Questions for Dame Clara Furse DBE, from House of Commons Treasury Committee

Personal/General

1. Do you have any business or financial connections or other commitments, which might give rise to a conflict of interest in carrying out your duties as a member of the FPC?

My other commitments are as a non-executive director of Amadeus IT Holding, DWP, Nomura Holdings and Vodafone Group Plc. The Bank's policy for managing perceptions of potential conflicts of interest is set out in the FPC code of conduct.[1]

2. Why have you decided to stay on for a further term? What have you learned from your experience of being on the FPC so far? Do you plan to approach your work differently during your further term?

The FPC endeavours to secure the UK's financial stability and thereby, its prospects for future sustainable growth. A further term will allow me to continue to support this important work. My experience on the FPC so far has shown that there is value in having a committee with a range of backgrounds and skills dedicated to assessing rapidly changing risks and building national resilience. This is particularly relevant as we are the world's most open major developed economy and we need to have the confidence to engage actively in global markets.
I do not anticipate that my approach to the work will change markedly in the second term. However I hope to spend more time listening to businesses and financial firms in order to understand how we affect their operations and strategy.

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

That is my current intention.

4. In what areas in particular do you hope to focus your work on the FPC in the next period of tenure? What is your main priority for research in your further term?

I have had and will continue to have a particular interest in the evolution of financial risks in the post crisis environment. The committee has spent much of its time in the last 3 years on post crisis repair and housing market risks. I expect these to remain high on our agenda but I will also continue to urge that we develop a deeper understanding of changes to capital markets and structure in line with our commitment to the resilience of market based finance. This was the subject of my second speech a year ago and it is clear that capital markets have become more fragile still.[2] The Bank is currently undertaking research into the reasons behind the sharp falls in market liquidity and the contraction of repo markets, for example. My most recent speech also expresses some concern about a reversal in financial deepening and integration, an issue that has implications for both our primary and our secondary objective; the former because resilience is greater when deep, liquid markets exist to dampen

[1] www.bankofengland.co.uk/financialstability/Documents/fpccoc.pdf
[2] www.bankofengland.co.uk/publications/Documents/speeches/2015/speech796.pdf

the impact of shocks; and the latter because we also support the government's economic policy, which includes maintaining the City of London's role as a leading international financial centre.[3] Finally, I think we should look at the changing nature of LTI risks in the housing market in a context where there appears to have been a major, longer term, global downwards shift in the 'natural' rate of interest, as recently posited in a Bank research paper[4] and a speech by my Bank colleague Jan Vlieghe.[5]

Financial stability and the Financial Policy Committee

5. What do you regard as the main challenges facing the FPC over your next period as an FPC member?

As the point of financial stability is a stable economy that is able to grow, I believe a main challenge will relate to the fragility of market based finance and the ability of our capital markets not only to fill the funding gap left by more resilient, more risk averse banks, but to provide finance to the economy well beyond the FTSE 250 (where this seems to be working reasonably well) to the wider economy.

Another challenge will relate to the apparent shift in the housing market from owner/occupier to rental. Alongside much lower transaction levels (and 'liquidity') in the housing market, this will also have implications for the risk profile of the market as a whole and the way in which consumption and economic activity generally could be affected.

Finally, although credit production and availability have been increasing recently, corporate gearing is at the lowest levels since 1988 and corporate investment remains very subdued. This implies that the rapid shift to a now very resilient financial system at the core may have had higher transitional costs than anticipated.

Having come close to the end of the post crisis repair phase, I expect we will need to be more sensitive to the complementarity of our primary and secondary objectives.

6. Which do you think are currently the most significant risks to financial stability facing the UK? Which is the most significant?

In addition to the points made in answer to the previous question, I believe the most significant immediate risk to financial stability is the sharp reduction in the intermediation services provided to the economy through capital markets. As explained in my speech a year ago, an economy with a highly resilient (and risk averse) banking sector requires market based financial services structures and providers to channel finance to it reliably and at a price that is likely to provide a return on capital invested. Large companies have benefitted from lower interest rates and a flatter yield curve, but 'tomorrow's companies' are finding it far more difficult to access finance for growth.

7. What have been the FPC's greatest successes so far, and where is there still work to be done?

I believe the FPC has done a good job of communicating actual and potential risks in a way that will undoubtedly have raised risk management focus and skills generally, thereby reducing risk appetite at a time of various increasing external risks.

[3] www.bankofengland.co.uk/publications/Documents/speeches/2016/speech883.pdf
[4] www.bankofengland.co.uk/research/Documents/workingpapers/2015/swp571.pdf
[5] www.bankofengland.co.uk/publications/Documents/speeches/2016/speech872.pdf

The greatly increased attention to cyber risk and the take up of CBEST by most of the 35 core UK financial firms are an example of this. The timely and sharp reduction of risk weighted assets in certain sovereign and commodity markets is another. Low transaction levels in the mortgage market for owner occupiers may also reflect, in part, the concerns expressed by the committee about the potential risks associated with high levels of household indebtedness (another indicator that remains flat following the significant post crises fall).

8. Has the FPC operated free of all political interference?

I have seen nothing that indicates any attempt at interference. I find the observations of the Treasury member of the committee very relevant and valuable.

9. Has the FPC operated free of business interference?

Yes. Other than through the good work done by the Bank's regional agents and through personal regional visits, we have no input from business of which I am aware. With regard to financial firms, we have consulted on a number of our policy proposals, and are currently doing so on the SRB.

10. Have you received the support from the Bank that you need to fulfil your role?

Yes, the secretariat provides me with very good support.

11. Are there any changes that the Bank could make to support external members of the FPC better?

It is easy to ask for additional support and I get it.

12. How well do you think the public understands the work of the FPC, and do you think it is improving? How important do you think it is that they do? You have given two public speeches in your role, what contribution to the work of the FPC do you think these speeches can make?

I believe we have a long way to go, but it has definitely improved. Given the impact we seem to have on something as vital to most people as their access to a mortgage, I believe it is very important that the public knows what we do and why. I hope the three speeches I have made have raised awareness on areas of risk that receive relatively little attention and require a better understanding.

13. How do you think financial firms regard the FPC? How well do you think the FPC communicates with, and understands the concerns of, financial firms?

I believe we have made a major effort to provide greater clarity to financial firms on our approach to financial stability risks (for example, in December in relation to the capital framework), but I think we need to do a great deal more to understand some aspects of financial services and markets, and certainly the concerns of those firms not at the 'core' of the banking sector, such as asset managers, insurance companies and investment firms.
In general I think it would be very useful to us to engage more actively with the business community. The Open Forum we held in November was an important success.

14. How well are the FPC's financial stability indicators integrated in the work of the FPC? Are there more indicators that would be of use to the FPC? How do you personally think about financial stability?

Very well. We need to continue to evolve the indicators and our interpretation of them as markets change. A recent speech by my FPC colleague, Jon Cunliffe, was a good example of how we might test the way we think about the Credit to GDP gap.[6]
I personally think about financial stability in terms of the value it provides to businesses who need to access finance in order to grow and what that implies for our future economic resilience and potential, At a granular level, it means that I am particularly interested not just in the availability of credit, but the terms of credit, the cost of debt and equity finance and the difference between them, i.e. the real economy effects of our actions.

15. How well do you think the power of recommendation has worked so far?

The statutory FPC has made 14 recommendations (as well as one direction) so far:

- Four recommendations on housing.
- Two recommendations on cyber risk
- Two recommendations (plus one direction) on leverage
- Two recommendations on disclosure
- One recommendation on each of: the standardised approach to credit risk; bank liquidity coverage ratios; interest rate benchmark contingency planning; and risks from a snapback in interest rates.

Action continues to implement our recommendations on cyber risk and the leverage ratio. The other recommendations have all been implemented.
I am satisfied that the relevant UK authorities have taken action to implement our recommendations promptly and effectively –I would say that this evidences the power of the FPC's recommendations.

16. Do you think industry responses to the FPC's recommendations have been sufficient and adequate so far?

Most of our recommendations have been to UK regulators rather than directly to industry. But many of them have led to action by industry – for example, most core UK firms are now taking part in CBEST testing (which is not mandatory).

Two recommendations were made specifically to industry:

- The recommendation on applying a 3% interest rate stress to new mortgages was made directly to mortgage lenders, who were required to have regard to it by FCA rules

[6] www.bankofengland.co.uk/publications/Documents/speeches/2016/speech880.pdf

- The interim FPC made a recommendation in 2012 to UK banks that they 'work to assess, manage and mitigate specific risks to their balance sheets stemming from current and future potential stress in the euro area'. This recommendation was reaffirmed by the statutory FPC. In June 2014 we judged that the banks had successfully implemented it, given that banks had reduced both their gross and net exposures to vulnerable euro-area countries.

17. Do you feel the FPC has sufficient tools within its power to carry out its objectives effectively?

Yes.

18. Do you agree with the conclusions and recommendations of the Warsh review as far as they concern the FPC?

Yes. The FPC needs to have the freedom to explore in open and robust discussion any ideas that seek to establish the nature of risk, particularly those tail risks that might unsettle and disturb economic activity if they were the subject of public interest and media speculation.

19. How easy has it been to maintain consensus on the FPC? How far have you had to compromise to achieve consensus? Has there been any decision on which you personally have come close to breaking the consensus?

I would not characterise it as easy and I would suggest that we might worry if it were. Like some of my colleagues I have had to consider my position on a number of issues.
I would have found it very difficult to support a move to increase the CCyB in December, as I did not believe the increase in the rate of credit growth was sufficiently broadly based or robust enough to suggest an upswing, particularly in light of the continued weakness in SME loans and signs of increasing fragility in financial markets.

20. Do you think that acting by consensus will be effective in the long run? What risks do you see with the consensus model?

Yes, I hope it will continue to be possible as clarity, predictability and confidence are fundamental to stability.
The risk with the consensus model is that the diversity of experience and approach, and the ideas and challenge promised by independent participation, are drowned out by what tends to be the 'house' view in any organisation with a hierarchy and strong culture. This is not a comment on the Bank, but on organisational psychology generally. In my experience the risk of the executives dominating the decision making process can be mitigated by a skilful chairman. The FPC has such a Chairman.