HBOS PRESS CONFERENCE

Thursday 19 November 2015

Opening Remarks by Andrew Bailey, Deputy Governor, PRA

Today, the two regulators – the Prudential Regulation Authority and the Financial Conduct Authority have published our review into the failure of HBOS. This review seeks to tell the story of why HBOS failed and examines who was to blame for its failure.

The review looks at the events from January 2005 to the point of failure – which we take as the day that HBOS needed to request emergency liquidity assistance from the Bank of England as it could no longer meet its liabilities as they fell due. This was 1 October 2008. This review does not examine the events following this date and does not offer a view of the merger between Lloyds and HBOS. The failure of HBOS is an interesting story because it is a story of the failure of a bank that did not undertake complicated activity or so-called racy investment banking. HBOS was at root a simple bank that nonetheless managed to create a big problem.

The review sets out, against the backdrop of almost uninterrupted economic growth over a long period and the rapid development of financial markets, the story of an institution that became unsustainable through its poor risk management, in respect of the credit risk on the assets side of its balance sheet, and in respect of the vulnerability of its funding on the liabilities side.

HBOS's flawed strategy led to a business model that was excessively vulnerable to an economic downturn and a dislocation in wholesale funding markets. The review documents particular, and dominating, cases of inappropriate risk taking, in the management of credit risk in the corporate division, the expansion overseas without regard to the risks involved, and funding the assets of the bank. The strategy of HBOS put the growth of the bank above these considerations until it was too late and impossible to change course.

So who was to blame for the failure of HBOS? Ultimately the blame lies at the feet of the HBOS Board and senior management. They failed to set an appropriate strategy, and also failed to challenge a flawed business model that placed inappropriate reliance on continuous growth without due regard to the risks involved. We do not expect senior management of banks to have perfect foresight but we do expect them to have strategies that can react and adapt to changes to the economic environment.

That is not to say that the regulator of the time, the Financial Services Authority, did not play an important role. The so-called light touch regulatory approach, combined with inadequate international standards of prudential regulation – both capital and liquidity – led to a situation where supervisors did not have the tools that they needed to supervise the bank properly. Flaws in the FSA's supervisory approach meant the regulator did not appreciate the full extent of the risks HBOS was running and did not take sufficient steps to intervene before it was too late.

It is important to point out that, both the strategy and operation of HBOS, and its supervision by the FSA, were creatures of the time – and much has changed since then.

To turn to a couple of points about the process of compiling the Report, much of the press commentary on this review has focused on the length of time that it has taken to publish so it would be remiss of me not to say a few words on this. The review did not begin until September 2012, following the conclusion of enforcement action against Peter Cummings, former CEO of HBOS Corporate Division. The review team had to examine over 200,000 documents in order to write the review and 66 people were interviewed. This took around 18 months. We then had to go through the process of Maxwellisation, which is a legal requirement to allow parties to comment on relevant sections. This took another 18 months. There will be some among you who say that this is too long – to which I would say that we had the choice to water the report down to get it through Maxwellisation more quickly – or we could choose to stick to our guns and publish a true reflection of what we believed happened. We chose the latter.

The Treasury Select Committee appointed Iain Cornish and Stuart Bernau as independent reviewers to examine and challenge the process of putting the review together. I am grateful to Iain and Stuart for the challenge that they provided throughout the review process.

In addition to the reports I have already mentioned, we have also published Andrew Green QC's report into the FSA's enforcement actions following the failure of HBOS. This is an independent assessment of the FSA's enforcement actions. Among other recommendations, Andrew Green recommends that the regulators should consider whether any former senior managers of HBOS should be the subject of an enforcement investigation with a view to prohibition proceedings. We accept Andrew Green's recommendation and will review whether any enforcement action should and can be taken against any members of HBOS Board and senior management. One further point on process. There is quite a bit of talk about the six year window to take action that could lead to consequences beyond prohibition. The six year window was introduced in legislation last year. It is not retrospective, so it is not relevant in this case.

One final point I want to make before questions. Rightly, a lot of the focus in these reports is on who did and did not do what, and that's appropriate in understanding responsibility, which is at the heart of the new Senior Managers and Certification Regime. But there is an important message on which I want to conclude. A lot has been done since the height of the financial crisis to repair the faults that caused it. The actions taken have been essential, and the story of the failure of HBoS illustrates why. But there are already siren voices calling for a rolling back of at least some of these actions. As I said at the Bank of England's Open Forum last week, many of the actions taken have had their intended consequences. Some have not - I mentioned the bonus cap, the re-setting of the sterling deposit protection limit, and some elements of Solvency 2 as examples - and where unintended and unwanted consequences emerge, we should deal with them in a timely manner. But the story of HBoS is a salutary reminder of the bad consequences of not having consistent and transparent objectives and standards of regulation.