House of Commons

Treasury Committee

Appointment of Paul Tucker as Deputy Governor of the Bank of England for Financial Stability

Fourth Report of Session 2008–09

Volume II

Oral and Written Evidence

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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Oral evidence

Taken before the Treasury Committee

on Wednesday 21 January 2009

Members present:

John McFall, in the Chair

Nick Ainger	John Mann
Mr Graham Brady	Mr George Mudie
Mr Michael Fallon	John Thurso
Ms Sally Keeble	Sir Peter Viggers
Mr Andrew Love	

Witness: **Mr Paul Tucker,** Executive Director, Bank of England, gave evidence.

Q1 Chairman: Mr Tucker, welcome to the committee and congratulations on your appointment as Deputy Governor. Can you introduce yourself for the shorthand writer, please?
Mr Tucker: Thank you, Chairman. Paul Tucker, currently Executive Director for Markets at the Bank of England and, from 1 March, Deputy Governor for Financial Stability at the Bank of England.

Q2 Chairman: This committee had recommended an interview process and a more open process for appointments. Can you take us through what the process was in your case?
Mr Tucker: Yes, absolutely. I think it was the same for me as it was for all of the other candidates, as far as I know. There was an advertisement. Behind that there was a document that set out the requirements of the job. That is publicly available, I believe. There was an application form that was fairly structured: that also required a short essay on what candidates thought they could bring to the job. The interface between candidates and the Treasury was handled by a firm of head-hunters. I thought that was rather a good thing. Through some process, which I obviously do not know much about, there was a short list; there was then a panel interview.

Q3 Chairman: How many were on the short list?
Mr Tucker: I do not know. I am sure more than one.

Q4 Chairman: Sometimes I have gone for an interview and I have been told there are six people on the short list, even after lunch.
Mr Tucker: A full handful is the impression I have—around five, six.

Q5 Chairman: Were you interviewed on a day separate from everybody else?
Mr Tucker: I believe, but do not know for sure, that I was interviewed on the same day as everybody else.

Q6 Mr Mudie: Can I ask who interviewed you: the head-hunters or people in the bank?
Mr Tucker: No, people from the Treasury. It was a Treasury interview. Nick Macpherson was the Chairman. I am not sure whether the other members of the panel are public. If you do not mind, Chairman, I think that is something for you to pick up with the Permanent Secretary, but it was a Treasury process; it was not a Bank of England process.

Q7 Chairman: We are placing a call at the moment to find out more about the process there. Obviously, the issue of financial stability is key for your job but also for our inquiry into the banking crisis. With legislation going through Parliament at the moment, are you satisfied with all the arrangements for financial stability, because this committee in our report has expressed less than satisfaction for the procedures at the moment. It is a bit muddled in our opinion.
Mr Tucker: I think the big step forward in the Banking Bill from everybody's point of view, irrespective of the fact that it happens to have come to the Bank of England, is the Special Resolution Regime. As many commentators have said, and as the Governor said in front of this committee, I think in the autumn of 2007, it was a great weakness in the UK set up that we did not have something that was broadly equivalent to the American FDIC system, where you can take a bank and resolve it in a variety of ways; and, of course, the Government introduced emergency legislation to give themselves precisely that power on an interim basis. I think, if anything, the importance of those tools has been underlined by what we have seen in the United States over the past six months, where they do have such a system for commercial banks but they did not have it for investment banks, which has rather complicated things over there. That is, I think, the centrepiece of the legislation in terms of new instruments.

Q8 Mr Fallon: Mr Tucker, the announcement on Monday of what is rather coyly termed the Asset Purchase Facility takes us into quantitative easing, the end game, does it not? It is printing money.

Mr Tucker: It does not immediately take us into quantitative easing, no. There are two phases outlined by the Chancellor on Monday and by the Governor last night. In the first phase the Bank will purchase corporate bonds and other corporate securities but financed by the issuance of Treasury bills by the Government; there will be no monetary financing or creating of money by the Bank during that phase. The second phase, if ever we reach it, which will be a decision for the MPC, would occur only when interest rates reach zero on some definition: and at that point the MPC would have discretion to buy these assets by issuing Bank of England money.

Q9 Mr Fallon: That is printing money, is it not?
Mr Tucker: That is creating money. It is not pound notes, but it is creating Bank of England money; absolutely.

Q10 Mr Fallon: How can you create money without having more pound notes?
Mr Tucker: There are two kinds of central bank money. There are pound notes, which all of us carry around as citizens, and there is central bank money that is held by the banking system.

Q11 Mr Fallon: Let us be clear. Who will own this scheme?
Mr Tucker: The vehicle will be owned by the Bank of England. It will operated by the Bank of England but within parameters, in terms of credit risk, set by the Government: and the reason for that is that there will be a transfer of risk from the private sector to the public sector, to the Bank of England's vehicle. We are an institution which does not have a great deal of capital, and the Government stands behind us, just as governments all around the world stand behind their central banks.

Q12 Mr Fallon: The Governor last night in his speech said such asset purchase involves taking more credit risk on to the public sector balance sheet. So who decides? Are you going to be told by the Treasury, "Now we want you to consider"?
Mr Tucker: This will be set out in an exchange of letters between the Chancellor and the Governor, I imagine in fairly high-level terms. I think the thing to underline about the scheme is that this is a scheme to purchase high quality assets. There will be a definition of that and then, I imagine, within those parameters, the Bank of England Executive will have a fair degree of discretion. Those details remain to be pinned down and published. That will happen towards the end of this month or the beginning of next month.

Q13 Mr Fallon: I just want to be clear. You are the Deputy Governor of an independent central bank, so you will be told at some point this is what you have now got to start doing?
Mr Tucker: I have not so far seen anything in this scheme that threatens the independence of the Bank of England or, if we reach phase two, the independence of the Monetary Policy Committee. I think if there will be a transfer of credit risk, as the Governor says, to the public sector—that risk will be underpinned, indemnified by the Treasury—I think it is perfectly reasonable for them to have an interest in the type of risk that we all take.

Q14 Mr Fallon: Could you be told, finally, as the Bank, to take on the kind of assets that you would not want to take on?
Mr Tucker: Within the parameters of this scheme, I would fairly seriously doubt it.

Q15 Mr Brady: How is it possible to judge whether the fiscal stimulus is having an effect?
Mr Tucker: I think it is difficult to judge whether it is having an effect yet. I supported it. I think that it is best thought of as leaning against some of the very nasty downside risks that confront our economy at the moment. It should, as both the Governor and Charlie Bean when they were in front of you in November said, incentivise households to bring forward their spending from 2010 to 2009, and perhaps right towards the end of the year, when no doubt retailers and others will be pointing out that VAT is due to go back up, prices will tend to rise, other things being equal. I think that was the experience in Germany a few years ago when they had a broadly similar scheme. I thought it was a reasonable degree of insurance to lean against these head winds that we will face.

Q16 Mr Brady: Is it a sufficient degree of insurance, or is there a strong case for further fiscal stimulus?
Mr Tucker: I think it has to be seen alongside a whole host of other things—the monetary policy changes, cuts that we have made and, absolutely crucially, the package on Monday, which is very much designed to unblock bank lending. As just about every commentator says, as we have been saying over recent months, the vital thing to do now is to unblock the flow of credit from the banking system and, ideally, if we can, in the capital markets too; and I think that is more significant than details of fiscal stimulus at the moment.

Q17 John Mann: What level of inflation is acceptable with fiscal stimulus in your view?
Mr Tucker: The inflation target has not changed one iota throughout this. We have a 2% inflation target. The conduct of monetary policy at the moment and in the coming months will be directed absolutely to bringing us back to 2% CPI inflation over the medium term. It is going to be a volatile journey. CPI inflation is going to dip below our target most likely, but then we will aim to bring it back up. Nothing that has been done by either ourselves or by the Government has affected the objective of monetary policy at all.

Q18 John Mann: What is the upper limit on fiscal stimulus that is worth policy makers not necessarily determining, but considering? What are the parameters? What is the upper parameter over the next year, 18 months, that we should consider?

Mr Tucker: I do not think I can put a number on that.

Q19 John Mann: No, but you can give an impression.
Mr Tucker: The vital thing is that at each stage the Government makes a credible commitment to get the public finances back on to a sustainable footing. That will not be achieved in a short time, but what is important is that they make that commitment, that they articulate over time how they are going to do it and then they stick to that commitment.

Q20 John Mann: My constituents are looking at everyone involved in the financial world and wondering whether these people are going to get it wrong again. It must be quite a re-education process to move from being ultra-monetarists to suddenly becoming rediscovered Keynesians. Is it a healthy process within the depths of the Bank of England?
Mr Tucker: I am not sure that we particularly see ourselves individually or collectively as kind of part of a doctrine in that respect. We would certainly understand and empathise with what your constituents feel about the problems that are facing our economy and our society, and the best possible thing we can do for the country is to get the economy going again to try and turn the downturn, which will go on for quite a few more months now, but we need to slow the rate of decline and eventually turn it, and all the policy levers available to the authorities are being used and will be used to that end.

Q21 John Mann: Finally, monetary policy—useful in its day—that doctrine of monetarism has it now outlived its usefulness?
Mr Tucker: I do not think stable prices—low and stable inflation—have outlived their welcome at all. Our economy, our country, faces very severe problems at the moment, but in the past we faced very severe problems from letting inflation get out of control and then the authorities having to put on the brakes in a very severe way. Monetary policy, here and elsewhere, has at least protected our society from that over the past ten to 15 years, and that is welcome, and it is something that should not be given up and we will not give it up.

Q22 John Thurso: In your answer to our questionnaire regarding what are going to be your primary focuses, one of the things you said was how to make the financial system more resilient in the future while still fostering innovation and enterprise. Just looking at innovation, many would think that it was the innovation that caused much of the problem. Do you think that the regulators in the future are going to have to be far more sceptical of innovation and operate a sort of financial precautionary principle?
Mr Tucker: I think that the authorities generally are going to have to think much more about the system-wide dynamics of the financial system, not just domestically but internationally, globally, because that will be the only way in which we can keep the benefits of innovation and entrepreneurship. If you look back over 100 years or more, if you look back to the period since the Second World War, the financial system here and elsewhere has played an immensely important part in improving the welfare of our people, but it has proved, again and again, to be prone to excesses and we need to improve the rules of the game for the financial system so that those excesses are identified before they get too far; and there are checks and balances in the system. There will plainly have to be some quite significant changes, but we need to do that in a way that does not completely choke off the benefits, and that is not going to be the easiest thing in the world.

Q23 John Thurso: To what extent, therefore, do we need to disaggregate the kind of money utility of the commercial bank from the innovative practices of the investment community; in other words a return to the kind of Glass-Steagall Act approach?
Mr Tucker: It is a very big question, and I do not have an immediate answer on my view on that. I think that it is seductive but, if we were to take that course, we would need to do so in a way where we were absolutely certain that the financial system, the investment banking part of it, did not threaten our economy, and that would be quite a proposition to sign up to. But I think it is something that the authorities internationally are going to have to think about over the coming years.

Q24 John Thurso: To a certain extent we are living the consequences of the opposite.
Mr Tucker: I absolutely accept that. That is why I think it is a completely legitimate question, but I do not think what we can do is say there is something called commercial banking, we will make that completely safe, and the rest we will let have free reign.

Q25 John Thurso: Can I ask you briefly about the Financial Stability Committee, which is a new committee that you will be very much a part of. How involved have you been in the preparations for that?
Mr Tucker: Not hugely. I have been getting on with my own job over recent months. I have been involved in some discussions on the Financial Stability Committee. Together with giving the Bank of England a statutory responsibility for financial stability, which I think is a tremendous thing to do, I think, taking those two things together, it is very good news indeed, because it will underpin, for a generation or more, that the central bank does have an absolutely core role in financial stability. In terms of its workings, I am sure that it will bring an outside voice and greater expertise into the corridors of the Bank. That will be a good thing. I think there is a challenge in achieving that without having people that are so close to current executive roles in the financial system that they have insuperable conflicts of interest, so that all the real discussions are going on elsewhere. And, separately from that, I am sure it will strengthen the Court's oversight of that part of the work of the Executive of the Bank of England. So it is a big step, and I think it is a good step.

Q26 Ms Keeble: In his speech last night the Governor gave a throw-away line, saying that at some point the MPC might wish to adopt these unconventional measures as an instrument of monetary policy. There has been quite a lot of discussion here about instruments used by the MPC. What is your view of this and could you expand on what the Governor said?
Mr Tucker: I am not sure it was a throw-away line, but, yes—

Q27 Ms Keeble: It was a brief line.
Mr Tucker: ---as I said to Mr Fallon earlier, if the MPC over the coming months were to vote on a level of interest rates that took us to zero, or very close to zero, there would then be a question: what can the central bank then do? Conventionally, although it has not been applied many times, what the central bank would do is it would move away from setting the price of its money to, instead, deciding the quantity of its money that was put into the banking system, into the economy. And having decided how much central bank money to put in, it then has two choices. Does it do that by purchasing public sector assets (gilts) or by purchasing private sector assets (corporate bonds in this case)? If we find ourselves in those circumstances, that would be quite a useful thing to do.

Q28 Ms Keeble: So the interest really is whether the MPC is going to look more at other instruments rather than just the interest rates?
Mr Tucker: In those circumstances, it would. The thing that is special about a central bank is our money, our liabilities. Normally, monetary policy proceeds on the basis of putting a price on that money, an interest rate. If we get to the point where the price on our money, the Bank Rate, is at or very close to zero, then what we would do is move to controlling the quantity of our money that was in the economy, and that would be an MPC decision.

Q29 Ms Keeble: Thank you. A further point that Michael Fallon raised was about the Asset Protection Scheme. I wanted to ask about estimation of risk. You said that the agreements that you were reaching about assessing this at a higher level, understandably, are going to be at that strategic level. However, the crisis that we are in now was triggered by poor people in America not paying their mortgages, and that was at a very low level. What kind of assessments are going to be done? What kind of ratings are going to be done which are going to provide the public with protection against things that are not operating at the strategic level but at a very basic level?
Mr Tucker: Beneath the high level parameters that I referred to there will be quite an extensive machine in the Bank of England looking at individual securities.

Q30 Ms Keeble: Who is going to do that?
Mr Tucker: The risk management area of the Bank of England, which reports to me at present, and it draws on outside advice. We have hired some people from outside. It is quite a largish team. We have been doing this already in the context of having widened, quite considerably, the range of high quality collateral that we take in our various liquidity facilities. So in a sense, in terms of the work in the Bank, this would be an extension of something that we are already doing rather than embarking on a completely new kind of activity.

Q31 Ms Keeble: What that means is that if in this scheme, which is one of the critical schemes the Government put forward, there is a problem about the creditworthiness of some of the assets that have been bought, or too much risk in the assets, ultimately the buck is going to stop with you?
Mr Tucker: And with the Bank of England, as overseen by the Treasury, yes.

Q32 Ms Keeble: But it is under your particular—
Mr Tucker: At the moment. I will have moved, but it will be under the Executive of the Bank.

Q33 Sir Peter Viggers: I want to ask about the key relationship with the FSA. You make it clear in your answer to our questionnaire that regulation is the FSA's job. How do you stay close enough to the FSA to feel confident that they are doing their job properly?
Mr Tucker: I think what everybody has learnt during this terrible episode is that one cannot have a state of affairs and, a caricature, where one set of people are doing micro-regulation of individual firms and another institution is doing macro policy, monetary policy, and occasionally meet. It needs to be much closer than that. As grown-ups, I am sure we can get to that without doing each other's jobs. I think, apart from the Standing Committee deputy's meeting, which is conducted at a reasonably senior level, we will continue to build the working level contacts. I have to say, there are not many silver linings from this crisis, but one of them in a minor way is that there is a much closer engagement at working level between the line supervisors, as they are called at the FSA, and the people in the Bank of England that work on financial stability. And what we need to ensure is that when we eventually get out of this, that degree of contact does not slip back into very occasional, periodic meetings: that we maintain close relations between the two teams. And part of that will be secondments. We need these two institutions to empathise with other, understand each other's objectives, know each other at almost every level of the organisation without trying to do each other's jobs.

Q34 Sir Peter Viggers: In order to understand the manner in which the two organisations will work together, one needs to articulate some form of structure. What I think is that the FSA does regulation and the Bank of England is responsible for what I call supervision. That just happens to be the terminology I use. Do you think of it in the same way and, if so, how are you to ensure that the Bank of England has enough people and that they are

close enough to sense the way the wind is moving in terms of banking and to be alert to signs of problems in banks?
Mr Tucker: You use the word "supervision". I think I would use a slightly different word, if I may. Oversight of the system as a whole, I think, has to be distinct in our set up from the supervision of individual institutions. This is not a set up where the Bank of England is seeing individual institutions at senior management level and going through the balance sheet of those institutions, both in peace time and in war time. We will get more involved with firms that are in actual or potential distress through the Special Resolution Regime role, which I was describing to the Chairman at the beginning of this session, but this is not going to be going back to the system of ten years or more ago where the Bank of England had an individual supervisory relationship with each bank or each financial firm in the country. We will—and this is a departure from the past, one that has developed over the past 18 months—we are doing more to try and understand how the system-wide threats that we identify might bear on particular institutions, but not with microscopic information about the individual institutions.

Q35 Sir Peter Viggers: One respects the individuals doing the job, but one might find oneself in a situation, in five or ten years' time, looking back and saying that we did not do enough to institutionalise and clarify the lines of responsibility. Do you think we need to do more?
Mr Tucker: In terms of clarity, I think there is clarity in that the financial services legislation sets out powers that are for the FSA to exercise, and those powers are inalienable, in the sense that they can only be exercised by the FSA. They can talk to other people about it, they can talk to us, they can talk to the Treasury, but it is their decision, just as, at the other end of the spectrum, the macro spectrum, the monetary policy decisions are for us and for no-one else: and in that sense I think that there is clarity. When it comes to sorting out particular problems, financial stability problems, I think a fair degree of clarity is provided for the Special Resolution Regime. The FSA will have its hand on the trigger in terms of whether a firm goes into the Special Resolution Regime; we will have our hand on which menu item that is set out in the legislation should be used; and the Treasury will, of course, the Government will control the public funds, and so there is a fair degree of clarity there as well. I say fair degree, because those are obviously circumstances in which the three authorities need to work together.

Q36 Nick Ainger: Mr Tucker, how confident are you that the package that was announced on Monday will bring some stability to the banking sector and also release the credit that the package is aimed to release?
Mr Tucker: It does have precisely that objective. If I may step back for a moment, the objective of the October package was to underpin the banking system and give confidence to depositors around the country. Had that not been done, things are bad enough, but there would have been absolute mayhem in our financial system and, more importantly, in our economy. The payment system would have ground to a halt, not only in this country but in other countries as well. We were preciously close to that, and the October package really has to be thought of in that context. Monday's package is, essentially, a second stage package, as you say, precisely directed to remove some of the road blocks in the face of credit creation, and it has three or four components. One is the capitalisation of the banking system, and the Treasury's insurance of losses is directed to that, and that could be a powerful thing.

Q37 Nick Ainger: We are familiar with the details. I just want to know how confident you are that that package will actually deliver.
Mr Tucker: I think it has a reasonable chance. There are no dead certs in this, there are no silver bullets, but I think it is a good package. I hope it will be followed, where necessary, by similar packages abroad, and that will help the chances of success at home. We will not get through this if the only government working on the key things is the UK Government or if only a few governments abroad do so.

Q38 Nick Ainger: I think the Chancellor said on Monday that part of the problem was not just the UK-based banks but that a significant proportion of international banks had actually withdrawn from the UK market. For example, I think there had been a fall of 45. They lent something like 45% of the mortgage market, for example. Do you think this package is going to not only stabilise the current lending from British based banks but also be able to significantly increase their lending to make up this very substantial shortfall from the banks that have withdrawn from the UK market?
Mr Tucker: I am not sure that we should want, in any short-term, or even medium-term, to get back to the levels of lending or the terms of lending that were prevailing in the early part of 2007 and 2006. I do think that the package can unblock lending—crucially, right now to the corporate sector for working capital finance and, potentially, in the mortgage market as well. But this is something where the overseas banks, their attitude to lending in this country is going to depend, in part, on whether we do start to see a slowing in the rate of decline in output growth. They will come back when they see that there are profitable opportunities, and also depending upon their circumstances at home. That is why I say that it is important that, not only our Government, but governments elsewhere, have fairly comprehensive packages.

Q39 Nick Ainger: Governments elsewhere, certainly in the past in Sweden and Japan, have actually nationalised banks. With the clear instability on the stock markets in relation to a number of banks' shares, do you think temporary state control of certain banks would actually bring longer-term stability to the banking sector?

Mr Tucker: I think that in terms of getting us out of where we are, the precise modalities are less important than having measures, packages, that are addressed to the key things, and I will not enumerate them all, but this is a package that addresses capitalisation, it is a package that reduces the pro-cyclicality of capital requirements, it addresses funding and, through the actions that we will take, it might help to unlock parts of the corporate credit market as well. You could have a different set of precise instruments that will be directed at those four goals, but actually I think directing oneself at those four goals is more important than the precise techniques.

Q40 Nick Ainger: There are those that, coming from a free market perspective, have already said that they feel that certain banks should be taken into temporary state control. You do not agree with that?
Mr Tucker: You pose that question. I think that is a question ultimately for the political authorities. As a central banker, the important thing is (1) that the confidence of our depositors in the banking system is underpinned, and key steps were taken on that in October, and (2) that we take measures to move the road blocks, or reduce the road blocks, on credit creation, and Monday's package is directed precisely at that. I think it is a good package.

Q41 Mr Love: Going back to questions that were raised about the FSA, in your new role would you have any remit in relation to the reintroduction of short selling in financial markets?
Mr Tucker: I imagine that is the kind of thing that might be discussed amongst the authorities and, within the FSA, I imagine that, in broad terms, it might go to the FSA Board, on which I will represent the Bank, but I should think, essentially, it is a question for the FSA Executive.

Q42 Mr Love: Even where there has been quite a lot of turbulence in banking shares in the last few days, whether that has been caused by the reintroduction of short selling, indeed, I do not expect we will know for some time, but there must be some concern in the Bank at what has happened to banking shares presently?
Mr Tucker: Obviously, it has not been an entirely comfortable few days, but I go back to what I was saying earlier. In a way those developments in financial markets risk being a distraction from the package on Monday. For some months now everybody has been talking about the importance of removing some of the road blocks to credit creation. I do think that is the most important thing, both in stabilising our economy and stabilising our financial system. I think that is the bigger thing this week, and over time I hope it will come to be seen as a bigger thing, but as I said earlier, it is not absolutely guaranteed to succeed. Events from abroad could knock us off course. I hope they do not.

Q43 Mr Mudie: I think what you have said is very sensible and very welcome, but why do you think the October capitalisation failed?
Mr Tucker: I do not think it did fail; I really do not. I think—and I saw this very clearly from my current vantage point as the Markets Director of the Bank—we were preciously close to banks being unwilling to lend to each other, even over night. If they had stopped doing that, the financial system would have ground to a halt, and this was pretty much global, certainly across the industrialised world, and that would have been felt by households and firms almost immediately, and that was averted. If I may add one other thing, something that I said in my submission: the importance of developing the infrastructure supporting financial markets. And something that has worked behind the scenes throughout this period are improvements to strengthen the payment system in terms of intraday flows between the banks. These were steps taken during the 1990s and, had those steps not been taken, I am absolutely sure that we would have been in a ghastly position in the autumn.

Q44 Mr Mudie: But the Chancellor sold the October measures to the House on the basis of capitalising the banks so that they could lend money to the real economy and stop the recession going into the real economy. I totally agree with you in terms of the importance of corporate over mortgage lending. First of all, what share of corporate lending do the four major corporate banks have?
Mr Tucker: I do not know an exact figure. I would have thought, in terms of small and medium sized companies, rather than the country's largest companies who normally access the international capital markets, a pretty big share, certainly over 50%.

Q45 Mr Mudie: Fifty per cent?
Mr Tucker: I would have thought so. I do not know that for sure; I apologise.

Q46 Mr Mudie: As I understand it, again from the Chancellor's remarks on Monday, you only had to be seen as promising to do something like corporate lending if you participated in the package. How many of the big four banks participated in the October package?
Mr Tucker: In October what they had to do, as I recall, subject to correction, is they had to satisfy the authorities that they were adequately capitalised.

Q47 Mr Mudie: How many?
Mr Tucker: I think all of them actually, but they did not all take capital from the Government.

Q48 Mr Mudie: How many?
Mr Tucker: Three.

Q49 Mr Mudie: The Chancellor seemed to suggest on Monday—I am not trying to be funny—two, which would fit in with Lloyds and—
Mr Tucker: HBOS and Lloyds are now the same bank, so that may be how one gets from three to two.

Q50 Mr Mudie: Did RBS?
Mr Tucker: RBS did in October, yes.

Q51 Mr Mudie: So let us say two.
Mr Tucker: Yes.

Q52 Mr Mudie: But that takes Barclays and HSBC out.
Mr Tucker: Yes, but they both satisfied the Government that they were adequately capitalised at that point.

Q53 Mr Mudie: You are saying lending is very, very important. It is. It is absolutely crucial that we get money into the corporate sector and get business going again. If two of the biggest banks are outside of this and are not compelled to lend to the corporate sector, surely the package is just going off half-cocked?
Mr Tucker: I would say two thing to that. First of all, there is considerable awareness of that in the official sector, and the current package is constructed accordingly. Secondly, my belief and hope is that all of the banks do not need to be compelled to lend to the corporate sector because they will see it as in their own commercial and long-term interests to.

Q54 Mr Mudie: We are dealing with people with very bad judgment who have got us into this mess.
Mr Tucker: I think they can see, though, that the domestic economy, the global economy is in a downturn and they will make things worse for themselves if they do not support the credit flow in the economy, because that will just rebound on the quality of their asset portfolios.

Q55 Mr Mudie: Okay. When the Governor was last before us he was musing about the need, which seemed to me incredible 18 months into a credit crunch, to build up better monitoring of lending, and he referred to the bank as having anecdotal evidence of a lack of lending. Paul, in your work looking after financial stability, was the Governor right in suggesting to the committee that there was a need to monitor lending, to set up a monitoring system for lending, and that the Bank's evidence on lending is based on anecdotes?
Mr Tucker: I think there are two comments on that. Firstly, in 2006–07 we introduced a quarterly credit conditions survey, which has helped us a lot during this period. The news has often been unwelcome in it, but it is better to have the bad news than not. Secondly, I think what the Governor was referring to is that we wanted the data more frequently than the normal monthly timetable, and some data is collected only on a quarterly basis and we are collecting that on a more frequent basis as well for the lending panel that the Chancellor established.

Q56 Mr Mudie: Did the 2.5 billion given to the Russian by RBS come as a surprise to the Bank of England?
Mr Tucker: I do not know; I did not know about it.

Q57 Nick Ainger: It was a surprise though.
Mr Tucker: It was a surprise to me, but I would not know every single loan in their portfolios.

Q58 Chairman: I think it is right to say it came as a surprise to Stephen Hester! However, a number of major banks who have been speaking to me in the past few days have been talking about the loans issue. It is hard for them to get loans for three or four days themselves but they are lending for three or four years. Do you think the Government's package on Monday is going to ease that and when do you think it will start easing that?
Mr Tucker: I think so. I think it should help. We have seen over the last month or so a reduction in the so-called spread between LIBOR and the expected policy rate, and it is still extremely high but it is less extremely high than it was. I think in terms of the package, extending the drawdown window for the Government's credit guarantee scheme for the banks which guarantees the Bank's funding and extending it to asset backed securities is helpful to that. And I think, indirectly, the Bank of England scheme to purchase corporate bonds will help that too.

Q59 Chairman: In your questionnaire you discuss the possibility of a macro instrument for preventing the build up of debt, and Charlie Bean and others have been speaking about this as well. Very briefly, what would your preferred choice be?
Mr Tucker: First of all, it is quite clear that at the micro level, both in Basel II and probably in some accounting policies, these need to be a bit more counter-cyclical and a bit less pro-cyclical. The question at a macro level is whether during the upturn, when credit growth is buoyant, it will be sensible to raise the level of capital required across the banking system. This is not a point about idiosyncratic individual institutions, but "if we are going to grow at this kind of rate, then you need to carry more capital against it", and that would both protect the banking system and, probably at the margin, help to slow down the rate of credit growth. I should say, Chairman, I think that is a proposition that is worth exploring really thoroughly. I do not know that it would certainly work. That is the debate that needs to be had.

Q60 Chairman: Okay; things are at an early stage. You also state that one of the problems, in your words, is the leaky world of unimpeded international capital flows. How far is that true for households rather than corporations, especially after the high profile failure of the Icelandic banks?
Mr Tucker: It is probably less true for households than of corporates, but over time, over a year or so, I doubt whether we could insulate ourselves from it entirely.

Q61 Chairman: Will your role still include oversight of the banking services section?

Mr Tucker: Of the Bank of England?

Q62 Chairman: Yes.
Mr Tucker: I think so, yes; not my current section, the markets directorate, but probably the banking services directorate, which runs the payment system and is the back office.

Q63 Chairman: Finally, what do you regard as the major objectives for the banking services section of the Bank of England over the next few years?
Mr Tucker: To maintain the integrity of the note issue, which is obviously of vital importance to the economy, and to ensure, crucially--- every central bank sits at the hub of the national payment system and we need to do that with complete reliability and we need to ensure that payment system is safe.

Q64 Chairman: Thank you very much. We did say we would enquire for further details during this evidence session, and I have had it reported back from the Treasury that your post was advertised 12 October, the closing date was Monday, 3 November, the appointment was made, with the approval of the Queen, on 10 December and there were 33 completed applications. So, well done, but we do not know how many were on the short list. I think what we can say is it is near transparency, not full transparency, and there is work to do by us yet, but Paul Tucker, can we thank you very much for your evidence. We have valued it in the past and no doubt we will value it with much more regularity in the future. Thank you.
Mr Tucker: Thank you, Chairman.

Treasury Committee Questionnaire: Response from Paul Tucker

Individual Role

1. *How has your experience to date prepared you for the role of the Deputy Governor of the Bank of England (Financial Stability)?*

The financial stability function involves the following: identification of threats to stability; making the system more resilient; and crisis management if the first two fail. The underlying subject matter covers financial markets, the macroeconomy, the financial system's infrastructure, firms and regulation. To cover and synthesise all that effectively, the Bank needs to join up a range of disciplines from market intelligence, desk-based analysis, and academic research. It has to result in policy prescriptions, and be matched by actions. The necessary policy levers will sometimes be in the Bank's hands, but often will lie with others, so it is essentially a collaborative endeavour. That means working effectively with UK (Tripartite) and international partners; and entails active engagement with the financial sector, here and overseas. It also requires compelling explanation to stakeholders of what the authorities are doing—including to Parliament, the media, the corporate sector and the general public.

My career had provided extensive experience of synthesizing the various types of analysis, and turning analysis into policy and operations. It has covered, within the Bank, spells as a bank supervisor; designing parts of the wholesale payments and settlement system; running government debt management, and implementing the Bank's monetary operations; running the monetary assessment and strategy part of the Bank's monetary research area; Deputy Director of the Financial Stability directorate (1999–2002), including leading the production of the Financial Stability Review and overseeing the Bank's regulatory policy and IMF work; and my current role which, in addition to MPC membership, involves heading the Bank's market intelligence effort, and managing the Bank's balance sheet and market operations. I have had two spells outside the Bank—in the mid 80s as a corporate finance advisor; and in the late 80s, as an advisor to the Hong Kong government on the restructuring of its securities markets and regulatory framework. I have fairly extensive experience of international central banking groups.

2. *Are there new approaches you think the Bank of England will explore to communicate with the public over financial stability issues?*

We are going to need to do more to communicate to a wide audience—including what the Bank's role is, and is not; our assessment of risks to the system; and what we are doing.

I would include firms within the 'public' in this sense, because they tend not have day-to-day contact with the Bank in our financial stability role but are important users of the banking system (as wholesale funders, borrowers, and users of the payments system). In communicating with firms, we can probably do more through the various employer organizations. We may also be able to do more via the Bank's regional Agents, including in UK financial centres outside London, although the Agents' responsibilities are essentially to support the MPC, reporting to the Bank's Chief Economist.

For the general public, we will consider how far we can get via briefings, op-ed pieces in newspapers, interviews, and speeches by the Governor and others pitched for reporting beyond a specialist audience. We will need to tackle this without cutting across the FSA, or risking any confusion about which body is responsible for consumer protection (FSA).

3. *Do you plan to serve your full term?*

Yes.

Interest Rate Decisions and Economic Policy

4. *To what extent do you think there is a need for increased Government intervention in the economy at the present time—either via a fiscal stimulus or direct Government lending to firms?*

The effectiveness of monetary policy is impaired, but not eliminated, by the problems in the banking sector and in capital markets. For example, the MPC's 350bp reduction in Bank Rate since the autumn will have reduced the debt-servicing burden for many existing households and company borrowers. But the impact of the cuts will plainly be smaller than otherwise because the supply of new lending has tightened severely due to the problems in the banking sector and capital markets. For that reason, I have supported on macroeconomic grounds measures to underpin the functioning of the banking system and to incentivise households and firms to bring forward spending. I think the recent Budget is best thought of as leaning against the risks of a downward spiral.

The October banking package prevented complete seizure in the payments system, which could have had truly devastating effects on our economy. Building on that foundation, as a second stage, more now needs to be done to lubricate the credit system, by reducing some of the impediments to bank lending and, perhaps, activity in the capital markets.

5. *Should it be necessary for interest rates to fall to close to zero, how would you see "quantitative easing" working in the UK?*

The term "quantitative easing" covers a pretty broad church. Narrowly defined, it means the central bank moves away from the normal practice of setting policy solely in terms of the price of its money (Bank Rate), supplying whatever quantity of money the economy demands at that price. Instead, the central bank moves to an operating framework where it chooses what level of central bank money ("reserves" or "base money") to inject into the banking system, which may be greater than the amount demanded at a zero interest rate. In theory, the effect might be to increase demand for other financial assets, or even for goods and services, as individual banks, and possibly firms and households, try to shed the extra (base) money.

For any given target level of reserves, they can in principle be injected by buying (or lending against) a wide range of assets. So a very important dimension of such operations is the choice of assets. The purchases may reduce liquidity and risk premia, and so may increase wealth and reduce the cost of borrowing for firms and households. If effected via outright purchases of risky assets, such operations can plainly also transfer risk to the public sector.

How such operations affect aggregate demand and inflation would, however, depend on conditions in the financial economy. At present, the transmission would be dampened, although probably not eliminated, by conditions in the banking system; bank lending is the mechanism via which an injection of base money boosts broad money (deposits with banks) via the standard money-multiplier process. That underlines the priority of maintaining appropriate levels of lending.

6. *When considering the UK economy, how much emphasis do you place on the international economic environment? How concerned are you about global imbalances?*

We need to place a lot of weight on it. The UK has a very open economy, and is home to a major international financial centre. The significance of that has been underlined, if it needed to be, by the current crisis. The persistent international current account imbalances have been one of the drivers of systemic stress. The large and persistent external surpluses in Asia (and the oil exporting countries) had their counterpart in cumulative current account deficits in the West, especially the US and the UK And within those deficit countries, the household sectors accounted for a lot of that build up of debt.

At least with hindsight, the West needed to think harder and do something about the threat it faced from the accumulation of (internal and) external debt. If we could not persuade others to adapt the international monetary system, eg by allowing Asian exchange rates to float, we needed to guard against the risks from those faultlines in the international environment.

One lesson from this is to do more to integrate global macroeconomic analysis with intelligence/analysis on what is going on in the financial system. Too often, macro and financial system debates have been conducted, internationally, in parallel universes.

7. *To what extent do you think the Bank of England, or another agency, will have to be given additional tools to combat the build up of excess debt or leverage in the economy?*

New instruments are needed to tame the credit cycle. In principle, those could be micro or macro instruments.

By "micro" I mean things like the details of regulatory capital ratios (risk weightings etc); the specification of accounting conventions for valuing financial contracts, etc. The current crisis makes it plain that measures designed for micro ends can, when aggregated across firms and markets, have material macro effects. That must be recognized by the designers of such micro rules, even where it takes them into unfamiliar territory. The macro authorities (perhaps most obviously central banks) need to be ready to engage actively in such debates. In a broadly similar vein, we need to be ready to guide the development of central infrastructure for capital markets, so that those markets can be more resilient.

My provisional view, which may prove wrong, is that it will be insufficient to rely on the design of micro rules. I therefore think it will be worthwhile exploring whether a "macro" instrument could be devised. Candidates include varying across-the-board capital ratios for banks during the upswing part of the credit cycle; or setting and varying margin requirements for leveraged lending to non-bank financial institutions and others. Banks building up reserves during the good times (so-called "dynamic provisioning") is another variant. Amongst others, I have publicly encouraged public debate on this (for example, a talk to the Institutional Money Market Funds Association in April).

Operationalising such a system on a national basis would not be straightforward. In the monetary policy sphere, each country can pursue its own domestic monetary objective (price stability) in a world of floating exchange rates. In the "credit policy" sphere, any official tightening of capital or margin standards would be leaky in a world of unimpeded international capital flows; that is to say, UK firms and households could borrow from less restrained lenders abroad. There is, therefore, an international element to this debate.

Financial Stability

8. *What do you regard as the strengths and weaknesses of the work undertaken by the Bank of England on Financial Stability at the present time?*

A key weakness in the UK set up as we entered this crisis was the lack of a special resolution regime for banks. That is being addressed by the Banking Bill, together with 100% deposit protection and more rapid payout for retail depositors (a responsibility of the FSCS). The Banking Bill also establishes a financial stability objective for the Bank of England. That is a major step forward.

In pursuing our strengthened mandate, the Bank will need to ensure that we:

- Integrate financial stability analysis with monetary analysis, where useful; the crisis has underlined that a stable banking system is necessary for a stable economy.
- Are sometimes more forceful in conveying messages to the banking system and to other official sector authorities, internationally as well as domestically. (That does not mean that the messages should or will always be delivered in public.)
- Draw on the Bank's operational expertise to contribute to debates/initiatives to strengthen the infrastructure and "rules of the game" for the financial system.
- Are ready to intervene, where the Bank has expertise, on micro policies that are clearly relevant to market dynamics and so to stability; eg some parts of accounting conventions, some market infrastructure.

In doing so, we can draw on a strong endowment, rooted in our being the UK's monetary authority:

- Analytical strengths, especially given the Bank's position in the labour market for Masters and PhD economists.
- Financial market/banking operational expertise, stemming from our role at the heart of the monetary and payment system.
- A wide range of contacts in, and so breadth of intelligence from, capital markets given our operational roles.
- Goodwill towards the Bank across the international financial system; and the high standing of the six-monthly Financial Stability Report.

9. *How will you ensure there is an effective dialogue between the Bank of England and financial market participants, especially around Financial Stability?*

The bedrock of the Bank's dialogue is, and will always be, its relationships with the firms that are counterparties in the Bank's financial market operations, which provide a natural and frequent point of contact at working level. Those relationships need to be managed in a structured way. Building on them, the Bank has developed an extensive network of market intelligence contacts, going well beyond the markets in which we routinely operate in normal conditions and well beyond our direct counterparties.

But, while it builds on them, the Bank's contacts with the market cannot be confined to the Markets and Banking directorates. I aim to put in place arrangements encouraging and helping executives in the Financial Stability and other directorates to extend their own networks. I will maintain my own contacts, including using my new position to broaden and deepen them where I need to. The Governor and I will maintain contact with CEOs of the main UK and overseas banks, and other financial institutions.

10. *What do you regard as the main challenges you will face as Deputy Governor of the Bank of England during the next five years?*

- With Tripartite and overseas colleagues, getting out of the current crisis.
- Again with others and over the medium-term, redesigning the "rules of the game" for the domestic and international financial system to make systemic crises a lot less likely in future. (Amongst many other things, that will involve: (i) doing something about Too Big To Fail; (ii) strengthening capital and liquidity regulation for banks; (iii) doing something about the capacity of non-bank banks to undertake maturity transformation without constraint; and (iv) strengthening the infrastructure supporting important capital markets.)
- Implementing those parts of the Banking Bill directly affecting the Bank; notably, embedding the new Special Resolution Regime function, working with the new Director for the SRR, who will report to me.
- Ensuring that the Bank's assessments of the system's resilience and vulnerability take account of the conditions affecting firms without becoming, or being seen to become, a "shadow supervisor" (regulation is the FSA's job).
- Raising the profile of the Bank's financial stability function in a durable way (ie beyond the current crisis).
- Ensuring that the Bank can attract, develop and retain staff, at all levels, with the necessary skillsets. Offering a high status career in the Bank on financial stability issues.
- Ensuring that the Bank remains in touch with the financial system at all levels, and in ways that are not overly reliant on a few key individuals.
- Ensuring that the Bank's systemic assessments and policy initiatives draw on the whole range of skill sets and experience within the Bank.
- To the extent possible, encouraging and building more effective international co-operation in crisis management.

11. *In your first term of office, what will be your primary areas of research within Financial Stability?*

This will be for refinement when I am in post and can discuss it with the team, but my initial list of "big areas" is:

- How to make the financial system more resilient in future, while still fostering innovation and enterprise.
- Instruments/frameworks for taming the credit cycle.
- How to strengthen the infrastructure supporting key capital markets.
- The operation of the international monetary system and its affects on financial stability; the G20 and IMF are both focused on the "macro-meets-finance" issue.

12. *Do you foresee the Financial Stability section of the Bank of England requiring additional resources to undertake its work?*

Yes. Most obviously, extra resources will be needed to staff: (i) the unit responsible for the Special Resolution Regime being introduced by the Banking Bill; (ii) payment system oversight which, although not a new function, is being put on a statutory footing and so will entail more process and so more resources.

Beyond that, I will need to look at resourcing issues once I am in post and so closer to the work of, in particular, the Financial Stability directorate. That will mean looking at the type of skill sets employed as well as the number of staff.

13. *How will you ensure there is effective communication between the Treasury, the FSA and the Financial Stability section of the Bank of England?*

- By regular contact at senior level with HMT and FSA, outside of formal Standing Committee meetings (and membership of the FSA board). I will do this myself, and I will encourage my team to so do too.
- Aiming to understand, and so empathise with, each other's separate objectives.

— Tolerating a degree of overlap. That can be uncomfortable for bureaucrats, and can lead to accusations of turf creep. But handling overlap in a grown-up way is far better than living with underlap, ie gaps, which is much worse for society. We will all need to remember that when, eventually, we get back to "peacetime".

— Encouraging cross secondments.

As well as HMT and FSA, the Bank will also need to deepen relations with the board and staff of the Financial Services Compensation Scheme, given the connections between the FSCS's deposit insurance and the Bank's Special Resolution Scheme role.

14. *What steps are you taking to address the "heightened uncertainty about the value of banks' asset portfolios"?*

This is tied to the question of how to relieve some of the impediments to bank lending. It would be desirable to make regulatory capital ratios less procyclical as the economy slows; and to underpin confidence that funding will be available to the banking system as it combines lending to the real economy with deleveraging other parts of the balance sheet. Routine detailed examination of individual banks' asset portfolios is for the FSA and their overseas regulator counterparts.

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