make our own judgment.
Chair: You do not trust them—if I may just concertina that sentence.
Sir Mervyn King: Let me put it this way: we have to make our own judgment. We can't just excuse ourselves by saying, "Oh well, we thought it was all right because it happened to be rated a triple-A experience."
Chair: If you thought their stuff was good you would not need—
Sir Mervyn King: If we thought we could rely on it totally and always—but I think it is our duty, taking these assets as collateral for loans that we make to banks, to make our own judgment and impose our own haircuts and that is what we will do. That is the responsibility of each central bank.

Q6 Chair: You are reasonably relaxed about the fact that others in GHOS will be using risk rating agencies to do this work.
Sir Mervyn King: Let me put it a slightly different way. This LCR is easy to get around if a country is determined to do it because all its central bank has to do is to create more central bank reserves and they count clearly as high quality liquid assets. To the extent that the authorities want to make it easy to meet the LCR, the instrument is already in their own hands of simply creating central bank reserves.

Q7 Chair: I would like to raise another subject with you before bringing in John Thurso. The bank has announced an interesting alternative approach to loan to value caps. The bank was shy of introducing loan to value caps and you did not recommend them in your document last year on the grounds that they did not have enough public acceptability. You seem to have found a back-door way of achieving what you were a bit chary about introducing through the front door. Have I misrepresented?
Sir Mervyn King: Slightly.
Chair: Only a little.
Sir Mervyn King: No, more than a little: somewhat. We were very conscious when we made our original recommendation about not including loan to value ratios in the list of instruments over which we should have the power of direction. We were conscious of two things. First, we could certainly recommend that loan to value ratios be changed and that is something we can do. It was very clearly understood that the document we put out yesterday refers only to those instruments over which we have the powers of direction. The second was that even then, we were talking about it and said, "Do we really need loan to value ratios?" They are not quite the same but sectoral capital ratios go a very long way to enabling us to say to banks, "Look, if you want to lend to a group of people by offering high loan to value ratios, that set of lending will attract a much higher capital weight". That seemed to us to achieve broadly the same objectives as being able to constraint loan to value ratios. We did not say that we would not operate loan to value ratios. But what we did feel was that, since having a regulation that says to someone, "You cannot borrow more than a certain amount", which is independent of our assessment of their creditworthiness, is quite a strong statement to make, we would be willing to do that if, but only if, Parliament had a proper debate about this and you made a clear recommendation that somebody should be given this power, and then we would be happy to implement it. We did not think it should just, in some sense, slip in through the back door along with a bunch of other directions. There should be a very clear public decision to be willing to accept the consequences of giving someone the power to set limits to loan to value ratio.

Q8 John Thurso: Governor, good morning. The FPC's fundamental objective has been now qualified by being subject to Government's economic policy. Does this mean it starts life with one hand tied behind its back?
Sir Mervyn King: I don't think so. I think it is a reasonable position. It mirrors the position that the Monetary Policy Committee finds itself in, and that has not been a constraint, so no, I think this is a reasonable position. I know it came out of a whole series of debates in Parliament about what the objectives should be, and it is important that it is not muddied to such an extent that no one really knows; but I do not think this "subject to" clause does muddy it.

Q9 John Thurso: One of the problems we have had, and it is something we have discussed when we have talked about the FPC on a number of occasions, is that by contrast with the MPC, where a letter from the Chancellor sets out a clear objective and then you are set free to deal with it, everybody is in favour of financial stability but nobody can necessarily accurately define it. One of the problems being that Governments in the past have found it difficult, in the famous words, to remove the punchbowl when the party is in full swing. That is really what we are asking the FPC to tell us to do. How can they do that if they have one hand, which is an economy that is going well and a Government that likes that, tied behind its back?
Sir Mervyn King: As I said I do not think its hand is tied behind its back. I think the bigger issue here, and one that we will not know the answer to until the FPC does issue directions to the regulators or make strong recommendations, is whether there is going to be sufficient public support to maintain a regime which everyone will understand may be uncomfortable in the short run, but benefits us all in the long run. I think with the Monetary Policy Committee, no one enjoys, if they have a mortgage, seeing the interest rate go up, but by and large there is broad public acceptance of the need to have a group of people charged with the responsibility for setting interest rates and conducting monetary policy. The question is whether in practice that will be true of the FPC. It is a bit of an experiment. It is an experiment that other countries are inching towards. Many developing countries and emerging markets have gone further than we have, but for the industrialised world this is a bit of an innovation. I think we are at the forefront of it. I think

it is worth the try, given what happened in the pre-crisis period, but one has to admit there is an element of experiment and we simply do not know yet what the public acceptability of the use of these instruments by the FPC will be.

Q10 John Thurso: Who will make the judgment as between financial stability and stated Government economic policy? In other words, if there is a moment when the committee feels that something should be done to maintain the financial stability objective of the bank but the Government feel that it is contrary to its economic policy, who directs whom?
Sir Mervyn King: The FPC makes the decision very clearly. The objective to comply with Government policy is a "subject to" criteria, and that means that the overriding concern is to maintain financial stability and that is exactly what the FPC would do, and the individual members of it would come to their own personal judgments and if necessary would vote. It is an 11-person committee.

Q11 John Thurso: So "subject to" is the new "have regard to"?
Sir Mervyn King: I think it is the way that I would see it, yes.

Q12 John Thurso: Can I ask a question of the two external members? An advert has been placed for the new external members going forward. Can I ask each of you in turn the same question? Has the job been as you expected it? What are the things that you would advise a new incoming member of the FPC? Is there anything you think that the Government should change, having had the experience of sitting on the committee? Can I ask you, Mr Jenkins, first, then Mr Cohrs?
Robert Jenkins: I think the ad is a good description of the profile that we need to fill. I think the key is whether or not individuals who are urged to speak up and are urged to have the courage to make a difference will do so.

Q13 John Thurso: Is there anything at all in the way it is operated that you feel you would like to advise? Has the job been as you expected it?
Robert Jenkins: No. I look forward to the time when the committee moves from an interim committee with the moral power to influence to a time when it has powers to recommend on a "comply or explain" basis.

Q14 John Thurso: On the conversation I have just had with the Governor, do you see that as a problem for an incoming FPC member: the clash between the Government wishing to pursue a policy and the FPC potentially having to make a decision?
Robert Jenkins: Stability is not incompatible with growth and growth is dependent ultimately on stability so the two should not be in conflict over time. The key area is the one that the Governor identified, which is, "Will there be popular support endorsement and Government tolerance for unpopular recommendations and decisions when they are made?"

Q15 John Thurso: Can I ask you, Mr Cohrs, the same basic questions? What would you advise an incoming member? You have both come into this not knowing what on earth was going to be happening, how it was going to go. You have made some very interesting speeches. What would you advise on the job?
Michael Cohrs: To do the job properly takes a lot more time than is advertised so it is virtually a full-time commitment.

Q16 Chair: That is not a pay bid, is it?
Michael Cohrs: No. So that is one point I would make. I think you have to have a tolerance to be attentive and sitting through very long meetings, much longer than what one is used to in the private sector, and stay alert and listen in these very long meetings, because quite often I find I come into a meeting with a point of view and, on listening, it changes. That was not my experience in the private sector where meetings were 15 minutes to one hour. We have quite long sessions, quite detailed sessions. You have to have an attention span that works to that rhythm. I think overall we have learned a lot. As the Governor said, there is a bit of work in progress about this as we all know. I think we have learned a lot. I think the job description is pretty good. It accurately describes what is needed to do this.

Q17 John Thurso: Is there any, in your view, conflict—I will ask the same question—in the change of objective?
Michael Cohrs: Yes, I think there is. Interestingly, in the couple of years that I have been now doing this the concept of the independence of central banks is something that I have rarely encountered. I happened to be giving a speech at a university recently where a student asked me the question about the independence of a central bank. I thought to myself, "Gee, that is interesting. In two years it is the first time I have had that question or even seen that discussion." I think that ties a little bit into the question you asked. I agree with Bob and Mervyn that there are ways I think it can work. I do not think that what has been put in place makes this committee unworkable, but is it a concern? Yes, I think it probably is a small concern but we can work it. The question will be, "Will we have the courage to take the punchbowl away when times are good?"
John Thurso: Of course we all hope we will never find out. Presumably it will be up to us to keep your feet to the fire, as a committee, and make sure you do.

Q18 John Mann: I have a question for each of you, if I may. I will start with you, Governor. A few minutes ago in relation to the Basel negotiations you said there needed to be a resolution that satisfied, and this is quoting you, "Everyone: the markets, the regulators and the banks". Which one of those three is representing the interests of taxpayers and the unemployed?
Sir Mervyn King: The regulators are there to do exactly that. Remember, the committee that makes the decision finally on this agreement is not just a group of regulators; it is the group of governors and heads

of supervision. All the central bank governors are there and one of their responsibilities is—as you will know; I have been trying to do it for a very long time—to get rid of the "too big to fail" syndrome, which is precisely an implicit subsidy to the banking system. I work very hard to achieve that. What I wanted to get across in my earlier reply is that it is right to ensure that the banks have enough capital now because that is not conflicting with growth. It does protect the taxpayer but that is not the same thing as saying that we need to force banks to hold lots of high quality liquid assets today. They already do because of the expanding balance sheet of the banks. The right transition to the new regime is a longer one. I do not think that in any way threatens taxpayers. The real threat to taxpayers comes from banks that are inadequately capitalised. *[Interruption.]*

Chair: We have been going a quarter of an hour. We have already had a couple of interruptions from electronic devices. Could everybody in the room please turn off all electronic devices? Sorry, John.

Q19 John Mann: Mr Cohrs, looking at employment, would you like to see the FPC set a precise numerical target for unemployment?

Michael Cohrs: I do not think so because, from a stability perspective, I am not quite sure how we would tie an employment target into our stability objectives, so I am not quite sure how that would work. I understand the point, which I think Mr Thurso made, about there not being as much clarity for the FPC as the MPC because we do not have this mechanism between the Chancellor and the Governor or targets. I can see the attraction of trying to find a target, but I am just not sure that having an employment target would dovetail nicely with our objective on stability.

Q20 John Mann: Mr Jenkins, would you set any precise numerical targets, given the choice, on the FPC?

Robert Jenkins: I wouldn't recommend it unless it is couched over a very long period of time and it is an aspirational range.

Q21 John Mann: Mr Haldane, are you concerned, considering the last four years, about the level of diversity in the makeup of the FPC under all criteria of diversity?

Andy Haldane: I can only really speak to the conversations and the policy discussions we have had over the past 18 months. If we are judging diversity by—*[Interruption.]*

Chair: Whoever has that electronic device on, please turn it off now. Someone has something on near a microphone. Andy, I am very sorry to interrupt.

Andy Haldane: If we are judging diversity by the diversity of views around the table, diversity of experiences of those around the table, I think we have had some quite diverse discussions of substance on what the right policy choices should be, and indeed some disagreements about what the right policy choices should be. I think judged through the lens of, "Has the committee taken a range of views, drawn upon a range of expertise and debated those rigorously and vigorously", my answer to that would be yes.

Q22 John Mann: What about the diversity of the range of lenders? In Germany the smaller local lenders would have a much more direct say. In Canada regional representatives would have a say. What about that kind of diversity of makeup?

Andy Haldane: I think we would be well advised to avoid putting the FPC in a position—or any member of the FPC to put themselves in a position—of being conflicted. Ultimately the FPC is a regulatory body that is exercising regulatory powers over the financial system including banks, big and small. It is only right and proper that we, as the FPC, explain ourselves to those affected by our powers, including the banks. I think to give those we are regulating a say at the table would rather fly in the face of the principle underlying regulation in the first place. I am very conscious that the episodes we have historically here in the UK, and elsewhere, of self-regulation have not been a conspicuous success, LIBOR being the most recent example of the failures of such a self-regulatory approach. So I would be cautious about drawing in those to whom the powers are subject to the decision making.

Q23 John Mann: Thank you. Finally, Mr Bailey. At the moment, high street savers in the UK are getting a lower return than high street savers in Germany, France, Ireland and Greece; but at the same time high street lending rates, both to individuals and business in the UK, are higher—1% higher than Germany, 1.5% higher than France, 2% higher than Ireland and even 1.5% higher than Greece. Why is it, with all the policies that we have, and your role and others on this Committee, that in the UK savers are getting a lower return than they would if they were living in those other four countries, but those wishing to borrow are having to pay more than they would if they were living in those other four European countries?

Andrew Bailey: I cannot easily give you a precise comparison country by country in terms of reasons, but I think that if you look at the UK situation, which is clearly important, what you have seen over the period since the introduction over the summer of the Funding for Lending scheme is quite a marked change starting to take place in rates paid on deposits. We are seeing some evidence of rates changing on lending as well.

Just to start with deposits. I think that what is interesting about the period since the teeth of the crisis was that banks, and it goes back to the points the Governor was making about building liquidity buffers, had begun to compete very strongly for retail deposits. An interesting measure of this, which the Bank of England has published from time to time, is if you look at the spread between the MPC rate of interest—the official rate of interest—and the average rates on deposits paid on, say, term deposits in the retail market. That had widened quite markedly, very markedly. A good part of that is also the level of interest rates. Of course, we are at historically low levels of interest rates so you have to factor that in as well.

What the introduction of Funding for Lending scheme has already shown us is that that competition for deposits has eased off quite a bit and that has been reflected in a change in the rates paid on deposits. To be fair that lies behind quite a bit of the criticism coming from those who rely on that source of income. That is clear.

You raise a very good point, then, which is, are we seeing the same sort of adjustment on the lending side of the balance sheet, bearing in mind that one of the things that the Government made very clear when it introduced the Funding for Lending scheme was that it did expect to see on adjustments to rates. I think my answer to that would be that that adjustment has not taken place yet probably to the same extent, although we have seen changes in the availability of mortgage lending. The credit conditions survey published a week or so ago did reveal that. I think the jury is still out—and your question is apposite, therefore—on whether we have seen as much adjustment there as you would expect to see and ought to see.

John Mann: I am sure we will come back to it in the future.

Andrew Bailey: We will. I am sure.

Q24 Andrea Leadsom: Good morning. I would like to follow on from Mr Mann's point. I do not really find your answer is complete, Mr Bailey, because what we have in the UK is undoubtedly a less competitive system than there is in Europe. So you have not addressed it from that perspective. You are talking about structural changes to enable banks to lend more cheaply by making it as profitable for them to lend at finer margins, which is effectively what the funding for lending scheme does. It does not address the issue that they still demand much wider margins between lending and deposits than they do on the continent. So Mr Mann's question remains. Mr Haldane, I would like to particularly ask you: you have done a number of speeches about the issue of "too big to fail". Is not the opposite end of being too big to fail that there is not enough competition out there? What we have is an oligopoly of banks that are very comfortable in their ability to rip off the depositor and rip off the borrower. What is the FPC going to be able to do about that?

Andy Haldane: You are quite right, as the Governor said a few minutes ago, that "too big to fail" and the implicit subsidies that follow from it are a grade one, perhaps the grade one, issue. We have done a lot and may need to do more to get our arms around that problem, including requiring the biggest most interconnected banks to hold more capital, including ensuring that they all have adequate recovery and resolution plans, including Vickers in this country, Volcker in the US, and Liikanen prospectively across Europe. That is all with a view to bearing down on and ultimately seeking to eliminate that implicit subsidy and therefore levelling the playing field as between the big guys and the smaller and medium-sized guys. Is that adequate to enhance competition in the UK banking market? My view on that would be no. What more might be done? Andrew and Martin Wheatley are reconsidering the case for an appropriate authorisation process for new entrants, and more will be said about that in the next few weeks.

Thought should be given, as you have done, to whether there are barriers on the current account deposit side of the equation that might not be broken down, by thinking about IT means of facilitating current account switch. I think it is a very promising avenue.

Q25 Andrea Leadsom: Could you be more explicit on that, because it is, is it not, a game changer for banking if you could switch your current account, as a small business or as an individual, today, tomorrow and the next day? Could you just be very specific about why, in your opinion, that is a potential game changer for competition and therefore access to finance and consumer choice? Also, at the other end of the spectrum, could you also address the issue of how it might potentially be a risk of a run on a bank—an inadvertent or malicious run on a bank—but also how it could prove a tool for resolution?

Andy Haldane: Yes. There is already an agenda of work to speed up the process by which a current account can be ported from one failed bank to a surviving bank, as referred to in the Vickers proposals. That is seeking to meet a seven day deadline. It is effectively a redirection service and that takes us some distance on the resolution front. I think that the bigger prize, however, is having a switch take place in a more seamless, costless, more timely fashion all of the time, not just at the point of failure. I think historically it has been the case that people have found it costly and time consuming to toggle between different current accounts. I think many of those costs are still true today and if those costs were lifted and freed up, that would be very healthy, in particular for the new entrants who suffer from the inertia that is embedded in the current system.

I think this could have a fundamental impact on the efficiency of the financial services sector in the UK because so many of their current costs are bound up in preserving legacy systems. I think if we graduated towards a different model that used state of the art technology and meant that those legacy costs won't be paid out, it would result in lower margins and a better deal for customers. Could there be some costs in terms of the ease of switch increasing the chances of a run? For me that is not the most fundamental issue. If they want to run the bank they will run anyway. The fact they can do it overnight rather than over a seven day period strikes me as neither here nor there. For me personally, I think there is a lot to be said for transformational technology for facilitating current account switch to improve the efficiency of banking in this country, and ultimately the proposition to customers.

Q26 Andrea Leadsom: Would you go so far as to say you would like to see it as an amendment to the Bank Reform Bill? Would you like to see it brought in as soon as possible, or would the bank like to wait and see how seven day switching works?

Andy Haldane: I am not sure in the context of the Bill. It would be very good if we pre-committed today to a thorough evaluation of the costs and benefits of this longer term option that took us beyond the seven day deadline to effectively instantaneous switch or something close to it. That we are currently missing. I think it would very important to put that evaluation in place, whether or not it is in legislation.

Andrew Bailey: Could I make two points just coming back? I agree with everything that Andy says on this front. I think that it needs to be done. It needs a proper evaluation—it needs an evaluation that is not captured by the banks and also, by the way, not captured by the IT companies either. I agree with you that we have seen a serious reduction in competition in the UK banking market. We can explain why that has happened over the crisis but we know it has happened. We will, as Andy said, be coming out with changes to the authorisation process that will lower the barriers. There is, however, one uncomfortable fact in here, which I think partly goes back to Mr Mann's question, which is that one of the problems that led up to the crisis in the UK banking market was a squeeze on the retained earnings from the mortgage business. The net interest margin on mortgage lending was squeezed over the course of the seven or eight years leading up to the outbreak of the crisis. Northern Rock was a classic case of this. They were not earning and retaining enough capital to support the risk that they were taking. That is an uncomfortable fact, in the sense that it goes back to this question of what is the appropriate margin between deposits and lending. That is a fact. We have to, in a sense, bring this uncomfortable fact on to the table, because otherwise it can get dressed up in all sorts of other arguments.

Q27 Andrea Leadsom: Mr Cohrs, on a final note you have said yourself that you think we must not see an overregulation—that we would end up with a graveyard style of regulation if we went too far. But on the other hand, I know you are also very keen to see greater competition. Is one solution potentially to create a bad bank: in other words, to clean up some of the worst assets on bank balance sheets, stick them somewhere, obviously at the taxpayer's expense yet again, but at least that way to enable the banks to move on from their potential zombie position at the moment?

Michael Cohrs: It is a different topic from the topic you have just been discussing. Good banks/bad banks have worked quite well in places where they have been put in place, and at other times, frankly, the bad bank just lingers for ever and it does not work so well. So it is hard to give a generic answer to that question. Having said that, I am sure that the people at UKFI and HMT have looked at this very carefully. We have not looked at it very carefully so I don't want to give you an off-the-cuff comment, other than to say, if you think about the situation we are now in with our banks, it is such an obvious question I am assuming that it has been looked at.

Q28 Andrea Leadsom: If that bad bank were to be created and banks' balance sheets were to be cleared up, would you support, then, potentially, the break-up of RBS, Lloyds HBOS to create new challenger banks, or do you think that is too drastic?

Michael Cohrs: I have said that the banks have to explain to us, to the public and to their shareholders what the benefits are of being global and being large. In the absence of that explanation of why it is good for society and why it is good for the owners, I think the banks are too big. I think the "too big to fail" issue is the key question. It is one of the key problems we have on competition. We have structural problems. We do not have banks that upgrade in the regions in this country anymore. That is a big issue. In regional visits that I have made I talk with both customers and banks and it is clear that our banking systems are London-centric, which is an issue. There are a whole host of issues in your question relating to comments that Andrew and Andy made, but it is also structure, it is also fixing maybe bad bank/good bank. So it is a meaty question.

Chair: Both those issues, particularly the former, are being looked at by the Banking Commission and I will make sure the comments that we have just heard are drawn to the attention of commissioners.

Q29 Mr Newmark: My questions are directed mainly to Mr Cohrs, based on his speech at the University of West of England. You noted that in order to assure accountability there needs to be even more dialogue between all units of the bank and Parliament, preferably through the Treasury Select Committee. Other than wanting to ingratiate yourself with our chairman, what more would like to see happen?

Michael Cohrs: It comes back to this issue we were talking about that Mr Thurso raised. I believe that, if the party ever gets started again and we try to take the punchbowl away, there will be a huge row. Only if we are seen as being highly accountable and have had a lot of sessions will it be acceptable to you and your constituents. I am trying to think about this very difficult situation where we are taking punchbowls away. I am trying to think about what I think is a very difficult situation if we end up setting things like loan to value ratios on people's mortgages. There has to be huge amounts of dialogue. I am sad to say—I have been told that I don't have enough to do—I am bit of a Parliament TV junkie. These sessions are very useful. This Committee, standards—doing this job, listening to these sessions, a lot of interesting information comes out. The more of this that can be done, the better.

Q30 Mr Newmark: Following on a little bit on the subject that Andrea Leadsom was talking about, you highlighted that although they are an important step forward, you do not believe that Liikanen and Vickers will necessarily make financial institutions less likely to fail. What more would you like to see done?

Michael Cohrs: My evidence is that in the recent financial crisis there were examples of pure retail banks that failed, pure investment banks that failed, universal banks that failed, so just about every type of financial institution had troubles, and an insurance company in America failed. So I don't think you can say that structure alone fixes the problem. I come back to size and complexity—absent this explanation as to why size, complexity, globality are good things. We need to take action on those things. Ultimately, when

I was in front of this Committee a long time ago, I said to you that I thought total separation probably was right but that it was not easy; nor did I think it was even possible to do. In a later session Mr Thurso asked another banker whether they thought it was possible, and that banker agreed it was probably not possible to separate universal banks.
I think where we are going right now are steps in the right direction—Liikanen and Vickers—but I also am aware, because I also saw your session with Volcker, there are some powerful arguments to be made for total separation.

Q31 Mr Newmark: Just touching on some of the points Andrew Bailey made, leverage ratios still seem to be running at around 3%, implying a multiple of 33 times leverage. Do you think that sort of leverage is too high and that the leverage ratios themselves should maybe be increased to—I think Vickers talked about a 4.06% leverage ratio?
Michael Cohrs: It depends a little bit on how much capital and liquidity the bank has, and to some extent all three of these are intertwined: capital, liquidity and leverage. Capital is very hard to adjust. Bank management is taught to run with small amounts of capital because historically they focused on ROE. We are trying to change that. Bank owners, the shareholders, want managements to run with small amounts of capital because they are focused on ROE. We are trying to change that. The point is, changing capital has proven to be very sticky. I like the concept of leverage because it is another way of making a bank very resilient. It is easier to do. I note that most of our banks have a large chunk of their balance sheet that consists of assets that we may not think are terribly important to society. I think banks can also de-lever without necessarily stopping the essential services they provide to the real economy. Therefore, I think the leverage ratio from a practical perspective is very important, and I happen to think 3% is too low.

Q32 Mr Newmark: The implication of that, then, is that the banks need to raise more capital, RBS and Lloyds in particular. Do you have an idea of how much equity they need to raise? Is there a way that this money can be raised outside of dipping into the pockets of the Treasury or the taxpayer?
Michael Cohrs: The committee has spent quite a bit of time on this issue. When you look at the three pillars of capital in Basel, we have thought about where we have shortfalls in these three pillars. It is not an easy question to answer. What we have said as a committee is we do think there is a shortfall of capital in the system. You either have to raise capital or you have to reduce your balance sheet. The other way to fix this is to reduce the balance sheet. Remember that I happen to think that the balance sheets can be reduced in a way that would not impact the real economy. You have to do one of those two things.
Are there ways? I am—

Q33 Mr Newmark: Let us start with my next question. How much money do you think they need to raise—£5 billion, £10 billion, £20 billion? That is a lot of money. I suspect you would not convince George Osborne to dip into, effectively, the Treasury's pockets: to go out and effectively ask the taxpayer to foot the bill for that £5 billion, £10 billion or £15 billion equity infusion. You are an industry practitioner; that is why we have people like you on this committee. Is there a way of raising capital—how much capital would you suggest?—outside of going to the Treasury and the taxpayer?
Michael Cohrs: The amount of money is quite large. I am sympathetic to not asking the taxpayer to pay more, particularly when other countries are exiting their banking holdings. There are structures that had been used in the past where a large owner does not participate in a rights issue and the rights are sold to new people. So if there is enough demand and the thing is structured right and priced right, there are ways, potentially, to raise serious amounts of capital without the Government having to put the money in.

Q34 Mr Newmark: You are an intelligent guy. You have been out there. You know the sort of ratios that are in your mind. I think taxpayers out there, the public, would like to know how much more equity, in pounds, you feel the banks that they, as shareholders, now own, need. Is it £5 billion; £10 billion? Give me a number.
Michael Cohrs: Brooks, it is hard to give you a number because it depends on a whole bunch of things. One way to raise the capital is to sell businesses. Another way to raise capital is to sell businesses. That has to be looked at very carefully. I can come back to you, but I do not have a number in my mind as to how much each of the two banks that are owned by the state would need to raise.
Mr Newmark: Come up with a ballpark number for me.
Michael Cohrs: It is a big number.

Q35 Mr Newmark: Okay. Finally, the US bank bailout seems to have been a success. The American taxpayer effectively went in, got out and made returns of up 15%. Do you think that the UK taxpayer will get similar returns? If not, why not? Do you think effectively that we ended up overpaying for the UK banks?
Michael Cohrs: Given where we are today, I do not think that the taxpayer will get those types of returns.

Q36 Mr Newmark: Will they get a positive return?
Michael Cohrs: I don't know. It depends on the strategy. I am not aware of what the strategy is at UKFI and HMT for exit, when they want to do it and so on. I am just not privy to that so I don't know.

Q37 Mr Newmark: Do think when the bailouts happened that we overpaid? Do you think when we ended up buying the banks early on that we ended up overpaying, unlike the US Government?
Michael Cohrs: Probably.

Q38 Chair: You made some very interesting remarks about leverage. As you probably know, the Banking Commission concluded that the FPC should be given

the job of setting the leverage ratio. Do you agree, Mr Cohrs?
Michael Cohrs: Yes.

Q39 Chair: How bad or how unreliable are the risk-weighted asset calculations, given the modelling that was done by the banks?
Michael Cohrs: I would ask my colleagues to correct me, but I think the evidence is that when the FSA put out a hypothetical portfolio, the spread from lowest to highest was three times, on identical portfolios. I think that is about right and that gives you some empirical evidence.

Q40 Chair: I have heard about that. The Banking Commission has asked for that evidence. I do not know whether we have yet received it; I certainly have not yet seen it. We would like to see their calculations. You did this on the basis of a survey, didn't you? We would like to see that survey, if necessary, on a confidential basis.
Andrew Bailey: Sorry, I was not aware that you had asked for it.

Q41 Chair: Perhaps it may need an occasional redaction in places. That brings me to another point. Right at the beginning of that cross-examination by Mr Newmark, Mr Cohrs, you agreed that we need to find ways to bolster the FPC's legitimacy by giving it enhanced parliamentary scrutiny. I am sure you recognise that we face a more difficult problem with the FPC than we do with the MPC, where almost all the material that we need to do the cross-examination is available in near real time, certainly within a fortnight or so, with the publication of the minutes. Much of the information on the basis of which you work has to remain confidential for one reason or another. Do you therefore think that there is merit in this Committee's proposals to improve governance of the Bank, so that the proper board of the Bank of England can do some of the heavy lifting for us, so that then we in turn can use them as an intermediary—their seeing the confidential material, but us not necessarily needing to?
Michael Cohrs: I do see the rationale for that and I think the changes that are being made will partly satisfy that, i.e. the new oversight committee.
Chair: Partly but not wholly.
Michael Cohrs: Remember that Court does not hire or fire the Governor and has one shareholder. So any time you have a body with one owner and you do not hire and fire the Governor, you should have realistic expectations as to what that body can do.

Q42 Chair: In that case we might need something else, might we not?
Michael Cohrs: I think you need the combination of what you are doing—the oversight, the ability for that body to help you—and there needs to be more of this type of dialogue.

Q43 Mark Garnier: Mr Jenkins, on 9 October you made a speech to the CFA UK annual chairman's dinner and in it you said, "The old financial structure has crumbled and a new edifice is rising but its foundation is flawed, the walls are thin and the beams are brittle." You did not mention the ring fence. What are your thoughts about the ring fence?
Robert Jenkins: The main purpose there was to bemoan the degree to which the new rules still permit an excessively leveraged banking system. The foundation of a sound banking system has to be adequate capital, which is the flip side of reduced leverage. The Vickers proposal has the benefit of requiring for some portion of the UK banking system additional capital or loss-absorbing capability. So from that point of view it is a step forward. I would have preferred Vickers in its original recommendation, with less leverage, to the way it eventually came out.

Q44 Mark Garnier: I think there has been some interesting comments about the leverage but I am particularly interested in your thoughts on the ring fence. The Parliamentary Commission on Banking Standards recommended electrification of the ring fence. Certainly Mr Bailey and Mr Haldane have been quoted in this. Mr Haldane was quoted as saying, "It is an idea worth thinking further about." Mr Bailey, again, you have been quoted as saying, "Get it right and it is a very sensible deterrent that would make people think twice about tunnelling underneath it". Do you think that if we are going to have a ring fence it is important that we give it electrification?
Robert Jenkins: I would have preferred total separation but that was not possible. I prefer to have a plan B, which is, if the ring fence does not operate and achieve the objectives that you have said you wanted to achieve and that we all hope will be achieved, then there would be a demonstrable fall-back, which would be the threat of separation, yes.

Q45 Mark Garnier: So for a bank that is misbehaving or trying to obviously game the ring fence, you suspect full separation is a good sanction against them?
Robert Jenkins: I think it should happen now. I do not think we need any more evidence of them misbehaving.

Q46 Mark Garnier: John Vickers did raise some quite important questions, and I would be interested, Andrew Bailey and Andy Haldane, on your thoughts on this. He said there were obvious questions about who would exercise the power of switching on the electric ring fence, and if it exists as a reserve power, under what conditions would that power be exercised. Have either of you had any more thoughts about how to exercise an electrification of the ring fence? Andy Haldane, why don't you start?
Andy Haldane: I have had no thoughts beyond those I already shared with the Parliamentary Commission in my written submission, which I think is now in the public domain.
Chair: It was very helpful.
Andy Haldane: My thinking has not progressed, in truth, much beyond that.
Andrew Bailey: I think we discussed this at the hearing before Christmas. My position remains the same. I do think it is a sensible reserve deterrent power. I think it is such a substantial power that it is

not one that the regulators should use by their own fiat, and there has to be a higher level of transparency and accountability around a decision of that nature because of the impact it has on private property rights within the firm itself. I thought the Commission report had some interesting suggestions on that, which I think we did discuss in the hearing, and we can develop those further. But my basic key point is that that is such a big decision that it has to have a higher level of accountability than a simple regulatory board coming in and saying, "I think we will do this".

Q47 Chair: They have set out how that will be achieved. What do you think about that?
Andrew Bailey: I think it is very sensible.
Mark Garnier: Notwithstanding, obviously, those who would like to have separation already, does anyone think electrification of the ring fence is a bad idea?
Chair: I think you can move on, Mark.
Mark Garnier: I think I can. Thank you.

Q48 Mark Garnier: Turning to Europe, the financial stability report was dated 20 November and published on 28 November, and obviously since then we have had some more news coming out of Europe. Has the risk to the UK banking system from Europe increased or decreased since you published your report?
Michael Cohrs: Since we published the report it probably has not changed.

Q49 Mark Garnier: Does anyone have any different views on that? Is the European Banking Union going to deal with the problem that they have in the euro crisis?
Chair: We like straight talking.
Sir Mervyn King: Shall I give you an answer on that?
Mark Garnier: Go on then.
Sir Mervyn King: The main problem with the euro crisis is the ability to find a way to finance current account and trade deficits. The banking union is only an answer to that in so far as it enables countries that have banking systems that need to be recapitalised to have that recapitalisation financed by other members of the euro area. There is no immediate progress on that front and that is not likely to happen for quite a long while.
So the question of who supervises banks in Europe may in the long run be relevant to a monetary union, though not inevitably so; but it certainly is not relevant to the short run problem of how to finance the current account deficits and in particular the need to attract sufficient capital inflows to finance recapitalisation of the banking system. Ultimately, the big choices about whether you improve competitiveness of countries in the euro area or whether you move to a transfer union—that direction has not really been stated clearly. We await that. The actions of the ECB have been successful in calming markets and in buying time. It has all been very helpful. What it cannot do, because no central bank can do this, is to resolve the underlying real challenges of either moving to a transfer union or finding a way to take sufficiently effective measures to change the competitiveness of the member countries of the euro area. In that sense banking union is certainly not a magic answer.

Q50 Mark Garnier: If the UK is not part of the banking union, are we as a country going to be disadvantaged in the long term when it comes to our ability to attract inward investment capital, say for the City?
Sir Mervyn King: I do not think any more so than now, because the real difficulty we have in regulation are the powers that were given away before the last election, which mean that qualified majority voting can determine the framework for financial regulation. In that sense we do not have a veto power over it, and that is the same today as it was then and nothing has really changed. I do not think a banking union makes that worse. I think one of the attractions of a banking union to the UK is that you would then have two very large supervisors dealing with the major global banks based in Europe: the ECB on the one hand and the Bank of England on the other. I think we would find it easier to deal with the ECB as an opposite number than we would dealing with myriad different national supervisors, some of whom might be more subject to political pressure than one would hope the ECB would be. In just the same way as we have been able to negotiate understandings between ourselves and the United States in terms of how we might resolve global banks that span borders—because there is no prospect of having any agreed legal framework common to the two countries—we will rely on an understanding and agreement as to how resolution will take place. We have that with the FDIC and we have talked a lot to the Fed as well. In Europe I think that kind of parallel will be a lot easier to reach with the ECB than it would be to reach separately with a wide range of individual supervisors.
Andrew Bailey: If I could just add, I think the Governor is absolutely right. I have been quite close to this issue. The attraction to us is if it creates a credible strong single supervisor in Europe to whom we can act as a counterparty. The second thing is that we have seen the single market coming under threat from the Balkanisation and the restrictive measures that are going on. But the only solution to that, as the Governor says, is to solve the underlying problem. We cannot solve that as a supervisor, and trying to take measures against supervisors who appear to misbehave in this respect is not the point. The point is that the single market is under threat because of the underlying problem at the sovereign level.

Q51 Chair: Do you think that a banking union can mean what it says on the tin unless it has full depositor insurance?
Andrew Bailey: No.

Q52 Chair: What are the prospects of getting there?
Andrew Bailey: That is not for us to answer, but it is obviously not anywhere near as widely discussed and progressed as the whole question of supervision. As the Governor said, supervision might have some benefits to us but it does not solve the problem.

Q53 Chair: Well that seems to go to the heart of it. This was a tricky question delivered to you very early on, about 10 minutes ago, Mr Cohrs. Is there anything you want to add now you have had a moment to think?
Michael Cohrs: I think the Governor has said it very elegantly. I agree with what Andrew has said. I personally do not think it makes a lot of difference to our banking system whether we are in or out. The trade agreement is what is really important.

Q54 Mr Mudie: Mr Bailey, I want to speak to you about FLS but before that, can I just carry on with the discussion that was raised many times in the press conference and has been raised today: the true financial state of the four big banks? We have moved from an accepted criticism of light regulation to strong regulation. We are spending a lot of money on it. We are very proud of it. We are working hard. But we do not seem to know the true health of the four big banks. Why not?
Andrew Bailey: The thing that I have found very helpful about what came out of the recommendation that the FPC made is that it started to answer the question of why there is a capital shortfall and how much, because that is crucial. It pointed to three areas, which we are working very extensively on, all of which are very genuine areas of uncertainty. I will just briefly go through each of them.
On the question of loss provisions and asset valuation, as we have said many times before, there is a really very difficult issue with the application of the accounting standards. We disagree with the accounting standards, frankly, in terms of their lack of forward-looking loss provisioning. I have said a number of times in public that since the teeth of the crisis in 2008, there has been a substantial increase in the capital requirements, the so-called Pillar 2 capital requirement, which if you like is the substitute for old-fashioned general provisioning of the forward-looking variety. Because of this shortcoming in the accounting standards and because of our particular concerns about certain areas of assets—I would highlight vulnerable euro area assets and commercial property—we need to do more on that.
The second one is conduct and the likely future cost of conduct redress. If I had been sitting here a year ago and you had said to me not, “Are there conduct issues around...?”—we knew that—but, “Would you predict the scale and cost of these conduct issues to come over the next 12 months?” I will be honest with you: I would have got it wrong. By that I not only mean the domestic conduct redress of the PPI sort, but LIBOR and what we have seen going on in the US. You have to put all of these things together to arrive at the judgment the FPC wants, which is in terms of the impact on capital generation and the prudential impacts. So that is a substantially new element.
The third one, which we have touched on before, is the RWA issue. My own view on that is there are two things here that need to be done. One is that we need to bring this to a conclusion and have a credible set of work to say not only what is a sensible set of measures to judge capital, which for me is a combination of a risk-weighting approach and a leverage approach, but also what is a sensible underpinning of the risk-weighting system to stop this drive to the bottom.
The last point I would make is that we need a lot more transparency to the outside world about how this system works. It is interesting—I talk a lot to investors and the analyst community, as Bob and other members of the Committee do, and they do not understand it and they have lost confidence in it. That is a very bad place to be in. One of the encouraging things, to be frank, is that towards the end of last year, under the auspices of the Financial Stability Board, a set of recommendations was published call the Enhanced Disclosure Task Force Recommendations, which recommend that banks should adopt a much more meaningful set of disclosures across the board but including in this area. So, do not just dump data into the world: please have meaningful, sensible disclosure that allows people to more properly map risk weights into balance sheets. I have said this to the banks. The best thing they can do is get on and implement that.
Going through the three things that the FPC has very helpfully asked us to do, there are good reasons why we should be doing this now. We should always be doing it, but we should be doing it now.

Q55 Mr Mudie: You speak about transparency; is there not a case for being transparent yourself in the context of this? You have mentioned you have different valuations, different views. Would it not be a helpful step to put that in the public arena—to put their valuations in and your valuations? That applies pressure, and lets investors and everyone else know the extent of the difference of opinion and reveals the mystery about what is happening in the banks.
Secondly, I welcome your approach but some of the answers in the press conference were, “We are putting this into operation. We are hoping to do this” and so on. Is your regulation strong enough that you will ever be in a position to come to this Committee and say, “The four banks are in perfect health. We are quite content”, so that things like lending to small businesses might even start happening? When do you think you will be in that position?
Andrew Bailey: I think it goes back to the questions that Michael was answering. I will give you my view on this, which is that I think that there has to be a sequence of actions. The first action is that the banks—and obviously this applies to some more than others; you know that—have to adopt structures and business models and balance sheets that are sustainable. If you go back to the question that Mr Newmark was asking Michael, if you want to sell the Government’s shareholding, you have to sell it in an institution that has a balance sheet and a business model that has a stable future. This is reflected in the words that the FPC adopted. You will see in there the language and terms of what should be done. It is not just capital-raising. As to Michael’s point, I would expect out of that you will see rationalisation of balance sheets. We are already seeing that from some institutions. We are already seeing a reduction in the size of investment banking balance sheets, for

instance. Then you get to the question of capital-raising, because then you have the answer to the question, "What capital does this institution need to maintain a successful business model?" That is the answer to the question and that is where we should get to, to be able to come here. I am never going to be able to say to you that there are no problems on the horizon. If I said that, do not believe me, by the way. But that is how we get to the answer to your question, which we must do.

Q56 Mr Mudie: Can you give us, as we sit here, your valuation of the losses that will be sustained by the four banks on PPI and on interest rate swaps?
Andrew Bailey: No, I can't, because that is the work Martin Wheatley is leading for us to input into the FPC. He is the expert in this field in terms of assessing future conduct liabilities and we are working very closely together on that.

Q57 Mr Mudie: When will we know?
Andrew Bailey: As the FPC said, they want the answers to these questions for the next round of meetings, which takes place in March.
Chair: Thank you. That is very helpful.

Q58 Teresa Pearce: To follow on from what George Mudie was asking you, Mr Bailey, you said that a year ago if you had sat here, you would not have known about the scale of the problems such as LIBOR. LIBOR is not an activity regulated by the FSA, is it?
Andrew Bailey: No. It has not been.

Q59 Teresa Pearce: But it is meant to be monitored by the FSA. Is it not part of your remit that you and the BBA are meant to monitor LIBOR?
Andrew Bailey: It is certainly part of the BBA's remit because they were running—

Q60 Teresa Pearce: Is it not part of the FSA's remit?
Andrew Bailey: I should tell you this is well before my time. It is not my area of activity in the FSA. It was not a regulated activity but there are, as there have been in the parliamentary questions that have come through, very good questions about the overall monitoring of activity and markets.

Q61 Teresa Pearce: Well over a year ago RBS suspended a number of traders because of LIBOR, and their individual registration with the FSA was suspended at that point and is still suspended. So you still say that a year ago you would not have known the scale?
Andrew Bailey: Let me make clear what I said. I did not say we did not know about LIBOR. Clearly we did.
Teresa Pearce: But you did not know the scale.
Andrew Bailey: What I was saying to you is if I had sat here at this time last year and you had asked me to predict the full extent of the impact of all of these conduct issues put together, if I am honest with you, I would have got it wrong. That is the point.

Q62 Teresa Pearce: Thank you. I turn to what I was meant to be asking about, which is remuneration. You, Mr Bailey, and Sir Mervyn, have made recent statements about remuneration, about clawback and about the link of remuneration to risk. Do you think anyone has actually heeded your statements? Sir Mervyn?
Sir Mervyn King: It is a regulatory matter so it is in Andrew's hands. Perhaps Andrew should answer.
Teresa Pearce: That is what you said previously.
Andrew Bailey: There was clawback last year. I can safely predict to you that there will be clawback this year. It is vital. It is absolutely vital because otherwise, people get away with it.

Q63 Teresa Pearce: Do you expect clawback from RBS, should the large LIBOR fine be imposed?
Andrew Bailey: I think RBS have already announced a number of actions, and as the remuneration round comes to a conclusion I would expect to see that go to fruition.

Q64 Teresa Pearce: Sir Mervyn, on a recent report on people deferring their bonuses to 6 April, just as a matter of opinion, do you think that is ordinary tax planning or do you think that is morally repugnant?
Sir Mervyn King: It is clearly not unlawful. Investment banks are in a privileged position because a lot of their compensation comes in the form of bonus, the timing of which can be adjusted. I find it a bit depressing that people who earn so much seem to think that it is even more exciting to adjust the timing of it to get the benefit of a lower tax rate, which they will benefit from in the long run to a very great extent, knowing that this must have an impact on the rest of society. Even now, it is the rest of society that is suffering most from the consequences of the financial crisis. I do not know what will happen—they have not made any statement—but I think it would be rather clumsy and lacking in care and attention to how other people might react. In the long run, financial institutions, like all large institutions, do depend on good will from the rest of society. They cannot just exist on their own.

Q65 Teresa Pearce: One last question, which I am not sure you will be able to answer but maybe you could get a written answer to me. It is about the external members of the permanent FPC and their appointments. Will there be employment contracts? Will they be office-holders? Will they be subject to PAYE and NIC?
Sir Mervyn King: They are certainly subject to all the normal tax rules. They will employed by the Bank. I will get a correct technical answer to you but let me assure you they will not be employed in the way that a certain journalist for the BBC alleged they were to have been employed, if that is behind your question.
Teresa Pearce: You understood my question. Thank you.
Sir Mervyn King: Yes. It is certainly not of that kind.

Q66 Mr Love: Governor, can I come back to this issue of resilience that Mr Bailey outlined a moment or two ago? Many people have interpreted the FPC report as an indictment of the failure of the banks. Would you agree with that interpretation?

Sir Mervyn King: I do not think we necessarily want to make judgments of that kind. Our aim is to try and make the system more resilient. In that context we felt, on the basis of empirical work done jointly by Andy's team and Andrew's team, that there was a strong prima facie case to believe the system did require more capital, for exactly the reasons that Andrew gave: inadequate provision for future losses; inadequate provision for future compensation payments and conduct fines; and somewhat optimistic use of risk weights based on their own models. We have asked Andrew's team to go away and conduct a detailed assessment of these issues with respect to the major banks and report back to us in March.

Q67 Mr Love: It is that assessment that I want to look at. Andrew Bailey mentioned earlier, and you note in your report, concerns about portfolios of real estate bonds made in euro area countries and UK commercial real estate. Reading between the lines, it would appear that those concerns are significant. Would you agree?
Sir Mervyn King: Yes, they are significant. How far they have already been provided for is the empirical question to which Andrew's team will find the answer. That is the thing that we need to be very careful about. So that is what we are asking Andrew's team at the FSA to report back to us on by March for our March meetings.

Q68 Mr Love: He has already expressed scepticism about accounting standards used in this area and no doubt we will look at that.
Mr Bailey, the report states that the estimate of PPI losses, further unrecognised losses, will be in the region of £4 billion to £10 billion. You would not disagree with that, I assume. Also, of course, we have interest rates, swap mis-selling and LIBOR manipulation. Is it not true that the losses are going to be much more significant than any bank has taken into account so far?
Andrew Bailey: I think you are right on that. It comes back to a point I was making earlier. We have talked quite a bit in the FPC about what I would call the headwinds to capital generation. This is internal capital generation, retained earnings. One of those headwinds is the rise in conduct redress costs and fines. Don't get me wrong, I am not arguing against this: this has to be done. Let's face it, this unfortunately, sadly, is a reflection of things that were done in the past for which action has to be taken. But to put ourselves in a prudential context, these numbers have now become sufficiently large that we have to take note of them and factor them in on forward-looking basis because they are now a considerable headwind on the path to internal capital generation.

Q69 Mr Love: Mr Haldane, I will ask you this because I think the others have commented on it. There is a complete lack of transparency on internal ratings-based models that banks use. Aren't they useless? The implication being that they are—I use the words that appear in the report—aggressive application of risk weights. Aren't they being used to soften the blow for banks?
Andy Haldane: I think that risk is real. Michael referred earlier on to the results of the FSA's hypothetical portfolio exercises. They make clear that for a common exposure banks can hold very different amounts of capital and in some cases that means a number of banks are probably holding too little. If you look over the course of the last 20 years at the average risk weight that banks assign to their assets, you would be astonished to see how far that had fallen over the period. One interpretation of that is that the assets on banks' balance sheets are a lot safer than they were 20 years ago. But that rather flies in the face of the evidence we have had over the last five or so years, and certainly flies in the face of the evidence that the FPC put in the FSR from November. So to go to your question, many of these models are not just complex and lack transparency, but more fundamentally they lack any robustness. They are not a sound or reliable basis for the setting of capital regulation. That problem is being increasingly recognised, not just by regulators but by investors in banks and indeed banks themselves. Many of the loudest complaints about those models have come from banks themselves. So now is the time for a drains-up. For me personally, the regulated community made a significant error in the 1990s in the reliance it placed on what are deeply complex and deeply fragile models, and that balance now needs to be redrawn.

Q70 Mr Love: So if I take those three items together, we have a much more serious problem of resilience than perhaps we had understood up until the present time. In paragraph 18, Governor, it goes on to say, "It was possible that any capital overstatement could be corrected over time and that gradual adjustment of balance sheets would slowly return UK banks to a position that would enable them better to support the economy." That is dismissive. Do I interpret that correctly, that you are saying that really won't measure up to the challenge that the banks face?
Sir Mervyn King: I think that the lesson from the past has always been that if you have a problem of an undercapitalised banking system, you are far better off dealing with it straight away. The equity holders will not be happy with that, and therefore the current management, but in the long run in the interests of the institutions and the economy it is better to recapitalise the banks. In many ways, as Michael said earlier when asked about the comparison between the US and the UK, the sad truth is that in 2008 the idea of focusing efforts on recapitalising the banking system was a UK idea. We got there first, but like many UK ideas the Americans developed it faster and better. We would have done better at that point to have done more. I think we are suffering now from the consequences of not having done that. The situation has clearly deteriorated—

Q71 Mr Love: Let me interrupt you, Governor, because we are running out of time. The reality is that you could not possibly go to the marketplace with resilience in the current state that it is in. Would you accept that?

Sir Mervyn King: No. I think the banks could. In Europe they have done so. European banks raised quite a lot of money last year. UK banks did not. So again as Michael said earlier, banks have two options here: either to raise more capital or to restructure their exposures. Either would put them in a more resilient position. We need to do that and if you combine that fact together with the fact that the UK banking system is heavily reliant on a small number of big banks, two of which are predominantly in state hands, that is one reason why we are in a difficult position at present. I do not want to exaggerate it now. Andrew's team will do the work on the numbers. They will come back to us in March and then we will be in a position, and only then, to be clear about the precise scale of the problem. Our view was that there was a prima facie case for believing that the problem was sufficiently big for action to be required, and that is why we made the recommendation to the FSA.

Q72 Mr Love: Let me just ask Mr Bailey, because you have to come back. You have been given this poison pill.
Andrew Bailey: It is my job. It is not a poison pill.
Mr Love: I think you accept that the challenge is perhaps much greater than originally indicated. If they are to sell off assets in possible fire sales, it will come up against political objections as well. Are you measuring up at the FSA to the challenge that you may have to meet here?
Andrew Bailey: Look, I did not say "fire sales". What I did say was that I think that the institutions concerned will have to take steps to restructure their balance sheets and their business models to put them on a sustainable basis, and that is the best way then to sell capital. That is the point I made.
I will just make one other point finally on this. What we are doing now—and I do not want to give you the sense that this is because we have done everything—is judging the capital needs on these fronts against actions that have already been taken. I will give you just one example on modelling, to Andy's points. We are withdrawing the modelling concessions for many banks in the area of commercial property because the models were so ropey that they should never have been there in the first place, and we are moving them to what I call a non-model approach. It is called "slotting", for want of a better term. It is saying, "Just put your loans into simple buckets and we will set simple weights against them. Do not try and do pyrotechnics because we know what happens then". It is Andy's point about ever-declining risk weights.

Q73 Mr Love: You were very coy at the press conference and you are very coy here about the scale of the need for recapitalisation. Will you have a ballpark figure around the area of recapitalisation when you report back?
Andrew Bailey: Absolutely; I expect to. I am not sure it is question of being coy. The reason is that I really did not want to set off a whole frenzy of trying to speculate what this number is while we do the work to work out what the number is.

Q74 Chair: I think I heard you right earlier when you said you are concerned on prudential grounds about the scale of these fines.
Andrew Bailey: They are substantial enough to register on the scale. Let me be clear, that is not because I am going to Martin Wheatley and saying you should not be doing this for prudential reasons. That is not at all the case. In terms of the path of internal capital generation that takes us not only to dealing with the issue we are dealing with and talking about in the FSR but also to the Basel 3 levels, these headwinds, as I call them, are registering. There is no doubt that they have substantially dented the rate of internal capital generation. That is the point.

Q75 Chair: In the legislation you could veto them.
Andrew Bailey: You could but let us be clear—
Chair: If you were really fed up with it, you could bring a stop to it.
Andrew Bailey: You would have to have a very clear framework for evaluating the risk that they were placing on financial stability. Let us be clear on Martin Wheatley's duty: these are very important issues in terms of redress to the public.

Q76 Chair: I am not doubting that for a moment, as you well know; I am just trying to clarify that the legislation that has just been put on the statute book—
Andrew Bailey: Indeed. I am very aware of that.
Chair:—hands you a veto over the prudential aspects of these fines.
Sir Mervyn King: Not in respect of the overseas regulators, obviously.
Chair: No, but over the domestic regulators.
Sir Mervyn King: Yes.
Chair: Absolutely.

Q77 Stewart Hosie: The Government are going to grant the FPC the three powers: the capital buffers, the sectoral capital ratios, and a leverage ratio that comes with a delay—not before 2018 and after a further review in 2017. Are you content with that delay on the leverage ratio?
Sir Mervyn King: No. We would have preferred to have had it earlier. It is not an ideal world; you do not always get what you ask for. But as Michael said earlier, I regard the leverage ratio as absolutely key to being able to implement macro-prudential policy.

Q78 Stewart Hosie: That brings us to a practical problem. If between now and 2018 or later, the FPC would have issued an instruction under a direction-making tool that they do not have in relation to leverage ratios, what will the FPC do?
Sir Mervyn King: Sorry. If—
Stewart Hosie: If the power has not been granted.
Sir Mervyn King: Well, we can make a recommendation. We still have the ability to make recommendations. In other words, we will be saying pretty clearly, if we had the power this is what we would want to do now. If you have not given us the power in Parliament, we cannot use a power you haven't given us, but we can certainly make clear what we would have done, had you given us the power.

Q79 Stewart Hosie: I do not want to delve too far into the realms of the hypothetical, but should you make that recommendation and Government or others do not follow through as you would be able to do had you had the power yourself, there would be—how can I put it gently?—an almighty row.
Sir Mervyn King: No—an interesting exchange of views amongst all parties concerned. What I would hope is that the substance of it would be discussed and debated, and no doubt the committee would come before this Committee and express its views and say why it had made that recommendation, and you could write a report saying whether you thought it was a pity that the powers had not been granted to the committee—or the other way round.

Q80 Stewart Hosie: Indeed. In terms of the tools more generally, do they have the correct degree of symmetry, in the sense of allowing the FPC to cope with a financial system that is under-providing financial services as well as one that is becoming too risky?
Sir Mervyn King: We like to think so. As I said, this is all rather experimental, this committee. We will see. Certainly the aim is that, if we had raised countercyclical capital buffers, for example, in an upswing, then when things started to turn down it would be open to the committee and highly appropriate to do so to cut back those buffers. So that would then be operating in a countercyclical way both on the way up and on the way down. I think we feel that in that respect, there are things that we can do, certainly. But of course, in terms of structural matters of finance, there is a clear limit on what the FPC can do because its aim is to improve resilience and, provided it does not set out to limit competition, its powers to create new financial instruments or expand the range of financial services have to be left to the industry itself.

Q81 Stewart Hosie: Indeed, and I am quite clear about the limits on the powers, and the responsibility and remit of the FPC. If you had any of the tools to be granted at the moment, would you have used or would you be using any of them at this point?
Sir Mervyn King: It depends when we would have been granted them in the past. Let us suppose we go back to say the mid-1990s. I think and I would hope that we would have used the countercyclical powers both on sectoral capital ratios and probably on countercyclical buffers in the run-up, in the 2000s, because what we saw was an economy that was not growing too quickly and wasn't generating too much inflation, but we were seeing a rapid expansion of the balance sheets of financial institutions. I think to have raised capital requirements on lending to the financial sector and probably generally raising capital requirements to prevent the run-up in leverage, which was quite rapid and rather extreme, would have prevented the build-up of the size of the financial sector that has made our subsequent problems much more difficult. Having done that, then we would have been able to unwind those in the downturn. But not having had the instruments to push up before the crisis, there is not much we can do afterwards.
Stewart Hosie: It is an interesting question.
Sir Mervyn King: It is.

Q82 Stewart Hosie: Mr Bailey, in your speech to the Bank of America you said that you agreed with the need for simplicity in the approach to supervision but that simplicity was not about one-club golf, you said.
Andrew Bailey: Yes.
Stewart Hosie: Are these three clubs—the countercyclical buffers, the sectoral ratios and the leverage ratio—enough? Is that a full set or is there something missing?
Andrew Bailey: What you have to see those as—I don't play golf, but let's stick with the golfing analogy—is clubs that you add to the ones that we already have. By the way, in the context of that speech, I wasn't particularly talking about these tools. I was talking about my own view that it is sensible in the context of the leverage ratio to have a risk-weighted system and to complement it with a leverage ratio; that is the point I was making in that speech.
Stewart Hosie: But the question is still valid.
Andrew Bailey: Yes.

Q83 Stewart Hosie: Are the three tools enough or is there something else that might be added to that that you think would—
Andrew Bailey: I think they are a very good starting point. We will learn a lot. Michael Cohrs was making the point earlier. The last year or so in this process has been, in many ways, a fascinating experience of learning how to make a policy framework. To my mind, this whole area of policy making is much newer and much greener, say, than monetary policy was in 1997 when the MPC set off on its course. We are experimenting in policy making at the same time as putting an institutional structure together. It is absolutely fascinating, but there is no doubt we will learn things and probably modify things along the way.

Q84 Stewart Hosie: Just one final question in relation to learning. I am looking at the indicator set, the metrics, for people to determine whether or not we have financial stability. When you start going through this in detail and the economic circumstances change, if you determine at that point you need another tool, another lever, another power, how will the FPC go about getting that power or making the case for it?
Sir Mervyn King: We have discussed this on the committee. We would write, in the first instance, to the Chancellor, have a meeting and the FPC will agree on a document. We would write to the Treasury, make our case and there would then be a public debate about whether or not this instrument should be made available. I think in our reports we would say we would like to have this additional power and there ought now to be a debate in Parliament as to whether or not we should be granted it, but I think we would want to be open about it.
I think one reason why we started with these three instruments was that we didn't want to be seen to be saying, "There is a lot of fun here. We can learn a lot by experimenting with all these different tools". These

are affecting people's livelihoods. We should start small. There is a very strong view on the committee that we should start with a small set of instruments and then see how that worked, and if we felt we needed more then we can come back to that.

Q85 Stewart Hosie: Just one final supplementary question on that. Should there be already in place a formal mechanism by which the FPC could request an additional power? Should that be formalised or should it be in the ad hoc way you described earlier?
Sir Mervyn King: I think it is clearly understood that it is something where we would be able to write and say we would like the additional instrument. That is clearly understood, so I don't think we need any additional formal power. Clearly, Parliament has to make a decision about whether it wishes to grant discretion over another instrument to the committee, but there is no impediment to our doing that and it is clearly understood in the Treasury and in the Bank—and I hope in Parliament too—that that is something that we could and would do. But we didn't want to start by saying, "Look, you never know, we might need to use all of these 37 different instruments, so just in case give them all to us now". I think that would have been irresponsible and we didn't want to do that. We will start small, then if we need more then I am sure you will make a decision as to whether you want to give it to us or not.

Q86 Chair: Governor, I am sure you appreciate that when you make these announcements on capital—whatever they may be—given their importance, we will want a full report and not just an information note, but something akin to a financial stability report, honed down to the relevant areas.
Sir Mervyn King: All right. I am sure that when we make another recommendation, or after 1 April use our powers of direction, then we would certainly expect to do that.
Chair: At that time and provide it to us at that time.
Sir Mervyn King: I want to reflect on the precise timing. I think when we would make a public statement, then it ought to be accompanied by public justification, yes.
Chair: Yes. I am not pinning you down on when you are going to make that statement but I am trying to pin you down on what you are going to supply to us at the time you make that statement.
Sir Mervyn King: I am sure when we make a statement we will supply you with all the information that we have that will justify the actions that we are taking.
Chair: This will put it into the context of financial stability more widely.
Sir Mervyn King: Yes.
Chair: That is what we need to see, which means it will have to draw on some of the essentials of a financial stability report and would be a serious piece of work.

Q87 Mr Ruffley: Governor, I would like to turn to the core indicator set for the countercyclical capital buffer and for the sectoral capital requirements that you have published. If a member of the public came to see you in the Bank of England and asked you if there was financial stability in the UK system, how would you answer that question with reference to the core indicator sets?
Sir Mervyn King: I think what I would talk about is what I would expect to see to be true in the longer run. In terms of leverage ratios, risk-weighted capital ratios, we would say in our judgment these are the sorts of numbers that you would expect to be at if you were in a stable position. Either we are below that, and if so, why are we below it; what are the current circumstances? I think the same would be true of rates of return, of interest rates. Look at things like long-term real interest rates; at present, they are actually slightly negative. This is not something that is remotely sustainable.
The question is, how are we going to get from where we are back to a more sustainable position and what are the actions required to achieve that? In other words, we have to tell a story about where the economy is now, where the financial system is now and how we are going to get it back to a stable footing. That is not just saying we react in any mechanical way to any set or subset of these numbers, but these are numbers we would use to demonstrate why in our story we believed that we either were or were not in a sustainable position and what was and was not needed to be done to get back to it. That, I think, is the essence. It is very similar in a way to how monetary policy works. There is no one indicator or a finite set of indicators. But the indicators that we would use in order to explain and justify our arguments are ones that people are familiar with, so we did not need to produce a table like this because in the area of monetary policy people had known that for many years. For financial stability it is perfectly reasonable to say, what are the kinds of indicators that will be helpful? We provided it but over time this may change, may be amended.
In any set of circumstances what matters is the arguments we use to say why we believe that certain actions are needed to slow down an expansion of the financial sector; or that, in a situation where we have already put in place higher capital buffers, now is a good time to reduce those capital buffers to enable banks to absorb losses or the problems of the downturn, without sacrificing lending to the real economy to the extent that would otherwise be the case.

Q88 Mr Ruffley: Do you envisage publishing in the minutes the indicators that are giving you or the committee concern—a sort of green light, amber, red?
Sir Mervyn King: Whether we do it as green lights or amber lights, I certainly think that all the numbers here would find their way into the Financial Stability Review with a commentary on what the position was and how we saw it. I think the commentary is the key thing, but certainly what is very important is that we integrate these indicators with our discussion of what the current position is and, therefore, the actions or recommendations that we have made. There is no point just having a table that you publish somewhere once every three months and then make no reference

to it. The key thing is to integrate these numbers with our analysis.

Q89 Mr Ruffley: Just so I am clear about this, would these indicators not form the most important part of your discussions and, if not, what would?
Sir Mervyn King: I am not suggesting that there is an alternative set of indicators that would dominate this; we would start with these. But then the key thing is: why are the numbers at their current levels? What is actually going on? What is the story that we would tell about the financial system? The analysis is crucial but we have to pin it to the actual numbers.

Q90 Mr Ruffley: Is it your intention to detail in the FPC minutes the discussion in relation to each data set?
Sir Mervyn King: I don't think the minutes would necessarily go through all these indicators and have a discussion.

Q91 Mr Ruffley: Why not?
Sir Mervyn King: Because the narrative, the story that we would tell, the analysis, would usually be based on—four or five of these would illustrate one key point. One might illustrate another, and another six might illustrate a third point. What really matters is the narrative, but that is for the FSR. The minutes, in a way, are to record our discussion and, where appropriate, where there were differences of view, where issues came up that people wanted to raise and where it wasn't obvious what the answer was; different viewpoints can be reflected in that discussion.

Q92 Mr Ruffley: You have talked about the possible necessity for amending these indicators with experience and according to different changing conditions. Do you not think there is a risk with that, that you might be seen to be moving the goal posts?
Sir Mervyn King: No, because we have not given target numbers for any of these ratios and I think it would be a mistake to do so. I understand why there is an attraction in that because it ties down the objective of the committee more closely, and I see attractions in that. But I think the difficulty is that financial stability, as we all understand it, isn't necessarily well measured by any one of these indicators. An example would be that if we had doubts about risk weights then risk-weighted capital is a much less useful measure than we might have thought. Once you discover that the risk weights may be biased then you don't want to attach so much weight to risk-weighted capital.
I do think that in the end what matters is our ability to convince you, people outside, of the validity of the arguments we have used to back our actions. If, in the arguments that we will use and will be based on these numbers, we make a convincing case, then I think that ought to be the test. I know it sounds rather vague but I don't think in practice we can do better than that because the attempt to choose any one of these ratios as a target will leave us exposed to the fact that once we do it, then behaviour may change in the financial system and we will be unhappy that we have chosen that as the target. That, in many ways, was the experience with monetary policy and I think it would be even truer here.
I think what we have to do is to work very, very hard to persuade you that the recommendations we have made or the directions we have given were sensible and reasonable actions, given our analysis and the data that were available to us and to you. That is clearly why, in our documents and in our speeches, we have to make a convincing case. We cannot just rely on the authority of the bank to do it but make a convincing case, and we will try very hard to do that.
Chair: Brooks, you have a rejoinder.

Q93 Mr Newmark: I do. Each of you have implied that the banks that the taxpayers own, RBS and Lloyds, are undercapitalised and need money, equity, put into them. You have all equivocated as to how much that figure is but it is of public interest what that number is, notwithstanding Andrew's comment that more work needs to be done. I have done a back-of-the-envelope assessment myself, so I am going to give you a multiple choice and I just want one number from each of you as to what that figure could be.
Sir Mervyn King: I am not going to give you a number; let me explain why.
Mr Newmark: Governor, let me finish asking my question and then you can give me your non-answer.
Sir Mervyn King: Right, because the premise is wrong.
Mr Newmark: Let me just ask the question first, then you can give me your non-answer.
Sir Mervyn King: Right.
Mr Newmark: The numbers that those two banks need are £10 billion, £20 billion or £30 billion. It is somewhere in that range—
Sir Mervyn King: Will I go first?
Mr Newmark:—but I am curious. I am going to start with Robert, then I will eventually get to you, Governor, rather than you answering everybody else's question for them, which I know you like to do. Robert, a number, please.
Robert Jenkins: The number depends on the work that the FSA has yet to complete and then—
Mr Newmark: No, I just want a number.
Robert Jenkins: When they come back and verify the number, I will able to do it. The number that I would be in a position to give you still depends on the FSA coming out and—
Mr Newmark: Yes, but you must have an idea of a number. There must be a number you have, and it is a big number. Taxpayers have a right to know. These banks are underfunded, they were overvalued when they were bought and it is an important figure. It is not a small number. You must have an idea. I just want a number.
Robert Jenkins: I think that is for the macro-prudential regulator to give you.

Q94 Mr Newmark: That is a cop-out. Okay, one cop-out. Andrew.
Andrew Bailey: It depends on what assets are on the balance sheets in the future. I really must come back to this point I have made that you have to get the

business model sustainable and the balance sheets sustainable and then answer the capital question.

Q95 Mr Newmark: That is another cop-out. Right, Andy.
Andy Haldane: I am going to cop out too.
Mr Newmark: Come on.
Andy Haldane: But just to be clear—
Mr Newmark: Andy, is it at least £10 billion? You are a smart guy, is it at least £10 billion?
Andy Haldane: The legislation does not permit the FPC to opine on individual firms. It is very, very clear on this. It would be a breach of our objectives to go into individual firm's numbers. Is it material? Yes. If it had not been material we wouldn't have said it.

Q96 Mr Newmark: What is your definition of "material"—a number?
Andy Haldane: We gave, in the report, a sequence of illustrative examples of the potential scale. They were all measured in tens of billions.

Q97 Mr Newmark: Right; it could be as high as £30 billion. Could it be as high as £30 billion?
Andy Haldane: Andrew's work will—
Mr Newmark: I know that but could it be as high as £30 billion?
Andy Haldane: We are talking the sort of orders of magnitude that I mentioned and the report made that clear.

Q98 Mr Newmark: Okay. Michael, you are a numbers guy; give me a number.
Michael Cohrs: I didn't answer you before, Mr Newmark, and I don't think it is in the public interest.
Mr Newmark: It is in the public interest.
Michael Cohrs: No, I disagree with that.
Mr Newmark: They are going to have to foot the bill, potentially.
Michael Cohrs: But a lot of work is being done and has to be done, because you know as well as I do—and everybody here knows—that these numbers will spin out of control through the journalist community, so I don't think it is in the public interest just to talk about numbers.

Q99 Mr Newmark: Okay. Governor, you are going to equivocate again, so you are going to explain why you are equivocating.
Sir Mervyn King: The reason why my answer is not going to be a cop-out is that I don't accept the premise of the question. The committee did not say that any of these institutions had to raise more capital. It said that if the numbers justified it, it will have to either raise more capital or restructure its exposures. Certainly, for banks in which the Government owns a large stake, one of the solutions is not necessarily for the Government to put in more capital; the private sector could put more capital in. But if not that, they could restructure their exposures in a very significant way that will mean that they would not need more capital. That is the answer.
Mr Newmark: Yes, we will wait and see. Thank you, Mr Chairman, for indulging me again.

Q100 Chair: If markets accurately priced systemic risk there would not be a need for you to do all this work, would there?
Sir Mervyn King: No, I am sure that is correct, yes; but I think it is rather optimistic.

Q101 Chair: In which case, perhaps you can give us some estimate now of how far away you think they are?
Sir Mervyn King: It depends on which market and which asset. I think that one of the things we ought to be a bit concerned about is that interest rates have been so low for so long that some of the actions have reduced risk premia to levels where the search for yield appears to be beginning again. This is a much more difficult question for us to tackle now because prior to 2007, one could say the search for yield had reduced the risk premium to unsustainably low levels and we were very clear on that in our Financial Stability Report—we said that. Many central bank governors said so at the time that the price of risk would be falling to unsustainably low levels.
Now the problem is that if a similar situation occurs, it is at a point when the economy is operating well below full capacity, the banking system is in a stretched position and we are clearly struggling to find instruments to ensure an economic recovery. A combination of a weak recovery and yet, at the same time, people searching for yield in ways that suggest that risk is not fully priced is a disturbing position, and it is one that we will have to monitor very carefully, but I think that is for our March meeting.

Q102 Chair: Mr Cohrs, you are a private sector man, do you think the markets are ever going to do the lion's share of the heavy lifting for us?
Michael Cohrs: No.

Q103 Chair: Mr Jenkins, do you agree with that?
Robert Jenkins: Could you repeat the question, Chairman?
Chair: Do you think that markets are ever going to be able to do the lion's share of the heavy lifting for us?
Robert Jenkins: Will ever be able to—I'm sorry.
Chair: The question was, do you think that the markets will ever be capable of pricing broadly accurately systemic risk?
Robert Jenkins: They didn't last time.

Q104 Chair: Okay. I am asking you about the future. What about the future, Mr Jenkins?
Robert Jenkins: There are many times in history when they failed. It would be a bad bet to bet that they would.
Chair: Okay. It has been an extremely interesting session, as much for the occasional question that was not fully answered as for the good number that were very fully and thoughtfully answered. We are very grateful to you for giving evidence in this session—there will be a good many more, I expect, in this field. Thank you very much indeed.

Written evidence

Supplementary written evidence submitted by Robert Jenkins, external member interim Financial Policy Committee, Bank of England

Dear Chairman

Thank you for giving me the opportunity to appear before the Committee.

During the session I was asked by Mr Mann if I thought the employment rate should become a BoE target? On reflection it is obvious that we have had a times experienced very low levels of unemployment immediately prior to the bursting of bubbles. Equally, it is self-evident that extremely high levels of unemployment can be both a symptom and source of financial instability. In short, from the perspective of the FPC and the financial stability objective it is difficult to imagine a meaningful target. What one should acknowledge is that the unemployment rate is a key data point in formulating policy—short and longer term. In summary, I would say that the unemployment rate should be a policy consideration but not a target.

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