

Questions for Richard Sharp

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?

I am chief executive of DII Capital Advisors, a FCA regulated firm. I have an interest in RoundShield Capital, a private capital company, and SW7, a regulated investment management company. These business interests are all declared to the Committee and published on the Bank's website. All my personal investments are reported to the Bank and under the Bank's code I seek approval for any individual transactions. The compliance officer of DII systematically communicates with the Secretary of the Bank of England to identify and address any investment activity which could give rise to a conflict and to ensure that appropriate disclosure and conflict management takes place. I have found that these processes are practical in permitting me to make an effective contribution in fulfilling my duties as an external member of the FPC. I am a Director of International Rescue which receives grants from time to time from DFID. I am a Director of the Centre for Policy Studies which from time to time publishes policy documents on financial matters.

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?

It has been a challenging three years on the FPC and I have found it to be a steep learning curve. I have had to develop expertise with respect to the intricacies and issues concerning the effective assessment of the Capital Framework for the banking industry. Moreover, I have had to learn how to work within the norms of a Central Bank and how to make an effective contribution to the development of macroprudential policy. I believe that having had over 30 years of experience of Finance, I have made an effective contribution. I believe in public service, and as I believe I can continue to make a significant contribution over the next three years, I have agreed to serve a second term. I don't expect to approach my work very differently over the next three years. However, I do expect to make more speeches in my second term as I am now more comfortable being able to communicate FPC matters without risking breaching the requirements to respect the consensus.

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

Yes.

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?

There is still work to do by regulators and firms to implement by 2019 the effective resolution regime that has been established in the UK. I find the pace of change frustrating. But I recognise that banks have had to have time to rebuild capital; and it is also true that it is unavoidable that global banks can only be resolved by the implementation of a globally coordinated process which takes time to negotiate. However sclerotic the pace of progress in this area has been, I certainly hope that successful progress in this area is made in my second term.

It will be interesting to see how the debate started by Kashkari plays out in the United States and how we react should policy makers in the United States regard the break-up of big banks as the only way to protect taxpayers. It is worth noting the concern particularly given that their banking system represents around 90% of US GDP whilst our banking

system represents around 390% of our GDP.¹ I hope to bring objective and informed consideration to the intersection of the requirement for effective regulatory oversight, the need for London to be a successful centre of international finance, and the need to protect the interests of taxpayers and customers of the banking industry.

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?

The FPC faces an operational challenge owing to its size. It is being enlarged, subject to the Bank of England Bill being passed, and will comprise 6 members from the Bank of England - the Governor, 4 deputy Governors and the Executive Director for Financial Stability; in addition there is the FCA Chief Executive (who himself will be a former Deputy Governor) and a non-voting member from HMT, and there will be 5 external members. The challenge for the FPC, even more so after enlargement, is to ensure that the overlapping responsibilities, which are so effective in ensuring coordination, do not inhibit the independent exercise of its function and its ability to isolate its financial stability responsibility. In my three years, I have been satisfied that we have retained our separate identity. However I believe that, given the extraordinary burden placed on the committee by it having had to address the banking system, we will need to remain disciplined in order to ensure that we retain enough bandwidth to remain alert to tail risk events and to fulfil our responsibility to assess other aspects relevant to our mandate.

For example, I would hope we can spend more time in the next three years assessing the requirement for effective regulation in the insurance sector and that we separately are able to examine in depth the need for more liquidity in the UK capital markets.

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

The FPC was created as a response to the failure of the prior regulatory regime with respect to micro and macro regulation. This included the manifest failure to have identified the risks to the financial system and the failure to have assessed properly the fragility of systemically important institutions and markets. There is no doubt in my mind that the financial system is now more resilient and that systemically important institutions have responded constructively to the requirement to improve their capital structures and to improve risk management. However, the global macro environment is extremely challenging and represents a major medium term threat. Leverage has increased since the crash. According to some external estimates, global debt increased over recent years to around 290% of global GDP in 2014. UK non-financial sector gross debt stands at around 245% of GDP, and within this, UK general government gross debt is around 110% of GDP. Fragility in the Euro market and the emerging markets will be exposed if we enter a period of global stagnation. In addition to its heightened debt position, the UK has an unresolved balance of payments deficit and remains exposed to the deflationary spillover effects of shocks arising in other jurisdictions, e.g. Greece, Brazil or China, should they take place.

Fortunately the banking system is not likely to act as an amplifier in quite the way it did in 2008, but there will undoubtedly be other exposures which could arise which would undermine stability should global deflation exist and persist. Moreover traded liquidity has declined and therefore the capital markets are less able to act as shock absorbers in the event of there being a need for significant liquidity. I happily support the broad assessment of risk laid out in the most recent FSR.

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

¹ Sources: Bank of International Settlements, Bureau of Economic Analysis, Office for National Statistics and Bank calculations.

The FPC has successfully established its independent position within the architecture of the Bank of England as a whole, and specifically with respect to its relationship with the PRA and the MPC, and the FCA. We have balanced the need to prioritise financial stability in the context of our secondary objective. On a more granular level, we have implemented successful actions with respect to the housing market and bank risk management (eg the structuring of stress testing which has been effective and prescient). I certainly hope work on Bank Resolution (TBTF) is completed and implemented, and that we are able to turn more of our time to broader issues – e.g. to the insurance sector or any further threats to financial stability which could arise from a persistent zero / negative rate bound.

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

Obviously we have our secondary objective to support the Government's economic policy, however as far as I am aware we have operated free from any political interference.

9. Has the FPC operated free of business interference?

I've been surprised that there has been no business lobbying of the FPC. It may be that such dialogue takes place between the PRA members of the FPC and the industry but I am unaware of any such dialogue interfering with the FPC's deliberations.

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

I have analytical support from the Bank and the Executive supporting the FPC has satisfied me of its commitment to support me as an external member.

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

No.

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'm pretty sure the broader "public" has no idea what the FPC does or is. I do believe that the professional and business community has a growing understanding of the role of the FPC. My speeches have indeed endeavoured to help illuminate to external parties the role of the FPC - I understand from feedback that they were well received; however I believe that as far as the broader "public" is concerned, the Bank of England is the dominant entity which is understood to be accountable for financial stability and that this will remain the case however many speeches etc FPC members make. This does not trouble me, as our accountability to Parliament and the scrutiny we receive from the industry and the financial press satisfies me that we are now being progressively understood by those who need to understand where we sit in the regulatory architecture.

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 that the FPC is well regarded by financial firms. I believe they appreciate the actions we have taken and, particularly in the context of addressing the deficiencies causing and exposed by the financial crisis, they accept our strictures. Whether this will persist I don't know, but I believe that our comments and publications are well received and that our actions are considered appropriate and warranted. The main point of contact for financial firms is obviously the PRA, hence the focus of any specific dissatisfaction would tend to be

focussed there. By contrast the FPC, seen to be more distant and operating on a system-wide basis, is, in any event, less likely to be a lightning rod for any financial community displeasure. I expect that it is the PRA which would be the focus of any concern rather than the FPC.

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?

Of course we examine the FPC's indicators all the time. They are useful in drawing to our attention specific areas of concern and also changes which might be harbingers of concern. When we assess specific matters we inevitably draw on other more detailed statistics, for example in examining buy to let we assess the scale and rate of change of that sector in detail. Hence the overall picture we receive from the indicators suffices because when we need to, we are able to broaden and refine our analysis as we see fit. I draw on other external sources of information which deliver to all of us global financial information at the speed of light. I separate in my own mind market volatility (no matter how unwelcome) from fundamental sources of instability (e.g. housing bubble) or resilience threatening shocks (e.g. a significant euro area default.)

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

The power of recommendation has worked well. Owing to its structure the FPC is extremely well coordinated with the PRA, the FCA and HMT. The broader financial community seems to accept the importance of FPC's recommendations.

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

Yes. The microprudential regulators are our conduit to the industry. I am unaware from our interactions with them that there has been any failure to respond appropriately to recommendations.

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

Yes. Moreover where we have felt the need to acquire more powers we have worked with HMT to secure such powers, for example the evolution of our powers of direction over buy to let indicate a constructive approach to increasing the FPC's tool suite where necessary.

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 be a forum where the consensus can be fearlessly challenged. We need to be able to balance very difficult conflicting issues in the context of uncertainty, e.g. in seeking to assess the nature of asset bubbles or the probability of tail events. In my judgement the consequence of complete transparency will make "group think" more likely and make robust discussion less likely - the consensus is always the safer place to be. Moreover, the appearance of splits or divisions within the FPC can risk providing ammunition to those who may not wish to implement the FPC's policies or recommendations. The Record has now become somewhat more detailed in response to the thought that the FPC should reveal more, as we set out in the Record of the March 2015 meeting. Given an individual member does retain the right to record any disagreement, I believe we have arrived at an appropriately balanced position.

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 have been on a number of Boards as member and as Chairman. In my judgement the FPC under its current structure and Chairmanship is extraordinarily effective. The Chairman provides space for comment and the positions of external members are considered and fully addressed. I worry that with the enlargement the Committee will be a slightly more difficult forum to provide effective discussion. Following enlargement I think it would be a mistake to allow it to grow any further. We generally have a series of pre-briefings concerning the structure of the agenda and in addition concerning agenda items. Accordingly before the meeting takes place differing judgments can be assessed and developed. I have found that the Executive Director for financial stability has been extremely effective in managing such "pre discussion" effectively and objectively. I have compromised to reach consensus, and on such matters I have been content to do so; we are dealing with matters of judgement and uncertainty and not matters of black or white. I have not come close to breaking consensus but would be prepared to do so should that prove to be necessary.

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

I do worry that the obvious value of the need for consensus and the presence on the committee of so many "insiders" may mean that always seeking to act by consensus creates an inherent risk. Moreover the important position of the Governor as Chair of MPC, PRA and FPC means that there is a "concentration of power". However, having now observed the obvious merit of a properly coordinated Monetary Policy and Macro Prudential Policy on the one hand and the importance of full coordination between the Macro and Micro Prudential Regulators on the other hand, I believe such a structure of coordinated Chairmanship is extremely valuable - we should not forget that it was precisely the failure of the prior Tri- Partite regime which was a contributory factor to the crash. I take comfort from the oversight of the working of the FPC by the Court and it is also vital that the FPC is answerable to Parliament. All governance structures can be made to work or can be open to manipulation so it's hard to predict that this structure will certainly work in the long run. Obviously a critical and innovative component of the governance is to incorporate external members in the process, and I think we presently have a constructive mix of external members with strengths in different areas. However, given the overarching importance of the financial stability mandate of the FPC, we should not be complacent that what is working effectively now should be an immutable arrangement.