<u>Questionnaire for Nathanaël Benjamin on their appointment to the FPC</u>

Personal

1. **Do you have any business or financial connections, or other commitments, that potentially give rise to a conflict or perceived conflict of interest in carrying out your duties as Executive Director for Financial Stability Strategy and Risk (FSSR) and a member of the FPC?**

   No, I don't.

2. **Do you intend to serve the full term for which you have been appointed?**

   Yes, I intend to serve my full term.

3. **Please give an overview of how your career and experience to date will inform your approach to, and suitability as, Executive Director for FSSR.**

   As Executive Director of FSSR, I am looking forward to building on the work of the Financial Policy Committee (FPC) and bringing my own perspectives on several of the key nodes of the financial ecosystem. Notably in relation to the crucial role that both banks and non-banks play in supporting households and businesses. The interactions between those worlds are particularly relevant at this juncture. We are going through a transition away from the last decade into a new era characterised by a changing interest rate environment, by increased digitalisation and fast-evolving technology, and by climate change. All against a markedly different geo-political environment. Tracing through the implications of that broader context is essential to identify and analyse appropriately future risks to financial stability. And that is the backdrop against which I approach the role, and to which I will bring my background as a risk specialist. Let me step through my perspectives on this.

   First, I have supervised investment banks at different points in the last two decades, from different jurisdictions, and in crisis as well as more benign times. These institutions are active in investment banking and trading, and as such have long been at the confluence of the banking and capital markets worlds. That has given me a unique vantage point on a number of important financial stability channels, especially those involving the non-bank sector. Recent examples of that include the default of Archegos, the turbulence in commodity markets, and the LDI crisis. I bring that first-hand experience to FSSR and the FPC, alongside my track record of strategic leadership and focus in this area, having been responsible for the Bank of England's strategy for supervising foreign banks in the UK. This experience will shape how I approach the role, in that I will want us to identify systemic vulnerabilities in the non-bank sector by tracing through the chains of financial relationships at play, their materiality, what is driving them, and how those incentives are reflected in pricing.

   Second, I bring my own experience of bank resilience, forged through my involvement in the management of the global financial crisis (GFC) in the UK and the US, in the policy

response to that crisis, and in the handling of more recent banking sector turbulence. I was directly involved in managing the failures of banks such as the Icelandic bank Kaupthing in 2008, several large, troubled banks between 2008 and 2009, and Credit Suisse and Silicon Valley Bank more recently. I participated actively in the supervisory and policy responses to the global financial crisis, e.g., the first public US bank stress test (the Supervisory Capital Assessment Program) in 2009 which it successfully achieved its objective of ensuring banks had sufficient capital for the future risks they face. I then led some of the work under the Basel Committee to strengthen the regulatory framework by improving the way it reflected risks which did crystallise in the crisis, such as counterparty risk. I was then one of the architects of the first public concurrent stress test of UK banks. This was a key pillar of strengthening the banking sector post global financial crisis and helped draw out the interplay between banks, households, and businesses. This experience will inform my approach to thinking about bank resilience, including the central role in the FPC's toolkit of stress tests and scenario analysis going forward.

And third, my experience will help me in considering comprehensively all the aspects of the role of the central bank's balance sheet, particularly important for financial stability – and the need for central banks to be a lender of last, not first, resort. I gained that knowledge in a number of ways. After supervising risk in commercial bank balance sheets, and when the Bank of England strengthened its own risk management infrastructure several years ago, I led the creation and implementation of a risk framework for the Bank of England's balance sheet, and of its new capital framework. This gave me a unique perspective on the interaction between the balance sheet of the central bank and that of banks and clearing houses. That perspective was further broadened when I served as the Bank of England's interim Chief Financial Officer during exceptional pandemic times.

Throughout the last two decades I have had the opportunity to develop a varied experience of effective international engagement: on the policy development front under the Basel Committee and other international bodies, as well as with supervisory counterparts in major jurisdictions. Close working relationships with international peers are, I believe, an important way in which the Bank of England strengthens financial stability in the UK and abroad, which matters a lot given that the UK is a global financial centre. The robustness of the UK's regulatory environment and the safety of its financial centre is one of the key reasons why it is attractive internationally. Previous close coordination with counterparts abroad, such as the Federal Reserve and the European Central Bank, has fostered strong working relationships and joint work on mutual priorities. Those include for example addressing risks from non-bank financial institutions (NBFIs) as well as outsourcing to critical third parties – both topics which matter as much for macro-prudential stability as they do for the safety of individual firms. I intend to pursue such international engagement with renewed energy in my new post.

I would also note that my career has taught me the power of data and facts, having observed how destabilising data deficiencies can be especially in times of crisis, and more recently having driven forward the PRA's data strategy. Data is a necessary ingredient to inform sound, objective, and forward-looking judgment and analysis. The FPC has noted the need for better data in some areas, e.g. parts of NBFI and private credit worlds. It is very much with this mindset that I am joining the FPC, and it will be an important feature of how I lead the FSSR directorate.

Finally, as a leader, I have a recognised track record of instilling safe and supportive cultures in my directorates, which are known for being inclusive and encouraging diversity of thought and challenge, enabling analytical excellence and delivery. This will continue to be an essential component of my leadership style as I take up my new post.

The Financial Policy Committee

4. What are your main priorities and ambitions for your tenure as Executive Director for FSSR?

My main priorities and ambitions as Executive Director for FSSR is to ensure the FPC is focused and forward-looking in the pursuit of its medium-term priorities, while promoting a fulfilling working environment for FSSR staff.

Given the breadth and depth of the issues covered by its remit, it is important that the FPC is deliberate in choosing which issues to focus on, and when. As Executive Director of FSSR, one of my main priorities will be to provide leadership and guidance to the directorate to ensure that we, and the FPC, are focussed and prioritise our resources wisely. It is key that our framework for understanding how risks affect financial stability is as robust and coherent in its approach to a wide range of different types of risk as possible. As part of that, I will be making sure the FPC continues to run well, have high-quality discussions, and deliver its objectives. I will also ensure our priorities are clearly communicated so that external stakeholders can take action to mitigate the vulnerabilities we have identified, and we deliver on our accountability commitments to Parliament. Indeed, we cannot predict all risks. But we can focus on building resilience in the system, no matter the risk. In addition, by being transparent and communicating clearly it can support the identification of risks by others and influence how others think about financial stability and act on it themselves.

As Executive Director of FSSR I will lead the development of work programmes, analysis, and policy to support the pursuit of the FPC's medium-term priorities. This will include improving the risk identification and resilience of market-based finance (MBF), where for example I will oversee the System-Wide Exploratory Scenario (SWES) exercise. This SWES exercise will increase understanding of the behaviours of banks and NBFIs during a stress, and how they might interact to amplify shocks to markets that are core to UK financial stability. Among various aspects of MBF, I will look to dial up the focus on risks from private equity and private credit markets (set out in question 10). I will also ensure the FPC can identify, assess, and respond to structural changes and new risks in the financial system and economy. This includes horizon scanning for currently unknown or emerging risks, while – as I mention above – tracing through the implications of the transition to a new era that is currently underway. I will also be focused on responding to lessons learned about building resilience for times of stress, bringing my own experience of managing various episodes of turbulence and learning from those. Finally, my focus will also include improving macroprudential oversight of operational resilience, where I have seen first-hand the importance of operational resilience for the safety and soundness of individual institutions, and how it can have macro, system-wide, consequences for financial stability.

I also want to promote an atmosphere where staff thrive and feel confident and safe in challenging the status quo. I will work to foster an inclusive environment where staff are motivated to stretch themselves, delivering work efficiently and effectively. Diversity of thought is vital to detect risks in a timely, pro-active, and forward-looking way, to analyse them incisively and robustly, and for policymaking to be creative and effective.

5. **What is your assessment of the track record of the FPC and the work of the FSSR directorate? In your opinion, what are the areas of most success, and in which is there still more work to be done?**

In terms of successes, I would point to the FPC's and other international authorities' work to build resilience in the banking sector. This helped to ensure that the banking system as a whole can absorb even severe shocks, rather than amplify them. In aggregate, major UK banks' capital ratios have increased (with aggregate common equity Tier 1 ratios at 14.8% in 2023 Q3, up from around 7% in 2009). This helps ensure that banks can continue lending to households and businesses through periods of stress. I have seen the benefits of this from earlier roles. The progress has been unmistakeable, and banks have survived a number of shocks including a pandemic, geopolitical conflicts, and overseas banking stresses. Regular stress testing has helped us stay alert to the sector's vulnerabilities. An enhanced regulatory capital framework has built buffers for times of stress. The FPC's housing tools have also helped to limit the build-up of household debt when interest rates were low so households are better able to adjust to higher rates. And the FPC's broader toolkit has meant it can react to vulnerabilities in the risk environment by increasing or cutting the CCyB as appropriate.

The FPC and the FSSR Directorate, in conjunction with the rest of the Bank, have also been active in responding domestically to the crystallisation of risks in the non-bank sector following a series of shocks. This was particularly clear when the FPC responded to the need for greater resilience in the LDI sector, recommended a minimum level of resilience for LDIs, and also separately, developed proposals to increase resilience in UK-based money market funds.

Additionally, given the global nature of financial stability risks, the FPC and the Bank have strongly supported and influenced international policy making. This includes the Financial Stability Board's (FSB) workplan to tackle non-bank risks and build the international regulatory frameworks for those. The FSB has recently published its NBFI progress report for 2023 ahead of the G20 Summit and its analysis on the risks arising from NBFI leverage. The Bank's active contribution to this work has been positive and important.

The FPC also has a good track record in building operational resilience, in particular with its focus on impact tolerances, cyber stress tests, and critical third parties.

However, there is a lot more to do and there are lessons to learn from recent stresses. With the failure of a number of foreign banks over the past year, the importance of banking sector resilience has been particularly evident. There is work to do in the UK and internationally to understand the potential speed and scale of bank runs in a more digitalised world, including to consider the importance of being able to use liquidity buffers

in stress, and whether there are other lessons that can be learnt for the liquidity framework. The FPC have an important role to play here in considering the macro consequences of this. The Bank's stocktake of its stress testing framework will also be instrumental in helping to ensure we draw lessons from the first decade of running the regime, so that it can continue to support the FPC and the PRC in meeting their objectives.

And given, for example, that around half of UK corporate sector borrowing now comes from market-based finance, it is important that we, in collaboration with other authorities, finalise outstanding policy work to increase resilience in MBF. This includes work to reduce excessive spikes in the demand for liquidity by NBFIs in times of stress, on open-ended funds, on margining practices, as well as developing robust policy reforms for NBFI leverage. Without this, the underlying risks remain significant and could resurface. Moreover, NBFIs are highly interconnected globally and their activities are often inherently cross-border. That means strong momentum in the pace of international work on MBF is important. For policy reforms to effectively address the vulnerabilities in MBF there must be consistent national implementation across all relevant jurisdictions. Absent international coordination on MBF reforms, there is the potential for cross-border spill-overs and regulatory arbitrage. So progress on this front will reduce the need for central banks to intervene in financial markets, putting public finances at risk, or leading to moral hazard.

Moreover, the growth in non-banks has also been driven by a movement of not just financial but also human capital from banks to NBFIs. So it is also important to consider the importance of people and culture for macro-prudential stability, and the implications for risk culture and moral hazard (see question 15).

Finally, with developments in digital money and from climate change, it will be particularly important that the FPC continues to focus on these topics, while also maintaining its strong ability to understand and tackle new risks that emerge. The FSB has also been working to advance the understanding of climate-related financial stability risks, and to develop a global regulatory framework for crypto-asset activities and markets.

6. **How important is it that the public and the financial services industry understands the role of the FPC, the decisions it takes and the views of its members? How many on-the-record speeches do you intend to make in your new role?**

Ultimately the key outcomes of financial stability are that households and businesses can rely on the financial system for the ability to pay, borrow appropriately, save, and invest. And it is the role of the FPC to identify, monitor, and act to remove or reduce systemic risks so that the UK financial system can continue to provide those vital services. It is therefore important that the public and the financial services industry understand the FPC's role.

For the public, it enables them to trust that their money is safe, and to trust the financial system to provide reliable vital services, which are necessary for economic prosperity and public good. Indeed, it is important that the public knows that the Bank of England is looking out for them by putting all its heart into its financial stability mission and will not hesitate to act when necessary.

For the financial services industry, understanding the FPC's role, its views, and its decisions enables them to know where they themselves have a role to play to mitigate risks so they can then act to do so. That is an important aspect of effective financial stability policy making. The financial industry needs a sufficient understanding of the financial stability risk environment, so that they can be alert to these risks and conduct their own business effectively and prudently. First and foremost, it is for firms and the private sector to ensure they have appropriately addressed the risks they face. A well-run financial sector that understands and takes steps to mitigate systemic risk is the FPC's first line of defence. Moreover, such understanding will reassure financial firms that the UK is a safe place to do business and innovate.

Over the last two years as Executive Director of Authorisations, Regulatory Technology, and International Supervision (ARTIS), I delivered several public speeches, participated in a range of external speaking engagements domestically and abroad, and held frequent and regular meetings with firms, industry bodies, and fellow central bankers and regulators. As Executive Director of FSSR, I will look to continue and enhance this engagement. Speeches are just one tool of public communication; I intend to do at least two a year (and more frequently if needed), while also participating in citizen panels and agency visits, alongside a range of industry engagement fora to promote the understanding of our work. I plan to use different forms of communications to improve public and financial firms' understanding of the FPC's role and decisions. For example, through not only regular publications such as the Financial Stability Report, but also social media posts, videos, and podcasts.

7. **How would you characterise the current relationship between monetary and financial stability policy, and the roles of the FPC and MPC?**

Monetary and financial stability policy are complementary. Price stability supports the FPC's objective of protecting and enhancing UK financial stability. And a more stable financial system makes the job of monetary policy easier.

The Bank's FPC and Monetary Policy Committee (MPC) are separate committees, each with their own objectives. The FPC's remit is clear that the FPC should continue to have regard to the MPC's actions, and thereby ensure coordination between monetary and macroprudential policy. Similarly, the MPC remit makes clear that the MPC should have regard to the policy actions of the FPC.

Given the above, it is important that the MPC and FPC have clear lines of communication so that they can understand the complementary nature of their actions and of their judgments. To support this, the MPC and FPC have overlapping membership, including with the Governor chairing both committees, and the FPC and MPC hold joint meetings on topics of mutual interest. The MPC and FPC are also part of the same institution – the Bank of England – and that ensures consistency and information sharing, subject to meeting each Committee's own primary objectives. This means that in practice, each policy committee can focus on their own respective remit, with the best available knowledge, and in doing so, allow the other Committee to have a clear focus on their objectives.

I think the relationship between the two committees is very effective, which is particularly important at this current juncture.

There are always topics that both Committees need to share information on. For example, over 2023 the FPC has produced extensive analysis of interest rate risk as the MPC has increased interest rates. For example, in March 2023, the FPC briefed the MPC about global banking sector developments and on its judgement that the UK banking system maintained robust capital and liquidity positions and was well placed to continue supporting the economy in a wide range of economic scenarios, including in a period of higher interest rates. Monetary policy transmission channels are relevant to both monetary and financial stability. The MPC briefs the FPC on developments in the macro-economic environment, drawing on its extensive forecasting of growth and inflation, and on monetary policy, such as on decisions associated with the design of the Quantitative Tightening programme.

As I mentioned above, we are currently experiencing a transition to a new era, characterised by higher interest rates in pursuit of the MPC's monetary stability objective, by increased digitalisation and fast-evolving technology, and by climate change, all against a markedly different geo-political backdrop. This means strong interaction and information sharing between the Committees will be particularly essential over the coming years. The Bank of England is well set up to consider the different aspects of these structural changes holistically and in a coordinated way.

Regulatory and policy issues

8. What is your assessment of the risks to financial stability arising from both higher inflation and higher interest rates?

Price stability supports the FPC's objective of protecting and enhancing UK financial stability.

As interest rates rise, both borrower and lender resilience can be adversely affected by higher debt-servicing costs. If highly indebted households and businesses cut back sharply on consumption, investment, or labour to make debt repayments, it could amplify macroeconomic downturns, and in turn impact the resilience of borrowers, and financial stability. And if highly indebted households and businesses get into difficulties repaying their debt, and then default, that could in turn lead to losses for lenders, test lender resilience, and also potentially impact financial stability.

However, in aggregate, households and corporates have so far, on the whole, been resilient to the effect of higher interest rates. Aggregate household debt is the lowest in 20 years, and while arrears have picked up slightly, they remain at low levels. This is not to say it is not challenging for many households. Household debt burdens are expected to rise over 2024 but remain lower than during the global financial crisis. For corporates, debt levels are similarly at 20-year lows, and while some firms are finding the higher rate environment difficult (e.g. SMEs, higher leverage firms, those in commercial real estate or

other sectors particularly exposed to the macroeconomic environment), UK corporates' ability to service their debts has improved due to strong earnings growth.

For the banking sector, profits have risen as rates have risen, although net interest margins appear to have now peaked. Asset quality is deteriorating slightly, but this is after a long period of stability at low levels of arrears, and in many cases, defaults have remained at or below pre-covid levels. Moreover, forward-looking indicators remain stable, and arrears are expected to remain below GFC peaks. It is important to note that it will take time for the impact of higher interest rates to feed through to households and businesses and therefore to the banking system. There are also a wide range of business models amongst smaller and medium-sized UK banks, and in a more challenging environment these business models may be impacted by different risks in different ways.

However, the UK banking system is well capitalised with high levels of liquidity, reflecting the work mentioned earlier (see question 5) to build resilience in the sector and develop its capital regime over the past decade. Given all this, our stress tests have shown that the banking sector has the capacity to support households and businesses even if economic and financial conditions were to be worse than expected.

Turning to the non-bank sector, there are a number of vulnerabilities which leave it more exposed to higher interest rates, especially if there is a deterioration in the economic outlook and a repricing of credit risk (see question 10 on private equity in particular).

9. **What is your assessment of the state of the global financial stability regime? Where would you particularly like to see international agreement?**

For an open economy with a very large financial sector, like the UK, the global financial stability regime is very important. Robust international standards help ensure we reduce the risk of spill-overs from the exposure of the UK financial system to developments abroad. Agreement and implementation of those international standards is a vital part of ensuring global and domestic financial stability. I have witnessed first-hand the importance of international convergence in these standards.

Global actions to increase the resilience of the banking sector have been particularly important. However, there are still lessons to be learnt from recent bank failures. This includes: the importance of robust regulation for managing interest rate risk; the potential for digital banking and social media to increase the speed and scale of deposit withdrawals, and the need for credible resolution frameworks and plans. The Basel Committee recently published preliminary lessons learnt for supervision and regulation. Meanwhile, the FSB has also published lessons learnt, and is undertaking two analytical deep dives in response to the March 2023 banking sector stress (due in 2024). One report is focused on understanding asset-liability mismatches and the intersection of interest rate and liquidity risks in the financial system. This is particularly relevant given the changing interest rate environment and the removal of extraordinary balance sheet measures such as Quantitative Easing. The other considers depositor behaviour, deposit stickiness, the speed of deposit runs, particularly given developments of technology and social media.

With the shift in financing from the bank to the non-bank sector, and the various stress events we have seen in the NBFI sector over the last few years (e.g. dash for cash, failure of Archegos, stress in commodities markets following Russia's invasion of Ukraine, stress in government bond markets following LDI and SVB), it is urgent to continue to move forward with the international work to enhance the resilience of NBFIs. The international nature of NBFIs means that vulnerabilities can only be addressed effectively through globally co-ordinated policy action. Absent such co-ordinated action, different or uneven regulatory approaches risk leading to cross-border spill-overs, regulatory arbitrage, and market fragmentation. That is why in my past roles I have put such emphasis and effort into effective engagement with international counterparts.

The FSB has a broad and expansive NBFI agenda covering a number of areas and it is important that we work via the FSB on this agenda so there is timely completion and implementation. That includes NBFI leverage, where the FSB will need to develop key policy proposals in 2024 to close data gaps, enhance monitoring and transparency, and contain the build-up of leverage. In addition, it is very important that we work together on areas such as money-market funds to address the structural vulnerabilities and 'run risks' associated with those funds. The UK authorities have developed proposals to increase resilience in the sector. But given the global nature of such funds, this work must be done in tandem with global regulators.

The global financial stability regime also needs to be alert to emerging risks and structural changes. This includes the implications of the changing interest rate environment and the withdrawal of quantitative easing, increased digitalisation and fast-evolving technology, and climate change. There is also a need to progress international work on cyber. These changes will be global in nature so regulatory responses must also be global. Therefore, it is vital that we work together to understand financial stability implications, understand what regulators can and should do, and take swift action where needed.

10. What is your assessment of the risks to financial stability from non-bank financial intermediaries?

Since the global financial crisis, market-based finance has grown significantly. Between the start of the GFC and the end of 2020, the non-bank financial sector had more than doubled in size. And NBFIs now account for around half of UK and global financial sector assets. This has reduced the reliance of many UK businesses on banks and diversified their sources of finance and other financial services. Indeed, more than half of the funding to UK corporates is now provided by the non-bank sector instead of the banking sector. In addition, non-banks play an important role in systemic financial markets, e.g. the gilt market. It is therefore vital that MBF is resilient enough not to cause financial instability. That means absorbing, and not amplifying, shocks.

Assessing and identifying risks in MBF is challenging because the non-bank sector is global, highly interconnected, complex, and there are also material gaps in the data about it.

There are a number of vulnerabilities in MBF that could pose risks to UK financial stability. These include deficiencies in managing maturity and liquidity mismatch, excessive leverage, contingent risk; procyclicality and insufficient preparedness to meet margin calls in times of stress; and weaknesses in operational processes and risk management impacting the capacity of markets to intermediate in stress. We have seen a number of these vulnerabilities crystallise in the non-bank sector in recent years. For example, the dash for cash in 2020, the failure of Archegos in 2021, and the LDI stress in 2022.

MBF vulnerabilities is something I will be particularly focused on as Executive Director of FSSR. One area in the non-bank sector which warrants particular focus is private markets such as Private Equity ('PE') and Private Credit. PE has grown significantly over the last decade. This sector is an important source of funding for corporates, while at the same time serving as an important source of revenue and credit risk for banks. Indeed, banks lend to both companies owned by private equity funds, as well as funds themselves. A decade of low interest rates has seen this sector grow significantly, as companies have had access to cheap funding, and investors sought returns in a search for yield. However, PE-held companies and PE fund managers are now starting to face higher funding costs and finding it more challenging to raise liquidity, while at the same time generating demand for financing from banks. So far, the majority of that demand – and risk – is playing out outside the UK. Some systemic banks have exposures to highly indebted corporates – including some major UK banks – however, the 2022/23 ACS stress test captured risks to major UK banks from highly leveraged corporates. But as I have seen from my time as a bank supervisor, firms have often struggled to avoid large counterparty concentrations. And in the case of exposure to private equity, aggregating direct and indirect exposures is difficult. Crystallisation of risks in private markets in other regions could also spill over to UK institutions.

As set out in question 9, given these risks and vulnerabilities, there continues to be a need to increase resilience in MBF globally, and that we act domestically and internationally where effective and appropriate. The recently published consultation by the FCA on their proposals to enhance the resilience of Money Market Funds based in the UK is a welcome step forward to reducing the vulnerabilities in that sector. In 2023, the FPC also set out its approach to assessing risks in MBF, and in the latest Financial Stability Report, it published an overview of progress on building resilience against key vulnerabilities in MBF.

11. What is your assessment of the risks to financial stability arising from climate change? What role can and should macroprudential policy play in promoting the transition to net zero carbon emissions?

*Climate change could pose financial stability risks via **'physical risks'** and **'transition risks'**. There is significant uncertainty in the magnitude of the financial risks and how rapidly material risks could emerge. However, the Bank's scenario exercise showed us that risks are higher in a world with climate change than in a world without, that these risks will build over time, and that they will be higher if the transition is delayed or disorderly.*

'Transition risks' include a sudden change in climate policy, which could, for example, result in stranded assets in high carbon industries, and a significant repricing in capital

markets. There could also be a rush for green investments, creating asset bubbles or greenwashing, which ultimately could result in sudden price corrections. Very sharp changes in asset prices can have large implications for financial stability, through the reduction in resilience of the holders of those assets.

The energy transition may drive higher demand for batteries, solar panels, turbines, and other machines to produce clean energy – these machines use industrial commodities, including precious and rare earth metals, in significant amounts. So the transition could see commodities markets become much more volatile. This will be important for financial firms with commodities franchises, who provide commodity hedges to corporate clients, and for whom margining is an important risk mitigant. Often, corporate counterparties are not set up to manage the margin flows which come from higher volatility, and in benign times they have often been allowed to operate with very small initial margin requirements. Indeed, banks have often yielded to commercial pressures and let such clients think that activities like hedging are cheaper than they truly are economically.

'Physical risks' (e.g., from severe weather events) could result in the destruction of physical property. The disruption to economic activity can also result in businesses reducing production, disruption to supply chains, or loss of efficiency. In turn this can affect employment, firms' ability to pay back credit to banks and the cost and availability of insurance coverage.

Another concern is that climate change could make other shocks, that are not related to climate, worse. This happens if climate change gradually erodes the resilience of the financial system as the economy and financial system changes, and effective risk management may not reflect that changed world. Moreover, as an open economy and host to a large international financial centre, the UK economy and financial system are of course exposed to shocks from abroad.

Given potential financial stability risks arising from climate change, it is important that the FPC appropriately considers those, so it can act to protect and enhance the stability of the UK financial system. Going forward, testing the resilience of the financial system to climate risks will be important to better understand potential risks arising from climate change – moving from scenario analysis of where risks might arise to stress testing of how bad things might be.

And I also want to reiterate, as the Bank has said before, that it is for Government, through policy, and households and corporates through their choices, to drive the transition. The Bank's role is to protect and enhance the resilience of the financial system under different climate outcomes.

12. What is your assessment of the balance of risks to financial stability and opportunities for innovation and growth arising from digital assets and currencies, and from the possible development of central bank digital currencies in the UK and globally?

In my view, innovation and growth in digital assets and currencies can act to lower risks if appropriately designed. This is because, if they are appropriately regulated, new forms of digital money (such as stablecoins) may diversify the provision of payment services and

reduce single points of failure or rely on more resilient technology. Similarly, a central bank digital currency could reinforce the role of central bank money and promote innovation, choice, and efficiency in domestic payments.

However, it is important to remember that the only way for this innovation to work in the long term is for it to be implemented in a sustainable way, which takes financial stability considerations into account. This underlines the importance of the Bank's recently-published discussion paper on a framework for a regulatory regime for systemic payment systems using stablecoins and related service providers, which will look to address the risks and support sustainable innovation.

Digital assets and currencies can affect financial stability through a number of channels such as via the payments system (the financial plumbing), through their impacts on systemic financial institutions or core financial markets, and via real economy balance sheets.

Given limited interconnectedness with the traditional financial system, and low adoption in the real economy, cryptoassets and stablecoins do not currently pose systemic risks to financial stability. However, if this ecosystem continues to grow and becomes more interconnected, associated financial stability risks could rise. For example, without adequate regulation, a stablecoin used for real-economy payments at systemic scale could put at risk confidence in money and payments more generally. Large and disorderly outflows to a stablecoin from the banking sector could also pose financial stability.

Therefore, it is important for policymakers to set out the regulatory requirements so innovators can plan ahead and so that innovation can be adopted safely. As the ecosystem evolves, it is important that these risks are addressed by appropriate financial regulation to maintain broad trust and integrity in the financial system, while supporting sustainable innovation. As mentioned above, the Bank recently published its proposals for a new regulatory regime for stablecoins. The FSB recommendations on cryptoassets and markets and the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions guidance on how the Principles for Financial Market Infrastructures apply to systemically important stablecoins are also important steps forward.

It is also too early to take the decision on whether to introduce a central bank digital currency. That decision will take account of developments in money and payments and be based on the Bank and the UK governments findings as they investigate further the operational features and technology needed for delivery.

13. What is your assessment of the risks to financial stability arising from the UK mortgage market?

So far, the mortgage market has been resilient to rising interest rates. This partly reflects the role of the FPC's housing tools which helped to limit the build-up of unsustainable indebtedness. However, the overall risk environment is challenging, with mortgagors' finances stretched by increased living costs and the impact of higher interest rates (which

is yet to fully come through). There is also considerable uncertainty about the outlook for growth and interest rates, so risks remain, and it is important that we remain vigilant.

As the majority of new mortgages are at fixed interest rates, the impact of higher interest rates has not yet passed through to all borrowers: around 55% of mortgages (around five million) have repriced since late 2021, with around 4.7 million more mortgages expected to reprice by 2026. This means that debt servicing costs are likely to continue to increase (but remain below GFC peaks). Moreover, the number of households most likely to face difficulties meeting their debt repayments (households with mortgage cost-of-living-adjusted debt-servicing ratios over 70%) is also expected to increase but remain significantly below levels seen before the GFC.

However, house prices have also risen by around a quarter since the Covid pandemic, giving households (and the banking sector) some buffers in terms of the build-up of equity.

Turning to the impact of this on the banking sector, overall, mortgage arrears (owner-occupied and buy-to-let) have risen but remain low in a historical context, and are expected to remain below their GFC peaks.

There are also a number of factors that should limit the impact of higher interest rates on defaults and therefore limit the impact on financial stability. This includes previous FPC recommendations on loan-to-income limits and affordability testing, current FCA affordability tests, and stricter conduct standards. In addition, most lenders have signed up to the government's Mortgage Charter and have robust capital and profitability which mean UK banks are both able and expected to offer forbearance and support to borrowers to limit the impact of the increase in repayments. When we have stress-tested the banking system, we have found that it is resilient to the current outlook and has the capacity to support households and businesses even if economic and financial conditions were to be substantially worse than expected.

14. Can you provide an example of where you have disagreed with the consensus view of the Financial Policy Committee?

In fact, most of my previous roles have been geared towards providing challenge – externally as well as internally within the Bank. And I join the FPC with that mindset.

In terms of challenging the private sector this has been a key part of my latest role as Executive Director of ARTIS. My speeches, public letters and supervisory interactions have focused on identifying and 'calling out' the areas in which I thought the banking sector failed to learn lessons from the past. For example, on counterparty risk management, on liquidity risks associated with repo matched books, or the risk that changes in firms' portfolios have undermined their ability to profit when markets are volatile. Further back in time, challenging banks was an important part of my involvement in the management of the Global Financial Crisis.

Internally within the Bank, as interim Chief Financial Officer part of my role was to challenge the rest of the executive within the organisation on matters such as strategic

planning and budgeting. Previously, building and leading the (then) new independent second line of defence risk function for the Bank of England's balance sheet meant that a core part of my job was to challenge colleagues.

As I join the FPC, it is important to note that I very much support the Committee's agenda and the direction of its work. However, the nature of risks we look at is such that it is near impossible to identify all risks before they crystalise. It is also inevitable that our judgment will lead us to focus on different things, and there will always be areas of risk that we need to look at more. Financial stability risks arising from private equity and private credit are one such area (see question 10). The FPC recently published a box in its latest Financial Stability Report about the risks from private credit. It showed that leveraged loan, private credit and high yield bond default rates remain below GFC peaks. However, it noted that default rates may increase in the current environment, and this could affect credit risk valuations, resulting in leveraged companies struggling to refinance especially if investor risk appetite declines. My experience as a micro-prudential regulator gives me greater concerns here, and this is an area I would like us to have even more focus on, particularly given the changing interest rates environment

With my experience in mind, I will also look to ensure the FPC appropriately connects developments in the micro-environment with those in the macro-environment. I have found that, fundamentally, the safety and soundness of a firm relies significantly – and principally, in fact – on the competence and integrity of its leaders and their ability to instil a healthy risk culture throughout their organisation. This is as relevant in the non-bank sector as it is in core banking sector (as set out in question 5 and 15).

15. Apart from the issues highlighted above, would you highlight any other risks to financial stability in the UK and globally?

One risk I would highlight concerns developments in artificial intelligence (AI) and machine learning (ML), and how the financial system adopts them. The adoption of AI and ML is becoming more widespread. This can bring significant benefits, driving greater operational efficiency in the financial service sector, while also improving risk management, and providing new products and services. But it could also result in new or increased risks.

Banks and insurers and micro-prudential regulators have their part to play in the oversight and control of potential risks. But the picture is changing rapidly, and it is not clear that sectoral regulation is keeping pace or is appropriately calibrated to consider the complexity of the challenge. Moreover, the wider adoption of AI and ML could conceivably also pose system-wide financial stability risks, for example by amplifying herding or broader procyclical behaviours, or increasing cyber risk and interconnectedness. Therefore, it is essential that there is further consideration of the financial stability impacts of AI and ML, and this is something the FPC will consider in 2024.

Separately and more structurally, perhaps related to comments above on risk culture, it is important that, given the significant extraordinary interventions necessary in recent years, moral hazard does not become entrenched, given expectations among some that central banks will do 'whatever it takes' in times of stress. This will not be the case in all scenarios

and could result in at least some mispricing in asset markets, in the form of insufficient margin requirements or haircuts in repo and derivatives markets related to fixed income or commodities asset classes.

I also want to reiterate what I have said throughout about the need to focus on the implications of a number of structural changes which are affecting the economy and the financial system during this period of transition. This may play out in unforeseen ways. The work of the FPC is vital in enabling that transition to be smooth and in building financial system resilience to future shocks.

Please provide a full CV when returning this questionnaire. The Treasury Committee will publish your answers to this questionnaire alongside your CV. All documents should be provided in Word and PDF. Please provide these documents by [13th December 2023].