

Treasury Committee

Oral evidence: Re-appointment of Martin Taylor to the Financial Policy Committee, HC 938

Wednesday 18 April 2018

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[Watch the meeting](#)

Members present: Nicky Morgan (Chair); Rushanara Ali; Mr Simon Clarke; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Mr Alister Jack; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 1-28

Witness

I: Martin Taylor, External member, Financial Policy Committee, Bank of England.

Written evidence from witnesses:

- [Martin Taylor CV](#)
- [Martin Taylor Questionnaire](#)

Examination of witness

Witnesses: Martin Taylor.

- Q1 **Chair:** Thank you very much indeed for being here before the Committee this afternoon. You have heard your two colleagues being quizzed earlier, and I suspect we are going to cover much of the same ground. I want to start with one of the questions I asked Mr Brazier, which is about finding consensus on the committee. In your written evidence, you say, "The apparent ease with which consensus is maintained on the FPC is perhaps deceptive", and that you "have found some decisions more uncomfortable than others". Can you expand on that evidence?

Martin Taylor: I wouldn't like to expand on it in a way that broke consensus by going into chapter and verse. I don't think it is surprising that some decisions are harder than others. One finds oneself sometimes a bit ahead of the committee, sometimes a bit behind.

I go on to say in my written evidence that there is a good deal of respect among the committee members for the concerns that they might express. We know that if a particular member thinks we are getting something wrong in a certain area, it is certainly worth listening to them. That is partly because there is not enormous experience of doing this kind of work, and partly because we have no history of doing the calibration of the CCyB, for example, whereas on interest rates we have got centuries of history. It is a brave member of the committee who says, "It's absolutely got to be 1.25%, rather than 1% or 1.5%." We haven't got that.

- Q2 **Chair:** Would you agree that, sometime in the future, there could be a need for members to vote if consensus cannot be reached?

Martin Taylor: Yes. I agree with what Alex Brazier said. In fact, I expect that at some stage we will get to a point at which there is a pretty binary choice on the CCyB, and if the committee can't reach a consensus easily, we will have a vote and publish the results. I think that will be a healthy development, actually.

- Q3 **Chair:** You also stated—you've taught me a new phrase—that the common position of the FPC can "rightly be a deferral to the next meeting". The new phrase is "dynamic procrastination", which I am going to use in all sorts of ways. You say that "dynamic procrastination can sometimes be a good idea". We have obviously talked to Mr Brazier and Dr Kohn about the countercyclical capital buffer decision, which was not taken in March—perhaps it is delayed until June. Is that an example of dynamic procrastination?

Martin Taylor: It may be. You have already heard so much about it from my two colleagues that you must feel like you were almost in the room when we were talking. A couple of points weren't made. One is that in December the Brexit negotiations—remember, we met just before the

December Council—were on a knife-edge and we were concerned about the possibility that things might go wrong between December and March. We were conscious also that if we do raise the buffer, the banks have a year to put the new capital in place, whereas if it's released, it's released immediately—with immediate effect—and that's a deliberate asymmetry built into the system. That meant that if we wanted to have extra capital in place by March '19, we would have had to move in March this year, and that was the reason for the concern about Brexit.

The concern about Brexit tailed off in the first quarter, thank goodness, but we became more worried about the general build-up of global risks, which we discussed in our record. Where I was, really, was to say that if it was right to say risks were standard and that 1% was the right number 18 months to two years ago—in the period before the referendum—then they are probably more than standard now, or at the top of the standard range. One would be looking for a slightly higher number.

What seemed to me the right thing to do, which we did, was not to move in March, to decouple the decision from the Brexit talks, but to leave the market with the expectation that there might be a move in the next quarter or two. I think that is a sensible place to be in and we shall look at it again very carefully in late March.

Q4 **Chair:** In your experience of having been on the committee, has the desire to achieve a consensus ever led to a delay or something that you have not been happy with?

Martin Taylor: No, I don't think so. Sometimes I have thought that we should have moved a bit faster than we did. I felt that about consumer credit, actually. I think we were probably three months late, but I don't think it was to do with consensus building.

There were two ways of looking at what was happening in consumer credit 15 months ago. You could say, "It's rising very rapidly. Do something about it," or, "It's rising from such a low base that there's no need to worry." It's not surprising really that the committee at that point decided to wait before acting. Consumer credit continued to rise very rapidly and the consensus moved into acting, but there was no feeling of, "Let's hold off, because we can't get a consensus together."

It hasn't been a painful process; it's been a delicate process. People take care—I don't think they take too much care; I think they take proper care—not to break consensus unnecessarily.

Q5 **Chair:** In your evidence about the financial stability indicators, you talk about them giving very contradictory signals at present: some ice-cold; some very hot. Is there anything else you wanted to add, having heard the thoughts of the others?

Martin Taylor: Not really. There may be some people in the Bank, or outside, who feel that we could get to a kind of magic mechanical position, whereby we can get a perfect reading from a certain set of indicators and it would tell us what to do. I don't believe that.

What's really useful is to look down the list and to look for the ones that surprise you, really. The Bank runs quite interesting heat maps, which you have perhaps seen. Running up to the financial crisis, everything was moving towards incandescent, but looking at things recently there are a lot of hot indicators, which are mostly to do with the areas that have been discussed by my colleagues, like asset pricing and credit spreads—"the pricing for perfection", as Alex put it. Then there are some that, frankly, are pretty slack.

Q6 Wes Streeting: I will just ask a couple of questions about conflicts of interests, if I may.

You noted in your note to us that after you had disclosed your wife's appointment as deputy chief executive of the Co-op Group in March 2017, the Financial Policy Committee agreed that you would absent yourself from any future FPC decisions and discussions, and would not receive future FPC papers on firms' specific matters related to Co-op Bank and CIS General Insurance Ltd. How much of an impact did that have on your work? How many meetings did you have to recuse yourself from, and on how many votes did you abstain?

Martin Taylor: From none, as a matter of fact. There was a briefing on the Co-op Bank talks that led to the deal last June, which I was kept out of until after it had been completed. After it had been completed, the conflict was deemed to have finished. There is a kind of rule, which is sometimes quite hard to follow, that the FPC, which looks at the system as a whole, does not spend time on individual institutions, although since we have some very large institutions, it is sometimes hard to forget that. An organisation as small as the Co-op Bank would not normally trouble the FPC.

Q7 Wes Streeting: As a final general point, we regularly touch on the issue of conflicts of interest in the Committee, particularly during appointment hearings like this one, but more generally our work touches upon it. Have policies around conflicts of interest ever dissuaded you from taking another job or position as an FPC member, and do you think the framework around conflicts of interest are appropriate and in the right place?

Martin Taylor: I think they are appropriately tough. It is not exactly that it has dissuaded me from taking things; it is that I would not have sought things or they would not have been offered to me, because I would clearly have been offside. The two boards that I am involved with—one pre-FPC board and one later one—are both outside the UK, and neither has anything to do with the financial sector beyond the fact that all companies are involved with money in one way and another. But it is a constraint, particularly if you are looking to get people on the committee who have had and still have practical experience. You are trying to get them at that point in their personal life where they have given up most of their professional commitments and have not yet got hopelessly out of touch. But I think the rules have to be strict.

Wes Streeting: Yes, that's right. I'm afraid I have to go to another

meeting; I'm not walking out in protest at any of your answers. Thank you very much.

Q8 **Rushanara Ali:** Moving swiftly on to crypto-currencies—

Martin Taylor: Not China?

Chair: We are mixing it up so that you don't know who is asking what.

Alison McGovern: They're not unrelated.

Rushanara Ali: The March FPC record stated that crypto-currencies "had no intrinsic value beyond their currently limited potential to be adopted as money in the future, and hence could prove worthless". How worthwhile do you think crypto-currencies currently are?

Martin Taylor: I think this is somewhere where the committee really did have a clear consensus. There is considerable interest in the distributed ledger technology that underlies these things. Someone used the rather striking metaphor that the distributed ledger technology is a smartphone and the crypto-currencies are a lousy app.

Q9 **Rushanara Ali:** Do you want to declare the author of that statement?

Martin Taylor: It wasn't me. We believe that at some stage there will be good apps for the phone, if I can put it that way. But the present crypto-currencies seem to me—maybe I am just an old fuddy-duddy—to be interesting if you are a criminal or if you think you can buy something and sell it to someone else for a high price tomorrow.

Q10 **Rushanara Ali:** What are your concerns around criminality? What percentage of activity would you say?

Martin Taylor: I just don't know. Clearly, the privacy of the system would attract a certain sort of user at a time when money laundering rules are being tightened. To an extent it makes it uncomfortable to move money around even legitimately.

Q11 **Rushanara Ali:** Do you agree with J. P. Morgan CEO Jamie Dimon's characterisation that they are worse than tulip bulbs?

Martin Taylor: I believe there are some revisionist views that tulip bulbs actually might not have been half as bad as people said—at least you can plant tulip bulbs and the flowers are very beautiful—but there are serious problems. The FPC is not in the payments business. We are not interested in that, although of course the part of the Bank run by Andrew Hauser is very interested in it and its potential use to create central bank currency in the future, allowing us all to have accounts at the Bank of England so that the Bank can do QE to each of us and things like that. It could send us money every month—wouldn't that be a good idea?

What we have been concerned about is whether the development of these assets—we try not to call them currencies, because we do not believe they are currencies—could have financial stability implications. Our view at the moment is they could not. They just are not a big enough deal to bother

the financial system here, although some of the big banks are getting into dealing them—there is going to be a contract in Chicago—and one can imagine a point at which this would begin to worry us.

- Q12 **Rushanara Ali:** Can you perceive a future—in 10, 15, 20 or 30 years—where they, or some variant of them, could be?

Martin Taylor: As I understand it, a technological breakthrough is required to allow the technology to work much more rapidly and without bankrupting the planet with electricity usage—at the moment it is an incredibly slow way of moving money about—but yes, everything is possible. As I said, there is general agreement among those who understand these things that the technology is very promising, but we are at the promising stage rather than the breakthrough stage.

- Q13 **Stewart Hosie:** Mr Taylor, I asked Mr Brazier some questions about Fintech and open banking and the risks that posed. I am going to ask you some of those, but I want to draw on your written evidence. You wrote: "Developments in fintech and open banking could potentially have far-reaching effects on bank business models. Financial stability consequences would ensue if, for example, banks were deeply wounded by competitors with new business models and began not only to shrink but eventually to fail." What is the reality? How close are we to even getting near this risk?

Martin Taylor: I remember the introduction of new technologies to banking in the 1990s. You may remember there was one called telephone banking. At the time, many analysts predicted that the banks would all go out of business because of this brilliant new idea where you could actually ring up a call centre and get your money moved. The banks, of course, went into telephone banking themselves, and then internet banking came along and the banks did that as well. Generally speaking, what happens is that when a new technology gets traction, the banks themselves try to get in on the game and either buy the upstart or found their own business.

The question really is who they are competing with. You have lots of interesting people coming into the payments world. Banking is a strange world. People do not like the banks in general. They do not trust the banks, but they do trust their own bank with their own money. To take money from your own bank and put it with someone who has no physical existence but is just an app on a phone is a big step for a lot of people, although I believe that millennials do not find it odd. It really matters who these people are, and it is very hard to get traction against incumbents with gigantic deposit bases and established customer lists. The thing I would worry about if I were a bank CEO these days would be the big tech companies coming in.

- Q14 **Stewart Hosie:** I will come back to that, because the answer you give seems to indicate that the risk would be not necessarily to traditional banks, because of incumbency, but actually to new challengers, if the big banks seized this new technology and deployed it for their own benefits.

Martin Taylor: When you say new challengers, do you mean the banks that are—

- Q15 **Stewart Hosie:** I mean the challenger banks as opposed to other entrants.

Martin Taylor: Okay. The challenger banks, compared with the big banks, of course, probably have a lower cost base, but they don't have a very established customer base and generally speaking they have on average a riskier book, because if you are building a new bank, you are almost bound to do it by taking on business that other banks have turned down at some stage, and challenger banks are vulnerable in all sorts of ways to a downturn, which is why our colleagues at the PRA and FCA keep a good eye on it. Whether they are uniquely vulnerable to Fintech—I hadn't thought of it that way. You may be right.

- Q16 **Stewart Hosie:** I'm asking you what you think.

Martin Taylor: I will think about it. I don't have a strong view about it. I think, of course, the other thing that Fintech offers is potentially global platforms. That could at some stage bother national regulators.

- Q17 **Stewart Hosie:** I was going to ask, does that not offer a different transmission mechanism for all sorts of other risks?

Martin Taylor: It could be. These are cyber-instruments, and cyber-risk obviously concerns us very greatly. These are uncharted waters. They really are. The thing that would most concern me about being a bank CEO at the moment would be the loss of deposits. Banks gain enormously from customer inertia. You have all this current account money, which can theoretically be withdrawn overnight but in fact just goes round in circles.

- Q18 **Stewart Hosie:** Let me move on to another part of the circle we may go to. You spoke about non-bank entrants—the Amazons of this world. Again, you said in your written evidence: "The giant tech companies have so far played only on the fringes of the banking markets. If they were to compete seriously, I suspect there would be fireworks." What do you mean by fireworks, and what should the FPC be doing now in preparation for a big play by an Amazon or equivalent? What would the fireworks look like?

Martin Taylor: I don't think the FPC can anticipate what may happen, but it is simply that, unlike the Fintech start-ups, you are dealing here with companies with gigantic market capitalisations, enormous financial power and unparalleled customer reach, so if they want to do something in this world, they easily could do. The idea that these companies could enter the banking markets is not a new one, and on the whole, I think, they have been put off by the bother of becoming a bank. There are huge privileges to being a bank, but also there is a vast amount of regulation, and there are all sorts of things that you have to comply with if you are a bank. A lot of these companies seem to be interested in moving into areas where they don't need to comply with things, which people in various jurisdictions are chasing after them about. I think this more than anything may be what has kept them out of conventional banking.

Q19 **Stewart Hosie:** Just a question: I don't know if anyone knows the answer. Do any of these big tech giants own banking licences, even if they are not being used?

Martin Taylor: I do not know offhand. Not as far as I know. I am supposing that, if they wanted, they would just buy a bank.

Q20 **Stewart Hosie:** Just a final question—again it is similar to one I asked Mr Brazier earlier. As financial services develop and innovate, and more activity may move out of areas regulated by the PRA and into FCA-type regulated areas, are you happy with the surveillance and analytical work being undertaken by the FCA rather than the Bank for the FPC rounds?

Martin Taylor: I think the FCA is perfectly competent at doing what it does at the moment. This is something that I do not think came up in Alex Brazier's evidence with you. My view is that if the shape of the industry changed very considerably through an extremely rapid growth of what are now FCA-regulated firms, we would probably consider changing the perimeter and bringing those firms within the PRA's purview. That would be a natural thing to do. If in a sense a firm is outgrowing the FCA, you have a binary choice. You either take it up to the PRA, where it will be looked after in a different way, or you greatly add to and augment the regulatory capacities of the FCA. The first way seems to be an easier solution.

The Committee looks every year as a regular, routine discipline at the current regulatory perimeter in the financial services industry in the UK, and we are in fact required to decide every year whether we are going to recommend any changes to it. The bar for recommending these changes is quite high. It usually means legislation, so we probably would not bother Parliament with little, tiny things here and there. I would not be surprised—this is a safe prediction, because I will not be on the Committee by then—if five to 10 years from now the FPC came to Parliament and said, "Perhaps it would be a good idea to redraw some of these lines." That might be the answer.

Q21 **Stephen Hammond:** Mr Taylor, thank you for coming. In your written evidence to us, you said, "there remain structural fault lines in the Eurozone." That could refer to quite a lot of possibilities. I wonder which ones you were thinking of when you wrote that statement.

Martin Taylor: I wrote the statement probably a couple of months ago—

Stephen Hammond: 21 March.

Martin Taylor: It might have been written prior to that—but I was confident that it would still be true when it arrived on your desk.

I do not know, really. One can see the debates going on in Europe at the moment about possible backstops, and the question of the risk-free eurozone asset has come up again. The banking union is there. It is not easy for people in different parts of the continent to agree on these. I

sense that there is more understanding than there was a few years ago about the desirability of fixing some of the problems that people have. It seems to me more a question that people have different answers—they cannot agree on the answer rather than they cannot agree that there needs to be an answer. It is obviously something that we keep an eye on.

- Q22 **Stephen Hammond:** We had the Greek crisis in 2013. Is there any particular country in the eurozone that causes you more concern than others?

Martin Taylor: I do not think we should be in the business of predicting crises at moments of calm in places run by friendly powers.

Stephen Hammond: Okay. I shall not press you on that.

Martin Taylor: But I think when I wrote it, it is fair to say—this is not an original remark—there was obviously some concern about Italy. The Italian political scene was very fragmented and uncertain, as it remains. When we look at tail risks, we are looking at the product of the likelihood of the risk and the impact if it were to go wrong. It is perhaps far less likely that Italy will go wrong than it was that Greece would go wrong a few years ago, but, if it did, it would be a far more serious issue.

- Q23 **Stephen Hammond:** In response to questions you have heard, Mr Brazier's phrase was, I think, global debt markets "priced for perfection," and Dr Kohn referred to assets being priced for low inflation, low interest rate. How serious a risk do you think there is at the moment that markets will have a shock that will push them off their projected monetary path?

Martin Taylor: The trouble for me in saying that markets are priced for perfection, although I am happy to say it, is that I have been saying it for the last six or seven years, and they have remained priced for perfection, so I have been the little boy crying wolf in a sense.

- Q24 **Stephen Hammond:** At least the boy who cries wolf gets it right once.

Martin Taylor: Yes. I don't think it ended very well for him.

Stephen Hammond: Perhaps that is the issue.

Martin Taylor: There clearly are risks. With my professional hat on, not my personal one, I was very pleased to see the market tremors in the early part of this year, because it seems to me that the most dangerous kind of market is one where there is absolute flat calm and no sign of any worry. The fact that the market could have a reasonably violent sell-off and then recover a good deal of its gain seemed to me to be helpful. It sort of let some air out of the balloon. The habit of mind that you get into on the FPC is in looking for things to worry about. We are a tail risk committee. It is very important for people to understand that we are not predicting these events. We are simply trying to say, "If this happened, are we reasonably sure that the financial system could withstand it and people and businesses could go about their lives in an undisturbed way?" That is always where we are coming from.

Q25 **Stephen Hammond:** I note in your written evidence that you were pretty explicit—perhaps more explicit than Mr Brazier or Dr Kohn—about the risks from China. You noted the ratio of privately held debt to GDP very severely. Do you see that as the biggest risk to global financial stability at the moment?

Martin Taylor: We model a pretty complete Chinese meltdown in our stress tests, where growth goes from plus 8 to minus 2 or something like that. That is a very violent event. I would say two things. First, it is hard for economic historians to find an example of a country where debt has run up so far and so fast and something has not gone wrong. There are all sorts of reasons to believe that China is on top of this—it has huge reserves and the state has enormous power, but nevertheless the first remark holds. The second thing to say is that China is now such a big economy that even if growth just halved, it would have a big shock effect on the rest of the world. It is no longer in the class of a rapidly growing, developing economy which is interesting for itself and its region. This is now a global issue. It would hit the US, and it would hit Europe badly. It would hit us.

Q26 **Stephen Hammond:** Economic historians would also say that the scale and size of stimulus being applied to the US economy at this stage in the business cycle has in the last 50 years always led to bouts of quite significant inflation. Is that your assessment? How concerned are you that the risks might reverberate through the world system?

Martin Taylor: I think Don Kohn knows a lot about this and I thought he answered the question very well and very fully. I would simply add to that by saying that from where I sit the US economic policy stance has gone from being a contributor to financial stability to maybe a contributor to financial instability in the last six to nine months or so. That is unhelpful from our point of view.

Q27 **Mr Clarke:** Gosh—weighty matters! I will take things back to the personal and to your impending departure from the FPC next year, and how we set about replacing you. I have been reading through your CV, which is absolutely incredible in terms of your breadth of experience.

Chair: In the nicest possible way, he means, I imagine.

Mr Clarke: Absolutely—I mean that purely as a compliment. Very few people can have had the range of experience that you have had. With that in mind, I was interested in your thoughts on what you think makes a good external FPC member.

Martin Taylor: The most important thing is the balance on the committee of the externals.

Mr Clarke: Balance in what way?

Martin Taylor: That they should have different sorts of experience. That may sound odd, because they pretty much have to have some experience relevant to financial markets, whether they come at that from a central banking background, as Don Kohn does, from an academic background, as

Anil Kashyap does, or from a practitioner background, as the rest of us do—although we have been different kinds of practitioners.

That variety of ways of looking at things, even within what might seem to somebody from outside to be a rather narrow specialisation, is very useful. If I were advising the Treasury on how to look for a replacement for myself, and indeed for Richard Sharp, who leaves the Committee in March next year—his six years are up—I would say that that is the way they should look at it. I have found, oddly enough, that we do not have a great deal of gender or other diversity on the Committee.

Chair: We noticed.

Martin Taylor: You noticed. I have served with five different women members in the last three years, but not all at once unfortunately. We have a lot of international experience. We have Committee members drawn from a number of countries. That is true on the MPC as well. I think that is a great strength of the UK system. It is something that we seem completely comfortable with. In some of our European neighbours, that would seem eccentric beyond belief.

I would look for someone who brings an angle to the Committee that is not there already. As I said in my answer to Wes Streeting, it is not necessarily that easy to identify people who are in the sweet spot, just before they fall on the scrap heap.

Q28 **Mr Clarke:** You gave a speech titled, memorably, “The Committee of Public Safety”. Hopefully your Committee is somewhat less bloodthirsty than the original. You rightly cautioned in that speech about the importance of avoiding groupthink. Greater diversity presumably feeds into that. In practical terms, how do you try to mitigate that? I can see that it is very easy to fall into that trap.

Martin Taylor: I cannot remember if I made this point in the speech itself, but one of the things that most worries me as an external member is that the externals have a particular responsibility to help the Bank to avoid groupthink. That is one of the things that you have put us there for, if I can put it that way. One of the troubles is that the Bank is a very brilliant and seductive institution, and the more time you spend in it, the harder you work, the more research meetings you attend, and the more conferences you go to, the more you become imbued with its atmosphere and the more likely you are to agree with it.

Somehow we have to be good colleagues in among it, but keep our perspective, which is very important. Having people from outside the UK on the Committee helps, because their perspective is by definition different. At least we should be aware of it. The internal members of all the Committees argue very vigorously among themselves, but then they tend to reach a position. If their position is the right position, that is great. If it is not, we are all in trouble.

Mr Clarke: Indeed—that is the nature of committees. Thank you.

Chair: Thank you very much indeed for giving evidence this afternoon. As I said to your colleagues, we are very grateful for your time. We will consider our report, and we will issue our conclusions. Thank you very much.