



BANK OF ENGLAND

News release

Press Office

Threadneedle Street

London EC2R 8AH

T 020 7601 4411

F 020 7601 5460

press@bankofengland.co.uk

www.bankofengland.co.uk

13 July 2010

The Financial Crisis Reform Agenda - Speech by Andrew Bailey

In a speech to the British Bankers Association's Annual Banking Conference, Andrew Bailey, Executive Director of Banking Services (and Head of the Special Resolution Unit), Chief Cashier of the Bank of England and designated Deputy CEO of the new Prudential Regulation Authority (PRA), talked about the recently announced changes in prudential supervision and the resolution of large banks when they get into trouble.

Andrew Bailey began by reviewing the Bank's previous role in banking supervision. He explained: "My own view on this record is that the Bank was relatively good at the prudential competencies of capital adequacy and liquidity, but it was relatively weak at identifying and dealing with fraud and abuses of risk controls. The world is now a very different place to the 1990s, and it is very important to be clear that the new organisation of supervision will not be a return to the way it used to be done at the Bank – a slavish return to the past would be a mistake."

He went on to explain: "...we are not trying to design a regime in which no bank should ever fail. It would not create the right incentives around risk taking...". Creating the PRA would tackle the issue of overlapping responsibilities between the FSA and the Bank but would not solve the reliance on public money. On how to handle the process of creating the PRA, Andrew Bailey set out three guiding principles:

- That the process must be harmonious and constructive. He says: "Hector and I are fully committed to working together to get the right outcome, which is a robust, fair and transparent system of prudential supervision. The PRA's role will be distinctive. Its approach and culture will be built around judging and dealing with the build-up of unwanted risk in the financial system, and thus the robustness of the business models of individual institutions...";
- The need for various parts of the system to work together on the basis of clear roles; and The Bank will change in order to deliver its new responsibility, but in doing so it will remain focused on its two core purposes - monetary and financial stability. It will continue to work closely with the financial sector.

Andrew Bailey then turns to the "unacceptable" use of public money to sort out insolvent banks that are large and important to the financial system and thus the wider economy. He explores potential solutions:

- He repeats the message from the Bank's recent Financial Stability Report: "UK banks have raised their capital and liquidity buffers substantially, but they need to maintain this resilience while refinancing substantial sums of funding in the period ahead and providing sufficient lending to support economic recovery, something that is in their collective interest. Over time they will need to build larger buffers...an extended transition to the new quantum of capital liquidity will enable banks to build resilience through greater retention of earnings, while sustaining lending".
- "...the capital instruments issued by banks must absorb losses in situations either where the bank is preserved as a going concern, or where it is wound down..."
- Andrew Bailey looks at the issues for how banks could be restructured, and suggests that, on its own, creating "narrow banks" is not necessarily the answer because of the remaining "non-narrow" parts of the industry.
- Finally, he explores the approach whereby failing banks would be recapitalised. Drawing on practices in the non-bank world, he concludes that: "We need something to give us a credible chance of covering the losses and most likely recapitalising a big bank. Such an event should avoid the use of public money."

Andrew Bailey ended his speech with a tribute to Brian Pitman, an ex-President of the BBA, who passed away earlier this year.

Key Resources

The Financial Crisis Reform Agenda

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech441.pdf>