

Anil Kashyap Questionnaire for Reappointment to the FPC
5th June 2019

1. Do you have any business or financial connections, or other commitments, which might give rise to a conflict of interest in carrying out your duties as an external member of the FPC?

No.

2. Do you intend to serve for the full term for which you have been re-appointed?

Yes

3. Why have you decided to stay on for a further term? What do you regard to be your main achievements to date? Is there anything you would like to do in the next term, which you have not been able to do in your previous term?

I believe there is a learning curve for contributing on the committee. Having climbed that curve, I feel obliged to serve a second term.

I believe all the external members were instrumental in initiating the idea of using a simple and accessible FPC scorecard to describe the Brexit risks. I tried to challenge the assumptions that we adopted and believe the committee ultimately did a good job in triggering action to mitigate as many risks as we could and communicating our views to the public and the official sector. However Brexit turns out, I believe we have made sure that the core of the UK financial sector is prepared and will not be a source of amplification.

I also have become interested in cyber risks and have tried to contribute to our thinking on cyber resilience framework. This includes having co-authored an article with Bank staff to get the wider economic community to engage with a topic that is of huge importance to policymakers and the industry (see below). This work is still evolving, but during my term the FPC has put in place a clear framework for what's necessary to ensure the UK financial systems' cyber resilience. We have made a good first step on pushing this agenda forward and look forward to continuing that.

4. In the response to your previous questionnaire, you noted that you were the only "academic" on the Committee and hoped to contribute to conceptual issues. Please explain how your academic work and background has helped you contribute to the FPC so far?

My academic background often gives me a different perspective on issues – I typically start by trying to understand *why* in a given situations financial institutions may not act in the interest of society, and what this implies for potential policy interventions. For instance, in the context of cyber risk banks may place little weight on how their choices impact the overall resilience of the overall financial system. A specific example of how this could matter is that we should worry if all banks used the same IT suppliers.

In addition, there are a lot of areas where I can draw on my detailed knowledge of empirical studies on a topic. For example, in the context of our discussions of the risks associated with household debt I can draw on a detailed understanding of the drivers of households' mortgage choices.

I have also written 3 papers with bank staff on issues of relevance to the FPC. One was published in the *Journal of Economic Perspectives* earlier this year and describes the kind of financial stability response that would have been needed to improve the handling of the last crisis. This exercise is useful for identifying the kinds of powers that a successful financial stability committee would need to have. This is a helpful benchmark and the FPC looks like it is structured in a way that gives it a chance to manage risks. (We are much less sanguine about the structure of the US counterpart, the Financial Stability Oversight Committee, and whether it is positioned to succeed with these kinds of challenges).

A second paper, published last month in the *American Economic Association's Papers and Proceedings* outlines some principles for regulating cyber risks. We are discussing these principles in the context of our cyber policy deliberations.

Both these papers have been presented at multiple conferences, including some aimed at industry practitioners and others aimed at central bankers and academic specialists.

The third paper was prepared for the Federal Reserve's June 2019 conference on Monetary Policy Strategy, Tools, and Communications. This paper contributes to the international debate on how financial stability and monetary policy can interact.

Finally, I gave a speech in March 2019 outlining how I think about the reaction function of the FPC. I am doing some follow up research with a fellow professor from Northwestern University (Guido Lorenzoni) that tries to develop a model that captures the way I think we operate.

5. How have you contributed to raising the public profile of the FPC? How well do you think financial firms understand the work of the FPC?

I have spoken about the FPC's work at a number of venues, including in front industry groups, with students, with the media and at conferences. I have also done two agency visits (and have another scheduled next month) in which I have met with businesses and the public. These visits included question and answer session with the public and/or industry groups about our financial stability report (and the upcoming visit in July is also scheduled to have that kind of session). I have also given two speeches outlining our meeting process and the strategy of the FPC (from my perspective). I believe if people are interested in finding out about how the committee operates and makes decisions these speeches would be helpful.

Most of these interactions have involved audiences that are already somewhat interested in the FPC. There are many people who follow our deliberations closely and are aware of what we are doing. But I feel that in addition, the FPC needs to do more to reach out to people who may not know who we are, or who find the way central bankers usually communicate not very accessible. For example, I think we are still trying to educate many firms about our actions. Because of this I (together with other members) have been very active in pushing for innovations such as a 'layered FSR' that summarises our views and actions in a much more punchy way, including by tweets and infographics.

6. What do you view as the main achievements for the FPC since you joined? How do you think the FPC needs to evolve in the future?

Given the large potential risk that could have come with a disorderly Brexit, preparing for that and safeguarding the system has been a big accomplishment. We will need to continue to adapt as the financial system domestically and globally evolves. At some point, the risk environment will move beyond the standard range and we will need to make sure the calibration of our tools adapts appropriately.

We may also encounter situations where our annual review of the 'regulatory perimeter' uncovers material risks emerging outside of the areas that we are already focusing on.

7. What do you consider to be the most significant risks to UK's financial stability today and why?

As mentioned above, a disorderly Brexit still represents one of the most significant financial stability risks to the economy. I still think the risks that we flagged in the November FSR are important, particularly leveraged lending and global debt vulnerabilities. We also flagged risks emanating from the situation in Italy as a worry, and those seem to have become even more salient in light of the European Parliament election results and the arguments within in the current government.

I also worry about cyber risks a lot, in part because breaches are inevitable, so we are dealing in this domain with a question of when we get an event and not whether we get one. This is why we are doing our pilot stress exercise and have committed to do a follow-on exercise that will build on the lessons from the pilot.

8. In your response to your previous questionnaire, you stated that you did not see the current account deficit as a "big financial stability risk". Has your view changed at all? Do you think the current account deficit poses a bigger financial stability risk in 2019 than it did in 2016?

I still believe that a current account deficit is not necessarily a problem per se. Cross-border flows can create risks of reversal. But while a reversal of the capital flows that the UK relies on could be important for the macroeconomy, it is not inevitable that it has large direct effects on financial stability.

That said, I do worry about the composition of the foreign capital that the UK relies on. Right now the stock of foreign funding is potentially more flighty than it was in 2016. To the extent that some of this flighty funding is going to the financial system and could be withdrawn at short notice this could create cause for concern.

We are monitoring this closely – including by capitalising the UK banking system against a sharp fall in the exchange rate, and by closely monitoring the nature of UK banks' funding.

9. How has the rise of the "challenger banks" influenced the work of FPC?

The FPC recognises that a diverse financial system can have significant benefits. This is one of the reasons why we also check whether FPC decisions might have an impact on certain groups of banks such as challenger banks that is disproportionate to the financial stability risks these banks could pose. It is

also the reason why the FPC has designed its “Systemic Risk Buffer” framework in a way that does not unduly restrict smaller banks’ incentives to grow the size of their UK business.

The FPC also has a secondary objective to support the Government’s economic policy of achieving strong, sustainable and balanced growth. Ensuring that regulation doesn’t stand in the way of a diverse financial system and effective competition between incumbents and new banks is a key part of this.

Any risks associated with the rapid growth of challenger banks is something that we monitor carefully, but it has so far not been a central source of overall financial stability risk.

10. How far could banks’ business models be affected by open banking and developments in financial technology, and what implications will open banking and Fintech have for financial stability?

Open banking has the potential to be transformative. It has significant benefits for consumers, and supports the efficient provision of financial services to UK households. But if consumers were to migrate substantially to managing their savings with apps that could sweep large amounts of money in and out of different institutions that would create a big risk management problem for the banks. So far adoption has been limited, but this does not mean that large changes down the road could not occur.

This is something that the FPC has considered as part of its 2017 “Biennial Exploratory Scenario” stress test.

11. Where do you think there is scope for further research work into financial stability and macro-prudential policy?

There are many unanswered questions. My top priority would be to find a baseline canonical model of the financial system that we could use to study high level connections between different actors in the system. My paper that I referenced earlier with Guido Lorenzoni is a step in this direction, but there is much more that can be done.

12. How have you used the FPC’s core indicators in your work? Which is the most important, in your view?

We review this indicators each meeting round. Because of the wide range of indicators that we consider, it can be difficult to succinctly communicate our risk assessment to a broad audience. I am partial to simple average across the whole set that we consider. I hope we will eventually converge on a summary measure that we can agree upon and use in our communications. The staff is engaged in some new research in this direction and I have been following that closely.

13. To what extent is there growing pressure for a lighter-touch regulatory regime in the UK? How do you respond to such pressure? Are there any areas of the financial sector you consider to be over- or under-regulated?

We should be vigilant in guarding against these risks. With a financial sector that is 10 times the size of the economy, the possibility that financial instability could do real damage is something we must not forget. The committee has said on multiple occasions that irrespective of the particular form of the

United Kingdom's future relationship with the European Union, we must make sure that the financial system is at least as resilient in the future as currently planned, which itself exceeded that required by international baseline standards. If we determine that we do not have the necessary tools to deliver this, I believe we have a responsibility to report that to parliament and to make suggestions about how to correct any problems.

14. How easy has it been to maintain consensus on the FPC? What compromises have you made to achieve consensus? Has there been any decision on which you personally have come close to breaking the consensus?

It helps greatly that we have multiple rounds of meeting before our actual policy meeting – see my 2018 speech for a description of that process. Through the course of those discussions we are given ample chance to discuss positions and absorb the range of views of the rest of the committee. These deliberations are quite substantive and the staff also provides follow up analysis for points that are raised in these discussions. The chair does a very good job of noting alternative perspectives. So by the time we reach the actual policy meeting, most of the differences have been settled because the best and most convincing arguments are clear to all of us.

There were some times when I first joined where I was minded to move the CCyB up more quickly than we did, but by the time we reached the meetings we had found consensus that all members were happy with. In some cases included signalling our future intentions.