Questions for House of Commons Treasury Committee Hearing
Andrew Haldane

Personal/General

Q1. 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?

No.

Q2. Do you intend to work for the full term for which you have been appointed?

Yes.

Q3. Which of your publications and papers are of most relevance to your work on the FPC?

Since becoming Executive Director for Financial Stability in 2009, I have published almost 30 speeches, and written a similar number of published paper or articles, most of which are relevant to the work of the FPC. To highlight a selection of them:

Haldane, A. (2009), *"Why Banks Failed the Stress Test"*, speech delivered at the Marcus-Evans conference on Risk Management.

Haldane, A. (2009), *"Rethinking the financial network'*, speech delivered at the Financial Student Association, Amsterdam.

Haldane, A (2009), "*Credit is Trust*", speech delivered at the Association of Corporate Treasurers, Leeds.

Alessandri, P. and Haldane, A. (2009), *"Banking on the State"*, presented at the Federal Reserve Bank of Chicago/World Bank event, 'International Financial Crisis: have the Rules of Finance Changed?'

Haldane, A (2010), *"The $100 billion Question"*, speech delivered at Institute of Regulation & Risk, Hong Kong.

Haldane, A. (2010), *"The Contribution of the Financial Sector: Miracle or Mirage"*, chapter in 'The Future of Finance: The LSE Report'.

Haldane, A. and May, R. (2011), *"Systemic risk in banking ecosystems"*, *Nature*, issue 469, 351-355.

Aikman, D., Haldane, A. and Nelson, B. (2011), *"Curbing the Credit Cycle"*, presented at the Columbia University Center on Capitalism and Society Annual Conference, Microfoundations for Macroeconomics, New York.

Haldane, A (2011), *"Capital Discipline"*, speech delivered at the American Economic Association, Denver.

Haldane, A (2011), *"Risk Off"*, delivered on Agency Visit to Scotland.

Gai, P., Haldane, A. and Kapadia, S. (2011), "*Complexity, Concentration and Contagion"*, Journal of Monetary Economics, 58 (5).

Haldane, A. (2011), *"Control rights and wrongs"*, Wincott Annual Memorial Lecture, Westminster, London

Haldane, A. (2012), *"Financial Arms Races"*, speech delivered at the Institute for New Economic Thinking, Berlin.

Haldane, A. (2012), *"The Doom Loop"*, London Review of Books.

Haldane, A. and Madouros V. (2012), *"The Dog and the Frisbee"*, presented at the Federal Reserve Bank of Kansas City's 36th economic policy symposium 'The Changing Policy Landscape', Jackson Hole, Wyoming.

Haldane, A. (2012), *"A leaf being turned"*, speech delivered at Occupy Economics: 'Socially Useful Banking', at Friend's House, Euston.

Haldane, A. (2012), *"On being the right size"*, speech delivered at the Institute of Economic Affairs' 22nd Annual Series, The 2012 Beesley Lectures.

Haldane, A. (2012), *"In favour of macro-prudential regulation"*, published in Risk Magazine.

Haldane, A. (2013), *"Constraining discretion in bank regulation"*, presented at the Federal Reserve Bank of Atlanta Conference on 'Maintaining Financial Stability: Holding a Tiger by the Tail(s)', Atlanta, Georgia.

Aikman, D., Haldane, A. G., Kapadia, S. (2013), *"Operationalising a macroprudential regime: goals, tools and open issues"*, 24th Financial Stability Journal of the Bank of Spain.

Earlier in my Bank career, I worked on a selection of issues which are relevant to my role on the FPC. This includes the design of the UK's inflation-targeting framework, the design of market infrastructure and the resolution of international financial crises. I have written fairly extensively, including publishing books, in each of these subject areas.

Financial Stability

Q4. What are your greatest concerns regarding financial stability in the UK? What can be done to resolve these problems?

In the current environment, my top five concerns about UK financial stability would be:

a. Operational/cyber risk: The focus on credit, market and liquidity risk over the past 5 years may have distracted attention from operational, and in particular cyber risks, among financial institutions and infrastructures. This is a rapidly rising area of risk with potentially systemic implications. It calls for a system-wide response.

b. Too-big-to-fail: This is one of the biggest faultlines in the international financial system. Despite strenuous efforts, it remains essentially unsolved. More ambitious efforts, including further reducing leverage among the world's largest banks, may be necessary.

c. Search for yield: Low levels of interest rates have set forth a renewed search for yield in global financial markets. At present, this appears to be neither generalised nor leveraged, but bears careful watching and (if necessary) macro-prudential action to restrain risk-taking.

d. Low global real interest rates: With global real interest rates in uncharted territory, and expected to remain there for a protracted period, financial stability risks are posed both to institutions whose returns may be depressed for a lengthy period and to broader financial markets should low yields snap back suddenly. Stress-testing for these scenarios, and seeking insurance against them, will be key.

e. Non-bank intermediation: Future long-term financing of the economy will rely to a greater extent than in the past on non-bank sources of financing, including institutional investors such as pension funds and insurance companies. Ensuring the necessary market infrastructure and regulatory environment is in place to support these non-bank financing channels will be key to creating a diverse, vibrant and more resilient UK financial sector, able to support the wider economy.

Financial Policy Committee

Q5. What do you regard as the main challenges facing the FPC over your further tenure as FPC member?

a. Perhaps the greatest challenge likely to face the FPC over the next few years will be to operate a macro-prudential regime in an extremely challenging financial environment, at the same time as trying to build this regime. We are playing the role of architect, surveyor and builder all at the same time. There will inevitably be huge amounts of learning by doing and evolution in both the FPC's practices and the macro-prudential framework itself. This is unavoidable, but will at times be uncomfortable.

b. A second challenging area will be getting straight the relatives roles and responsibilities of the FPC, the PRA and the MPC. By design, the objectives and instruments of the FPC overlap with the MPC and PRA. Housing all three committees under one roof will help in ensuring information flow and, where necessary, coordination of actions. Indeed, it already has. But it will only be through experience that any potential tensions will be ironed out.

c. A third challenging area will be communications. The FPC needs to be immaculate in its communications if it is not itself to be a source of uncertainty. There is a difficult balance to strike here between the need for transparency around the FPC's deliberations on the one hand, and the need to avoid disclosures which could be counter-productive to financial stability on the other. As a matter of principle, I favour an approach of ultra-transparency, except in those instances where systemic stability would be seriously put at risk.

d. A fourth, related, challenge will be to build understanding of the actions and framework of the FPC, both among financial market participants and among the wider public. This will be as important to the reputation and standing of the FPC as it has been for the MPC. And the FPC, and macro-prudential policy generally, starts from a much lower base of understanding.

e. A final concern and challenge will be to ensure the effectiveness of the FPC, while operating within the regulatory constraints imposed by various EU Directives, in particular CRD IV.

Q6. What do you regard as the strengths and weaknesses of the work undertaken by the interim FPC?

The key strength of the interim FPC is that it established, for the first time ever in the UK, a macro-prudential agency, at arm's length from the political process but with objectives, instruments and accountability mechanisms set in statute. This means that a long-standing faultline in the UK's regulatory infrastructure has been closed.

This regime is not just new for the UK but globally too. Over time, I hope the UK's macro-prudential regime, and the FPC, can serve as a model for macro-prudential regimes internationally, much as did the UK's inflation-targeting regime in the mid-1990s. There is already evidence of this beginning to occur.

At an operational level, the strengths of the FPC to date have been:

a. Narrowing down the set of macro-prudential instruments over which the FPC might have Directive powers, and the set of indicators used by the FPC when taking macro-prudential actions. The FPC has published three papers on these issues, for public consultation. These are key planks of the macro-prudential regime.

b. The “four-pronged” package of measures announced by the Bank, FPC and FSA in the summer of 2012 to support bank funding, lending, liquidity and capital, and thereby the wider economy. These were, respectively, the Extended Collateral Term Repo (ECTR) facility, the Funding for Lending (FLS) scheme, the lowering of UK banks’ liquidity requirements, and the setting of a zero capital charge against lending to support the FLS. These were overtly macro-prudential actions. At least the latter two of these actions would not have been taken had the FPC not existed.

c. The sequence of interim FPC recommendations to improve bank transparency – for example, around Euro-area exposures, leverage ratios, forbearance practices and Pillar 3 disclosures.

d. The FPC’s recommendation to boost UK banks’ capital, as a macro-prudential action to support bank resilience, bank lending and thereby the wider economy.

The weaknesses of the FPC to date would include:

a. The FPC made its first recommendation about UK banks’ capital in 2011. These recommendations lacked specificity about both the source and the scale of the capital shortfall. It was not until the FPC’s November 2012 recommendation that the sources of these capital shortfalls were made clear. And it was not until March 2013 that the scale of aggregate capital shortfalls was identified. With hindsight, that was too long a period of uncertainty. The FPC’s early recommendations lacked clarity and decisiveness.

b. The FPC’s messaging around the “four-pronged” package of measures in 2012 lacked clarity and vigour. This was a decisive and important set of co-ordinated macro-prudential interventions, intended to support the economy in a slump. We should have done a much better job of explaining the significance of this package.

c. The FPC has made a range of attempts to improve wider understanding of the work of the FPC - for example, through engagement with market participants and through visits to the Bank’s regional agencies. But wider and deeper engagement will be needed in future, given the low levels of understanding of the FPC’s role among market participants and, in particular, the general public.

Q7. Has the Interim FPC operated free of all political interference?

Not entirely. The discussion around capital needs for the two part state-owned banks (RBS, LGB) was very difficult to detach from issues around the public purse, for understandable reasons.

Q8. How easy has it been to maintain consensus on the FPC? How far have you had to compromise to achieve consensus?

I have found the deliberations of the FPC full and frank. I have absolutely no sense of punches having been pulled.

All key decisions have so far been reached by consensus. But the process for arriving at these decisions has been as important as the final destination. For example, the FPC’s recent recommendations on bank capital led to a wide-ranging debate on the presumptive scale of capital shortfalls and how best these should be met. Several members of the committee, myself included, believed a greater degree of capital insurance was warranted. These views were reflected in the Record of the meeting. Ultimately, however, what was agreed was seen by everyone as a significant step forward.

In June 2011, I gave a speech making the case for lowering regulatory requirements to support the wider economy. This was discussed at an FPC meeting, but not fully recorded in the published version of the FPC Record. I believe that was a mistake. In the event, the FPC decided to reduce banks’ liquidity requirements in the following June.

Q9. How do you assess the public communications of the FPC so far with regard to financial stability policy and decisions? What challenges remain?

I think the FPC record on communications so far has been mixed. The positives have included:

a. The putting in place of regular press conferences to accompany publication of the six-monthly Financial Stability Report (FSR).

b. A new structure for the FSR, to more closely reflect the discussions, policy actions and priorities of the FPC.

c. A sequence of active attempts by FPC members to engage with external stakeholders, including through meetings with banks, market participants, regional and international visits.

d. A growing media awareness of the work of the FPC.

e. A growing number of speeches by FPC covering macro-prudential issues (more than 35 since the interim FPC commenced).

Clearly, however, there are a number of further areas for improvement, including:

a. Shortening the gap between the FPC's identification of macro-prudential concerns and the execution of plans to address these concerns – for example, capital shortfalls.

b. Building awareness among market participants and the general public of the work of the FPC (see above).

Q10. What is your assessment of the macroprudential tools that will be available to the FPC? Are there additional tools or powers which you think it would be useful for the FPC to have?

I think the Directive tool powers conferred on the FPC are a decent starting point. In particular, I think it was appropriate for the FPC initially to have sought a relatively small set of Directive tools, to help improve the predictability of the regime and to allow time for experience to be built.

That said, I would strongly have preferred the FPC to have been given Directive powers over the leverage ratio, as it requested, with immediate effect rather than in 2018 (subject to review). The Treasury Committee has itself made this case. The leverage ratio is the most robust measure of bank capital adequacy. For the FPC not to have been given Directive powers over this instrument is a significant structural flaw in the current macro-prudential regime.

Over the past 6 months, my views on the potential power of using loan-to-value and/or debt-to-income ratios as a macro-prudential tool have become more positive. That is partly in response to the positive experience of using these tools in other countries. I hope the FPC returns to reconsider their role.

Q11. What is your assessment of the FPC's core indicators? Which ones do you see as being the most important, and are there any additional indicators that you think should be considered?

The FPC's core indicators are a reasonable starting point. They were drawn up by conducting a careful sifting of existing empirical evidence drawn from a wide selection of countries and crises and drawing on the expertise of international experts. The core indicators are a good distillation of the current state of knowledge on measures of systemic stress.

My own preferred indicators from within this set are:

a. Leverage (bank and non-bank), which tends to lie at the heart of every systemic crisis.

b. Maturity mismatch (bank and non-bank), which comes a close second.

c. Credit-to-GDP ratio, which helps make clear that the FPC need to act in a symmetric fashion, loosening regulatory requirements in a bust as often as they are raising them in a boom.

Over time, I would aspire to:

a. a shorter list of indicators with reference ranges.

b. stress-testing becoming a more central feature of the FPC indicator set, as a way of summarising the FPC's judgments on issues such as future capital adequacy and the output implications of different macro-prudential actions.

c. conducting further research on explicit macro-prudential "policy rules", as a means of creating a more transparent and consistent, and less discretionary and unpredictable, macro-prudential regime.

Q12. What is your own initial view of the new FPC remit?

It is a good starting point. I am a strong supporter of:

a. The FPC's secondary objective of supporting the government's objectives, including for output and employment. This gives FPC a "dual" mandate, which is rightful recognition that it has a distinct role as a new arm of macro-economic policy in the UK, helping curb credit booms and cushion busts and thereby moderate fluctuations in the business cycle.

b. Creating symmetry with the MPC's remit around the secondary objective. The new remit makes clear that both FPC and MPC have an (equal) role in moderating macro-economic fluctuations.

c. Close collaboration and, where necessary, coordination between MPC and FPC, including the possibility of joint meetings. In fact, MPC and FPC have already met jointly for a research awayday and will do so again later in the year. We should build on that.

d. Consistency of messaging around FPC decisions, while at the same time making clear when FPC members have differences of view on an appropriate course of action.

The FPC has yet to discuss the new remit.

Longer-term, I think we should aspire to a macro-prudential framework, and accompanying remit, with a somewhat clearer and more quantitative yardstick of success. Personally, I would base this around deviation in credit provision and/or asset prices from their equilibrium paths. This is analytically challenging but, frankly, no more so than in the monetary policy sphere.

Executive Director for Financial Stability

Q13. What have been your key achievements so far as Executive Director for Financial Stability? What challenges have you faced and what lessons have you learned?

The past few years have been quite a challenge from a financial stability perspective. But out of crisis has sprung the opportunity to rethink afresh the functioning of the global financial system and the regulation of it. That has been my key objective in my role as Executive Director.

I believe the Bank, including me personally, have played a material role in the redesign of the global financial system: building the analytical case for change, calibrating the necessary extent of change, building the case for change internationally and then delivering that change domestically. This would include in areas such as:

a. Redesign and recalibration of international standards for capital and liquidity, including through my role on the Basel Committee.

b. Design and calibration of capital surcharges for systemically important institutions.

c. Design of structural measures (such as bank ring-fencing and central counterparties) to improve the robustness of the financial system.

d. Design and calibration of macro-prudential policy instruments, including the counter-cyclical capital buffer.

e. Design and calibration of financial market infrastructures (such as central counterparties, payment and settlement systems) to improve the robustness of the financial system.

f. Identification of the risks posed by high-frequency trading and other trading infrastructures and design of policy mitigants for these risks.

g. Overseeing the Bank's supervision of UK payment systems and, since April 2013, central counterparties and securities settlement systems.

h. Developing proposals for improving the soft infrastructure of the financial system – for example, accounting standards, transactions identifiers etc.

i. Redesign of the international monetary system – for example, IMF facilities and surveillance activities.

My speeches over the past 4 ½ years set out my evolving thinking on these and other issues. In every case, the issues have involved working closely with UK and international colleagues to secure change to international regulatory rules and principles.

For the past two years, I have also been closely involved in the design of the FPC policy framework, both as an FPC member and as Executive Director responsible for delivering the inputs to the FPC. Most of this has involved designing and implementing this framework from scratch.

For almost the whole of my time as Executive Director, intensive monitoring of the UK and global financial system has been necessary due to on-going fragilities.

Q14. What do you intend to achieve as Executive Director? What things might you do differently from now on and how should we measure your success?

Among my objectives in the period ahead would be:

a. Continue to develop the macro-prudential framework, and the role of the FPC, in the UK. We should aim to remain at the frontier of analysis and operations internationally on macro-prudential policy. I would like to see the FPC establish itself as the prime-mover of financial sector "supply-side" reform in the UK – creating a more diverse and innovative financial eco-system, better serving the needs of the economy and customers. And I want the FPC to be regarded as a beacon for other countries setting up macro-prudential policy regimes.

b. To build a broader constituency for macro-prudential policy, and financial stability generally, among a wider set of stakeholders in the UK and internationally.

c. To achieve effective co-ordination between the FPC, PRA and MPC.

d. To put in place an international regime which is capable of solving the too big to fail problem.

e. To put in place a simpler, more robust regulatory framework, better able to meet the needs of regulators, banks and investors.

f. To help put in place effective alternative non-bank mechanisms for financing the wider economy and for improving the functioning of the banking system. Examples might include the creation of a common securitisation platform, a credit registry for SME loans and current account portability.

g. To support Mark Carney and the Bank group in making a success of all elements of the new regulatory framework.

h. To contribute to making the Bank a more conversational, less hierarchical, more diverse, somewhat humbler organisation, as a way of improving its accountability, credibility and the quality of its decision-making.

I am more than happy to have my success judged against these objectives, even if a number of them are not wholly in my gift.

Q15. What is your relationship with other relevant parts of the Bank of England, particularly the PRA? What communication channels exist between your department and the Bank's micro-prudential regulators? Are the current structures and relationships correct?

One of the great benefits of the new regulatory architecture is the increased scope for cross-pollination and co-ordination between the three arms of policy (monetary, macro-prudential and micro-prudential). One of the less-heralded benefits of this new architecture is improved information flow between the different parts of the Bank responsible for these respective policy tools. For example, information flow and joint working between the Bank and FSA/PRA on financial stability issues has improved beyond recognition over the past two years, albeit from a (too) low base. The creation of the interim FPC made a dramatic difference to the extent of this collaboration. The arrival of the PRA appears to providing further momentum. For example, the FPC are provided with briefing from all parts of the Bank; and FPC policy recommendations as typically drawn up jointly by staff from the FS Directorate and the PRA.

The relationship between the PRA and FPC is nonetheless still in its early stages. The risks to this relationship, and to the FPC generally, include:

a. That senior management time, and resources, is squeezed on FPC issues, in part due to the competing demands from MPC and PRA. This crowd-out risk, in respect of macro-prudential issues, was a risk that was realised when the Bank last had supervisory responsibilities. In my view, time and resources have already been squeezed too tight during the period of the interim FPC. The statutory FPC is a chance to put this right.

b. That the FPC, and macro-prudential policy generally, are seen as a challenge, rather than an opportunity, by banking supervisors. The new regulatory system has an in-built tension between micro- and macro-prudential policy and it will be crucial that this doesn't result in defensive, resentful or non-transparent behaviour.

Q16. What are your key concerns regarding international regulation? What still needs to be done, and how much influence does the UK have over these decisions?

These would include:

a. That the problem of too big to fail, even once existing measures are implemented, will remain unresolved. That is the emerging view among regulators internationally. This may necessitate further action – for example, on bank capital or banking structure.

b. That the regulatory framework, taken together, is too complex a patchwork to be effective, as outlined in various of my speeches over the past year.

c. That international regulation finds an appropriate balance when regulating the non-bank financial sector. On the one hand, risk is likely to migrate out of the banking system, which regulators will need to be vigilant to. Yet the greater risk may be that regulators internationally are over-zealous in their regulation of non-bank sources of financing at a time when these sources need to be developed to generate a more diverse financial eco-system.

In my experience, the UK tends to punch at or above its weight in the negotiation of international regulatory policy initiatives. The opposite is, however, sometimes true on European regulatory issues.