Bank of England

Mais Lecture Audience Q&A
18th March 2014

Lucio Sarno, Professor of Finance, Cass Business School: Good evening. I have a very simple role here, which is to co-ordinate the questions and answers, which will last about 20 minutes. And just as reminder - at the end of the Q&A session, please do allow the Governor to leave the room before you move. So please try to make a sign to me and I'll keep the order of the questions as they are coming. This gentleman at the front, if you could just briefly say your name and affiliation, if you wish, and keep the questions as short as possible.

David Stringer-Lamarre, Chairman of Institute of Directors, City of London: I was very pleased when you were talking about international engagement of the financial services being a national asset. My question is - what role do you see for the Bank of England with respect to engaging with the EU and its institutions about regulations that may affect the financial services sector here in the UK?

Mark Carney, Governor: Well, thanks for the question. It's very on point, and actually this is something we've been giving a lot of thought to - how we can be more effective in Europe, both in terms of ideas and in the development of EU regulations that very much affect the system here.

Because there's been a bit of a tendency to concentrate, through Basel and through the international system, and - with an expectation that that would be mapped through Europe and have the same result as is agreed internationally, which, you know, has not always been the case. We've seen significant differences in the capital elements of CRD4, for example, relative to what was agreed at Basel.

And so what we need to, and what we are reinvesting in, is ensuring that we have much more regular and early contacts with our European partners to share ideas, share perspectives, develop ideas jointly. And we're doing a few things to do that, and then I'll give you a couple of examples.

The first thing is that Andrew and I and Jon Cuncliffe see this as fundamental to our responsibilities. I would point out that my first call as Governor was to Mario Draghi, and my first external meeting was with Michel Barnier, as a sense of recognising the importance of that relationship.

We spend a lot of time very engaged with the EBA, the ESRB - I'll be there tomorrow - Thursday, rather, in Frankfurt for the ESRB, and at the ECB General Council tomorrow evening. And so we're making sure that we're connected to the policy makers there, in trying to develop shared approaches.

What we're doing to change - within the institution – is – I referenced very briefly that we're bringing together our international responsibilities, and within that area, we're creating an international strategy unit which will help manage these relationships, both within Europe - at the G7, G20 - and at the BIS. And so that we're more consistent and co-ordinated up and the chain, and we're in there early with ideas and working together.

There are a couple of areas I think where we've seen the product of this effort. Andrew and his colleagues have been very involved in the stress testing process of banks. There iare both the major stress tests that the ECB and a single supervisor is running. There are associated UK stress tests – there is a sharing of perspectives there that I think is working to help.

We were very involved - I'll use this as the last example - in the development of the Recovery Resolution Directive, the RRD, which is an example of using Europe, and working with Europe, to internationalise something which we absolutely have to have for our financial system to continue to be a global good and a national asset, which is effectively a way to end too big to fail.

Now, last point on that, which is that Jon Cunliffe rightly said yesterday, I think, that we haven't yet ended too big to fail. And one of the reasons we haven't yet ended too big to fail is we haven't been able to get that RRD type approach absolutely internationalised across all of the G20 countries. And that's what we're working on today. So that's an example of an idea developed here at the Bank of England, worked through Europe - Europeanised - and now we're working to internationalise.

Thorsten Beck, Cass Business School:

Following up on this previous question and comment on co-operation between regulators across G20 or across the world, you mentioned this is very high on the agenda, this co-operation. But looking at the situation as an outside observer, I can't prevent the impression that there is a stronger focus now on national safeguards as opposed to international co-operation. I mean, if you look at the recent decisions of the US regulators, if you look at the Eurozone, which can't really get together a banking union that deserves the name, are you really optimistic about more co-operation, that we get to a system where this failure as to the end a global financial crisis with large and weak financial institutions don't happen again?

Mark Carney, Governor: In terms of overall co-operation, look, there have been some pretty major successes internationally. We do have a common global capital standard; we just got a common international agreement on a leverage standard which brought together actually quite varied positions between, if you followed it closely, the US position, the European and Japanese position, which actually worked towards a common standard there.

We have the prospect - not the certainty, but the prospect - of an international agreement on elements of the RRD 'bail-inable' debt over the course of this year, which is actually linked to one element of your question, which is the national ring fencing foreign bank holding company type approaches, to which you alluded, in the United States.

So there is much more that is being agreed than is commonly given credit for, and it's being agreed on a very rapid timetable. If you think Basel II took 10 years, effectively Basel III has taken three.

That said, the risk you're identifying of elements of balkanisation, inconsistencies - without question, that is a risk, and when we speak of how the Bank of England needs to help work towards an open global system, it's to address exactly those types of risk.

And so I would put my finger on 'bail-inable' debt or so-called GLAC as being key to reducing the balkanisation risk around banking - might not totally eliminate it; the mutual recognition effectively across derivatives markets, a form that doesn't look for a common standard, but looks for an acknowledgement that there are substantially the same outcomes on the derivatives side, as being essential as well.

And the thorniest issue ultimately will be - maybe not the thorniest, but one of the more uncertain issues at this stage - is how we collectively are going to treat the shadow-banking sector, because there will be very - the sectors are very different across areas and there are different potential approaches. And there needs to be a level of mutual confidence that appropriate safeguards are being taken, albeit they will look quite different, I suspect, in North America versus parts of the Continent.

Andre Spicer, Cass Business School: The intellectual case for bringing the different policy areas together is clear, but the organisational case is another matter. Building a common culture in a very long-established institution is difficult; I wonder if you'd have any kind of comments, not that - what you're going to do, but how you're going to go about doing it.

Mark Carney, Governor: Yes, that's a great question. There are certainly long traditions. I think what we want to do, what we're doing, is taking the best of the traditions and reinforcing it. So think international engagement – what we've just been talking about – intellectual leadership. I mean, those are two hallmarks of the Bank of England. Its structure, that which has been developed - I've been harping on this, but it's right, it's been developed through this lecture series - the open accountability structure and using the lessons of that and extending it across the policy areas.

So those are examples of where we are taking things that have worked, that have a long history, we reinforce and develop them. What we have to do, though, is use this opportunity of having a trebling basically of our powers, a doubling of the size of the institution because of the PRA coming in - a new leadership team coming in. And clearly, clearly, a macro and macro-financial environment that clearly has great risks. You know, we're moving into the recovery but we're in that low for long environment where we have a host of issues around maintaining the global, or enhancing the global system. So clearly things have to be done and we have to be co-ordinated to manage those risks. So there's clear understanding of those - so we have the right catalyst for change and quite a deep-shared understanding within the organisation - from different angles - but a deep, shared understanding of why change is necessary.

So how do we make it work? Part of it is organisational structure - so you move bits together where there are those overlaps. You manage reporting lines so that people are talking to each other. You have a senior management team that meets every day and talks to each other all the time, electronically and face-to-face.

We're changing how we pay people, how we measure their performance. We're putting a huge emphasis on collaboration, openness, inclusiveness in terms of the performance. We change the way we do research so that it's a cross bank - it's not just reliant on a few exceptional individuals, but we have an overall research agenda, which you will all know about if you're interested, and a number of you in this room can contribute to and challenge.

So we do that, and that's a cross-Bank initiative as well, so there's a broad range of things that we need to do to change culture. It starts with recognition of the core mission, and it's supplemented by the catalysts of - this is a different Bank than we were in '97 - because of the responsibilities - and it's a different world, and we have a much richer understanding of the risks that we're facing.

Toby Nangle, Threadneedle Investments: I had a question just in terms of bringing to life an example of where macroprudential and monetary policy might come into conflict or you might find that there are different tools for the same job.

And one of the areas today that is often cited as getting a head of steam is the property market in the UK - in the southeast anyway. And macroprudential tightening without necessarily getting into the cracks everywhere by raising rates, could be thought to be an interesting solution. But do you feel at all hamstrung by government policy in place, Help to Buy 2, for example, that that would limit the ability to macroprudentially tighten in areas which might otherwise merit attention?

Mark Carney, Governor: Good question - good name for a firm, by the way, Threadneedle - I thought we had all of Threadneedle - so you're not in the Bank of England doing this, are you?

Laughter

In terms of the question - we're not at all - I mean, we have clear statutory responsibilities. Clearly the types of macro vulnerabilities, risks that could arise from the property market, from the housing market, are something that falls squarely in our domain. Now we shouldn't be trigger happy. But we have the tools and we're well armed to address those risks - to continue the analogy.

We have taken initial steps. We did stop all the things we were doing, for monetary reasons, things we were doing to support the housing market - whether through capital or through Funding for Lending. The stress testing exercise in the UK at least will focus very squarely on risks to housing, which has an impact.

The FCA is tightening mortgage underwriting standards. We're creating new tools that we can use, including affordability tests. And we will have no hesitation to use any of the very considerable range of tools, if it's merited. But we're not going to use them just to prove that we can. We will use them in a proportionate, graduated way. We've already started. There are other things we can do, and if appropriate, we'll do them.

And vis-à-vis government policy, if there are government policies that are creating risk, we've been very clear that we will highlight those risks and we will make recommendations to government, and we'll do that on our timetable.

Again, but we're not going to do that just to show that we're tough. I mean, we'll do it if it's clearly right. And so we don't feel constrained in any way, is the short answer, because this is the advantage of having a clear mandate. Our job is to explain how we're discharging against that mandate, but we feel very comfortable in our ability to do so.

Joy Gibson,
QB Investments: You talked about the new structure and the new model of the Bank of England. Just wondering - do you feel that the financial markets understand that? You talked about the possibility that we are seeing a build-up of mispricing again of credit risks out of the markets. I'm just wondering if you feel that the financial markets - structures of yield curves and pricing and forward rates - that the market understands the new structure and the new policy approach that you're taking?

Mark Carney, Governor: I think the market has a reasonable understanding - I mean, it varies. We're trying to improve the understanding in terms of our monetary policy reaction function, which obviously influences the term structure of rates and a variety of asset markets. So there should be a reasonable understanding there. And you see it in term structure of volatility, for example, I think it's probably consistent with the guidance we've given.

In terms of some of the things I talked about, our new liquidity policy approaches, quite frankly they haven't been tested and we don't expect them really to be tested for a few years - I don't want to be too precise on the timeline. But basically, because the system is pretty flush with liquidity - certainly core institutions are flush with central bank reserves because of quantitative easing, so there's not really a need to be as active in these collateral markets, collateral transformation markets. But that time will come and that's when those will be tested.

If your question is more about a risk taking channel, "low for long" environment and the risk round that, you know, there are some signs of excess. There have been some signs of excess. Certainly one also sees quite compressed volatility across a range of asset markets that at some point will normalise. We've spent a lot of time focusing on the resilience of the core of the system and the core institutions, and what we have seen, even with people going out the risk curve, is that, certainly through the work of the PRA, and to some extent the FPC, over the course of the last several years, there has been a pretty steady improvement of the overall resilience of those institutions.

Now I wouldn't want to, you know, never, ever imply a mission accomplished banner around prudential supervision - unless, you know, it's your last day on the job -

Laughter

- so I'm not implying that, but I think we have to see it in that context before we would move much further.

Sumeet Drusali, Punjab National Bank and recent graduate from Cass: You talked about quicker and informed decisions when it comes to lending in terms of in times of crisis, but then you also mentioned new liquidity. Can you please speak a bit more about that?

And also, a second question, I'm sorry about this, but you said that there will be some sort of clear distinction or some distinction between staff and results or estimates by MPC members. So I've missed that point, but I'd like to know some more.

Mark Carney, Governor: The second one relates to our economic forecasting for the Inflation Report. What we're doing is we're taking a position that exists at present - Chief Economist, head of our Monetary Analysis Division - so Spencer Dale, who's made enormous contributions to the institution, where actually, as a reward for making enormous contributions on the monetary side, we're going to ask him to make further enormous contributions on the financial stability side – to move to the analogue job on the FPC, given its accordance.

But we're taking his role, and we're taking the Chief Economist element and making it a Bank-wide Chief Economist, not just a

Monetary Chief Economist. Andy Haldane is going to do that, if you know Andy.

But then we're having a Director position run the Monetary area, so somebody who is staff, not on the Policy Committee - that's the important distinction. So the person who will run our Monetary Analysis area, and therefore run the forecast, will be a staff economist as opposed to a member of the MPC.

And one of the things we've been moving towards as an MPC as a whole, and I don't want to prejudge decisions that the MPC could take or management could take, but we've been moving towards providing more information about what we call the key judgements that the MPC is making. And so one can think about those key judgements shading the staff forecast, as a consequence. And I think the question we have to ask ourselves - and it's reinforced by the structure that we're putting in place - is whether we can be even clearer about what staff thinks, what MPC thinks, and what those differences are.

And then of course people in this room and beyond will look at that and layer on what they think, where they think they are between staff and MPC. And that will, you know, that should - we'll get lots more challenges as MPC, but should ultimately make us more effective.

The first part of your question had to do with liquidity and lending, is that right? Yeah, the lending point I was trying to make was that as lender of last resort we should be able to react more quickly with the supervisory responsibility. One thing people sometimes suggest is there's a conflict of interest between being a supervisor and the lender of last resort. But if you manage this properly, what you have - the advantage you have - is that you have up-to-date real time information and informed people about the health of the organisation.

And if those people understand that they work in one bank, one institution with overall goals, there isn't a conflict. And that just helps us to lend more rapidly. The liquidity facilities that we have, as per the other question, relate more to the functioning of markets in normal times, in non-distressed times. And what we've done with those is expand them quite dramatically.

The point I just made in answer to a previous question was - we probably won't see that really used or tested for a few years until we start to draw liquidity back from the system, as we exit some of the Quantitative Easing. And that's not a prediction on when we're going to do that, by the way.

Laughter

Lucio Sarno, Professor of Finance, Cass Business School: I have received clear instructions and signs that I have failed in keeping the time.

Laughter

Therefore I'd like to close this Question and Answer Session and before that I'd like to thank, once again, Governor Carney for what is surely going to be another memorable Mais Lecture, and for sharing with us your thoughts on how you're shaping the Bank of England for the public good of the United Kingdom.

Mark Carney, Governor: Thank you very much.

Applause

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