HOUSE OF COMMONS

Treasury Committee

Oral evidence: The Edinburgh Reforms, HC 1079

Wednesday 1 February 2023

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Watch the meeting

Members present: Harriett Baldwin (Chair); Rushanara Ali; Mr John Baron; Anthony Browne; Danny Kruger; Andrea Leadsom; Anne Marie Morris.

Questions 1 - 62

Witnesses

I: Sir Keith Skeoch, Chair, Ring-fencing and Proprietary Trading Independent Review (2021-22); and Professor Sir John Vickers, Chair, Independent Commission on Banking (2010-11).

Examination of Witnesses

Witnesses: Sir Keith Skeoch and Professor Sir John Vickers.

Q1 **Chair:** Welcome to the Treasury Select Committee evidence session on the Edinburgh reforms. May I invite you to introduce yourselves?

Professor Sir John Vickers: Thank you very much for the invitation to be here. I am John Vickers, an economist from Oxford University. I believe that I am here because I chaired the Independent Commission on Banking in 2010-11.

Sir Keith Skeoch: I am Keith Skeoch. I am currently chairman of the Edinburgh International Festival and QBE European Operations. I think that I have been invited along—thank you—because I chaired the ring-fencing and proprietary trading review.

Q2 **Chair:** Thank you so much for coming along and agreeing to give us evidence. I wanted to start with you, Sir John, because obviously you put a huge amount of time and effort into the review of our banking regulations post crash. We have just had the announcement of the package of Edinburgh reforms. I was thinking that, from your point of view, it must feel like this Government are beginning to unpick a lot of the work that you took so much time and trouble over.

Professor Sir John Vickers: I was not entirely sure what to make of the package of Edinburgh reforms. There was quite a lot of fanfare that accompanied the initial announcement, even talk of big bang 2.0, as though this might be a very radical change, possibly even a radical going back on the reforms that were put in place 10 years ago. On closer reading and listening, I am not quite sure that that is what is going on. It remains to be seen.

I would certainly have concern if an erosion, a rowing back, on the reforms that were put in place then were to be in prospect. I am very happy this afternoon to explain reasons why that is my view.

Q3 **Chair:** There were about 30 different reforms announced at Edinburgh. Are there any in particular that you would like to highlight where you think this Committee should be paying very close attention?

Professor Sir John Vickers: The one that was top of the list in the Government's statement is obviously close to my heart, which is ring-fencing. I would be very happy to discuss aspects of that, the thinking that went into it 12 years ago and why I think it is very important that that be seen as a basic, fundamental part of the architecture of the way we do banking in the UK.

The second point on the list was whether the financial regulator should have a competitiveness objective. I am aware that there is other legislation going through Parliament on that point. As you say, there were dozens of other reforms, most of which I would not be particularly well qualified to speak about, though I could try.

Q4 **Chair:** Which of the reforms would you particularly like us to focus on in taking evidence from you this afternoon?

Professor Sir John Vickers: Ring-fencing would be my short answer.

Q5 **Chair:** Did you want to say something on the competitiveness objective?

Professor Sir John Vickers: If the Committee wishes, I would be very happy to.

Chair: I am inviting you to give your views on that.

Professor Sir John Vickers: The legislative proposal is that the financial regulators have an objective—it would be a secondary objective—to advance the competitiveness of the UK economy, particularly in relation to financial services. I doubt that would be a wise path to take, first because the competitiveness which should matter to us all is that of the UK economy as a whole. For that objective, I believe that we need very strong and sound financial institutions. Anything that led to a cutting of corners or relaxation of financial regulation that put that primary objective at risk would, in my view, be a very unfortunate step to take.

Q6 **Chair:** To clarify, you think that it is unwise and unfortunate that the Government have inserted a competitiveness objective for the regulators into the legislation that is currently going through this place.

Professor Sir John Vickers: In short, yes. The best that the financial regulators can do for the competitiveness of the whole economy is safe and sound financial institutions and well-functioning financial markets. That is already the primary objective of the PRA and the FCA. I see no gain, as far as whole-economy competitiveness is concerned, in spelling out in legislation that aspect.

When one sees the draft Bill, there is clearly special emphasis on financial services. While that is a very important sector of the economy, I would not give it special treatment in that regard. I would emphasise the importance of safety, soundness and well-functioning markets and stick with the objectives that the regulators already have.

Q7 **Chair:** Another part of the reforms that has generated some commentary has been around Solvency II and the insurance sector, and relaxing the capital requirements there. Do you have a view on those reforms?

Professor Sir John Vickers: I do, but it is a much less expert view than I am sure Sir Keith would have. My concern there is that if risk taking is to increase without a commensurate increase in capital buffers in the funding structures of the relevant institutions, one is elevating the risk that those institutions will not be able to meet their liabilities. If that happens, if we are talking about defined benefit pensions schemes, it is the pensioners who will lose out, unless they are bailed out by Government, either through the Pension Protection Fund or otherwise.

The logic is very similar to the logic of banks. The capital protection in the funding structure needs to be commensurate to the risks being taken. I have been concerned about some accounts I have read, which suggest that one can allow much more risk-taking without having more capital in the funding structure. If one were unlucky, and there is a serious chance that one might be, that could lead to very unhappy outcomes, including for the fiscal position.

Q8 **Chair:** You are also unhappy about the Solvency II proposals. I think we heard from Sam Woods that he was unhappy, and the Government have obviously landed at a different position than the Bank on this. You are siding with the Bank's view on this.

Professor Sir John Vickers: I am not sure that unhappiness would be the best description of how I feel about it. It is more a concern that this might be elevation of risk without mitigation of that risk. I did not see the testimony that the PRA gave, but I read newspaper accounts of it. I thought that Sam Woods, the PRA and the Bank of England were making very important points there.

Q9 **Chair:** Do you have any views on the senior managers regime? I am going to ask similar questions to you, Sir Keith, in a minute.

Professor Sir John Vickers: Following the Independent Commission on Banking, which I chaired in 2010-11, there was a Parliamentary Commission on Banking Standards in 2012-13, I believe. The issues of standards, the senior managers regime and culture, which we had thought about to some extent, were focused on much more sharply in the parliamentary commission. The measures that came out in the legislation were more following that commission's work than ours. In general, I would be very wary of weakening the regulatory settlement of 10 years ago, but I do not feel that I know enough about that regime and its workings to say more to this Committee.

Q10 **Chair:** Sir Keith, you have obviously been very much involved in reviewing what you have described as the ossification, or the potential for ossification, in this area. Of the 30 Edinburgh reforms, are there any that raise red flags to you?

Sir Keith Skeoch: Yes, there are two. One, because I have a background in asset management, is the potential reform or review of the short selling rules and transparency. It strikes me that that is an area where transparency is incredibly important. What we have in place is pretty much fit for purpose, and I would not want to see the public disclosures and the timeliness on short selling reduced in any way.

I sort of agree with Sir John on the competitiveness point as well. The regulators have been given two secondary objectives alongside their primary objective. I would be fully supportive of the growth objective. I have argued for a long time that we should be thoughtful about regulation, making sure that it helps turn savings into an investment. The wording on that is actually a step forward. My specific concern about the competitiveness is, alongside the desire to make the UK more competitive, it is the balance that needs to come with the promotion of financial innovation. I am not against it. These things need to move, but it is the pace at which that financial innovation progresses. When you look back, too much that was adopted too quickly and lightly regulated caused some of the problems of the last 20 or 30 years.

Q11 **Chair:** Do you have any views on Solvency II or senior managers?

Sir Keith Skeoch: On Solvency II, I agree with John about making sure that there is an appropriate and prudential level of capital. The particular issue I have with bits of the Solvency II legislation and regulations is the incentives that are embedded in the regulation that point to a particular form of investment. One might argue that, at a very high level, it has caused a big switch away from equities and long-term capital into a combination of Government bonds and credit.

Even within equities, the capital requirement that an insurer has to hold against various equities is a pretty blunt instrument. Something that has a long-term history, is well managed, is well run, has a decent yield, has good cashflows and has good visibility gets pretty much the same capital treatment as a very small piece of equity that is venture capital. There could be some tweaking within those overall regulations to perhaps give a little bit more investment freedom without causing a sharp rise in the overall level of risk, but it is down in the detail.

Q12 **Chair:** Before I hand over to colleagues, when you were appointed to do this review, did you feel that you were given a strong steer by the Treasury as to what outcome it wanted to see?

Sir Keith Skeoch: No, we were absolutely not, and I would not have taken it on in that situation. It respected our independence. When the aims of the review were set in place—and it was something that had to be done, as I am sure you are aware, by statute—we were told that we needed to come to our own opinion, but we needed to take account of the impact on financial stability and competitiveness within the UK banking system, the competitiveness of UK banks and any other unintended consequences. We checked in with our findings and at all times we were given the freedom to express our views as we saw fit.

Q13 **Andrea Leadsom:** It is a pleasure to see you both. I was a new MP and newly elected to this Committee when you were doing your commission on banking, Sir John. Also, I was City Minister at the point of deciding where the ring-fence went, so I have a strong interest in this, and I would like to ask you both a few questions about the ring-fencing specifically. In October 2022, some research published by the Bank of England said that there is compelling evidence that banking groups subject to ring-fencing are perceived to be safer. Do you both agree with the conclusion that UK banking is safer, or simply perceived to be safer, as a result of ring-fencing?

Professor Sir John Vickers: That is a very important study by people at the Bank of England and Warwick Business School, including John Thanassoulis. There are three main findings. One, exactly as you say, is looking at the short-term money markets and the funding costs. It shows that ring-fencing, for the ring-fenced entities, has reduced funding cost and risk. For the non-ring-fenced part of the banking groups, it has not had an appreciable or measurable upward effect on costs. Thirdly, the improvement in funding costs for the ring-fenced entities is not down to an enhanced market estimate of Government bailout. It is down to less risk-taking.

All that is very much in tune with the intentions of both the commission and Parliament in passing the legislation 10 years ago. It is early days. We are only four years on from the regime coming into place, so the evidence will emerge. I thought that that paper, which, as you note, was only published a few months ago, was a particularly interesting one.

Sir Keith Skeoch: I agree with John. It is undoubtedly the case that the UK retail banking sector is much safer. As a result, banks in aggregate are also much safer and there has been a reduction in funding costs. Of course, one thing we found was that it was pretty difficult to disentangle the reduction in funding costs from the impact of the ring-fencing regime and from the general drop in interest rates. The other thing that we found was that, while banks were undoubtedly safer, the reduction in the risk of "too big to fail" was not particularly a product of the ring-fencing regime, but rather of the broader resolution regime, which has developed significantly over the course of the last 10 years.

Q14 **Andrea Leadsom:** Yes, I want to come back to that. First, I want to push you both a bit further on the ring-fenced entities. They have tended to create quite enormous exposure within the ring-fenced entities in the UK mortgage market. That was where we went wrong last time, was it not? It was mortgage risk that sparked the financial crisis in the United States. I know that it was much more complicated than that, but, nevertheless, it is a specific asset class where we have been burned before. Are there risks of the exposure of ring-fenced banks to UK mortgages?

Professor Sir John Vickers: The original design of ring-fencing and the way it was implemented in the legislation deliberately allowed for flexibility. It did not say, "Here is the line between retail and investment banking". It said, "These core things can only be done in the ring-fenced bank. These prohibited international derivatives, trading things, cannot be done there". There was a big middle ground, including mortgage lending.

There was some commentary not long ago saying that competition had been heightened in the mortgage market, to which my instinctive response was, "Good". I do not see that as a bad thing at all. As for the risks that go with all lending, but particularly lending secured on property, whether it is residential or indeed commercial property, again, we need to go back to the question of how well capitalised these institutions are. The solution to the problem is to ensure that they have adequate equity capital. I wish that globally, but also in this country, there were higher equity capital requirements, but we are where we are. I certainly would not deploy the scenario, the risk that you state, as an argument against the structural reform. It goes much more to the equity capital point.

Q15 **Andrea Leadsom:** Sir John, you said that there is no appreciable increase in cost of funding to non-ring-fenced banks. Are there any other competitiveness issues that have come to light whereby, for example, there are barriers to growth in case they end up being ring-fenced, with the inevitable additional costs of that, or, indeed, the perception of risk in those non-ring-fenced entities? Is there any evidence to suggest that that has been a problem for them?

Sir Keith Skeoch: There are two issues associated with the non-ring-fenced banks. One thing we found is that there was an enhanced vulnerability in stressed conditions for non-ring-fenced banks because the Bank of England did not have a set of specific circumstances that were carved out where non-ring-fenced bank capital was available for the special lending scheme. Most of the capital was held in the ring-fenced banks. In a stressed condition, that was a source of vulnerability.

We found very little evidence of the restriction of services or the transmission of credit from a non-ring-fenced bank within the UK, but we felt that their competitive edge had been blunted by the fact that, where these restrictions were not in place, non-UK investment banks had the ability to grow their balance sheet and be much more competitive. It was at the margin because, as John says, it is very early days. Some of the evidence that we had said that that was an issue. We had other people who thought that, as far as the UK was concerned, that was a good thing.

Professor Sir John Vickers: Yes, exactly. Removing the implicit subsidy that went with "too big to fail" is a lot of the whole point. Those who were benefitting from the subsidy no longer have it, but the answer to that is, "Yes, that is how markets are meant to work".

Q16 **Andrea Leadsom:** However, going back to 2010, one issue that faced us was not just the "too big to fail". It was also the lack of new entrants. One massive change in the last 12 years has been the plethora of new entrants into the banking market. Specifically, to press you again on barriers to entry, has the ring-fenced bank regime led to greater difficulties for new entrants? It does not appear to have done.

Sir Keith Skeoch: No, we found no evidence, in fact. When we took evidence from challenger banks, their main issue was the cost of capital that they had to put up. Nothing came out of the ring-fencing regime.

Q17 **Andrea Leadsom:** Coming back to the resolution regime that you raised, Sr Keith, you have said that you think that the safety of those previously "too big to fail" banks owes more to the resolution regime than to the ring-fencing regime. Can you expand on that? Why would you argue that that is the case?

Sir Keith Skeoch: I do not think that it was the safety. It was the point that the "too big to fail" premium was reduced by, in effect, the creation of the resolution regime, rather than the ring-fencing regime.

Q18 **Andrea Leadsom:** It is the cost as opposed to the risk of those entities.

Sir Keith Skeoch: Yes. One reason for that is that the resolution regime looks to deal with bank failure and improve resolvability in gone concern, but of course the ring-fencing regime is silent about that. It deals with a going concern.

Q19 **Andrea Leadsom:** What is your view of that, Sir John?

Professor Sir John Vickers: I worry that we are agreeing a bit too much for a good session.

Q20 **Andrea Leadsom:** Yes. I was hoping that you would disagree and fight.

Professor Sir John Vickers: Let me take a different tack. The Independent Commission on Banking was all in favour of having good resolution regimes, but we believed that you need a package of measures. You need structural reform, good common equity capital buffers and resolution regimes. Part of Sir Keith's report that puzzled me somewhat was the suggestion that, as the resolution regimes develop more and more, one can perhaps remove the other aspects of regulation.

My view is that that would not be the right approach, for two main reasons. One is that ring-fencing, if it works, brings a number of benefits. It brings a degree of insulation from shocks—global shocks, trading book shocks or whatever. It is a healthier incentive system within institutions, which plays into the very important questions of culture within banks. It assists resolution, which is a point I will come back to. It provides a basis where you could have different capital requirements for UK retail banking and international banking. That would be a list of at least four benefits, of which only one is resolution. Even if resolution became wonderful, I do not think the other three would fade away as benefits that one should hold on to.

The second point is that we saw structural reform as very helpful to resolution. If you had the old universal banking, thinking of RBS pre-crash and how to resolve such an institution if it gets into trouble, resolving it over the weekend is well nigh impossible. It is formidably difficult anyway, but the modularity and subsidiary structure that ring-fencing gives you could be an enormous assistance if and when it came to resolution.

There is a wider issue about how credible these resolution regimes are. Are they going to work when push comes to shove? One could imagine some crises where it would probably work and some where it would not. My own view is that, if it is one institution that is in trouble and everyone else is fine, there is a very good chance that they would work. If the whole fleet is going down, I just do not know.

Q21 **Andrea Leadsom:** Having been involved a long time ago, 1995 I think, in the very Heath Robinson resolution of Barings when Nick Leeson carried out his little efforts in Singapore, that was absolutely as you say. It was trying to keep people not deciding to make this an existential threat to the entire banking sector as much as anything, so I agree with you. Would it be fair to say that ring-fencing is the prevention, whereas resolution is the cure? There is the old saying, "Prevention is much better than cure". Would that be a fair conclusion?

Professor Sir John Vickers: It is ring-fencing plus, super importantly, the capital buffers. You could try to do it only with capital buffers. If they are big enough, you do not need anything structural. We were trying to get a blend that, at least cost to the economy, would get the safety benefits.

Q22 **Andrea Leadsom:** I have one more really important question, which is pertinent to another inquiry we will be looking at. Ring-fencing itself results in a concentration of deposit funding inside the ring-fence, with limitations on what activities those deposits can be used to fund. Does this reduce the need for ring-fenced banks to compete for deposits? That is number one. Really importantly, the killer question is whether this could be a factor in the very limited, from what we have seen, pass-through of recent bank rate increases to savings rates. We are not seeing savings rates going up. Can you explain whether ring-fencing has something to do with that, potentially?

Professor Sir John Vickers: The deliberately flexible structure of ring-fencing, with the core and the prohibited but a huge amount in the middle, gives such a degree of freedom that the trapped deposit argument, in my view, is very unlikely to gain traction. On whether ring-fencing has anything to do with the limited pass-through, I see no reason why it would, but I have not thought that through.

A related issue is the question of interest on central bank reserves. Sir Paul Tucker wrote a piece in, I think, an IFS publication recently on that. That might have some relevance to that pass-through question. I do not see why ring-fencing itself would.

Sir Keith Skeoch: We found no evidence of ring-fencing creating the so-called trapped reserves, and we felt that quite a lot of it was to do with a combination of the very low interest rates and the surfeit of liquidity and cash that had built up in the system. The one unintended consequence we found was that because building societies had been constrained in the amount of wholesale deposits they could use to fund mortgages, there was an impact on some of the larger building society business models. I think that has been something that the Edinburgh reforms have looked to address.

Rushanara Ali: Good afternoon. I am going to focus my question on ring-fencing, culture and governance. Before I do that, I wanted to ask a follow-up question about Solvency II and Sam Woods's response to a question I asked when he was here. I raised the question about whether it poses a risk to financial stability and he switched to policyholders, which we have touched on. He said, "I think it is much more of a policyholder protection issue, because ultimately, what will happen here if it turns out that this was a problem—as I say, people can debate either side of it: 'That should have been addressed at this point, rather than at some point later or not at all'—then the way it comes home to roost is if there is not enough capital backing pensions. Now, you can look at history to give you a guide as to what is likely to happen if that occurs, and I would say it is highly likely that that comes back to the public purse if that occurs".

Having seen these issues in terms of a banking crisis and responding, do you think that the Government should step in and make sure that the risks to policyholders are addressed now, so that we do not belatedly find that we have to resolve these issues later and policyholders suffer?

Sir Keith Skeoch: It is really important to draw a distinction between the overall level of capital that is held for solvency reasons and the way in which that capital is deployed and built up. My understanding is that the PRA is always able, within that Solvency II regime, to make the appropriate adjustments to make sure that the aggregate level of capital is held. My issue is about the way in which some of that capital is deployed. If it is concentrated in particular assets and those assets, for the want of a better word, are overvalued through crowding created by the regulatory incentive, at the point at which that unwinds, the loss is ultimately to the policyholder. It is quite important to look at the make-up of the capital.

Q23 **Rushanara Ali:** If we want to avoid losses on policyholders—we, as representatives, want to avoid that—what should happen at this stage to make sure that we pre-emptively take steps to ensure that our constituents do not end up making losses as policyholders? It cannot be right that that is where we are heading.

Sir Keith Skeoch: When you look at the way in which the capital is deployed, technically, you need to take account of appropriate diversification levels to make sure that the balance sheet is diversified in a particular way and risk is not concentrated. Quite a lot of this is in the detail. If you cannot do that and concentration increases, there is the ability to increase the overall level of capital. My understanding is that, with some recent reforms that were looked at to be put in place post Brexit entry, some issues were removed on the risk-free margin, but an offsetting adjustment was made to insurance company capital. I am sure that, if you talked to insurance company executives, they would walk you through it.

Q24 **Rushanara Ali:** Yes, but we have a regulator saying that this is going to cost the public purse, with respect, so I am not really interested in what insurance companies have to say. It is important that the Government heed the concerns of the Governor of the Bank of England and the head of the PRA, who is saying that this is going to cost policyholders.

Professor Sir John Vickers: I would go back to the earlier point. You need assurance that there is plenty of capital backing the obligations. I know next to nothing about capital measurement in the insurance sector. I believe, however, that a lot of capital, as measured by the accountants, comes from an assumption called matching adjustment. Keith will know all about this. Maybe that is entirely well founded, but something to focus on, something to check, is that those are well-founded assumptions, rather than assumptions that might evaporate before one’s eyes in adverse circumstances.

We are talking about tail risks, but, if they are appreciable, they are a major public policy concern. I agree with Sam Woods and others that, if these risks crystallised, it would be policyholders, and maybe the Treasury if the Treasury had to bail out, and not a wider financial stability issue. It could turn out to be a wider financial stability issue if you imagine—I am not going to conjecture any names—a large insurance provider going under. AIG was part of the 2008 fiasco. Who knows what the wider consequences might be?

Q25 **Rushanara Ali:** To pursue this further, we have a difference of view here. Sam Woods has said that he is not so concerned about financial stability, but both the Governor and Sam Woods have expressed concerns about policyholders and cost to the public purse. What should we expect the cost to the public purse to be, to policyholders, if this goes south, if we do not act in advance, pre-emptively, to make sure we do not end up there? What is the worst-case scenario of a financial stability risk, if that comes to pass?

Professor Sir John Vickers: Either the policyholders or a proportion of them would just have to take the loss. Equitable Life is something that comes to mind here and was mentioned.

Rushanara Ali: That is what they referred to.

Professor Sir John Vickers: That, of course, was not a financial stability issue. It was a policyholder issue. I agree with Sam Woods that such a crisis would probably just take that form. I am simply saying, "Do not exclude the possibility that it could run wider", so I do not feel that I am disagreeing with his evidence on that.

Then it is the difference between the value of the promises made to the pensioners and the asset value backing them. If you had a much more risk-on approach to managing those assets, there is a chance that you are in an unlucky part of the distribution, equity markets tank—or whatever assets, private equity, all go south—while the cost of funding the promises stays high.

Q26 **Rushanara Ali:** With the reforms as being proposed, with the things that are being said about policyholders, in the worst-case scenario, if it goes wrong, the policyholders stand to lose and there would need to be some sort of bailout by taxpayers, essentially. That is the worst-case scenario if this goes south, right?

Professor Sir John Vickers: When you say, "there would need to be", it would be the Pension Protection Fund up to a point. After that, it is politics, which is not this side of the table.

Q27 **Rushanara Ali:** Exactly, so I suppose what I am saying is, if we were having these conversations pre-financial crisis, the responsible thing would be to ask these awkward questions about how we try to mitigate against going down that path where taxpayers and policyholders end up making up for mistakes that may happen when reforms are taking place that have unintended consequences or consequences that can be seen. There is forewarning here by senior people in the central bank and the insurance regulators, telling us that this is of concern. Should the Government be heeding those concerns and making sure that there is mitigation now, so that we do not even have to go there?

Sir Keith Skeoch: That it should be on the radar screen and the overall quantum of capital should be held with a significant margin over those long-term liabilities is a given, so you have the opportunity to raise that. One problem with these insurance contracts is that the economic mark, when you are matching to a long-term liability so that you can hold an asset, from an accounting perspective, is very volatile in the short run, but, because that is matched against a 30 or 40-year liability, actually you can look through it and hold that. If you force that liquidity shorter, you are in danger of crystallising the very event.

Actually making sure that the disposition of assets maps with the efficient disposition of liabilities and that the accounting and the discount rates are in the appropriate place is very important in this territory. That is a lot of what Solvency II has, effectively, tried to do.

Rushanara Ali: I appreciate what it is trying to do, because we have been looking at this for quite a long time. We need a guarantee that our constituents, in the long term, do not end up losing out because this has not been thought through, is side-lined or is not given the importance that is required.

Chair: It is fair to say that we are expecting a letter from Sam Woods on this very topic.

Professor Sir John Vickers: Could I make a general remark on this point? One, if you like, official way of trying to look ahead is to run stress tests. They are very important, but my view is that one should look at those with a very sceptical eye. Going back to banks, the starting point for any stress test is how much capital they have to begin with, before the hypothetical stress. The way central banks run stress tests is to assume that the accounting measures of capital are the truth.

When you look at the market values of a number of our banks, and the same would be true, even more so, in parts of Europe, the price-to-book ratios are a long way below 1 in a number of cases. That is to say that the market value of the banks, as the equity markets are judging it, is lower than the accountant's value. I have long held the view that we should have parallel stress tests, the official ones on the traditional assumptions and, maybe in an annex but at least there, something that is run on a market value basis in cases—they are widespread—where the price-to-book ratio is less than 1. We also saw with LDI that everyone had passed stress tests with flying colours until it actually happened. Again, scepticism is healthy.

Q28 **Rushanara Ali:** I am going to wrap up with questions around culture and ring-fencing. You received evidence from the PRA, as part of your review, that suggested that ring-fencing had improved its ability to effectively supervise UK banks. Given the changes that are now going to be made, how much more difficult would it be to supervise UK banks without ring-fencing? Does the removal of ring-fencing pose a risk to financial stability?

Sir Keith Skeoch: I want to be as clear as I can that the RFPT review did not recommend removing the core of ring-fencing. It actually recommended the alignment or integration of the ring-fencing and resolution regimes. One mechanism for bringing them together was: once the Bank of England, PRA or a collection of the authorities had deemed that a bank was resolvable—that is an interesting question in itself—it could be released from some of the bureaucracy that comes with the ring-fencing regime.

It should not lead to a diminution of capital. It should not release a large ring-fenced bank from the supplementary capital that it has on the board. It was simply that, because the resolution regime and the ring-fencing regime have taken different approaches to what are seen as critical economic functions, we felt that, for efficiency, it is important that those two regimes come together.

Q29 **Rushanara Ali:** They are going too far beyond what you recommended. What is your view on that?

Sir Keith Skeoch: We are basically saying that our analysis was that the resolution regime, over time, would overtake the ring-fencing regime. We wanted to keep those things intact.

In terms of culture, the SMCR has done some terrific work. One of the things we acknowledge in the report is the cultural change that we have seen take place. As somebody who has implemented SMCR for an insurance company and—a slightly tougher proposition—in an asset management company, the philosophy and high-level recommendations behind that are incredibly important. Some of the reporting and bureaucracy that goes with SMCR could be more efficient.

Q30 **Rushanara Ali:** With respect, Sir Keith, it sounds as though the Government are going a lot further than what you were proposing. Given where we are, does it pose a risk to financial stability—yes or no?

Sir Keith Skeoch: If it was removed altogether, it would create a risk to financial stability.

Professor Sir John Vickers: Let me try to summarise my view on this. I completely agree that the structural regime, ring-fencing and the resolution regimes need to work together. Given that ring-fencing was put in place before the way resolution has evolved, I am sure that there is some improvement and alignment. I have no problem at all with that. I would worry about this language of resolution regime overtaking ring-fencing. That troubles me, because I think it is very important to keep both elements, plus other things, such as capital requirements.

Q31 **Rushanara Ali:** Sir Keith has said that removing ring-fencing does pose a risk. Could I clarify that?

Sir Keith Skeoch: I said SMCR. I apologise. It was not ring-fencing. I was talking about SMCR.

Q32 **Rushanara Ali:** That would pose a risk to financial stability.

Sir Keith Skeoch: Yes, if it was removed completely.

Professor Sir John Vickers: In my view, removing ring-fencing would pose a very great risk to financial stability.

Q33 **Chair:** It is your understanding that that is not what is being proposed here. Is that correct?

Professor Sir John Vickers: That is not the immediate proposal, but there was something said in Sir Keith's report and also in the Edinburgh reforms package announced by the Government that, while it is worth retaining ring-fencing for now, there might come a day when resolution can do the job instead. That is the wrong approach.

Q34 **Mr Baron:** I want to turn to the point about international competitiveness of UK banks. Before I do, can I pick you up, Sir John, on something you said previously about stress testing banks? Having worked in the City for a number of years myself, I can only agree with what you have said. It is better to look at the value of a stock—that is the value as attributed by the market—than either the accountant's or at par value. It is usually a more accurate assessment. As a matter of interest, following your exchange with my colleague, why is it that you think that we do not do that, given that it would make for a more accurate picture?

Professor Sir John Vickers: My view is that it is not that the markets are necessarily more accurate, but I am very firmly of the view that you should look at both. I put it publicly to the Bank of England in about 2016 that parallel stress tests should be run and published, but there was robust resistance to that, again publicly, from the former Governor. I have never fully understood why the official line is so hostile to this.

There are all sorts of reasons why market values might mislead. There might be good explanations of why price-to-book ratios are less than 1. My answer to that would be to say, "Fine, publish those reasons". Then everyone can form their own assessment of them. At the moment, it is all done the official way. You see price-to-books of 0.5. For a very big European bank it is more like 0.25 or 0.3. That is a very big discrepancy between the market assessment and the accounting assessment.

Q35 **Mr Baron:** Yes, I completely agree. If I may push back a little bit, the market is not always right—we all know that—but the market tries to factor in uncertainty. It factors in risk. It factors in demand and supply. It is, in some respects, a more useful indicator than taking stock at par value or the accountant's version. They are somewhat detached from the everyday news, but perhaps the longer-term analysis also, as to the credibility and fundamental outlook of whatever asset you are trying to price.

Why is it that the regulators in this country and elsewhere are so reluctant to go down this road? What would you speculate to be the reason, given that it is certainly as valid as taking it at par value or valuing stock, and maybe even more valid? We agree. I am just trying to tease you out to try to get an explanation.

Professor Sir John Vickers: Those are very good questions for when you next have the Governor before you. I can see the awkwardness. Let us say that there is a bank with a price-to-book ratio of 0.5. If you say, "They pass all the official stress tests, but, if we plug in the market values and do the appropriate adjustments, they are failing", I can see why, if I were in the central bank, I might not be too enthusiastic about going public with that. I am not saying that would be the consequence of moving to a market view. The answer might be different from the official line.

Q36 **Mr Baron:** It could cause a lot of red faces, basically, and may require further capital. Can I move on to international competitiveness briefly? You are on the record, Sir Keith, as saying that you feel that the regime, certainly when it comes to non-ring-fenced banks, is putting them at somewhat of a disadvantage: increased cost, governance and so forth. We have not been in the regime for too long, so there has not been too much by way of evidence to suggest that is right. What makes you think your claims are credible?

Sir Keith Skeoch: You are right. We have not been in the regime for too long. It is the size of the balance sheet that allows an investment bank, a non-ring-fenced bank, to deliver a particular set of services and solutions, which is a particular issue in the UK. If you look at listed UK, the FTSE would not be full of companies whose primary business and revenue relates to the UK. They tend to be international businesses at scale.

Something like 70% of earnings comes from the rest of the world. The ability to provide all-round investment banking services is simply constrained by the size of the balance sheet. Some of the UK banks, the non-ring-fenced banks, face constraints in the way in which they can go and develop their business.

Q37 **Mr Baron:** You have suggested that the effects of this are pretty limited so far, even taking into account the short timescale. Our job is partly to try to look out a little bit, look forward and say, "Where are the stresses going to be and is the system robust enough?" How would you envisage that changing, in this calm scenario? What are the threats going forward, given what we know so far?

Sir Keith Skeoch: Do you mean the threats to the non-ring-fenced banks?

Q38 **Mr Baron:** Yes, the threats to the non-ring-fenced banks, our competitiveness, or their competitiveness, and the system as a whole.

Sir Keith Skeoch: It is that ability of a bank that is UK-resident to deliver a broad level of services, which requires a growing size of the balance sheet and to be seen as an important force in investment banking.

Q39 **Mr Baron:** Can I ask this question to you both? In this country, we are a bit of an outlier with regard to the regime we have introduced. Did you take that into account when this was being considered? Were you expecting other international banks to follow this course of action, this type of regime? What was your take on the international reaction to this?

Professor Sir John Vickers: When the Independent Commission on Banking was at work in 2010-11, in some sense we were indeed an outlier. In some respects, however, the transatlantic differences are not so great. Arguably, we have moved closer to the American model, where you have structural measures within bank holding companies. It scrapped Glass-Steagall at the end of the 1990s, but retained structural divisions of various kinds. The transatlantic division is not that great.

In our work, we were very careful to come forward with recommendations that were consistent with membership of the EU, which prevailed at the time. We put a great deal into that. I remember meetings in Brussels, including with Commissioner Barnier, where, in a way, this was the UK departing from what the rest of the EU was doing and there was scope to do that. Ring-fencing was, in that sense, made in Britain. It certainly was not made in Brussels.

However, in the year after our report, Governor Liikanen at the Bank of Finland was set up to chair a commission to look at whether, across the EU more generally, structural reforms should happen and in what form. The Liikanen recommendations were, in some respects, very similar to the approach that the UK took, but they were not, in the end, legislated for in the European legislative proposal. There was, for a moment, a prospect that it would be fairly similar across the EU, but that did not really come to pass.

Q40 **Mr Baron:** You decided to go ahead almost regardless, perhaps, of our views on whether others would follow or not.

Professor Sir John Vickers: In terms of our recommendations, we certainly went ahead. In a way, it was Parliament that went ahead with the legislation and the implementation.

Mr Baron: It is our fault.

Professor Sir John Vickers: A very pleasing thing is that it was cross-party, and a good thing too.

Sir Keith Skeoch: I would just add a couple of things. We did talk to both the Fed and the Swiss, who have a similar arrangement in terms of the ring-fence, if that is what it is. The fence is not embedded in legislation.

We were very mindful, at the time when Sir John did his report, that the weight of banking in GDP and the weight of financial services was very high. In a sense, that created a real reason why the UK needed to be different. There is a table in our report showing that there has been a marked reduction in the weight of banking and financial services in UK GDP. In a sense, it has done its job. Maybe that is going to erode.

Coming back to this point about resolution and ring-fencing, we were also very mindful that the resolution regime is in legislation and has a particular form in the UK, but it is something that takes place worldwide. Should we ever get to that crisis weekend, we felt it would be helpful if the UK had a similar policy framework and was not an outlier. It could create issues for policymakers over that difficult weekend if they had to do something different, hence wanting to integrate the two systems.

Q41 **Danny Kruger:** I might ask you to go over the ground you have already been over, for which apologies, but I would like to drill down a little into the issues around ring-fencing and the resolution regime. I am going to caricature you both, outrageously. Sir John, you are cautious and, Sir Keith, you are more gung-ho about the capacity of banks to ride out trouble. Excuse the caricature. You seem to be in fairly broad agreement that we need a combination of these regimes, but I want to try to unpick the differences a little.

Sir John, you made the point about the value of the ring-fence and indeed the capital buffers, which you stress are very necessary preventive measures to ensure we do not get into the trouble where resolution is required. Do you not acknowledge that the resolution regime itself has a preventive effect by reducing the implicit guarantee from the taxpayer of a bank entering distress? Does that itself not reduce risk? The resolution regime itself is preventive.

Professor Sir John Vickers: In part, yes, I agree with that. A very striking feature of 2008 was that, in theory, it should have been the bondholders who took large losses, and that the place that Governments around the world were not going to let these institutions go to was bankruptcy, which is where bondholders would lose money. Therefore, the taxpayer jumped ahead in the queue of loss absorbency.

If resolution is credible—that is the crucial thing—a bank's funding costs will reflect the risks they are taking, which has the incentive discipline that a well-functioning market should have. That very important channel was switched off pre crisis because the taxpayers were going to take the hit if anything went wrong.

I agree that there are ex ante benefits from a good resolution regime. However, they are not sufficient on their own to do away with the imperative need for the other elements.

Q42 **Danny Kruger:** I presume you agree with the general consensus, including from the banks, that the banks are in a better state than they were pre-2008. I would just be interested in your analysis of why that is and to what extent the improvements in resolution and the readiness for a resolution regime have contributed to that. Do you attribute it mostly to the ring-fencing that came in after your review?

Professor Sir John Vickers: It would be an absolute outrage if they were not in a vastly better state than they were in, say, 2007.

I would certainly add to your list, and put high on it the much stronger capital positions. They are not as strong as they should be, but they are much stronger. That is partly because some gross weaknesses in the risk-weighting regime have been remedied, at least to some extent. Whether we have attained perfection is another question.

I would also highlight the layers of capital in the structures and the advent of new things like the countercyclical capital buffer. These have all helped get us to a much better place.

Q43 **Danny Kruger:** Sir Keith, to push you a bit harder on the implications of your review, which the Government have largely accepted, the assumption is that banks that are resolvable should be removed from the ring-fence or should be capable of being removed from the ring-fence. The assumption is that all banks will be resolvable. We do not want any banks that could not be resolved in the event of failure.

The implication of that, surely, is that the ring-fence will be ultimately redundant for all large banks. Is that what you see as the implication of your report? Do you agree that we could eventually get to the point where we do not need the ring-fence? That is not what Sir John thinks.

Sir Keith Skeoch: We need to ensure two things. First, we need to ensure that banks are effectively resolvable, as opposed to being resolvable on a piece of paper, with a de minimis prospect of significant loss. As long as, as I said earlier, some of the really good stuff that is associated with capital and controls for the large, complex and retail elements of the retail banks in particular are kept in place, we can see that the ring-fencing regime, alongside the resolution regime, is a very useful planning tool as you think about that horrible weekend where you go into resolution.

However, one of the things we felt was quite important is that the resolution regime is structure-agnostic. The ring-fencing regime is not, and that creates an issue over the resolution weekend. It may well be that your planning puts you in a very good place, but it may also be the case that, to get effective resolution, one of those ring-fenced banks would need to come out of the ring-fence regime once it is a gone concern, as opposed to a going concern. Why not put the planning in a single regime?

The other thing—this is very much a tail risk, as John referred to it—is that part of resolution may well be the sale of the ring-fenced bank to somewhere else in the market. We felt that one of the technical problems was that something in a ring-fenced bank in the UK, in that situation, might only be attractive to another ring-fenced bank. It would not be attractive if it would pull somebody else into the regime. We need to think about how you make that effective and ensure it is in the right place. We pointed out that this will take years, and we think there needs to be an integration and a coming together of the two regimes.

Q44 **Danny Kruger:** I want to ask one more question. I would be grateful for a very snappy answer because it is a simple question. Sir Keith, are we in a position now, or might we be in one in the future, where we can be confident that no public funds will ever be required in the event of a failure of a major bank? How close to that position are we now?

Sir Keith Skeoch: We are not close to that, no.

Q45 **Danny Kruger:** Will we ever be?

Sir Keith Skeoch: We will never have a zero probability. We can reduce the probability significantly over time.

Q46 **Danny Kruger:** To what?

Sir Keith Skeoch: 5% or 10%.

Professor Sir John Vickers: Could I respond snappily to the same question? First, I do not believe any of these major institutions will be resolvable for sure, i.e. in all circumstances, within the foreseeable future. Secondly, even if they were, you should keep the other structural and capital elements for the ex ante benefits they bring, in addition to some ex ante benefit from resolution. Finally, ring-fencing gives policymakers options for resolvability that they plainly lacked in 2008-09.

Q47 **Anne Marie Morris:** In the interest of time, I am going to ask one comprehensive question rather than ask it in bits. Then perhaps you could both give me your thoughts.

I am turning to the restrictions on the ring-fenced banks to provide banking services to relevant financial institutions. There are arguments that they are causing problems for clients and banks. How serious are these problems? There is debate about whether those restrictions should be amended or removed. If your answer is that they should be amended and definitely not removed, which ones should be amended and why? Could you give me your thoughts?

Professor Sir John Vickers: I will give a very general answer, but Keith will be closer to the specifics because his review is more recent. There was a debate when we were making our recommendations. Some were saying, "You should go for total separation. You should not allow retail banking and investment banking in the same banking group". We thought that was not the right approach. When I hear people saying, "The ring-fenced bank is restricted from doing X", my first thought is, "Why can they not just do X out of the other bit of the banking group?" It is not saying the banking group cannot do it; it is just where it is done from, in particular whether you have UK insured retail deposits funding the activity.

Having said that, as time goes by, I am sure there will be some good adjustments that could be made, but I really care about the fundamental architecture. Parliament, cross-party, 10 years ago said, "This is how banking is going to operate in the UK". We should hold on to that, but that is not to say there is no scope for improvement in how it is implemented.

Q48 **Anne Marie Morris:** Keith, I would be very interested in your response.

Sir Keith Skeoch: They should be amended, not removed.

Q49 **Anne Marie Morris:** How should they be amended?

Sir Keith Skeoch: They should be amended so there is no underlying risk to the resilience of a ring-fenced bank or an increased risk to financial stability. To give you a very simple example, providing banking services to a small IFA in Surrey or Northumberland is not permitted at the moment within a ring-fenced bank. The scale of that business is much more suited to a ring-fenced bank. You would say exactly the same about a mortgage broker.

You do not want the ring-fenced bank implicitly taking on leverage by lending to a very large-scale financial institution. It should be amended. The recommendation was that we should start with SMEs, in effect.

Q50 **Anne Marie Morris:** The sorts of things we are looking at are lifetime mortgages, inflation swaps, the restructuring of loans in specific circumstances and taking stakes in technology—

Sir Keith Skeoch: No, forgive me; that is a slightly different issue. There is one issue about the lending you give to what are called RFIs—relevant financial institutions. What you are referring to is a set of activities that are excluded by legislation from a ring-fenced bank. There is a pretty long list, and most of that list needs to remain intact.

There are three or four—I think it is three—where we would recommend an exclusion. There are certain issues about dealing as principal. If a fund owned by the ring-fenced bank does a trade and the trade needs to be unwound, it cannot be unwound by the ring-fenced bank because it cannot deal as a principal. That is just a technicality. There is also something about commodity trading. It is a small subsection. From time to time, as markets develop, that list of excluded activities should be reviewed by the PRA and the Bank.

Anne Marie Morris: Okay, that is helpful. You are quite right to separate the two.

Q51 **Anthony Browne:** There is one area that I am interested in. I am sorry if this was touched on earlier; I came in a bit late. The effect of the ring-fence is very different for those banks that have large non-ring-fenced operations, such as HSBC and Barclays in particular. For Lloyds and NatWest it is very different. Indeed, in Lloyds they have a tiny amount of non-ring-fenced activity.

Does the ring-fence really make sense for a bank like Lloyds, where almost all of it is within the ring-fence and then it has a holding company on top of it? It is a question for John, really, in the light of experience.

Professor Sir John Vickers: If you look at what happened to HBOS, which became part of Lloyds, that might lead one to think, "Yes, it is pretty important to apply these principles in that area". It is such a large institution that I would be wary—

Q52 **Anthony Browne:** With HBOS, as with all the UK banks that blew up, it was all on the commercial lending side, which is within the ring-fenced operation, is it not?

Professor Sir John Vickers: Quite a bit of it was global in the HBOS case. There were some Australian exposures. It does and should bite on them. I can see that there is a point where it may become de minimis. It is really important to keep the basic architecture there. This is how we do banking in the UK. We have been a major financial centre for hundreds of years. We want the best of both worlds: safe and sound domestic banking together with a vibrant financial sector operating in international markets.

Q53 **Anthony Browne:** I would certainly agree with that objective. It is difficult to see how something happening in the non-ring-fenced banks of Lloyds and NatWest could lead to the failure of the ring-fenced bits because they are so much smaller. In Lloyds, about 5% or 10% of their operations are outside the ring-fenced bank.

Professor Sir John Vickers: That may be. Of course, NatWest is part of the RBS group. There is a certain irony in calling them the Edinburgh reforms, given what happened to RBS. There is that history. The shape and size of these institutions changes over time so one needs to be careful.

Sir Keith Skeoch: Our recommendation was very much that, until the banks are resolvable, they remain in the ring-fence, particularly the large and complex banks like Lloyds that John has talked about. We did make a recommendation that, where there are smaller banks, around the £25 billion threshold—

Anthony Browne: These are banks like Virgin Money and TSB.

Sir Keith Skeoch: Yes. If they were not doing any ring-fenced activity, they should come out of the regime because they were dual reporting. Alongside that, we felt they should be allowed a de minimis level of non-ring-fenced bank activity to help with, for instance, client facilitation, but that should be strictly limited.

Our recommendation was that it should be 1% of tier 1. As soon as they went through that, they would be pulled into the ring-fence arrangement. That was really just a freeing-up of the bureaucracy.

Q54 **Anthony Browne:** I just want to follow up on one thing. You said that we should only think about moving banks outside the ring-fencing regime if they are effectively resolvable. We will not know whether they are effectively resolvable until we have another financial crisis. We cannot do it on paper. That is just the nature of the thing: you cannot know. You can hope and pray and you can have good probabilities, but you will not know for certain. Presumably, the logical consequence of that is that they should never move out of the ring-fence regime.

Sir Keith Skeoch: This is a point where John and I differ. My view is that we should work hard now. The judgment on resolvability—I am absolutely clear—should be with the Bank of England and the PRA, but it seems to me that there is a point where the two regimes are integrated. Once they are deemed resolvable, they go into a single regime.

The view of the panel was that the hurdle for resolvability should be very high. One of the reasons we asked the Treasury and the Government to consider and look at this is because we did not want anybody suggesting that the June 2022 report would be a trigger for the removal of the ring-fencing regime. This is about trying to be forward-looking and make sure the two regimes get integrated.

Q55 **Anthony Browne:** I am not sure whether you were asked earlier about the Government's proposals, not yours, for the threshold for assets going from £25 billion to £35 billion. Is that something you think is okay?

Sir Keith Skeoch: We did not have a strong view. We wondered whether it should be indexed to inflation or GDP. When we looked at the rationale for £25 billion, it was that it captured a certain set of banks and left others outside.

I assume—I do not know—that £35 billion has been chosen with a certain set of banks in mind, allowing them to be removed with a bit of leeway. My understanding—John would know better—is that there was not a lot of science behind that £25 billion number.

Professor Sir John Vickers: The ICB did not have a strong view on a de minimis threshold. On balance we thought there should not be one, but that was not an issue we felt strongly about.

Q56 **Anthony Browne:** You did not think there should be a de minimis threshold at all.

Professor Sir John Vickers: That is what our report says.

Anthony Browne: It would apply to even the littlest challenger bank.

Professor Sir John Vickers: I thought it was entirely sensible to put one in place. That did no violence at all to what I think of as the fundamental architecture. I do not have a strong view. If £25 billion was a reasonable number 10 or 12 years ago, arguably £35 billion is a reasonable number now. I am agnostic on that.

Chair: That is really helpful. I know there are still quite a few burning questions, and you have been incredibly helpful and wonderful witnesses. It has been great having you both on together. I am conscious that the bell is about to ring, at which point I will adjourn the session. While we still have the luxury of the Minister being on his feet, I am going to ask Andrea, John and anyone else who has a further question to ask it, and we will get through as much of it as possible.

Andrea Leadsom: Have we and should we practise resolving a bank? I know we have had stress tests, but has there been a full practice to resolve a bank?

Q57 **Mr Baron:** Cand I suggest to you, very quickly, that we might be using a sledgehammer to crack a nut with the proposal to take banks that do not have an investment arm to them out of the regime? The Government may say it will stifle growth if we do not do that, but, on the other hand, we all know that, if you work in investment banking, there are various shades. It is often the security you are dealing with, not necessarily the actual activity itself.

Professor Sir John Vickers: I do not know whether war-gaming or whatever is done. On the latter question, if an institution is not doing anything of the excluded or prohibited type, the dual reporting requirement is redundant anyway. We have not seen that as a big cost in those terms, but Keith has had evidence more recently that may point in a different direction.

Sir Keith Skeoch: I would agree with that. The only issue is where you have a UK subsidiary that is specifically a ring-fenced bank, but you have an organisation globally, the parent, that is an investment bank. That causes an issue. It is quite important that the regulation that is around that UK entity is appropriate and there is no leakage.

On the question about going from £25 billion to £35 billion, we were also very mindful that there were international entrants coming into the UK, which were able to attract deposits. They were able to use UK retail deposits very much at the margin, but they were funding investment banking capabilities. We did not want to see a dramatic increase that would allow that as a particular way in.

I agree that there should be wargames.

Andrea Leadsom: You are not aware that there have been.

Chair: That is a question for the Governor, the next time we are discussing this. Thank you.

Q58 **Danny Kruger:** Can I just revert on the point about the risk of public money being used? The Bank said in its resolvability assessment in June last year that if a major UK firm, meaning one of the big eight, entered resolution today, it could do so safely. Are you less bullish than the Bank about the safety of the eight banks at the moment? Am I misreading what they are saying as suggesting there is no risk to the taxpayer at the moment?

Sir Keith Skeoch: You can never say never. There is a degree of uncertainty. John is a much bigger expert than me, but we are in a much better place with bail-in-able capital. It is that bail-in-able capital that prevents the taxpayer picking up the tab. Are there a set of circumstances where that bail-in-able capital is not sufficient? I suspect there are.

Q59 **Danny Kruger:** Presumably we are worried about it happening to more than one bank. That is where we are particularly concerned. If it were one bank, we might be able to handle it, but a series would be riskier.

Professor Sir John Vickers: Yes. Barings Bank and Equitable Life were mentioned earlier. Those were institutions that needed bespoke solutions. 2008 was entirely different because you had the whole system. As much as I admire all the work that has gone into resolvability and bail-in debt—and we have thought a lot about this in our work—I do not think you can rely on it.

It is all a question of trying to shift the odds of a crisis and the scale of rescue contingent on there being one. It is a percentage game. None of these solutions is perfect. That is why a combination is needed.

Q60 **Danny Kruger:** Just quickly, lastly, did you read the Bank of England's resolvability assessment in June? Was it a fair reflection of the state of readiness and risk? Were they being a bit too optimistic?

Professor Sir John Vickers: Your asking me makes me wish I had.

Sir Keith Skeoch: I did. It is written in a particular way that is there for public consumption, but, if you read between the lines and look at the recommendations that are made for individual institutions, there is clearly quite a lot of work to be done to generate a further significant reduction in the risk of "too big to fail" falling on the taxpayer. It is deeply reduced from 2008, but there is still a fair way to go.

Q61 **Mr Baron:** Very quickly, coming back to this business about public money and so forth, there are two related issues here, are there not? There is the regulation we put in place and all the safeguarding measures, but it also comes back to the stress testing and the value you attach, to a certain extent, to the assets you are examining. They are complementary, which is why I pressed you, Sir John, a little on how you value them. I know we are agreed, but is there any noise out there or any pressure to look not just at the regulation but at the way we value assets when it comes to stress testing? Is it just a side issue?

Professor Sir John Vickers: No, there is some attention academically from practitioners and so on, but I wish there were much more focus on this. There is a wider issue. I am sure all the accounting is done in good faith and all the rest of it, but this is such an important part of the economy, which is regulated, and it relies on these accounting measures. It is in the nature of banking that the assets are, to a large extent, illiquid, otherwise they would be traded on markets, not done with intermediaries. There is a huge sensitivity here. If you get it wrong—there are many historical episodes—the trouble can be great.

Q62 **Mr Baron:** You think we need to do more on this.

Professor Sir John Vickers: I would welcome much more attention on this, yes.

Chair: I would just like to thank you both so much for giving us this excellent evidence. We will go through our transcript and, if we have forgotten to ask you an absolutely crucial question, we will drop you a letter. At this point I just want to thank you very much for giving us evidence and putting up with the time pressures.