HOUSE OF COMMONS

Treasury Committee

Oral evidence: Appointment of Carolyn Wilkins to the Financial Policy Committee, HC 307

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Anthony Browne; Dame Angela Eagle; Julie Marson; Alison Thewliss.

Questions 1 - 27

Witness

I: Carolyn Wilkins, Appointee, Financial Policy Committee.

Written evidence from witnesses:

Carolyn Wilkins appointment questionnaire

Carolyn Wilkins CV

Examination of Witness

Witness: Carolyn Wilkins.

Q1 **Chair:** I am now going to turn to the pre-commencement hearing for the appointment of Carolyn Wilkins to the Financial Policy Committee. All the way from Canada, we have Carolyn with us. Carolyn, welcome.

Carolyn Wilkins: Thank you very much, Chair.

Chair: We can hear you crystal clear. Thank you for joining us. You have spent quite a lot of time at the Bank of Canada. As you look at the issues of financial stability policy between Canada and the UK, what kind of differences are there? What kind of lessons might there be for the UK, based on your Canadian experience?

Carolyn Wilkins: I have thought about that for many years, just because I have worked so closely in international fora and bilaterally with folks at the Bank of England. I always enjoyed those interactions. The best way to cut into this is to start with the governance of financial stability policy in the UK and highlight how it is at the leading edge internationally in terms of the clarity of mandate, the delegation of tools and the accountability back to Parliament, in a way that has enabled the Bank of England to implement policies in a timely way but also to build the tools it needs in order to achieve its financial stability objectives. The CCyB—the countercyclical capital buffer—would be one of those.

If I pick one example of an issue that both countries are facing right now, which is some exuberance in the housing market and some pressures on affordability that were maybe there before but have only been accentuated by Covid, there are a couple of lessons that I would draw from the Canadian experience that might be relevant. First, it may look like a good idea at the time to loosen standards to increase access to housing or not to take actions to tighten standards, because it does affect people and that is very difficult for individuals. At the same time, it is a question of picking your poison.

We saw what ended up happening in Canada. Before the crisis, some macroprudential parameters were loosened. That spurred a big increase in the debt of households—highly indebted households—and a housing price boom that has lasted for a while. That has made households vulnerable and housing even more unaffordable, but it has also created a vulnerability from the financial stability point of view.

As great as the tools are that the FPC has, a second lesson is always to be humble about what they can hope to achieve. In Canada, we have the same tools; it is just that they are governed in a different way. Sometimes there are underlying issues in the housing market, like the supply of housing, that are the root causes of the problem of unaffordability or inaccessibility. What is the right tool to bring to bear there? It is the Government's job, in a sense, not the central bank's job.

Keeping firmly in mind what a central bank can do and what it should leave to Government is extremely important.

Q2 **Chair:** Can I ask you a question that may be slightly out of your area on inflation in the UK? It is interesting that you are talking about house prices here, which are rising quite rapidly, particularly outside of London. Should that be a cause for concern going forward? The Bank of England is saying, "It will come up above target for a bit and then it will wash through in the end." Do you take that view, or are you more concerned about it?

Carolyn Wilkins: I would hesitate to step out of my lane. It is not a matter for the FPC. I have said and I did say in my questionnaire that, if inflation pressures were to take hold and become a feature that market participants were concerned about, it could raise financial stability concerns, because it would result in a steepening of the yield curve. Financial markets do not often do things slowly and in proportion; they tend to do them quickly and in great proportion. Given the high level of indebtedness for households and businesses, that could be very difficult for people, especially those who need to roll over their debt or renew their mortgage.

That is why it is so important that the FPC does the stress tests of financial institutions to see how that might play out, as a tail event. When it comes to Canada, the US and advanced economies more generally, what we are seeing today is largely mechanical. It is a rise in inflation that comes from previous declines in mainly gas prices at the onset of Covid. I would make a difference between the base case outlook and a view that you still need to worry about tail risks.

Q3 **Chair:** Can I quickly ask you about one of your interests? You are a board member of the about-to-be new owner of Royal & Sun Alliance Group, the insurance company. Do you see that as an issue in this new role? You may have to recuse yourself from some of the information that is circulated and the discussions that are held. Is that likely to be a problem? How big of an issue is it, would you say?

Carolyn Wilkins: I see the issue as a conflict of interest that needs to be managed. I am glad that in the entire process that led to my appointment and my being here today, which I am grateful for, it was declared right away. I realised that Intact Financial Corporation was an undertaking that could put me in a conflict of interest situation. It was dealt with head on.

My understanding is that, once I declared it in the application, Her Majesty's Treasury and the Bank of England got together to determine whether it was a conflict that could be managed, and they decided that it could. It is my understanding that the Bank of England has a very robust recusal process, which means in practice that I will be recused from any meetings that discuss Intact or issues that may be of material relevance to it. I will not receive any documents that have the same content. It is transparent to other members of the FPC, so they will not inadvertently give that information to me. In the event that I recuse myself from a particular item that is discussed on an FPC agenda in one of the policy meetings where there is a report, it will be disclosed in the report. It is transparent publicly.

I was concerned that this process was robust, because it is in my interest, the interest of the Bank of England and the interest of Intact Financial Corporation that we manage this carefully and with the appropriate amount of caution.

Chair: Thank you. That is a very comprehensive answer.

Q4 **Anthony Browne:** Welcome, Carolyn. My questions are going to be about the way the FPC and the PRA responded to the pandemic. They released the countercyclical capital buffer, suspended stress testing, and urged and then required banks not to pay out dividends. I am just wondering what you think are the lessons learned from all that. What worked really well and what did not work well, if we end up with another pandemic?

Carolyn Wilkins: Let us hope we do not end up with another pandemic—it was very costly for individuals and their families—but we will certainly see disruption in the future; it seems to be the way the world works.

On the countercyclical capital buffer, the big lesson that I would draw is that it paid off all the investment that was done in Basel post the 2008 crisis. We took advantage of the momentum and the call to action to take some hard decisions and create a framework, which the Bank of England then very diligently built out. In fact, it was one of the first to do so. The great thing was that there was actually a buffer that could be released.

Whether or not it is used, and why buffers may not be useable, is a question we still need to attack. They are there to be used, and central banks and prudential regulators around the world have tried to make that clear. Whether or not they are released may not be a sign that it was not successful. If you are a financial institution in a time of uncertainty, you want to keep some insurance. The fact they had that extra headroom may have prevented them from being even more cautious than they would have been otherwise. It will take some time to know whether that is the case.

The other area that was a success was actually before the crisis as well. It was the big change in 2016 to remove central bank reserves from the leverage ratio. That was important. You could see it with the operations that are being undertaken right now across the world. Having such a riskless asset in your leverage ratio could be countercurrent to the intent of central bank interventions. The lessons from previous crises are always about how you build back afterwards, rebuild the buffers and get back to square in terms of the regulations that you relaxed, which made sense at the time. It is about restarting the stress testing and that sort of thing.

That is going to be the challenge for the FPC and the PRA: to find the right timing and the right pace to do that.

Q5 **Anthony Browne:** You raised a question about the usability of the countercyclical capital buffer. There are lots of reasons why banks may not want to use it. You mentioned the inherent cautiousness when there is economic uncertainty about. Even if they are not worried about the macroeconomic circumstances to the same extent, are there other factors that may stop them using the buffer to increase lending?

Carolyn Wilkins: I do not want to speak on behalf of banks, because individual banks may have their own reasons, but the reasons I have heard when discussing this with banks tend to vary. They do not want to be the only bank that is using the buffer. There is a collective action problem, because they will face market discipline. That is probably the biggest one.

I have not heard this about the UK, but across the world some say that some supervisors do not love it when buffers are used and they raise eyebrows. I am going to emphasise that I have not heard that about the PRA at all. The third thing on the lending is that the tricky thing for financial institutions at this point is that we are going through a credit cycle. There are a lot of households and businesses that are under stress and in terrible situations because of Covid, which affects their credit quality. Banks need to take difficult decisions with respect to sound underwriting of loans. There could be a bit of that in the mix.

Clearly, in the post-mortem that we will all be doing, it is something that will be worthwhile to put our heads to: how can we improve the situation for the next time?

Q6 **Anthony Browne:** If the countercyclical capital buffer is not used, there are going to be question marks about whether there is any point in having it in the first place.

You mentioned the risks. In your evidence, you highlighted the legacy of corporate as well as household indebtedness as a result of the pandemic, particularly corporate indebtedness. Households have generally saved quite a lot, but some of them are in debt. Do you see that as a big problem? How big a problem is it? Are there particular sectors that you worry about? Is it an issue that the FPC itself should need to address in some way, or is it just something that it needs to watch?

Carolyn Wilkins: They definitely need to watch it. My issue with the debt is not so much that corporations should not undertake debt or households should not. Clearly, corporations need to do that to invest and to keep afloat. It is part of business. It is a question of whether the underwriting and the extension of that debt was done in a way that stands the test of time or creates vulnerabilities, not just for individual lenders but for the system.

Take some of the risk taking we have seen and some of the ways lending has been occurring, particularly through non-bank financial intermediation in facilitators like open-ended money market funds and hedge funds. They are not bad in and of themselves; they provide diversity from banks, but sometimes things get out of hand or are not seen early enough, and that creates broader problems and may require action.

The other issue is that it just creates a vulnerability if there is a downturn. We know that, on the housing side, housing price drops are terrible for people and can put them underwater, but the worst thing is losing your job. Personally it is hard, but it also makes it really hard to pay off your debt. It is the same with businesses that need to close their doors. If we were to get a shock or an event that created headwinds for growth in the UK, it could create financial headwinds that banks and other creditors would need to absorb, which would create an accelerator to a macroeconomic slowdown or decline.

Q7 **Anthony Browne:** Can I just push you on a point? You touched on the issue about financial stability and corporate indebtedness. Could corporate indebtedness be a financial stability risk?

Carolyn Wilkins: In terms of the stress tests that I have seen, the reverse stress test from the Bank of England last year had a really terrible scenario and banks were able to absorb those losses. From that point of view, that homework has been done.

What we do not know is the part of the financial system that is not visible to us. There was an example in the UK of a hedge fund that had taken large positions. These positions were not transparent. Their prime brokers were unaware of them when they onboarded them and as they provided the services. You can see how hidden risks in the financial system can blow back to the banking system in ways that we did not predict in advance.

That is my way of giving an example of why you should never say "never" when it comes to high levels of indebtedness and complex financial products creating trouble for the financial system.

Q8 **Anthony Browne:** You are right. It is very difficult to see how it might flow through the system.

Stress tests are coming back. Do we need a special stress test for pandemics? The FPC decides on different scenarios every time, and the banks normally complain about the scenarios being unrealistic. The economic consequences of the pandemic have been extraordinary.

Carolyn Wilkins: That is an excellent question, because it opens up a bigger conversation than just stress tests of financial institutions and the credit losses that are in typical stress tests. In a typical kind of stress test, the scenarios are supposed to be plausible but severe. You can imagine a pandemic-type scenario being like that. You could even imagine creating one. Do I think we need to do one? We need to do more than one scenario, because there are so many ways that things could go pear-shaped. The trick is not to overload financial institutions and the Bank of England with work, because these things are enormously time-consuming and complicated.

In my mind, it raises the utility of doing other kinds of what we could call stress tests on the operational side. One of the lessons from Covid is that operational resilience and continuity of operations is just so important. At the Bank of Canada, we introduced 11 programmes over four weeks, and in a 10-day period we had all our employees except for maybe 100 starting to work from home. Banks around the world, including in Canada, did the same thing. It is just an amazing feat, and it was the product of a lot of prior investment.

With that being said, cyber risk has increased because of working from home. The operational plans that you had for continuity of operations, what you do if the lights go out, all need to be redone if we are going to stay with at least partial remote working. That is not a stress test in the same way, but it is testing your resilience and your ability to recover from stress events that are operational in nature.

Anthony Browne: I would love to ask more questions, but that is all I have time for. Thank you.

Q9 **Alison Thewliss:** I have some questions that lead on quite nicely from what Anthony was saying. There are some questions around shadow banking and the lessons from the 2020 dash for cash.

You mentioned that things can get out of hand quite quickly. Since the financial crisis we have looked at regulated banks more heavily. Sir Jon Cunliffe told this Committee that the non-bank sector has grown enormously since then and that it is inevitable that increased regulation of banks will push financial activity into the non-bank sector. What risks do you see from this?

Carolyn Wilkins: Jon was quite right when he said that non-bank financial intermediation has grown quite a lot. Part of it is financial innovation; part of it is financial regulation coming out of the crisis. As I said before, I do not see that as inherently bad, because it provides diversity in funding sources and sources of financial products in a way that serves the system well. With that being said, with something new that is not always visible and that can be outside the regulatory perimeter, accidents can happen and risk can build up.

You mentioned the dash for cash. One of the big eyebrow-raising moments for me was seeing the disruption in the Government bond market, which is usually where funds flow to, and even in the US Treasury market. When you see bid/ask spreads blow out like that, you have to think, “What is driving that?” Clearly, people were caught off guard in a couple of areas. I will mention just two. First, some institutions were taking positions in the derivatives market that made a lot of sense but came with a need to post margin. When the prices started to move quickly, they needed to make good on their margin requirements, but their collateral management policies, their liquidity policies, were not up to the task. That is one example.

Open-ended money market funds had some redemptions that required them to do some gating, which is fine as part of a process, but is not fine if you are a retail investor who is expecting daily liquidity. There is an inherent mismatch between the duration of the assets and the duration of the liability.

What happened was that there was a dash for the same thing: cash. Central banks needed to come in—that is their job—to provide some liquidity to that market, making that market for a time, to restore normal functioning. It is just core. That is just one area that we need to look at. More generally, the opaqueness of the market makes it really difficult for any authority, whether prudential, systemic or consumer protection, to see what is actually going on. There are questions about that and questions about what kind of due diligence financial institutions do in understanding the clients they serve.

Q10 **Alison Thewliss:** I have a couple of questions that come from that. I will try to remember everything that I want to ask you. You talked about central banks stepping in and acting where there are weaknesses. Does that disincentivise the private sector from behaving responsibly, if they know that in the future they can do the same thing and the Bank will step in and deal with that? Are there things that need to be put in place to prevent that from happening?

Carolyn Wilkins: It could actually disincentivise them. Central banks spend a lot of time worrying about that. It is called moral hazard. There are a couple of guardrails for that. One is the financial and prudential regulation and the rules of the game for other players, which mean they need to self-insure. This action is the last resort possible, when we are at the end of the road. That is No. 1. There may be new things that we need to do. I have not started yet, so I cannot really speak on that, but there are new things that we need to do to reinforce that self-insurance.

The second thing is the design of the programme. You can design a programme with respect to the auction mechanisms—the way that service is extended, whether it is a repo or an outright purchase—so that it works when things are disrupted and it becomes unattractive when things get back to square. That means that market participants will just go back to their own business, because it is not worthwhile to transact with the central bank. In fact, I cannot speak to the UK facilities, but in Canada people quite quickly just stopped using some of the money market facilities that we put in place, because once markets were re-established our pricing was not very attractive. That was by design.

Finally, we need to remember that, when it comes to shocks that affect everyone, aggregate events like a pandemic, it is not very efficient for firms to self-insure themselves completely. I do not even know if they could. That is why central banks are there. The trick is just to make sure that, when they do their job, they are not creating bad incentives for the future, as you are clearly worried about.

Q11 **Alison Thewliss:** That is useful. In terms of the smaller investors that you felt got lost in the shuffle, does there need to be more protection for them specifically?

Carolyn Wilkins: That would be a question for the Financial Conduct Authority, so I hesitate to answer that. Just as a general matter, especially for the new services that are emerging all the time in fintech and in the crypto space, clearly it is important for authorities to keep up on consumer protection. The link back to stability in my mind is that, if people do not trust the system, especially the core payment system, that is not supportive of financial stability.

Q12 **Alison Thewliss:** This was the first major stress test since the creation of the Financial Stability Board. How well did they perform during this? Are there any lessons further from that?

Carolyn Wilkins: On the good side, it was critical in March that not just the UK but countries around the world had implemented Basel III, as well as the other aspects of the financial stability programme. The reason is that the worry that markets had was not about each other; it was about what this pandemic was going to mean. As soon as somebody came in to say, "We are going to manage the things in the pandemic," things went back to pretty much normal. I cannot emphasise enough just how relieved we all were around the table at the time that this was the case.

With that being said, I think we knew. Hindsight is 20/20, for sure. We did not know the extent, but at the time we knew that non-bank financial intermediation was growing and that there were issues there. If you look at the Financial Stability Board's website and the BIS website, there are lots of papers on that. It is just that there was not the impetus coming from a financial crisis that allowed regulators to battle out what are really important debate issues about innovation, the role of markets and the role of regulation.

The lesson there is that we need to take this opportunity and the call to action that is happening right now to do that work.

Q13 **Alison Thewliss:** To move on to a couple of wee specifics, we have seen a number of high-profile non-bank failures lately, including Greensill Capital, quite notoriously I suppose, and Archegos Capital Management. What lessons should the FPC be taking from these failures?

Carolyn Wilkins: This is an FPC and PRC matter. I am still working out how that co-ordination occurs, so forgive me if I am speaking about what is really a PRC matter and not an FPC matter. This will be the third time I have mentioned transparency and opaqueness, and it is worth mentioning it three times. When you do the analysis of hedge funds, to take that example, Archegos and these other asset managers made bets that were done legitimately through derivatives markets, taking positions without actually owning the assets. Somebody else owned the asset.

If you are looking to price this properly and understand where the risk lies, you cannot see it; it does not need to be disclosed. The lesson from that is that where things could have systemic importance—that is the FPC's job—that transparency should be improved. We have to think through the mechanism to do that. It turns out that Archegos was not systemic, but that does not mean there are not other large, opaque positions out there in larger firms that could create trouble.

The second lesson is about understanding better what went wrong with the onboarding process, the risk management of the prime brokers and how it was that they did not see that. It is clearly a case where it is in their best interest to see it, so that is a question for supervisors to look at. The FPC could highlight that, and it probably already has. I would just close with those two lessons.

Q14 **Alison Thewliss:** That is really useful. Your point about transparency is very well made. It cannot be stressed enough. Three times is the very least we could talk about that transparency. Lastly, I do not want to draw you down the road of the regulator, but is there a financial stability case to expand the regulatory perimeter to bring any particular types of firms or products into the view of regulators to enhance that transparency that you were talking about?

Carolyn Wilkins: I am hesitant to answer that, because I might not be able to be precise enough to avoid being misinterpreted or saying that I am going to commit the FPC to something when I have not had the conversations.

I would be surprised, though, if there were not areas that did not need to have more of a framework around them. One area that we did discuss is the crypto asset space. It may not be systemically important at this point, but it is likely to gain in importance because of its size and because of its links to others. It seems important to me that we have the discussion there. That is for sure.

Alison Thewliss: I am sure one of my colleagues is going to go on to talk about that in a little while. Thank you very much, Carolyn.

Chair: Thank you very much, Alison. It might be right now, as we go to Steve Baker.

Q15 **Mr Baker:** It is right now. That was marvellous bridging work. I should refer again to my registered shareholding in Glint Pay.

In your questionnaire, you say very plainly, "I do not consider cryptocurrencies, such as Bitcoin, to be money," and you go on to say, "I think of Bitcoin and other cryptocurrencies as highly risky investment products rather than money." That puts you at odds with the people who invented Bitcoin, does it not?

Carolyn Wilkins: It does, that is for sure. That was just the quick answer to your question.

Mr Baker: We love quick answers to questions. Do not worry about that, but give us the long one.

Carolyn Wilkins: Even with Bitcoin, though, that community has a couple of personalities. Some would like it to be digital gold, which is not money. Some would like it to be a means of payment. Some would like it to be maybe more of a utility, providing a service behind the scenes. My claim with respect to Bitcoin not being money was just based on the traditional definition of what money is.

Q16 **Mr Baker:** I wanted to pick up on that slightly. I have to say this is partly about intellectual curiosity and partly because you are going to be so important to the evolution of this conversation. One of the reasons you gave was that it is not money because it is not backed by any entity, but the idea that money needs to be backed by a particular entity is a relatively new idea in the history of monetary orthodoxy, is it not?

Carolyn Wilkins: It is. In fact, if you go back to the free banking era in the US, that was not the case. What I meant—I cannot remember my exact wording—was, "Is it used and thought of as a store of value? Is it used as a unit of account? Is it used as a medium of exchange?"

If we start with the store of value, you are quite right. Theoretically, it is possible to have a stable store of value that is not backed by a central bank. I would claim that the best store of value is one that is backed by a good central bank, one that keeps its eye on the ball, but that is a matter of debate. When you actually look at how Bitcoin is used—there are different ways to do that—there is no evidence that it is being used as a store of value. In fact, it is being used in a couple of ways. One is to make money as a speculative asset. It is more like a commodity. Sometimes it is used for payments, but not payments that we want to encourage.

Q17 **Mr Baker:** That is very interesting. I am a software engineer, so I regard these cryptocurrencies as a matter of very considerable interest. I want to pick up on two things. I also regard them as a speculative bubble, like the tulip mania, which is an area where I agree with you, perhaps, and certainly with things the Governor of the Bank of England has said.

You used the term "digital gold" moments ago. That leads me on to the point you just made about money being backed by a central bank. Bitcoin does have a supply schedule that is intended to mimic the supply schedule of gold being mined, but isn't that precisely because the people who intended to make Bitcoin available as money were trying to escape the undermining of the purchasing power of money inherent in central banking and the evolution of money since the end of the Bretton Woods era?

How do you see the actual evolution of things like Bitcoin, bearing in mind the different competing factors at work? It has emerged as a mania, as a speculative asset, you are right about that, but the intention for it was to produce a money that was more reliable than central bank-backed money. Given those competing factors, how do you think the evolution of digital currency will flow?

Carolyn Wilkins: It is true that there is a rule, like a monetary policy rule, that is embedded in Bitcoin, in the program, which creates a certainty about the supply of Bitcoin. There are two issues, though.

First, if you want to have stability of the ability to pay, the value of the money, you also need to be able to predict the demand for money, which is highly variable. You might remember—maybe you are not old enough; I do not know—that back in the 1970s and the 1980s monetary policy was run on a money growth rule, which failed spectacularly because money demand is so unstable.

Secondly, the supply of Bitcoin is not the only supply that matters for price stability in the digital world, because they cannot control the supply of other Bitcoin, like Bitcoin Cash, which comes from hard forks, and they cannot control the supply that comes from other kinds of digital currency. That experiment is interesting, but it cannot succeed, in my mind, at stabilising prices.

There is a future for crypto assets and that kind of technology in terms of perhaps being a utility. Stablecoins could help do peer-to-peer transactions behind the scenes but backed by a fiat currency. I see that as a very interesting set of work, and in fact it is the reason I am part of the Creative Destruction Lab at Rotman School in Toronto.

Q18 **Mr Baker:** I would love to continue this conversation for hours, but I want to pick up on two further points very briefly, if I may. What is going to be the future for credit expansion by private banks, if we end up deploying central bank digital currency?

Carolyn Wilkins: That is an issue that we need to work through. A lot of work has already started at the Bank of England and among central banks. Clearly, the extension of credit and financial intermediation are really important parts of the economy.

In my view, a central bank digital currency, properly designed, would not get in the way of the extension of credit. The channel through which people worry about it is that deposits would flow from banks to individuals' central bank digital currency wallets, and so a source of funding for banks would dry up. In my view, all a central bank digital currency would do, properly designed, would be to create contestability in that market. Banks would have to up their game in terms of the quality of service they provide to customers as well as the cost at which they provide that service.

That could, properly designed, be a win. In fact, they would have an ability, in the fintech world, to provide a group of services that are far superior to the plain vanilla central bank digital currency. I do not see that as being a big issue.

The design features are important. Clearly, whether it is compensated through interest is an important one. Whether it is limited in terms of the amount you could have, and whether it is a one-tier or two-tier system, so whether it is distributed directly or indirectly through banks, will really matter, to answer your question.

Q19 **Mr Baker:** I want to come to my final question in a moment but, just to pick up on that, you have written about monetary sovereignty in your questionnaire, but you have also now talked about contestability. Are we not in a slightly strange situation where entrepreneurs, in innovating, are trying to contest the state's monopoly of money and money power, and the state is trying to enter a market created in the private sector? Is that not what is actually happening? Then we are into a conversation where we have to decide whether we are going to assert monetary sovereignty or not. Isn't that what is actually going on?

Carolyn Wilkins: You have got it. You have got it exactly right.

Q20 **Mr Baker:** I will have to apply for the job, next time round. This is the final point that I wanted to put to you. I get the sense that you are much more optimistic about blockchain, the underlying technology, than you are about Bitcoin as an application of blockchain. Is that right?

Carolyn Wilkins: Yes, absolutely. That is because it can provide a service in terms of not only the ledger, but smart contracts, smart money and linking people up without an intermediary in a way that could provide more safety and more efficiency. The devil is always in the detail as to which distributed ledger technology you are using, whether the service has the proper governance and the proper legal underpinning. With the right elements in place, there is something there that can be used not just in financial services but across different industries.

Mr Baker: Thank you very much indeed for this very interesting conversation.

Q21 **Dame Angela Eagle:** Just thinking about cryptocurrencies, I am going to get on to climate change and the consequences there. Of course, it is massively energy-using to mine cryptocurrencies. That is something we have not talked about yet, but that is definitely a cost associated with them.

Carolyn, you have told us that you are going to have to recuse yourself from FPC discussions on the Climate Biennial Exploratory Scenario, because of your conflict of interest in being on the board of a large insurance firm. Will you be able to make an effective contribution to the FPC's important work on climate change while absent from a major exercise like that?

Carolyn Wilkins: We will have to see where to draw the line. I am very confident that I will make a contribution to other very important areas of the FPC's agenda. This is a discussion to be had with the conflict of interest folks at the Bank of England, but, in my mind, the line that we drew together with respect to that scenario is because RSA was participating in that particular exercise.

In situations when we are discussing climate change modelling, scenario analysis and modelling in general, or talking about the financial stability implications of climate change in general, there may be a possibility for me to contribute. To the extent that we are looking at the physical risks coming from climate change as opposed to the transition, that is almost always going to be dealing with P&C insurance, so that leaves me out.

When it comes to how the market for green finance is and how ESG is being applied, again those are very important issues. They are not front and centre for the FPC, but there is certainly an interest that those markets are developed in a way that does not create systemic vulnerabilities. Those are areas where I hope to make a contribution as well, subject to that being passed by the recusal process.

Q22 **Dame Angela Eagle:** Of course, they will have to approve your involvement, presumably, before you are allowed into the room. That is fair enough.

In your questionnaire response, you seem sceptical about the role of central banks in encouraging the transition to a net zero economy. Is that because you think the market will do that itself? Surely this is an area where there is major market failure.

Carolyn Wilkins: I do not think the market will do it on its own. There is a very good opportunity for Governments and the private sector to collaborate in a number of areas. You will see that in the report by the G7 panel on economic resilience, which I sit on as part of the UK's presidency of the G7 this year, the recommendations in the climate area, which we released today, involve quite a bit of public-private collaboration in areas related to green finance, among other things. I will not go through it.

It is important for a committee whose mandate is very clear, focused on financial stability as a primary thing, taking other things into account as they go along, to stick to its knitting. In fact, there is already a very big contribution that the FPC is going to make in scenario analysis, because it is working with banks and other financial institutions. That is going to encourage them to understand and manage the risks. I would not underplay that contribution.

Q23 **Dame Angela Eagle:** Are we short of the right kind of analytical tools to assess whether something that claims it is moving an organisation towards net zero, or that it is an advance in the green space, actually is an advance in the green space, and not just something that is being erroneously claimed because that happens to be what everyone is looking for at the moment?

Carolyn Wilkins: There is some work to be done to improve standards with respect to what qualifies as green. The EU, among others, has tried to push this forward. This is going to be a global market, so there is still more work that needs to be done there. It is going to be tricky, because this is always about a technology that has a possibility of working. If it is an investment in some renewable energy projects, we do not know whether it is going to work. At the same time, there is still work to do to make that more consistent.

Making it more consistent will not only avoid greenwashing; it will also make it a more vibrant and deeper market. That will be to that market's advantage. I would just emphasise that it is going to be very important to think about transition bonds. Carbon-intensive industries that are working to lower their footprint also need to have some kind of framework to allow that to happen. That would be in the best interests of climate change.

Q24 **Dame Angela Eagle:** Is there a role for offsetting in that sense? Does offsetting perhaps need to be phased out? How much of fossil fuels should stay in the ground forever? Are you at the Greta Thunberg end or—I do not know—the Chinese coal industry end?

Carolyn Wilkins: You are asking fundamental questions that are starting to creep out of my area of expertise but also my responsibility as part of the FPC. I will maybe leave that for another conversation.

Q25 **Dame Angela Eagle:** The Bank recently published a discussion paper on greening the corporate bond purchase scheme. There was some comment originally that it was not nearly green enough when it was introduced. This paper includes the option of divesting of firms that are not investing in the net zero transition. Is it an appropriate role for financial and monetary policy to be doing that? Should there be those kinds of very strong signals from states that actually drive the market in a particular direction?

Carolyn Wilkins: I feel hesitant. That is a Monetary Policy Committee action, and I am encouraged not to talk about that. As a general matter—

Chair: I am very sorry to interrupt, Carolyn. The Division Bell has just sounded, which means there is a Division in the House of Commons. What I would normally do at this stage is suspend the Committee and come back, but we are so close to the finish. Can I just ask whether there are any Committee members who need to attend that Division?

It looks like everybody can continue. Let us continue, Carolyn, with your answer. Thank you.

Q26 **Dame Angela Eagle:** I was just asking you a question that was outside your remit.

Carolyn Wilkins: It was.

Dame Angela Eagle: You were coming on at least to make an observation about it.

Carolyn Wilkins: The first observation I would make is that there is a difference between applying an ESG policy and one that proactively seeks out investments that are green.

The second one is that a central bank, especially in financial sector policy, because that is what I am going to talk about, cannot lose sight of the primary objective, which is the financial stability angle. If anything they do on the green side puts that at risk, it is not only at odds with the mandate of the FPC; it is at odds with the legislation that was passed, which I read, that says it needs to be primary.

That may be a binding case in some situations. I will just speak about Canada and the Bank of Canada's corporate bond purchase facility. There are not a lot of issuers in Canada. One part of our principles was that we wanted to be neutral in the markets, and to have an impact that would stabilise these corporate markets and, by doing that, stabilise the financial system and allow monetary policy to do its work. If we had only purchased green bonds, for example, there is not a very vibrant market there and we would not have achieved our objective.

Q27 **Dame Angela Eagle:** What is the short and medium-term approach to this? Clearly, the global economy has to be shifted towards a net zero space quite quickly. If we have a crisis today, clearly the markets in net zero, green goods and the green transition are not there, but surely there has to be a path plotted for the future that the market knows about so that the transition is assisted. Is there a role for doing that in your space? If climate change becomes uncontrollable, there are tipping points that can manifest themselves very quickly, and then you are in a huge crisis that is also about financial stability.

Carolyn Wilkins: There needs to be a path to the transition, and that needs to be a private sector, Government and Government affiliate exercise. In my mind, the place to start on that is in building a market for green bonds and transition bonds, and making clear what they are, so that, if purchasers of these assets are using that as a criterion, they have a firm leg to stand on as to why they made this choice and not the other choice.

From the point of view of a central bank, which relies on its independence and the trust that Government and citizens have put in it for delegated authority, that ability to explain why this and not that is fundamental. That is not in place right now.

Chair: Thank you very much, Carolyn, for joining us. It has been a very interesting set of discussions. We wish you well for the future.

Carolyn Wilkins: Thank you for the invitation.