House of Commons

Treasury Committee

Oral evidence: Silicon Valley Bank UK, HC 1226

Tuesday 28 March 2023

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Watch the meeting

Members present: Harriett Baldwin (Chair); Rushanara Ali; Mr John Baron; Anthony Browne; Dame Angela Eagle; Emma Hardy; Danny Kruger; Dame Andrea Leadsom; Siobhain McDonagh; Anne Marie Morris.

Questions 1 - 73

Witnesses

I: Andrew Bailey, Governor, Bank of England; Sir Dave Ramsden, Deputy Governor for Markets and Banking, Bank of England; and Sam Woods, Deputy Governor for Prudential Regulation, Bank of England, and Chief Executive Officer, Prudential Regulation Authority.

Examination of witnesses

Witnesses: Andrew Bailey, Sir Dave Ramsden and Sam Woods.

Q1 **Chair:** Welcome to this special, additional session of the Treasury Committee to discuss the recent turmoil that we have seen in the banking sector and, in particular, Silicon Valley Bank UK. I am very grateful to you, Governor, for finding the time to come in and speak to us on this issue. I know you've got a hard stop at 11.30.

Andrew Bailey: Yes, sorry about that; I've got an international meeting.

Chair: We appreciate that you have made time in your diary to come in and speak to us, and that we will be talking to you about monetary policy and inflation the next time we see you, in May. Today is all about the banking sector, and—starting with you, Governor—may I ask the witnesses to introduce yourselves?

Andrew Bailey: I am Andrew Bailey, Governor of the Bank of England.

Sam Woods: I am Sam Woods, head of the PRA.

Sir Dave Ramsden: I am Dave Ramsden, deputy governor for markets, banking, payments and resolution.

Q2 **Chair:** Clearly, it has been a very busy time for all of you over March. Would you say that the events that led to the rescue of Silicon Valley Bank

UK came out of left field? Were you taken by surprise?

Andrew Bailey: Yes, I would say that, actually. In my experience, which goes back 30 years now, it's probably—I'm talking about the parent bank in the US, to start with—the fastest passage from sort of health to death, really since Barings, I would say. Barings, as you will remember, was a sort of Friday-to-Sunday thing, and this was pretty similar, so yes. I would, if you don't mind, draw a distinction with Credit Suisse, which we might come on to and which was actually a much more drawn-out affair. But yes, it was a very fast passage to failure.

Q3 **Chair:** You mentioned Credit Suisse, Governor, and obviously quite a few banking stocks, regional banks in the US—we have heard in recent days there is pressure on the share price of Deutsche Bank and so on. You probably won't want to comment on areas outside the UK, but I just wondered whether you think today that these individual, idiosyncratic events have now passed and that things have settled down and this turmoil in the banking sector in March is behind us.

Andrew Bailey: Well, we have sent you an assessment of the UK banking sector, and obviously we would be very happy to discuss any points you want to discuss out of that. I think the US authorities are still dealing with some of the consequences of the issue in the regional banks that manifested itself in Silicon Valley Bank. I think Credit Suisse—obviously we may come on to that, and I am happy to talk about it—is a rather institutionally specific story about long-run issues in the institution. Certainly, my very strong view with the UK banking system is that it is in a strong position both capital and liquidity-wise. It is not showing signs of problems in that respect, and we tested, as you know, very extensively. I also think that, with what we saw at the tail end of last week—on Friday in particular, when there were quite sharp market movements—there are moves in markets to, if you like, test out firms. I would not want to say that those, in my estimation, are based on identified weaknesses more than testing out. There is quite a bit of testing out going on at the moment, I think.

Q4 **Chair:** Last September, obviously, there was the stress test of the liability-driven investing, which was way outside the parameters of any stress test that you had run. Sam, have any of these developments been outside the stress test of the sorts of things that you model for?

Sam Woods: Well, I would make a distinction here with the capital treatment of interest rate risk, which was a relevant factor in the demise of the parent bank, Silicon Valley. We do capitalise that risk very thoroughly for UK banks—including, by the way, for Silicon Valley Bank UK—and I am entirely content that the stresses we have seen are inside the types of stresses that we apply for capital purposes.

Where I think there might be more of a policy question—an international question in which we will take a close interest—is around the calibration of the liquidity coverage ratio. That is the one-month liquidity that the banks have to hold. As Andrew was just mentioning, a striking feature of the

Silicon Valley Bank run, though not so much of the Credit Suisse one, was the speed with which it took place.

There is a table in Andrew's letter, which is quite helpful. You can see that £2.9 billion in deposits went out in a day, on Friday 9 March. Those are the sort of outflow rates we have—so, the percentage of deposits that are assumed to run out in that ratio, the LCR. Some are actually 100%, so deposits from financial institutions are assumed all to go, but operational deposits are less than that and retail deposits less still. So, there is a question for all of us—but it is a question, I emphasise—about whether those outflow rates are quite high enough.

Q5 **Chair:** It is much easier now to move deposits electronically. People do not have to queue around the block to take their money out of a bank; they can move it in seconds. Presumably, you will have to think about what it is that you stress test for when you look at some of the rules.

Sam Woods: I think that is right. All of us can move money from our accounts in as short a time as it has taken me to answer this question. That is a relatively new feature of the market. The other aspect that we have had—which we have dealt with in the past, by the way, but it is more prominent now—is the speed at which news can travel, particularly among communities and sometimes through private messaging groups. That is a noticeable phenomenon here and elsewhere. I think that in this case we also had the issue that you asked about in your letter, which is the concentrated nature of the deposit base in this particular firm. That was an exacerbating factor. But we will have to look at all that, sure.

Sir Dave Ramsden: May I—

Chair: Just one moment, Dave.

Governor, on the events of March, I am not sure that I heard a clear yes or no answer to my question about whether this was pressures from idiosyncratic cases around the world, or whether it's something more systemic. Today, near the end of March, can you say whether this turmoil is behind us?

Andrew Bailey: I think there is a story in the Silicon Valley Bank US case, which I am sure we will come to, that is to do with the treatment of what we call interest rate risk in the banking book. It is not trading activity, but interest rate risk in the bank. We treat that differently in our capital regime, which we set out in the paper we sent you—we would be happy to go through that. We treat it differently from the US, and that is an important difference. So, I think there is an issue there—

Q6 **Chair:** So we—the banking industry—are not out of the woods?

Andrew Bailey: Let me just finish. That is an issue, but it is not an issue in the UK, because we treat it differently. It obviously relates to the question of the rise in interest rates and of how much and how quickly. However, I think a lot was idiosyncratic about Credit Suisse, which we can say a bit about, but obviously it is not one of ours as a parent.

Now, to your question, I do not think—we have said this—that any of those features cause stress in the UK banking system. The definitive yes/no answer to your question goes back to what you said about the markets last week: they are trying hard to find points of weakness at the moment. I do not think that we are at all in the place that we were in in 2007 or 2008—a very different place from then—but we have to be very vigilant.

If I give you the answer, "I don't think there's a problem going forwards", I do not want for a moment to give you the idea that we are not very vigilant, because we are. We are in a period of very heightened—frankly—tension and alertness, and we will go on being vigilant. That is the message I would really like to give you in answering that question, if you don't mind.

Q7 **Chair:** Thank you. Dave, you wanted to make a point.

Sir Dave Ramsden: All I wanted to do was to illustrate the point that Andrew was making about the wider context. Think of what is going on in global financial markets at the moment: the US Treasury market, one of the most liquid in the world, had implied volatility last week close to post-global financial crisis highs. The markets have responded to recent events in particular banks and are testing.

That also plays into a longer-term picture. We have all appeared before you to talk about the LDI episode last autumn, where we saw events off the scale—moves in markets triggering responses. This is why we have to remain incredibly vigilant, focusing and monitoring very closely. As we said last week in the Monetary Policy Committee minutes, we will keep a close eye on bank funding costs and what the consequences of those could be for households and businesses. Equally, we are looking out for other risk factors. We have to remain incredibly vigilant.

Chair: I would just note that in terms of the Government bond markets—you mentioned US treasuries—two of the big buyers, which were the Federal Reserve Bank and China, were probably not buying as much as before, so I accept your need to be vigilant on those risks.

Q8 **Anthony Browne:** My questions are going to focus on whether Silicon Valley Bank was prepared, or how well prepared it was.

On Thursday 9 March, I think I am right in saying, your assessment of Silicon Valley Bank would be that it met all the regulatory requirements.

Andrew Bailey: Are we talking about UK?

Anthony Browne: Yes, Silicon Valley Bank UK. It met all the regulatory requirements you had expected of it: it was well capitalised; it had the right liquidity coverage ratio; it was closely supervised by you, you had the information you needed about it. And yet it collapsed the following day. Does that not suggest that your supervisory regime and criteria simply are not fit for purpose?

Andrew Bailey: Let me start—I am sure others will want to come in. I have two key points to start with. No subsidiary can be expected to survive the failure of its parent. I don't think that is a reasonable expectation. They are too tightly associated and connected to do that.

Anthony Browne: That is not always true. Some subsidiaries will.

Andrew Bailey: I think it is unusual, put it that way. I would not work on the basis of that expectation.

By the way, one of the key things that was done—it was done last summer, and took about two years to do—was that Silicon Valley Bank UK was a branch until then. It passed through the point in our policy where, if a foreign branch goes above a certain level of FCSC-protected deposits, then we say, "I think you need to subsidiarise." It did that.

I stress that, because had it not done that—had we still had a branch on our hands—it would have been an altogether much more difficult situation. So that is important; it was subsidiarised.

I said in response, "Well, no subsidiary will survive the failure of its parent." That's not the end of the story. What we had on our hands was a well-capitalised subsidiary, and it had strong liquidity. As Sam has just said, it lost about 30% of its deposits in one day, but it did have the cash buffers to meet those outflows.

That is important, because what it meant is that, going into the weekend, we were working with a bank where there was a reasonable prospect that we could do something to resolve it, which would come out on the other side, as it did, with a purchase. Frankly, if a bank is not solvent going into the weekend, that becomes immeasurably harder.

I would emphasise: I don't think you can expect, and we should not work on the assumption, that subsidiaries will survive the failure of their parents, but what we must do is have the subsidiary in a good state, so that when we then turn to resolution, we can do something with it.

Sam Woods: I think the team did a very good job of making sure that the UK subsidiary was capitalised, including on concentration risk and on interest rate risk. But, back to your original question, there is a bit of a trade-off in these things. We could remove run risk from banks by requiring 100% outflow of all deposits to be held in reserves at the Bank of England, but we are choosing not to do that. We do not want to operate a reserve failure regime, because there would be some significant costs in terms of availability of lending to the economy. That is a trade-off that is made in all regulations.

Having said that—and I won't repeat what I said earlier—I do think we have to look back at these outflow rates, in the LCR specifically, and ask what we have learned and, in due course, what we have learned from the other banks in the States that we are not involved with.

Q9 **Anthony Browne:** Obviously, it has only been a couple of weeks. As far

as you are concerned, is that outflow rate the main thing? Is there nothing else you would need? On Thursday, you reported that it was a totally healthy, solid subsidiary. It collapses the next day. What else is there that you would need to know to be confident that it really was healthy, and not actually on the verge of dropping dead?

Sam Woods: Well, there is the point that Andrew referred to before, which is that there are some differences between how the interest rate risk that banks carry is dealt with for smaller US banks and how we deal with it in our system. My colleague in the Fed, Michael Barr, has confirmed that he will bring forward some proposals about how they run that part of US regulation. Actually, they will do that pretty quickly, I think by 1 May.

There are three main distinctions. First, the accounting is different, in that the US gap is much accommodating of what is called auto-maturity. Secondly, the way that smaller firms—but quite large banks, in our terms—in the US are allowed to deal with the remaining part of their bond portfolios, which are available to sell from a capital point of view, is different. They have an exemption; they don't have to take those losses through to capital. That is an exemption that they can choose to use, and SVB US did use that. We don't allow that in our system. Thirdly, we capitalise that risk very explicitly in what we call Pillar 2A, in minimum requirements.

Having looked back through this episode, I think that all those things in our system are working fine. Our US colleagues have been doing a fantastic job, but they have said themselves that they are going to look at how that works in their system.

Q10 **Anthony Browne:** You have both mentioned the concentration risk in Silicon Valley Bank, because it was a narrow sector, obviously, and you required extra capitalisation for that. Are you confident that you have measured the concentration risk right and that the extra capital that it had was sufficient for that? Part of the reason why the run was so rapid was that it was a small, networked group of people; a few VC funds told all their clients to withdraw their money almost instantly in a few WhatsApp messages. Those clients also, certainly in a lot of cases, were required to hold their entire capital in Silicon Valley Bank, so it was quite natural for them to try to withdraw it as quickly as possible. So, had you measured concentration properly, and were your mitigations of capital sufficient?

Sam Woods: I would say, on the capital side, 100%. I feel completely confident about that; I have no reason to question the way that that was done. But, coming on to the liquidity side, as I say, the regime that we've got was implemented in full for this firm. As Andrew said, it is actually quite interesting if you look at the balance sheet. You can see that they are having to pay out the deposits with cash on that day, while they are also having to sell some of their liquid assets—you can see about £700 million in liquid assets.

That all worked fine. Our problem was that we thought that confidence had been lost in the institution overall—because of what was happening at

the parent—so significantly that that couldn't be sustained. I do think that we will need to come back, not particularly for this firm, but with that learning—also regarding the point that the Chair was making, around the speed with which money can move—and say, "Well, actually, have we got those outflow rates right?"

But I would finish by saying that you don't want to cover that risk completely, because the only way to cover it completely is to go down the route that I have just described. You will always have a judgment there, but we should revisit and question that judgment based on what we have learned.

Q11 **Anthony Browne:** Certainly in the US—and I believe in the UK as well, although I might be wrong—the Silicon Valley Bank often required its clients to hold all their capital with it, rather than elsewhere. I certainly know—I have spoken to tech firms who are customers of Silicon Valley Bank who wanted its banking facilities and were required to hold all their capital there. So, they hadn't tried to diversify. If you have £100 million, you don't normally hold it all in one bank; you try to put it in a range of institutions to ensure that if something like this does happen, you don't face wiping out. I know that that restrictive practice of SVB has been subject to commentary in the US. Does it cause concern for you as a regulator?

Sam Woods: Well, to the extent that it exacerbates one risk—I think that is why we would really worry about it. On the asset side, from a capital point of view, I think it is a commercial choice that can be made, and we just need to ensure that we capture it properly in our requirements, which I think we have.

I would say that that arrangement was quite unusual. But it was striking to me, as for you—we had a huge amount of inbound over the weekend that we are talking about from firms—that many firms did find themselves in that very concentrated position, and that exacerbated their exposure.

Andrew Bailey: There is another point that I think we will naturally have to look at, but it is a broader point, not just a regulation point. Something that businesses say to me—particularly start-up businesses, but not just start-up businesses—is that opening many business accounts to get a diversified range of banks is not easy. I think there is a point there on ease of account opening for businesses.

Q12 **Anthony Browne:** In your opinion, does having that concentration of your capital in one bank, and a policy like that, exacerbate one risk, because the clients face complete wiping out, as opposed to just losing a portion of their money?

Sam Woods: When you've got a combination of individual firms that are very concentrated—so, they haven't diversified themselves—and that client base also being very concentrated, you can see how that could lead to a higher run risk. That is one of the learnings from this.

Sir Dave Ramsden: And if people are very tech savvy and already using messaging and the like for more conventional messaging, they can really go on it when you are in a run situation.

Anthony Browne: This is not a question; I am just making a point. It would be good for you to look at the point that Andrew made about whether it is difficult for companies to open multiple bank accounts. It is clearly a lot more stable, from an economic stability point of view, if companies are encouraged, allowed or facilitated to have multiple bank accounts where their deposits are, rather than holding all the VC money they raise in one firm, which is clearly high risk economically.

Q13 **Mr Baron:** May I briefly turn to the Bank's approach to resolving the SVB UK issue, its interaction with the Treasury, and what alternative options were being considered? On Friday 10 March, the Bank published a statement that said that you intended to place SVB UK into a banking solvency procedure. Your subsequent letter to us went on to say that a "sale would better promote public confidence in the stability of the UK financial system." What caused the Bank to change course and pursue a sale of SVB UK instead? If a sale was going to be the better outcome, why weren't you pursuing that in the first place?

Andrew Bailey: Can I make a crucial point? We could not guarantee that a sale would take place until probably around about 4 am Sunday going into Monday—Monday morning. The reason we said what we said on Friday evening had three points to it. First, the bank insolvency procedure is a standard one for smaller banks. We know that we can execute that procedure over a weekend. So we can give certainty that there is a solution that we can execute. That is important for two reasons: one is to give certainty that we can do that; the second was to make the very clear statement that goes with that, which is that in our view this bank was not a systemic risk to financial stability. That is critically important: we had to draw a line and say, "This is not a bigger problem."

The third thing is that, in effect, that statement then puts the bank up for sale. We have quite a lot of tools in the resolution toolkit that we can use. There was an important form of words in that statement, which was that if further information came to light, we would act upon it, and that is exactly what we did. We then went into a process over the weekend, a sale option became a clear possibility and then went beyond that, and we were then able to reconsider the resolution objectives from the point of view of what would deliver the best outcome for our objectives. Once we knew that we could do a sale, we concluded that that was the better option. On Friday evening we could not say that.

Sir Dave Ramsden: We have a preferred resolution strategy for every institution that we are responsible for, and the one for SVB UK was the bank insolvency procedure. For all the reasons Andrew gives, it made sense to clearly give that signal on Friday evening, with, as Andrew says, the phrase "absent any meaningful further information". By announcing that, what you are doing is saying that you have a credible counterfactual. You can then assess the alternative options that come along over the

weekend—hopefully; you cannot guarantee it—that you can assess against an option that you know you can deliver.

Mr Baron: I suppose what you are saying is that you need to ensure that you get the message out—one of confidence and stability—while leaving the door open to possible options.

Sir Dave Ramsden: Exactly.

Q14 **Mr Baron:** I get that. Can you perhaps then explain the role of the Treasury in all this? We saw the Chancellor's statement a few days later. To what extent did the Treasury bring pressure to bear with regards to the preferred option of a sale? I would like to explore further whether there was a little bit of—in the nicest possible way—ignorance as to the importance of the customer base to the UK economy. Given subsequent actions and the involvement of the Economic Secretary, who said "subsequent emerging developments…made clear the risks to the firm's customer base, in particular those in the technology and life sciences sectors, meant that there was public interest in ensuring uncovered depositors" and so on, can you take us through the interaction with the Treasury? Can you give us some sort of flavour as to whether the nature of the UK customer base was a factor in the Bank's decision making?

Andrew Bailey: I would start by saying that it is not just the Treasury that would prefer a sale: we would prefer a sale. That is a better outcome. If we can effect a sale, we would always do that. Fortunately in this case, we did. That is always our preference. Secondly, we work very closely with the Treasury. If you go through the Banking Act, it sets out a pretty tight relationship between us and the Treasury on this, and that is important for several reasons. There is always a risk that there might need to be a bigger public intervention—it was not the case in this example—so we followed through on that.

You make a very interesting point about the technology and life sciences sector. I think that is important as well, so please do not in any sense think we do not agree with that point. An important distinction is that the judgment we had to make on Friday evening was about the stability of the financial system and financial stability. I was criticised in some quarters that said I do not understand systemic stability, because there is another system out there which is the tech and the life sciences. No, I do understand that. We had to make a particular judgment according to our powers. Of course, yes, if we could—as we managed to do—effect a sale that preserves continuity of banking for those important businesses, we would do it.

Sir Dave Ramsden: It's really important that we are open and transparent about the relationship between the authorities. The Banking Act is very clear, and in the form with which we exercise our resolution tools through the resolution conditions assessment that we have to make, the role of the Treasury is very clear. We are responsible for deciding on the tool, unless there is a risk to public funds, where absolutely it is right that the Treasury should lead on that.

Mr Baron: I get that.

Sir Dave Ramsden: That's a really important way in which to frame things. We can give technocratic advice and make assessments, but where public funds come into play, that is why we involve the Treasury, as appropriate, as we did on the Friday evening on the resolution conditions assessment that got us to the bank insolvency procedure, and then in the early hours of the Monday morning that effected the resolution that we ended up doing.

Q15 **Mr Baron:** A final question. May I press you on the nature of the customer base? This is deemed to be a high-growth area for the UK and deemed to be an area where we have world leaders across the spectrum. It is an important part of the economy, if you like, for the future. To what extent was that a factor in your decision ultimately to take the preferred option of a sale to a bank like HSBC?

Andrew Bailey: It wasn't, in the sense that if we can sell a bank over a weekend, we will sell a bank. It doesn't really matter what its customer is, because that is a better outcome for the customers. It did not make the difference in that sense, but given, as you say, the important nature of the customer base and the wider importance to the economy, I am very pleased that we were able to do that.

Mr Baron: Okay. Thank you.

Sir Dave Ramsden: But we are always conscious of the depositor base, particularly if there are going to be uncovered depositors. We are conscious of the context. We are trying to sell a bank; we don't have to do it very often, as it happens. We have not done a resolution since 2011—in that case, for the Southsea, it was a bank insolvency procedure. The Bank of England will be aware, and that is why we have to consult also with the Financial Services Compensation Scheme. But it's not a crucial factor for us in exercising our powers.

Q16 **Dame Angela Eagle:** So really you're saying, Governor, that the bank insolvency procedure is the backstop, the counterfactual—

Andrew Bailey: For small banks.

Dame Angela Eagle: For small banks, yes, and we're talking about a small bank here. So you put that backstop in on the Friday and then presumably spent the weekend hunting around for better options.

Sir Dave Ramsden: Actually, we spent the weekend making sure that we could then deliver on that backstop. It's really important to understand that when you're going through, even with a small bank, a resolution weekend, it's going to have lots of twists and turns in it. For it to be a credible counterfactual, you have to be able to deliver that on the Monday, so you have to get an insolvency practitioner sorted out and have all the engagement with the firm to ensure that you are not going to get any wires crossed. Equally, alongside that, you'll be looking for a purchaser. That's just the nature of a resolution. We have multiple tools and, as we

set out in our letter to you, the choice of tools—you'll be wanting to have more than one in play, and then where you end up will depend on the circumstances of the particular resolution.

Andrew Bailey: The bank insolvency procedure team was working on that process until 4 am on Monday morning, because—

Q17 **Dame Angela Eagle:** Because any sale can fall through at the last minute.

Andrew Bailey: Yes. I've done in the past a resolution—well, it was a firm that had a UK presence—which fell through at about 3 am on Monday morning.

Sir Dave Ramsden: In which case, if you don't then go for an insolvency procedure, you might fall back on a bridge bank. You need to have multiple options, and that's the great thing about the resolution regime compared with where we were when I was working—

Dame Angela Eagle: I remember it well.

Sir Dave Ramsden: When I was working in the Treasury, where the only two options we had during the global financial crisis were: either you allow the bank to fail, and risk financial stability, or you get a bail-out from public funds, which comes back to the answer that I gave to Mr Baron.

Q18 **Dame Angela Eagle:** Were banks other than HSBC sniffing around as potential buyers, because it is quite a big book of companies? Although some of them are risky, they may grow. And HSBC got it for £1. Were a few other big banks interested?

Andrew Bailey: Silicon Valley Bank UK set up a so-called data room, they hired advisers, and from late Saturday and throughout Sunday, that data room was open, and quite a few people came into that data room to have a look. There were a number of possible offers, but—I've had quite a lot of experience of doing these things—most of them don't turn into anything real. And occasionally you get ones where they set conditions, and you say, "No, sorry, we can't do that."

By the end of that process—by that I mean the earlier part of the evening on Sunday; this was around 7 or 8 o'clock on Sunday evening—we really only had one left, and that was HSBC.

Q19 **Dame Angela Eagle:** What due diligence guarantees did they do on the book? Did they do all that over the weekend?

Sam Woods: As Andrew said, it was clear to us that in that early evening of Sunday we needed to narrow down the sale options to one, based on what we had at that point and also in terms of just getting to the line by 7 in the morning. HSBC can speak for themselves, but they went into the data room. This was an extraordinarily high-pressure situation, with lots of us working both nights over the weekend, and HSBC therefore didn't have much time—to your question—but they did have some time. They did a lot of due diligence very intensively and they prepared their teams during the

Sunday, and then there were further yards of that that had to be done late into Sunday night and early into Monday morning, which is why, of course, we had to keep the other options going—in case something emerged from that.

Having said all that, there was a risk judgment that HSBC had to make: did this look attractive enough commercially that they were happy to run the risk of doing something at a much higher speed than they would normally choose to do it? In the end, the answer to that question was yes.

Q20 **Dame Angela Eagle:** But there were quid pro quos, weren't there? We had yesterday the statutory instrument that changed the ringfencing regime. So there are quid pro quos here—presumably, to give them comfort.

Sam Woods: This was an important part, by the way, of why HSBC were a credible bidder: they only really asked for two things. One was change in control of rewards—they are not allowed to take it over unless we agree—and the second was around ringfencing. Did you want to go into that now?

Q21 **Dame Angela Eagle:** I think a colleague of mine will be asking about the detail, but did they suggest changes to the ringfence?

Sam Woods: They were clear. We will perhaps come on to this if your colleague will go into this. They were very clear that a necessary condition for them was that some allowance was made there.

Sir Dave Ramsden: If I can just add to your point about the valuation, in the time available we carried out an independent internal valuation—as in, we did the valuation, as opposed to anyone else doing it—of, under stress circumstances, what the bank was worth. That is what led to the share transfer taking place at the value of a pound, because we had to mark down the balance sheet very significantly.

Andrew Bailey: I was going to add—this goes back to Mr Baron's question—that Sam made the point that of course they were still having to make a judgment on the value of the assets. That judgment is easier because the bank had capital—it is much easier to make that judgment than if it does not have capital.

Sir Dave Ramsden: All the capital was owned by the parent, which from our perspective made it very straightforward.

Q22 **Dame Angela Eagle:** I suppose the other issue is that, going forward for smaller banks, is the insolvency procedure a viable option and, therefore, does it have teeth as a part of your toolbox? Because you are clearly anxious to avoid it. What would have been the outcome had this bank had to go into the insolvency procedure? Had HSBC got cold feet and run away at 3 am on Monday morning, what would you have been left with?

Andrew Bailey: I think it is a viable procedure; Dave said earlier that we have used it in the past. What would have happened is that the insured deposits would have been paid out within seven days. Now, they were not a very big proportion of the total deposits, but they would have been paid

out. The uninsured deposits would then have been paid out as the insolvency practitioners realised the value of the assets. I think there is a very reasonable chance that they would have been paid out in full, because of the capital base that the bank had, but you cannot tell that definitively until it actually happens. The effect, going back to the effect on the businesses—on biotech and fintech businesses—is that even though there was a reasonable prospect that they would have been paid out in full, they would have had to wait for that to happen.

Q23 **Dame Angela Eagle:** So there would have been a great period of uncertainty.

Andrew Bailey: That is the crucial point, I think: from the point of view of the liquidity of those businesses, they would have seen a very substantial effect.

Dame Angela Eagle: Particularly for payroll on Monday morning.

Andrew Bailey: Yes, exactly.

Sir Dave Ramsden: If you think about what the US Federal Insurance Corporation is having to do with its management of the parent, it is now involved in a bridge bank set up—

Q24 **Dame Angela Eagle:** Yes, it has guaranteed the entirety of the deposits with no loss at all, plus generous bonuses, I think.

Sir Dave Ramsden: But I think yesterday it was announced that it had managed to sell some of the book to another bank, so it is working through the balance sheet in that way. If we had gone down the bridge bank route, we would have been in that position. Just to reinforce Andrew's point, I think we absolutely need the bank insolvency procedure as one of the three potential strategies, along with partial transfer and bail-in, for how we approach the banks that we are the resolution authority for. It is still an important element.

Andrew Bailey: They key issue is: who bears the cost? I think that in this case, because the bank had capital, as I was saying a moment ago, it may have been that there would not be a cost, but there would have been a cost in terms of liquidity for the firms. But the key issue is: who bears the cost? In the bank insolvency process, it is the uninsured deposits that are standing in line, effectively, after you have taken out whatever is left on the capital side, but let us assume for a moment that there isn't. If you go to the big banks, we have put in place so-called bail-in regimes where they issue debt that can be bailed in to bear the losses to recapitalise the bank. In the bank insolvency procedure, the key point is that the losses would more likely fall through into the uninsured deposits.

Q25 **Siobhain McDonagh:** Mr Bailey, existing legislation already makes Silicon Valley Bank exempt from ringfencing rules for four years after resolution. What do you make of the Government's intention to make that exemption permanent?

Andrew Bailey: Sam is the expert on ringfencing.

Sam Woods: That is a broad claim, but I am keen on it.

Siobhain McDonagh: Perhaps he just did not want to answer the question, Sam, and put you in trouble!

Sam Woods: He would have been happy to, but he knows that I am a great enthusiast for the ringfence. There are three bits of it. The first is that Parliament, in drafting the Banking Act 2009, very wisely allowed for a four-year exemption, thinking about exactly this kind of situation, where a ringfenced bank is buying another bank in a distressed or resolution situation. That gives the other bank four years to come into line with ringfencing legislation. Nothing had to be done to make that happen; it automatically follows, just as you said.

A second thing that needed to be done urgently, given the situation we were in, was that it was important that, on the Monday morning at 7 am, HSBC was able to fund Silicon Valley Bank UK without restriction, because we were in the middle of this very high-speed run. Of course, we thought that the sale would rebuild confidence, but there can be a lag effect. So, the Treasury needed to lay a section 75 order, which I think was just debated in a Delegated Legislation Committee yesterday—

Andrew Bailey: I think that was referred to earlier.

Sam Woods: That was just to allow them to lend freely, because that is obviously not an arm's length public transaction.

The third piece is more directly on what you are asking about. The Treasury has agreed to make a permanent exemption for SVB UK within HSBC UK, within the—

Q26 **Siobhain McDonagh:** Did they do that because they were desperate for somebody to take the bank and were happy to cave in to HSBC's demands?

Sam Woods: I will explain what their rationale was and give you my view on it. As I said, HSBC did not seek many things in this transaction, but they were absolutely clear that a necessary condition of them being willing to go forward was that they could keep the entirety of SVB UK as one business, because they thought that the integrated nature of the business was part of the value that they were getting and they could only make the numbers work if they had it as a subsidiary of HSBC UK.

The Treasury therefore faced a trade-off: does it agree to make a very small hole in the ringfence permanently, in order to get this one over the line to serve the wider objectives that we were looking to achieve over the weekend, or does it not? It decided that it should. For what it is worth, I think that that was a good call. I am probably one of the very last people on earth who would support punching any kind of hole in the ringfence, but this is very small in relation to HSBC.

If I may make one more comment, though, something that we should be alert to is that I think it would be a very bad thing if other banks sought to

say that because this had happened in this one case, it needed to be generalised for everyone in business as usual. You might face the same situation again in a stress takeover like this, in which case you might have to think about it, but I can see an argument being made that because that little hole was made, everyone has to have their little hole.

Q27 **Siobhain McDonagh:** Is that not almost inevitable?

Sam Woods: It might be inevitable, but if it comes, I think we should resist it.

Sir Dave Ramsden: There is a big distinction, I think, between a stress event and the kind of environment that we think we will be going into, that the Skeoch review was thinking about. This is a reminder that stress events happen and banks fail, so it is important that we have a ringfencing regime that works in good times as well as bad.

Sam Woods: That order has not yet been brought forward to the House, but it will be, I think, debated. Another important piece we might come to is that the permanent exemption is suitably limited both in terms of size and in terms of the shape of the business, because obviously you do not want to say, "We've allowed this very small hole in the fence", only to then turn around and find that it is suddenly a massive hole. That will be an important part of it.

Q28 **Siobhain McDonagh:** Is that not how holes normally happen?

Sam Woods: Well, it depends on the robustness of the rest of the fence. Ours is very robust, so I think it will be okay.

Q29 **Siobhain McDonagh:** What proportion of Silicon Valley Bank's business would not ordinarily be allowed to be undertaken by a ringfenced bank?

Sam Woods: I cannot give you a precise percentage, but it would be quite significant, for the reason that a certain amount of the lending—quite a significant proportion of the book, actually—is in the form of subscription finance, which is basically to bridge investors in venture funds between making the commitment to put money in and actually having the money available. Those clients will often be, I think, well-known financial institutions for the purposes of ringfencing, which means that ringfenced banks cannot normally lend to them. So, I think it would be quite significant, which is why it was a red line for HSBC. That is why it was quite credible that it was a red line for them.

Q30 **Siobhain McDonagh:** Are there any wider prudential or competition risks from these exemptions? For example, do they provide scope for HSBC to take on additional business that it would previously not have been able or allowed to do?

Sam Woods: I think that comes to the limitations. If you look at the size of SVB UK today, it is a £10 billion balance sheet. HSBC is $3 trillion globally. I really don't think that that represents a risk to them. It could be someone larger, and it still would not represent a risk. Those limits are important, but I think the wider risk is the one we were touching on a

moment ago, which is: if somehow this is prayed in aid of other business-as-usual things, that is where you could have a problem.

Andrew Bailey: I do think it is important—this goes back to Mr Baron's question—that the larger banks in this country provide support for high-tech biotech industries. We need to have them in that market to support these really important and growing firms we have in this country. The fact that HSBC took a decision that they wanted to get into this business—obviously, they have got to prove that they can do it, but it is a good thing.

Sir Dave Ramsden: Yes. I think it is aligned with what they were already thinking about, strategically. It obviously came along as an opportunity in a stress situation, but it should be part of the broader approach.

Q31 **Siobhain McDonagh:** If it is good for HSBC and we want our large banks to lend to precisely the types of companies that Silicon Valley Bank did, why would it not be good for all the other bigger banks? Could they not reasonably say, "We would like access to this market, too, so please do something for us"?

Andrew Bailey: It comes back to the point that Sam made a few minutes ago on the question about whether it is necessary for them to have both sides of the balance sheet in the same legal entity or not. That is a crucial question, because that is where the ringfence creates the restriction. They can clearly do both sides of the business, but the ringfencing regime would require them to have one side of the business on one side of the fence, and the other on the other side of the fence. In the context of Keith Skeoch's review, you could probably have that debate. I think that is a sensible debate to have. Sam has very wisely set out why we do not want the hole to become bigger by not thinking about it. It is a perfectly reasonable debate to have, because there was quite an extensive debate about small firms in the context of the ringfence when the ringfence was first put in place.

Q32 **Dame Andrea Leadsom:** Isn't it the case that allowing a tiny hole to be punched in the ringfence starts a precedent that basically means that next time there is a problem and a bank fancies buying that for a pound, that precedent is set? Isn't it simply undermining the whole basis of the ringfence?

Sam Woods: Life is not perfect, and you have to make trade-offs sometimes. I do think it is possible that if we found ourselves in exactly the same situation again with a very small non-ringfenced entity and a big bank offering to take it over with the same conditions, you are right; it is quite possible one might have to consider that. One should have an open mind to that. It is not something one would want to do in normal circumstances, but I can imagine the calculus being the same. We have to be open to that, but what we should resist is the idea that other people can come along and kick lots of little holes in the fence without the very extreme urgency that you had in this situation.

Sir Dave Ramsden: We have a fit and ready resolution regime, but the key thing is that, through the work that Sam leads on, we don't find ourselves having to use it unless we really have to. This is the first time we have used it in 12 years. Hopefully this precedent, which you are right to flag and which Sam has responded on, is not a repeated event. Obviously, we cannot rule out other resolutions; they will happen, but we are not thinking that there are going to be a couple of resolutions a month and this precedent is going to become more apparent.

Q33 **Emma Hardy:** Thank you, all of you, for your work. This must have been quite a difficult week or so for you all, and 4 am finishes are never ideal, so thank you. The demise of Credit Suisse looks like a bit of a car crash in slow motion. Should the regulators have taken greater steps earlier to prevent the smash?

Andrew Bailey: I have to be honest; we cannot speak for the Swiss regulators. It is a Swiss bank, obviously, and the home regulator is the Swiss regulator. We have quite a large operation in this country and we have taken, over a long period of time, a lot of steps to make sure that that UK operation was properly set up and insulated as best we could in the event of a problem. Sadly, I am afraid, you are right. I think Credit Suisse has had problems going back over a long period of time. It has managed to stack up a lot of problems over time.

The real question with Credit Suisse, in the end, was not actually insolvency in a sort of passé sense; it was actually the viability of the bank going forwards, given the severe business model restructuring that the chief executive had identified needed to take place, combined with two other things. One was the emergence of some particular problems over the weekend of the Silicon Valley Bank action—we were actually having to do both together at one stage—particularly to do with the US securities regulator identifying problems in the context of their Sarbanes-Oxley compliance in the US. Secondly, subsequently, a couple of days later, its major shareholder indicated that it was not going to provide more support. That is obviously a critical blow for any firm.

Then, of course, you have to say that while the proximate causes of the Silicon Valley problem and the Credit Suisse problem are different, there was a coincidence of timing and there was a lot of stress in the market. A bank that had been in a long-running viability challenge came to a sort of crescendo at that moment.

We have taken a lot of steps over the years to get the UK operation to a place where we thought we could deal with it if we needed to deal with it. That has been very high priority for us, going back a decade almost.

Q34 **Emma Hardy:** Have there been any lessons from international regulatory co-operation that you have learned about the failure of this, or ideas about how things could have gone better? When reading about this, I found it really interesting that the bank "had plenty of capital and plenty of liquidity" but an issue with its culture. I thought that was unusual.

Andrew Bailey: Well, it has had a whole series of problems over the years. When we say it had a plenty of liquidity, it was experiencing a run. We have to be very clear on this—it was experiencing a run. This is a very interesting question. When banks have problems, people often ask me, "Was it solvency or was it liquidity?" I am afraid the answer is not that simple. It certainly had a strong capital ratio, but in that case you have to ask why the depositors were leaving. What I think it pointed to is what I call a viability problem going forwards, which meant that there was a loss of confidence by its depositors in its future viability. That is the thing. The solvency position is helpful and important, but it doesn't end the story at that point.

Q35 **Emma Hardy:** To what extent was the UK as troubled as its Swiss parent? Or was it not as troubled?

Sam Woods: The way to think about Credit Suisse in this instance is as that three-legged stool: there is a parent and also a Swiss bank in Switzerland, there is a major operation here in the UK, and there is also a big operation in the US.

Throughout the period, particularly from October onwards, there was a very intensive discussion at all levels between the Fed, FINMA and ourselves, including very regular calls between me and my opposite numbers in those two institutions. As Andrew said, over the weekend when we were dealing with Silicon Valley, we were also in touch.

I actually think that that worked pretty well. Those discussions are about, first, the live situation with the firm and how we are managing the risks, and secondly, a lot of contingency planning, including with some of Dave's team, about what we are going to do if it comes to the crunch. That was extremely helpful when it came to that weekend because it meant that, a bit like with Silicon Valley, although none of the options is that appealing, you have options.

Sir Dave Ramsden: We have been contingency planning, as Sam says, since last autumn, engaging both with the Swiss authorities and with the FDIC in the US. We had meetings of the crisis management group, which is cross-authority of the authorities represented by the three-legged stool, as Sam called it, in the run-up to the events of March. Again, we were making sure that we were ready in contingency-planning terms for whatever was going to play out, and then, as Andrew says, the crescendo played out in a particular way, and we all know what the outcome is today.

Q36 **Emma Hardy:** I suppose what I am really keen to dig into is the lessons learned but also the possible impact this could have on the UK banking system or the future of the UK part of Credit Suisse. I am keen to know whether we are to expect any more concerns or issues. Are there things that could have been done differently? Are there any other banks that you are concerned about? How is it impacting the UK? That is what I want to know.

Andrew Bailey: On Credit Suisse in the UK, I would say that both the PRA and the FCA—and I can sort of speak for both, going backwards—have frankly taken a lot of actions over the years with this firm to require clean-ups to take place. I think that has put it in a place where, certainly from the point of view of what happens next, the UK entities are in good order in that sense. Obviously, it is up to UBS now to decide what it will do with those operations. It is not for us to decide what to do. It is up to UBS now to decide what to do with those operations. A lot of actions and planning over the years have had in mind not only the need to take action at the time, but this outcome: "What would we do if we got to this point?"

Sam Woods: Our overwhelming priority in these situations is to avoid a disorderly collapse. That is what you want to avoid, because that would, obviously, have very big ramifications in the financial system and, because we have a big financial centre here, it would affect us. That is what all the planning was for. There was the resolution side of it, which was absolutely ready to go. There was also always the possibility that the Swiss would find some other structure through which to deal with the situation, which, in the end, they did.

Q37 **Emma Hardy:** Sam, further to the questions from my colleague and friend, Siobhain, do you think the Government are right to push ahead with ringfencing reform in the light of this turbulence in the banking sector?

Sam Woods: We talked about it a bit last time. There are all those recommendations that Keith Skeoch made, which are sensible tweaks to the regime to make it work a bit better without reducing its effectiveness. I really think they are fine. There are two that I think we need to keep an eye on.

One is the proposition, which is perfectly sensible in principle, that, if you have a bank that is north of the ringfenced threshold in terms of how many deposits it has but doesn't do any investment banking at all or only a tiny bit, they could be allowed not to have the regime. I think that is not a crazy proposition in itself, but there are some definitional issues. You would not want to have a situation where a UK entity that was north of the threshold and only did retail banking got a pass because it was part of a much wider group that does lots of investment banking. We need to watch that one.

The other one, which the Government are taking further evidence on, is the question that Sir Keith and his team raised as to whether there might come a point where, if banks are resolvable, they can be removed from the ringfence. My view on that is, at least for the moment, that it is a bit of a misthink in a sense that, for those banks with a ringfence, it is integral to the resolvability of those banks—so they are complements, not substitutes. I think that all these experiences we have been having—Silicon Valley Bank and Credit Suisse as well—are very difficult situations but it has been very clear to me that there are a series of options that you have, but also that you would not want to rely on any one tool, so you

need to have various things, including ringfencing, bail-in and private sector purchase. That is what you need as you go into these situations.

Andrew Bailey: It is also important, in that thinking process, to say that I don't think it is right to think of a bank as resolvable for all time. The world moves on, things change, and you have to keep coming back to this resolvability assessment and judgment.

Q38 **Emma Hardy:** Just quickly, would you prefer if the Government paused their ringfence reform during this turbulent and slightly difficult time?

Sam Woods: I am actually quite content for it to go ahead. I think it is fine. I just think we should keep a careful eye on the bits that could potentially weaken the regime, but the rest of it is sensible adjustments that should go ahead.

Sir Dave Ramsden: To be clear, what the Government are doing is putting out, as Sam was saying, a further call for evidence on this interplay between resolvability and the ringfencing regime. I would like to associate myself with Sam and Andrew's comments. Having both the resolution regime and the ringfence gives you more options. As we have tried to describe to you, that optionality, if you are in a crisis situation, is really important.

As Andrew said, we did the first round of the resolvability assessment framework last year for the major eight banks. We did a big publication last June in which we said that we thought that we had overcome the "too big to fail" problem. It got no attention at all, of course, because the world was calm then, and you were not taking evidence on that kind of thing.

Andrew Bailey: I think you asked me about it, actually.

Sir Dave Ramsden: We need to keep doing those RAFs—resolvability assessment frameworks. We did the first one, after years of work and preparation, in 2022. We have another one starting next year. Meanwhile, the Government are calling for evidence on that interplay with resolvability. There will be lots of opportunities for stakeholders to input into that call for evidence, but we think the events of recent times show how important that optionality can be, whether in the case of a Credit Suisse or an SVB UK.

Q39 **Rushanara Ali:** Just to follow up on ringfencing, Sir John Vickers said, "In my view, removing ring-fencing would pose a very great risk to financial stability." Do you all agree with that?

Sam Woods: Yes.

Q40 **Rushanara Ali:** He also said, and this was in response to questions I asked in the evidence session he came to, "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." Do you all agree with that?

Andrew Bailey: Yes. I will echo what Sam just said: I think resolution and ringfencing are complements, rather than alternatives.

Q41 **Rushanara Ali:** It is quite a serious point he is raising that we should all be alert and vigilant about where the Government are heading, not least because of the recent turbulence. It brings it into sharp focus. The Chancellor is giving evidence tomorrow. On this route we go down, tweaking for improvement is one thing—complementarity and a set of tools that you can deploy is one thing—but quite another is what the Governor has written in black and white, saying that Sir John Vickers is raising alarm bells about it.

Sir Dave Ramsden: Just to be clear on where the process is, the Government have the Skeoch review and then the follow-up in terms of this question of what we consider to be the complementarity between the two regimes. That is a call for evidence. The Government are clear that there is an opportunity for people to feed in all the relevant evidence.

Q42 **Rushanara Ali:** But I am a bit more sceptical, with respect, about where the Government are on this and where you are. We want to ensure the experts' opinions are taken seriously and the warnings of the architects of ringfencing are heeded by the Government in the rush to pursue reforms that may be problematic. That is all; I just wanted to put that on the record. Turning to Credit Suisse and the wider implications, Governor, were you surprised by the decision of the Swiss authorities to provide some relief to equity holders of Credit Suisse, but to fully write down the more senior AT1 debt holders?

Andrew Bailey: We do not know all the circumstances and the situation that the Swiss authorities faced. We know quite a lot of it, but we do not know all of it. As Dave was saying earlier, there is a resolution plan for Credit Suisse, which was agreed internationally. That is the backstop resolution plan. The Swiss then, as you can do, implemented something ahead of that instead. What I would say is this: as I understand it, the Credit Suisse AT1 bonds have a different contractual clause in them from most other AT1 bonds—certainly, AT1 bonds issued by UK banks—in that they have a clause that allows this contractual wipe-out, if you like, to take place under certain circumstances. I am not going to go further than that, because no doubt there will be lots of law cases in Switzerland to challenge it, but that is my understanding of it.

Q43 **Rushanara Ali:** How important is the AT1 market for financial stability in the UK?

Sir Dave Ramsden: Just to add, on the Monday after the Swiss authorities made their announcement, we set out very clearly the position with UK banks' AT1 bonds and how the creditor hierarchy would be preserved and maintained. It is very important for our market to set that out.

Andrew Bailey: I will be absolutely straightforward with you: the reason our banks have not issued them goes back, probably, about a decade. We did, in the best sense of the term, frown on some suggestions that it

might be included. I do think—I probably take a different view on this—that it complicates things because it makes the quota hierarchy more complicated and probably less intuitive. We do not want our banks doing that, but I know Credit Suisse did it and it is therefore a contractual provision, as I understand it.

Rushanara Ali: Sam, did you want to add anything?

Sam Woods: The distinction Andrew is making is between the version of these bonds that converts into equity, which, as Andrew said, is almost entirely what we have in our market, and these ones that wipe out. If you have the wipe-out ones, in a sense you have a bit of inverted credit or hierarchy built into the system, because they are designed to wipe out while there is still some capital left in the bank. We had always thought that the other version was more desirable for the hierarchy reason.

Andrew Bailey: The statement we made a week ago Monday—indeed, the euro area authorities made a similar statement—was to emphasise that in a resolution, one of the cardinal principles is that you stick to the creditor hierarchy. I am not saying that the Swiss did not do that, because they had a different contractual provision, but we wanted to emphasise that in any resolution we will always abide by the creditor hierarchy because that is a cardinal principle.

Sir Dave Ramsden: As we did with the SVB UK resolution.

Q44 **Rushanara Ali:** Bill Winters, the chief exec of the Standard Chartered bank, says, "The big question is how do you wipe out $17 billion of AT1s in a solvent bank without a review process? I think it had very profound implications for the regulation of banks and for the way banks manage themselves." Do you think he has a point?

Andrew Bailey: I think you have to come back to the fact that, as I understand it, these AT1 bonds had that contractual provision in their terms and therefore I would assume that investors who bought them understood that that was the case. Of course, that was the basis on which the Swiss acted.

Obviously, you can see that it caused a disturbance in the AT1 market and that is why, in good part, we and the authorities in the euro system made the statement that we did. We were very clear that we had to emphasise the basis on which we have to treat them in any resolution to clear any confusion up over that.

Q45 **Rushanara Ali:** So you would agree with him, then, that it has profound implications for the regulation of banks?

Andrew Bailey: I think the situation in Credit Suisse, again, is a matter for the Swiss authorities. It comes back to the point I made a few moments ago, which is that they will have had to judge, looking forward, the solvency and viability of the bank and what capital protection was required to effect the transaction with UBS, rather as we had to do with Silicon Valley Bank UK.

Q46 **Rushanara Ali:** Exactly, and that is a much bigger institution. Does that not set off some alarm bells about a pattern and the sort of things that can happen in how regulators then have to respond on a case-by-case basis?

Sam Woods: The bigger picture here is that we had a very large international bank that had reached the end of the road in terms of its viability. Something had to be done and had to be done that weekend for sure. In the end, the Swiss authorities found a way to stabilise the situation that involved a purchaser and some losses being taken by holders of the high-risk end of the bond stack. By the way, shareholders in Credit Suisse have had a pretty rough ride as well. With the variety of our new tools, we ought to be able to take care of these situations short of a bail-out, which is the answer we had last time.

Sir Dave Ramsden: It does go back to the question that the Chair almost started with. As Andrew was just saying, we were in a situation both of overall volatility of markets and of real volatility in particular segments, such as the AT1 market. We remain very vigilant. We are certainly not complacent, but things are calmer than they were that Monday. The pattern of previous financial crises, or certainly those that I have been involved in, is the way that things mushroom, and other things happen—

Q47 **Rushanara Ali:** I am just trying to understand whether you agree or disagree with this statement: "I think it has very profound implications for the regulation of banks, and for the way banks manage themselves". It cannot be that difficult to directly answer that question.

Andrew Bailey: I have a great deal of respect for Bill Winters, but one point he wrote in that article that I would disagree with and challenge him on is where he said the bank was solvent but in another part of the article questioned its viability. You cannot compartmentalise those two judgments. They are part and parcel of the overall judgment. If a bank is not viable then it might be solvent as of today, in a moment in time, but if you question its viability going forward you are essentially questioning its solvency going forward. You have to ask, if everybody thought the bank was solvent, then why was it having a run?

Q48 **Rushanara Ali:** I am just trying to get a straight answer.

Andrew Bailey: That is the challenge. I do not think it is as simple as Bill sets it out to be, in that sense.

Q49 **Rushanara Ali:** Okay. One final question: how much of the $17 billion of Credit Suisse AT1 bonds were held in the UK?

Andrew Bailey: I don't know. I can tell you that the FCA, many years ago, banned UK retail investors from buying AT1 bonds because it felt that they were too complex, so they should not be in the retail sector in the UK. I cannot say beyond that.

Sam Woods: The key thing for us to run down in these situations is what the exposures of UK banks and insurance companies are. They were minimal.

Sir Dave Ramsden: Also, these are quite complex and relatively sophisticated financial instruments, so you would imagine that the people who do hold them are aware of the risks. That is also taken account of, to some extent, in the yields that they get on them.

Q50 **Danny Kruger:** I am going to ask you about the moral hazard question. I am struck by the letter that you sent us, Governor, suggesting that: "By ensuring that all deposits, including those not covered by the FSCS, remained safe, secure, and accessible, the Bank maintained public confidence in the stability of the UK financial system."

You are talking about the stability of financial systems, so it is not about the industrial sectors that the bank supported, which I will come on to. I do not think you are suggesting there was a contagion risk—we have discussed that. You seemed to be suggesting that single banks should not fail, and, specifically, uninsured depositors should not lose their shirt. That seems to be the implication.

Andrew Bailey: No.

Q51 **Danny Kruger:** Well, if you are suggesting that the confidence in the stability of the financial system requires that deposits, including those not covered by the insurance scheme, remain safe, then you are suggesting that the confidence in the financial system would have been harmed if uninsured depositors had been harmed.

Andrew Bailey: When we made the announcements on the BIP, on Friday evening, that envisaged that there could be a loss to uninsured depositors—as with the point I made earlier about the capital base of the bank. I think the context that I had in mind when making that comment was the position in the US. I perfectly understand what the US has done, because we faced the same challenge in 2008—as you may remember. It is a very difficult decision to make, but in the heat of the moment, there are times when you have to make that judgment. I would agree with what Janet Yellen said subsequently, which is that this is not a state of affairs that should be the norm—that all deposits are guaranteed.

Q52 **Danny Kruger:** Yes, okay. We obviously took a different approach, but we can say there are different circumstances, perhaps.

Andrew Bailey: Very different circumstances.

Q53 **Danny Kruger:** I appreciate that you do not want to criticise another jurisdiction, but could you reflect a little on what you think of the actions of the US authorities? Do you have concern that moral hazard has been introduced into the system where it is dangerous?

Andrew Bailey: I would say that they had to take actions promptly—and did so. As I said, we have been there ourselves. I know how bad these situations can be. The decisions that you take at the time are the ones you have to take to fit the time. I think they did that, and I would not wish in any sense to criticise them for that. The question then is how do you work out the system from there, and what is the steady state going forward? I

would not support—and this is exactly what Janet Yellen has said—the idea that a 100% deposit guarantee becomes a norm.

Q54 **Danny Kruger:** Do you think the communications in the US since the bail-out have increased or decreased the general expectation that this would be repeated? Is there now an expectation of bail-outs in the future? Do you think they have exacerbated or dampened down that expectation?

Andrew Bailey: Having been there, it is a very difficult situation to have to handle. Once you have put a deposit guarantee in place as a tool to ensure, frankly, that you calm things down, create some stability and stop runs happening, if you then go out and say, "Well of course, we are not going to continue this and we don't think it should exist," you risk starting up the very run that you have just calmed down. You don't want to do that. On the other hand, you do want to say, as best you can, that this should not become the norm. Balancing those two things is remarkably hard. I have had the experience; it is very hard to do. I do not for a moment wish to criticise the US authorities. They have been dealing very well with a very difficult situation.

Q55 **Danny Kruger:** Coming back to the UK and what we have done, as we have been discussing, Silicon Valley Bank UK supports a number of key sectors in our economy or in our future economy. The Government appear unwilling to accept that the depositors should lose and have worked hard with you to ensure that did not happen in this case, but do you think that is just because it was a bank supporting those key industries? I am aware that this is a sector where there are a lot of clever people, particularly in the US, putting all their eggs in one broken basket, as it turned out. Imagine that the UK arm was a regional bank supporting some unfashionable industry, such as old-fashioned manufacturing or some kind of community; there are a lot of community depositors and so on. Do you expect you would have spent your weekends working hard to save that bank?

Andrew Bailey: I have had to do it. When we had to do the resolution at Dunfermline Building Society, those discussions about the regional nature of the business and the deposit base rates were exactly the ones I was having with the Treasury and the Chancellor at the time. It happens.

Q56 **Danny Kruger:** Okay. So it is simply on the case of the bank itself, rather than the sector that it supports. That is your priority.

Witnesses *indicated assent.*

Sir Dave Ramsden: It comes back to Andrew's point earlier that it is a question of where the cost will be borne. Depending on the institution, you will always be alive to those considerations, but you have to carry out a resolution that meets the overall resolution objectives.

Andrew Bailey: We keep this issue under review. I will slightly oversimplify, but there is a contrast for the major banks. We have just discussed this with Credit Suisse. We insist that they issue more loss-

bearing debt, so they have the capital stack that Sam looks after and they have a resolution debt slice in their balance sheet that Dave looks after.

Sir Dave Ramsden: The MREL, so that that can be bailed in.

Andrew Bailey: That allows the bail-in to happen. For the small banks, we don't do that. It would be very difficult for the small banks to issue debt; they can't issue debt into the markets in the same way the large banks can. They are not big enough to do it. We do have different resolution approaches for the small banks, but I am sure we will have to come back and look at these things as part of—going back to the earlier question—the lessons learned from this.

Sir Dave Ramsden: One agenda that we have been looking at is whether we can improve depository outcomes in bank insolvency. We are working with UK Finance on that. That is one thing in terms of speeding up payments to insure depositors, but, as we discovered with SVB UK, you still have the issue that many of the customers were businesses. They have got to provide payroll on a Monday. You have got real issues around their continuity of business, and you have to think through whether they are a tech firm or a manufacturing firm.

Danny Kruger: I have a question or two on the small banks regime, but is Siobhain going to pick up the Edinburgh reforms?

Chair: We are going on to Andrea now, who is going to pick that up.

Danny Kruger: Great. Over to you, Andrea.

Q57 **Dame Andrea Leadsom:** We all worked through the fallout of the last financial crisis. The thing that stays with me is the "heads I win, tails you lose" approach of bankers. On a yes or no answer, is each of you content that it is reported that SVB and Credit Suisse will continue to pay bonuses to their staff?

Sam Woods: Can I answer that with more than one word?

Dame Andrea Leadsom: I would like yes or no, and then you can have more than one word. I would like to know whether you are content with that.

Sam Woods: I just cannot answer the question simply in one word, because I need to talk about which bit of the bank we are talking about. SVB UK is the bit that is directly within our bailiwick.

Dame Andrea Leadsom: Okay. Let me ask it in another way. In what other sector in the UK, if your boss or business fails, do you then get a bonus?

Sam Woods: Obviously, that is not a normal arrangement. On SVB UK, what happened here was that an issue at the parent crystallised—

Q58 **Dame Andrea Leadsom:** With any other business where there is a UK end of an international business, where else would you get paid a

significant bonus? The point I am getting at is, isn't this creating moral hazard on a grand scale? No matter where I work, if I am in financial services, there is no downside for me personally?

Andrew Bailey: That is why we have in place a regime by which bonuses have to be deferred, and then they can be taken back.

Q59 **Dame Andrea Leadsom:** But will they be?

Andrew Bailey: I do not think any of us yet knows the facts around that, so we are not going to comment on that. What we do have in this country, which is pretty unique to this country, is a regime where bonuses are deferred over a period of years and have to be surrendered if facts come to light in the performance of either the individual or the firm. That is the appropriate thing to do. We cannot comment on Credit Suisse, because that is a Swiss issue.

Q60 **Dame Andrea Leadsom:** Okay, but the facts have already come to light. SVB went bust. Credit Suisse went bust. They have both been bought, rather than resolved. They would have to have been resolved, otherwise. Yet, their subsidiaries in the UK—their branches in the UK—will still get their bonuses. Is that reasonable?

Sam Woods: I would make a distinction here between what happened in the UK and in the UK bank of SVB, and what happened at the group level. The UK entity was well capitalised; it was liquid. The issue that knocked it out was that an issue crystallised at group, which immediately spread into the UK and led to a run. Obviously, there have been severe consequences for any executives that held any of their wealth in stock in those banks. However, you need to look to what happens in the US, and I am sure there will be some quite significant consequences there. The Swiss have made some statements, but as Andrew said, it is not yet clear exactly how they are going to handle Credit Suisse. I know it is not the most popular thing in the world to say, but I would draw that distinction with what happened in the UK. If any taxpayer funds had been involved in the UK in either of these entities, we would be in a very different situation.

Q61 **Dame Andrea Leadsom:** I completely understand that, but the fact is that SVB did not have to go bust. It went bust because of the high risk-taking activities of bankers in SVB; those in the UK are party to that, regardless of whether they are in a usefully ringfenced structure. As I think the Governor said, it was previously a branch; it was forced to become a UK ringfenced bank. Suddenly, by virtue of action taken by you, the UK bank is now ringfenced, so you are able to say "I would draw a distinction between the UK bank and the US parent." Is that fair? Is it fair, on this occasion, it is not the taxpayer—to those who are, in effect, paying for the financial system? Is it right that bankers still get bonuses even after what we saw following the financial crisis?

Andrew Bailey: Can I just add that that is in good part why we have this regime, whereby those bonuses then have to be deferred and there will have to be judgment made?

Q62 **Dame Andrea Leadsom:** But you just said yourself, Governor, that you

do not know what the situation in SVB or CSFB will be.

Andrew Bailey: We have not had that discussion yet.

Dame Andrea Leadsom: But you will.

Andrew Bailey: I am sure it will be part of the supervision of the firm—it is owned by HSBC now.

Q63 **Dame Andrea Leadsom:** Okay. In terms of the senior managers and certification regime, do you think anyone will be held personally liable for the risks that have been taken, either in SVB or CSFB?

Sam Woods: I do not want to get ahead of where we are on either of those cases. Credit Suisse has had a number of issues through time that accumulated in this event, and there has obviously been enforcement action taken against Credit Suisse in a number of ways and in different jurisdictions. On Silicon Valley Bank UK—as I say, I do not want to comment on any detail—I would come back to the observation that I made, which is about the distinction, as I see it, and you may or may not buy it, between what happened in the UK, the way the UK entity was run and how that was sorted out in the UK, and what happened in the US. I think there is a distinction there.

Q64 **Dame Andrea Leadsom:** You seem to have been saying all the way through this evidence session, Sam, that our regulation is better than anyone else's. I am not putting words in your mouth—that is how I am hearing it, and you can disagree. Is it not therefore the case that you, as the PRA, are going to have to look very carefully at all the activities going on where headquarters are somewhere else, to ensure that we do not just see this wholesale and end up owning a problem that, perhaps, we can deal with where it is a UK ringfenced entity, but that, in the case SVB, if it had not become UK ringfenced, would have been a massive problem for us—not of our doing—through regulations somewhere else that we disagree with?

Andrew Bailey: Can I just go back to what I said earlier? It had to become a subsidiary because we have a policy that said, "You have hit a trigger; you have to become a subsidiary." So there is a—

Q65 **Dame Andrea Leadsom:** But if it was £1 million under that trigger, it would not have hit that trigger, so that is fate. That is just how it happened.

Andrew Bailey: It is more than fate, if you like. The bank was growing, and therefore it had to change.

Q66 **Dame Andrea Leadsom:** Are you saying, then, that had it been slightly smaller, and therefore it had not hit that trigger, the issue for the UK would have been easy?

Andrew Bailey: I think that our supervisors said to it back in 2020, "You are on a trajectory that means you will have to subsidiarise," and so they did.

Q67 **Dame Andrea Leadsom:** So if this had happened in 2019, what then?

Andrew Bailey: It was a much smaller institution at that point. We would have still had to deal with it, but it was much smaller.

Q68 **Dame Andrea Leadsom:** So you are saying that, even for small banks, the smaller end of small banks will present fewer systemic and regulatory issues for the UK.

Andrew Bailey: Can I just refer back to something that Sam said early on in this hearing? This has been true for the PRA ever since we started it 10 years ago: we do not operate a no-failure regime, because that would have all sorts of consequences.

Sam Woods: Maybe I could add two brief comments. One is that I do not contend that our regulation is better than everyone else's. I think that that would be a very foolish thing to do and, in particular, I have great respect for the US and the way it runs its system. As it happens, in this case there are some differences, which is what I was alluding to.

On your broader point, there is of course something in that. We are a very large host of branches. On the latest numbers I have, we have £6.3 trillion in branches in this country—more than 150 branches. That is a necessary condition if we want to run a very large financial centre, but we have made a judgment, as Andrew says, around where to draw the line in terms of what makes you have to become a subsidiary, and we have enforced that.

There is a legitimate question, which may be what you are angling at, and which we need to reflect on: in the light of how the system is evolving, is that threshold in exactly the right place? Might it be in another place? I think that that is an open question, but I would want to impress upon you that we make a risk choice here: we host a lot of branches and, as set out very clearly in Andrew's letter, when you have a branch, you are massively more dependent on the home. There is, of course, some risk in that arrangement.

Dame Andrea Leadsom: Okay. Thank you very much. I would certainly be interested to see the outcome of the senior managers and certification regime in terms of executives of SVB and Credit Suisse in the UK, but also to see whether, in fact, they implement their deferrals of bonuses and so on. Frankly, why would bonuses be paid in any case? I still would assert that it is their good fortune that they were in a UK ringfenced bank, because if they had not been, they would presumably not be getting bonuses now.

Chair: Thank you, Andrea.

Q69 **Anne Marie Morris:** One of the tools in the Bank's toolbox to deal with inflation is increasing interest rates, but events have made it clear that it is never quite that simple. There are macro and microeconomic events, which mean that other things have to be considered when you make those decisions about interest rates. In the market, certainly among fund

managers, there is a growing concern that what we are doing at the moment in increasing rates—an interest rate rise—will give rise to a credit crunch. Do you share that concern?

Andrew Bailey: I would divide it into two parts. When we are setting policy—taking monetary policy decisions—we always have to take into account credit conditions in the UK, and we always do that. We did it last week when we took the decision, and that's normal. Now, I would say, and our regional agents have said, that we see some evidence of some tightening in credit conditions, but we do not see a critical development in that respect. Moreover, and in the context of the Financial Policy Committee, we think that the banking system in this country has ample capacity to lend to support credit.

Q70 **Anne Marie Morris:** What would you do if that did not happen—if you were wrong?

Andrew Bailey: I will come to that. I have two more points, and I will come to the point you have just made as the second one, if you don't mind. I would draw a distinction. Because, as we said in the letter to you, we judge the UK banking system to be stable, safe and sound, the MPC—which received the assessment, by the way, that you have, and also received it from the FPC—was able to conclude last week that it did not have to, if you like, aim off monetary policy, because of the stability of the financial system. That's important. We were able to take that decision about it.

Turning to the point that you rightly made, what would we do if we felt that capacity to support credit in the economy was compromised in any way, or threatened? The first thing we'd do in the FPC is lower what we call the CCyB—the counter-cyclical capital buffer, which we have set at 2% for the banks. We can do that—indeed, we did it during covid immediately the covid period started, and we could do it again.

Our current judgment—in the last round of the FPC; the next one is coming out next week—is that we do not think that the credit conditions in this country required us to take an action to release that buffer to support credit creation in the economy. We don't think the system is under that stress, but if it were, that is the action we would take.

Sir Dave Ramsden: Just to correct, the FPC is coming out tomorrow.

Andrew Bailey: I am sorry. Yes, tomorrow. Thank you.

Sir Dave Ramsden: Next day, not next week.

Andrew Bailey: I have been up too many nights.

Q71 **Anne Marie Morris:** Governor, one of the things that has been of concern—it seems to have driven much change very quickly, which has been difficult to deal with—is the speed with which you've raised interest rates. Now, we all appreciate that events have put on a lot of pressure and that action has been necessary, but in hindsight, do you think there was a

different strategy or different, if you like, sensors that you could have had that would have made you think about increasing interest rates slowly, earlier, which therefore wouldn't have had the consequences that we now see?

Andrew Bailey: I have said before, and I'm afraid I am going to say it again, that we don't have the luxury of hindsight decision making. I really will say that I'm afraid.

What I will say comes back to something Sam was saying earlier—and I absolutely agree with the point that we don't think our regulatory system is perfect; if you think that, you're heading for a fall straightaway. I don't want to go to that point, but what I would say is that, as Sam described, the way in which we treat the so-called interest rate risk in the banking book, which has to go through to the profit and loss account and therefore hits capital, and the fact that we require capital against those risks that are not treated in that way, mean that we are, I think, in a good position from the point of view of assessing the impact of raising interest rates on the position of the banks themselves. That's a sense of risk that we do not have to, in a sense, factor in because it's taken care of in the regulatory system.

Q72 **Anne Marie Morris:** You say you do not have 20:20 vision and therefore the benefit of hindsight, but foresight clearly is something that I imagine you are now going to be looking at—

Andrew Bailey: Yes, we do. We do use that, yes.

Q73 **Anne Marie Morris:** —much more curiously. I think it was yesterday that you commented that you had a concern about early retirees and the impact that might have on inflation. How seriously do you take that risk, and what other things—looking forwards, now that we know we need to be more vigilant—are happening with foresight?

Andrew Bailey: What I said yesterday was in the context that I was actually making a speech about the role of the supply side of the economy in what we experience, and saying that, during the last three years, it has actually had a bigger role than you might think in normal conditions.

The point about labour supply is that we have had, over the last three years, an increase in so-called inactivity—that is, people who are not working and not seeking to work. Now, many countries had that in the early stage of covid. In many of those countries, that has now reversed itself, but it hasn't really reversed itself here. It is concentrated more in the 50 to 64-year-old age group.

There are two things going on here, one of which would have happened anyway, which of course is that the population is ageing, so that would have happened covid or no covid. But we've also seen this additional effect that has happened during the period of covid, and that has tightened the labour market, relative to what we would normally expect.

The point I made last night was that—and I know we have discussed this many times here in the Committee—if you go back to the summer and

early autumn of 2021, what was going to happen when the furlough scheme ended? We thought—rather less, by the way, than most other forecasters, if you look back at the forecasts—that it would lead to some increase in unemployment, that there would be a sort of so-called scarring in the economy and that some firms would not be able to come back into business, leading to unemployment and some slack in the economy, but it didn’t. What happened was that there was an increase in inactivity in the economy, which means, of course, that the labour market isn’t slackening in that sense, and the supply side has played a role in that.

You’re right about foresight—we have to use it all the time—and that was a judgment we had to make. And things did turn out differently—I absolutely warrant that. I would say—and we publish in every monetary policy report a box that looks at what other forecasters are thinking—that most other forecasters thought that unemployment would go up by more than we did, but that’s by the bye. The point is, yes, that was a judgment that was key at the time, and it has turned out to be different.

Sir Dave Ramsden: Perhaps I can just add two points to that. One is that it was actually at this Committee last May that we had a discussion around these issues of labour participation, and I think our analysis has brought it up the agenda. You now see it very much as a focus of Government policy to increase participation and engagement with the labour market.

The second thing I would say, and it comes back to where we started, is that we are very conscious on the Monetary Policy Committee that we are putting up rates and having to put up rates markedly because we are concerned about the persistence in inflation. All of us who are on the Financial Policy Committee have been flagging concerns around what the implications might be of that increase in interest rates. We have been particularly focused on non-bank finance—what we call market-based finance. Following what we saw with the LDI episode, where, because of fiscal events, we saw a very sharp increase in long-term rates, we have been focused on what the impact of that was. But long-term rates have been going up more progressively, and pension funds and the like have had to adjust to that, because the inflation environment and the interest rate environment has been changing.

I remember discussing this. We were asked, “Well, where could the next risk crystallise?” And we are super alive to whether those risks could crystallise in the banking sector; we have got the regulation to deal with that. But, also, we have to be very vigilant to those risks from higher interest rates playing out in other parts of the economy. That plays into the volatile and challenging environment we’re in.

Anne Marie Morris: Thank you. I will leave it there, given the time.

Chair: Thank you very much, Anne Marie. We are up against the bell, so I just want to reiterate my thanks, Governor, Sam and Sir Dave, to you for coming in at short notice to give us this update, and also to all your teams for all the hard work they did through the night, going through this live stress test of the regime that has been put in place, and the test of your

toolbox. I know that you will keep us posted as to how you look to adjust your stress test based on the lessons that have been learned as a result of this live one.

I think that, as Anne Marie was just flagging, the question as to what impact this will have on the real economy and the tightness of the financial markets in the UK, is still an open question, so I know that we will have more questions for you on that. I would flag up, of course, to the watching public that we are doing an inquiry on quantitative tightening and the fact that not many people really know what the impact of that might be. We will be coming in and doing some evidence sessions at the Bank itself. Just to reiterate the need for vigilance, thank you for your vigilance, gentlemen.