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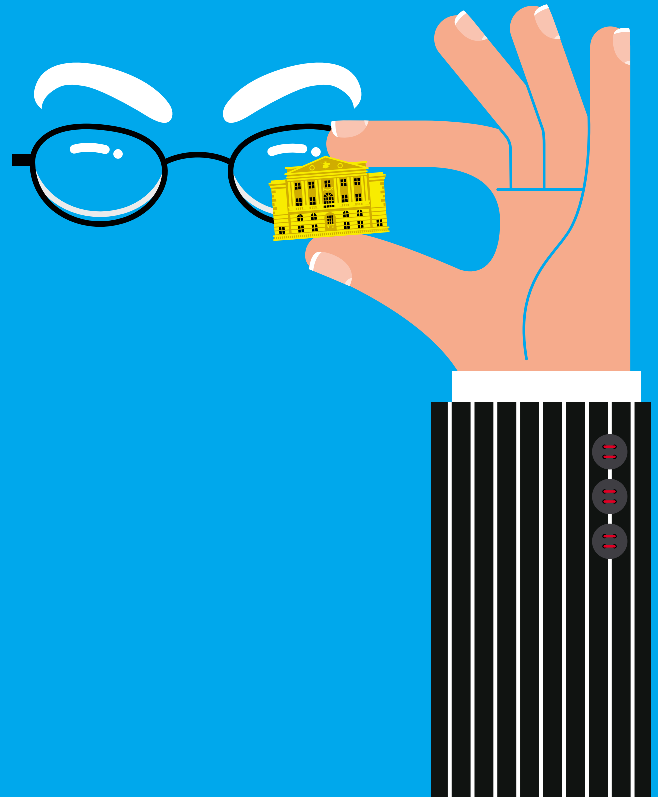
THE COURT OF KING MERVYN

Under modernising governor Sir Mervyn King, the Bank of England has emerged as the big winner of the financial crisis and one of the world's most powerful central banks. King's intellectual rigour has won plaudits but did his dominating leadership style and struggle to adapt contribute as much to the turmoil as to its resolution? *Chris Giles* reports. Illustrations by *James Joyce*



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Mervyn King was confident as he celebrated the 10th anniversary of Bank of England independence at the Royal Bank of Scotland five years ago. That evening, the only disappointment was that Sir Fred Goodwin, RBS chief executive, was unable to host the governor at dinner. He was busy working on the deal to take over ABN Amro that would later sink his bank. No one present thought this could be a harbinger of doom. The economy was sound, the governor believed the risk to financial stability "appeared to be low" and lauded BoE independence as "the dramatic constitutional change" that convinced financial markets that Britain would run a stable economy. Life at the BoE and RBS was sweet.

Five years on, the government has stripped the knighthood from Sir Fred, his institution has collapsed and is majority-owned by taxpayers. Britain's economic stability has similarly hit the rocks. But after the worst recession since the 1920s, the highest rates of inflation among big economies and a level of financial instability thought impossible in a modern economy, the BoE has emerged as the big winner of the crisis. Legislation to make it one of the most powerful central banks in the advanced world is passing through parliament. And its governor received not just a knighthood in 2011, but the highest form of that award, the Knight Grand Cross (GBE).

Nobody would say the Bank of England is solely responsible for the global financial and economic crisis, but neither can it absolve itself after the event. How can so many of its intellectually powerful figures have misdiagnosed Britain's economy so badly? How can the country feel secure it will not happen again once the organisation receives sweeping new powers next year? And did Sir Mervyn's personal style – dominating the BoE –contribute to the crisis?

Answers to these questions must start with the institutional setting surrounding the BoE after it gained independence in 1997. A new Financial Services Authority (FSA) would regulate banks, insurance companies and other financial institutions. The Treasury would act as back-stop in case of crisis. And the BoE would be in charge of the big picture, adjusting interest rates to control the ups and downs of inflation and warning whether risks were building in the financial system as a whole. Only the BoE could have influence over system-wide financial stability, since the FSA did not regulate foreign banks and the BoE's job was to scan the wider economy.

But within weeks of Sir Mervyn becoming governor in 2003, staff became aware the new governor had big plans to remould the BoE in his own academic image. Already shorn of banking supervision and government debt management in the post-1997 changes, Sir Mervyn wanted to create a modern monetary authority concentrating on monthly decisions on interest rates. Although one of the BoE's two core purposes was "to ensure financial stability", it seems he neither enjoyed nor fully understood the influence the BoE still had in calming financial excess by use of its powerful voice. Work in the financial stability division did not excite him and he told colleagues to "operationalise" it, by which he meant simply writing and publishing two financial stability reports every year. Sir Mervyn demonstrated the low status he attached to such reports by not presenting them himself, unlike the inflation report, which he nurtured and presented as chief economist (1991-1998), deputy governor (1998-2003) and governor (2003 onwards).

Staff found presenting financial stability issues in front of the new governor frightening because of his apparent disdain for their work. One current official remembers a talk on the Spanish banking system. "How is that relevant?" Sir Mervyn asked. Staff learned the only answer was to find a reason why such matters should concern the monthly decision on interest rates. Former colleagues say that Sir Mervyn found it difficult intellectually to grapple with the influence the BoE had when things were not written down with formal targets and powers, so he preferred to assume markets were likely to be efficient and crises would not occur.

In the Financial Stability Committee, the most important pre-crisis internal decision-making body, which reviewed risks to financial stability and discussed policy responses, things were worse. Unlike Sir Edward George, his predecessor, the new governor rarely attended the monthly meetings. "Since the governor was never present, it became a talking shop," says Mario Blejer, who headed the BoE's internal university, the Centre for Central Banking Studies, between 2003 and 2008. One former economist, whose current financial sector employers are so nervous about the BoE they refused to let him be quoted on the record, says: "I went to two meetings. Mervyn turned up to the first one and fell asleep. It hardly made me think I needed to worry about that." The financial stability committee was soon a "running joke" in monetary analysis, the division of the BoE geared around setting interest rates every month. The signal sent by these events could not have been clearer. "Before the crisis, working in financial stability was an absolute career graveyard," says Richard Barwell, UK economist at RBS who left the BoE in 2010 after nine years.

How could Sir Mervyn impose his view on the BoE that financial stability mattered primarily just for monetary policy and the

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boring task of bi-annual report writing?

"It is a monarchy and always has been – sometimes constitutional, other times autocratic," says Sir John Gieve, who was deputy governor for financial stability at the time of the crisis between 2006 and 2009. Jens Larsen, who rose to become a head of division before he left in 2010, says, "If the governor has the inclination, he can decide anything."

Within the BoE hierarchy, the staff dance to the governor's tune. "My overriding feeling was how old-fashioned and hierarchical the Bank was," says Kate Barker, an external member between 2001 and 2010 of the Monetary Policy Committee (MPC), the nine-strong body that meets monthly to set interest rates. Deputy governors, such as Sir John Gieve, Rachel Lomax or Sir Andrew Large, had little say and were not authorised to commit the BoE to policies even in their areas of responsibility if the governor thought the matter important. In such a structure, current and former staff say decisions were delayed and things slipped.

In the BoE, the governor and deputy governors' palatial offices are located behind locked doors in "Parlours", where senior staff are attended by "pinks", doormen dressed in pink tail-coats with silver buttons and top hats. Everyone calls Sir Mervyn "Mr Governor". It is so quiet there, you can hear the old-fashioned clocks tick. The doors are closed. "There is no sense of collegiate decision-making," says Alistair Darling, former chancellor.

Institutionally, the BoE had few defences against a governor determined to focus his attention on monetary analysis. But the Old Lady of Threadneedle Street was also unlucky. It was far from alone in failing to foresee the crash: pre-2007, politicians from all political parties were complaining about too much burdensome regulation in finance. BoE independence appeared such a masterstroke that even traditionally cautious organisations, such as the FT, declared the first 10 years a "resounding success".

Governor's day takes place in July at the sumptuous Bank of England sports centre in Roehampton, south-west London. It is a fun day, open to all staff and their families. On the edge of the cricket pitch in 2010, for example, families flew around a dodgems track under a red-and-yellow-striped canvas roof and enjoyed a barbecue after another hard year of central banking. Sir Mervyn's slow left-arm spin rarely troubles the better batsmen these days.

The atmosphere is inclusive – far removed from the days of Sir Edward, when only the senior staff were allowed inside the marquee and the riff-raff, one former staff member recalls, stayed outside without food. The day reveals the monarch of the BoE at his best and worst. Sir Mervyn has brought the event into the 21st century, but his less admirable personality traits are also on display. "He fusses... about who has turned up, who will win the toss, all the little stuff," says another former employee.

The changes to governor's day are a microcosm of the wider BoE under Sir Mervyn, which he has modernised and now runs according to his own views.

Sir Mervyn joined the BoE as chief economist in 1991 from

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the London School of Economics, intending to stay at most for two years. His big break came with the sterling crisis of 1992, when the pound was forced out of the European exchange rate mechanism. Britain needed a new economic framework and Sir Mervyn was on hand to offer the Treasury inflation targeting. It was the new fashion that sought to use interest rates to keep inflation at a specific level rather than seeking to control it through pegging sterling to other currencies or seeking, 1980s-style, to control the amount of money in circulation.

Once Lord Lamont, then chancellor, accepted Sir Mervyn's advice, the centre of gravity in British economic policy-making began to shift. The Treasury traditionally looked down on BoE staff's intellectual heft, but by 1997 Sir Mervyn had transformed economic thinking and made the Bank academically superior.

"He showed very strong leadership in his stewardship of monetary analysis, the inflation report, the professionalisation of BoE economists and the single-minded focus on the inflation target," says Danny Gabay, who was a staff member at the time. "He got people out of their tank tops and sandals."

"By the late 1990s," Peter Westaway, a former head of division who left in 2009, adds, "Mervyn had turned the Bank into an intellectual and policy powerhouse. Intellectual rigour was a really good discipline and meant you could never get lazy".

Born into a modest background in 1948, the son of a railway worker and a mother who sang in the church choir of his school in Wolverhampton, Mervyn Allister King, now 64, rose rapidly up the academic economics ladder with teaching spells in Cambridge, Birmingham, Harvard and the Massachusetts Institute of Technology before he became professor of economics at the London School of Economics in 1984. At the heart of his ascent was an academic economist's mindset, taking issues back to first principles and deducing policy responses from those foundations.

The rigour also applies to his daily routine. Lambasted for being lazy in the tabloids when he dares to visit Wimbledon or the cricket a couple of days a year, colleagues say there are few more dedicated public servants, almost none with his force of intellect and intolerance of alternative views.

Intensely private and hardly a socialite, Sir Mervyn is a lover of classical music, regularly strolling from the BoE to the Barbican to hear the London Symphony Orchestra. He married Barbara Melander, a Finnish interior designer, in the summer of 2007. They had met in the 1970s but only began a relationship after Melander split from her husband in 1996. The couple divide their time between Notting Hill and a converted oast house in Kent.

Sir Mervyn has always wanted to be in control. Had he not been an academic or central banker, he told a US radio interviewer in 2004, he would like to have been a conductor. The opportunity "to lead a team, just to get a team of people playing for you" attracted him. It is this same desire to drive and conduct the BoE's monetary policy analysis that ensured the team played to his tune. The most common memory of former staff members is the lengths to which they would go to ensure Sir Mervyn would approve of the presentations they had to give to the MPC.

Staff who had not been sufficiently careful were regularly

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subject to abrasive public criticism. Richard Barwell remembers being "slapped down once or twice... so the basic incentives align people to tell him what he wants to hear". Others say he was an "intellectual bully" in meetings, with one senior official recalling: "I remember watching someone present say something known not to be the governor's view and it was like watching a career go down the plughole. That doesn't mean Mervyn never changes his mind, but he doesn't appreciate open challenge."

Acolytes are promoted and now dominate the top echelons of management. Those who cross the governor rarely see their careers advance. Gabriel Sterne, an economist who left the BoE for the private sector after 20 years, says, "Those that made it to head of division were not from a breed of challengers."

As Sir Mervyn's power and influence has increased, his detachment from most employees at the BoE has grown to such an extent that he now cuts an aloof figure in Threadneedle Street, only occasionally going on "royal visits" to visit far-flung divisions around the Bank, usually on a Friday afternoon. When he became governor he refused to go to meetings in the morning, preferring to use the time to think and, as Treasury officials rather pejoratively put it, compose essays on various topics. Though Sir Mervyn's dislike of bankers has attracted many plaudits, as the crisis hit, the lack of any personal relationship with the heads of banks placed a strain on efforts to find solutions.

For those Monetary Policy Committee members not beholden to the governor or the BoE for their career, the challenge of sparring with someone so intellectually powerful is exhilarating. Stephen Nickell, a former MPC member who is now at the Office▶

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Peter Westaway, a former head of division at the Bank of England

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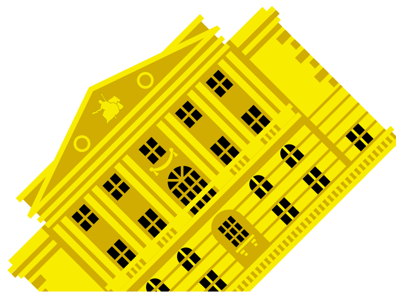
Mervyn King, governor of the Bank of England, August 8 2007 (pictured right)



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for Budget Responsibility describes Sir Mervyn as "quite open". His view is shared by Charlie Bean, the current deputy governor for monetary policy, who says Sir Mervyn is a man "who can argue his views very strongly... [but] he's open to persuasion, if you provide good arguments and evidence".

For this article, the FT was not able to muster sufficiently persuasive arguments for the governor to provide an interview, despite repeated requests first made almost a year ago.

When the thrust of this article was communicated to the BoE this week, the governor's spokesman disputed the concerns raised. The BoE provided five quotes from external members of the MPC and the Financial Policy Committee who corroborated the comments from Nickell and Bean. Among them, David Miles of the MPC said: "The governor chairs the [MPC] meetings but does not dominate them." Michael Cohrs, an external FPC member, said he was impressed by the quality of debate and the way the meetings were chaired. "I have seen little evidence of the much talked about 'group think' at the FPC," he added.

"I really don't think that this is an institution which, if you like, quashes dissent," says Bean.

The vast majority of the 21 current and former officials interviewed for this article neither recognise Bean's characterisation of an open organisation with open discussion nor that of a tyrant, shouting and banging his fist. Instead they paint a picture of a Bank honed to deliver to the governor what he wants. "As a member of staff, there is no incentive to rock the boat," says Barwell. "It is implicit, you knew what the governor wanted and you said what he wanted to hear – it happens in all institutions, but it matters more in a central bank."

Most staff do not relish overt challenge and so it rarely happens. "If you go to work in a central bank you're not the sort of person who is going to say, 'f*** it, I'm going to do something crazy today,'" one official says.

Sitting behind the desk in the steeply raked lecture theatre of the BoE on August 8 2007, Paul Tucker, then head of markets and now deputy governor for financial stability, was a worried man, he later told friends. He was on the panel of BoE executives at the quarterly inflation report press conference and Sir Mervyn was rehearsing his views on economic stability in his usual professorial tone. "The best contribution that central banks can make to ensuring the lack of disruption in international financial markets is to pursue domestic monetary stability in a predictable and sensible way," the governor said.

The first fissures in the financial crisis had rumbled the previous day, but the governor was unconcerned. When questioned about high levels of credit and complexity in financial systems, he insisted everyone should remember "a very, very key point, which is that our banking system is much more resilient than in the past". Although Sir Mervyn did raise the possibility that the tremors might be the start of something worse, Tucker subsequently told friends he thought the governor's complacency on the day was unwise.

The next day credit markets seized up and Sir Mervyn's intellectual framework began to unravel. Stable inflation was clearly no longer a sufficient condition for economic stability, but the BoE was paralysed by the new reality.

Sir John Gieve recalls: "The Bank reacted very slowly and reluctantly in summer and autumn 2007 and we were lucky the outcome wasn't worse."

Significant dissent in the BoE became evident for the first time, with most of the financial stability wing and the deputy governors calling on the governor to follow the US Federal Reserve and European Central Bank in lending banks large sums for longer than usual and against a wider range of assets without charging a penalty interest rate. The BoE's rule book allowed such procedures in an emergency, but Sir Mervyn stood firm, believing such action would encourage risky behaviour in future.

Staff were wary of contradicting the official line. Blejer said that at the Centre for Central Banking Studies, "people [who foresaw the dangers] said things on courses they would not have dared to say in senior staff meetings". The atmosphere inside the BoE soured. The Bank was intellectually unprepared and appears to have done little contingency planning.

The monetary policy side of the Bank continued as if nothing had happened. On Thursday September 13, the day before the run on Northern Rock started, the BoE embarked on a two-day conference – the event is now deleted from the BoE's website – entitled "On the sources of macroeconomic stability". Senior staff were rushing about as the Northern Rock crisis built during the day and, even as queues formed outside the bank's branches on Friday, the conference concluded that good monetary policy was the most likely source of stability and luck had played a minor role.

Such was the turmoil inside the Bank later that autumn that elements of the dispute over whether to extend liquidity to the banking system were taken to the BoE's governing body, the court of directors. But with Sir Mervyn setting the agenda, it did not get to hear the real differences in opinion. The independent chairman of court, Sir John Parker, got a verbal presentation from the governor, which said everything was "tickety-boo" according to one member present, and the court accepted it. Two others present say there was "not a serious discussion" and court members saw their role as backing the governor even when others were trying to raise concerns. "Court was largely out of the loop," says Sir John. The BoE has refused to publish court minutes from the period.

Sir Callum McCarthy, then head of the FSA, and Alistair Darling, then chancellor, barely hid their frustration with the BoE and its governor. "We used to get these notes – essays is a good word – arguing his case from first principles. It was not much use in a crisis," says a senior Treasury official.

Darling was particularly alarmed that the dissent within the BoE was not recognised by Sir Mervyn. "Even if I said, 'none of your staff agree with you', he'd say 'but I'm the governor'. That is why you need institutionalised checks and balances," says Darling.

Some of the MPC felt information was being withheld. Barker says: "As external members we just weren't told enough in the

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early stages, and Mervyn King seemed to take an over-academic approach to what was a market-driven event".

There is a remarkable consensus from close observers of the period. Sir Mervyn was unable to take decisions, got flustered, lost control and was not a man for a crisis. Former colleagues say that if things fail to go according to plan, even little things such as travel arrangements or the cricket team on governor's day, he struggles to adapt.

This criticism about the early days of the crisis is partially accepted at the top of the BoE. When interviewed for this article, Bean told the FT: "I think it's fair to say that in the early stages of the financial crisis most of us expected this to be a relatively short-lived seize-up in the financial markets; it would be over by Christmas, if you like. Whereas it was only gradually, over time, that we appreciated the full severity of what was occurring".

The turning point came in December 2007, when the BoE could disguise a U-turn on the back of internationally coordinated action, largely brokered by Tucker. That calmed nerves. And once the Bank had introduced the special liquidity scheme in April 2008, it is almost universally acknowledged that the BoE and Sir Mervyn played a constructive role, sometimes a leading role, in the remainder of the crisis. He was early to spot the capital deficiencies in Britain's banks, and the BoE, unlike the FSA, had a plan for a mass recapitalisation ready once the Lehman Brothers collapse brought the UK banking system to its knees in September 2008.

But trust between the BoE, Treasury and FSA was still limited, with the relationships described by a senior participant as "bloody awful". Sir Mervyn has recognised the strains, but blames others. "Relationships within the tripartite were perfectly successful and operated extremely well until it became clear that Northern Rock generated significant political damage to the government. At that point, people wanted to deflect blame and to try to create a different climate of opinion," he told a parliamentary committee in March. As for lessons learnt, the Treasury and FSA have held internal inquiries, but the BoE has refused. Under Sir Mervyn, the BoE stands firm in insisting it has learnt the necessary lessons – mostly that it lacked tools for efficient bank bankruptcies – and no further navel-gazing is required.

Back in the BoE's lecture theatre on May 12 2010, Sir Mervyn was presenting another quarterly inflation report. David Cameron had become prime minister the previous evening, after striking a deal between his Conservatives and the Liberal Democrats. Sir Mervyn had just come off the phone with George Osborne, the new chancellor.

A happier governor proceeded to nail his reputation to that of the new government's fiscal austerity, saying, "I am very pleased that there is a very clear and binding commitment to accelerate the reduction in the deficit over the lifetime of the parliament." These words caused consternation on the fiercely independent MPC, where at least two members, Adam Posen and Kate Barker, believed the governor had crossed the line of political impartiality. "Excessively political" was Posen's verdict later that year.

But switching sides so adeptly has brought huge rewards to the BoE. As he was praising the coming spending cuts, Sir Mervyn also knew the new government would make good on the Conservatives' pre-election promise to enlarge the BoE and give it unprecedented powers over the financial system.

A Financial Policy Committee (currently operating as an interim body modelled on the MPC) would seek to spot unsustainable rises in credit that threatened the financial system. In addition to voicing concern – influence the BoE always had but did not use effectively – the FPC would be able to force banks to maintain larger buffers in case of an impending crisis. The BoE is also set to win back the supervision of banks and gain the regulation of insurance companies for the first time in a new subsidiary called the Prudential Regulatory Authority (PRA). Bank staff view the move as a takeover of the interesting bits of the FSA. Once flush with its new powers – scheduled for March 1 next year – the BoE will become mightier still. In summary, Sir Mervyn will be chief executive of the enlarged BoE, he will chair the MPC, FPC and PRA board and he will also chair a clutch of international central banking bodies in Switzerland. But this governor will not have long to rule over his new mega central bank. His term ends in June 2013.

Close colleagues of Sir Mervyn recognise that the enlarged realm over which the new governor will have sway requires a new management style. "It's a big job," says Bean, who is not seeking to be a candidate. "It is important that whoever does it is able to delegate."

Former deputy governors insist that delegation alone is not sufficient to create more effective decision-making. "Unless there is a job description for the governor which leaves room for well defined roles for the three deputies, the governor's job will be unmanageable and the deputy governors may end up being pretty frustrated," says Rachel Lomax, deputy governor between 2003 and 2008. "The deputies need clear external accountabilities too. The Treasury and the Select Committee should expect to hear from the deputies as well as the governor, and if there are differences of view, they should be aired, even though the governor will normally have the last word."

So far the legislation is disappointing former staff and parliamentarians, who remain concerned there are insufficient checks on a governor's absolute power – an area of systemic weakness in the past crisis and the main fault line in the reforms.

Ed Balls, shadow chancellor, explains that in the new system, "it can't be the old BoE where every decision is made under, or in, the name of the governor". Reform of the court of directors is seen as vital. Darling says: "Unless you reconstitute Court so criticism is seen as a good thing, it will remain a [medieval] court."

Aides to George Osborne play down fears that the BoE will become an over-mighty citizen. The chancellor's team notes that most of the BoE's decisions will be taken through bodies with significant external challenge – the MPC and FPC. A further safeguard gives the chancellor power to direct the BoE when public money is at stake, something Darling sorely lacked in 2007.

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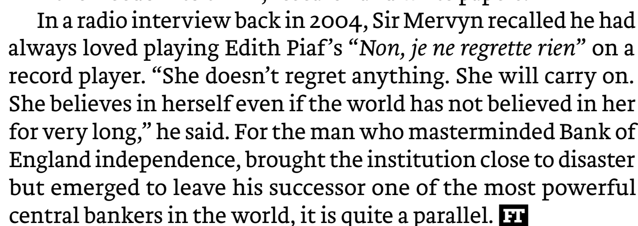
But few outside the government and BoE believe these new controls are sufficient. There is no plan for an institutionalised challenge process in the BoE; no part of the legislation weakens the power of the governor – indeed the next governor will serve one eight-year term, rather than renewable terms, so will have more autonomy not less. Many of the BoE's policy decisions, such as operations to provide funding for banks, will still be made outside policy committees.

For four months next year, once the BoE has new power, Sir Mervyn will be able to sit in Parlours, overlooking the BoE's courtyard, listening to the clocks tick and contemplating his career and a retirement he hopes will last at least 25 years. Five years ago, he praised his predecessor for not interfering with the BoE once he had left; Sir Mervyn is expected to follow suit, but he is unlikely to retire quietly. Most bets are on an academic position, giving him the freedom to think, research and write papers.



In a radio interview back in 2004, Sir Mervyn recalled he had always loved playing Edith Piaf's "*Non, je ne regrette rien*" on a record player. "She doesn't regret anything. She will carry on. She believes in herself even if the world has not believed in her for very long," he said. For the man who masterminded Bank of England independence, brought the institution close to disaster but emerged to leave his successor one of the most powerful central bankers in the world, it is quite a parallel. FT

Chris Giles is the FT's economics editor. To comment on this article, please email magazineletters@ft.com

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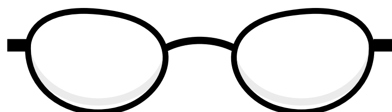


"Even if I said, 'none of your staff agree with you', he'd say, 'but I'm the governor'. That is why you need institutionalised checks and balances"

NEXT IN LINE

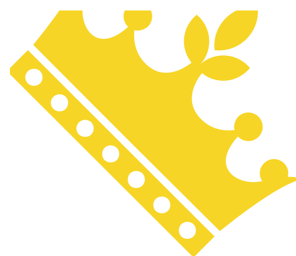
Such is the importance of the Bank of England governor that Paddy Power, the bookmakers, is taking bets on its next head. Paul Tucker, deputy governor for financial stability, and Lord Turner, chairman of the FSA are favourites.

As legislation stands, the new all-powerful governor will be expected to be an economic expert on monetary policy, have deep knowledge and a host of contacts, and know the intricate details of UK banks' balance sheets. "Only a super-human need apply," says Ed Balls, shadow chancellor.

His serious point, backed by the former chancellor and former deputies, is that no one has such skills. The three areas of responsibility therefore need to be headed by a deputy governor, with the governor acting in more of a chairman's capacity – able to challenge but not in charge.

Unless the legislation is changed along these lines, the bookies are right to install Tucker and Lord Turner as favourites. Lord O'Donnell, former cabinet secretary, Mark Carney, governor of the Bank of Canada and Sir John Vickers, who chaired the Independent Commission on Banking, would also make any shortlist.

If the government is seeking a governor in name only, whose real job is as chairman of a board of executive and non-executive directors, the field is wide open. But such a change would need to be defined in legislation.



Alistair Darling, former chancellor of the exchequer

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