



Interim Report Publication
11 April 2011
Opening Remarks
Sir John Vickers

Good morning and welcome.

Let me begin by thanking all those who have contributed – through written submissions, hearings and other discussions – to the work of the Commission since we published our *Issues Paper* in September. That document outlined a wide range of possible reform options to promote stability and competition in banking, and called for evidence on their strengths and weaknesses.

Today's *Interim Report* has a different purpose – to focus the next stage of debate on the reform options which, in the current and provisional view of the Commission, appear to have most merit.

Stability

Everyone agrees that we need a much more robust banking system than that of the past decade. This is especially important for the UK given the size of our banks relative to the economy. Everyone also says that taxpayers should not be on the hook for the banks. So reform is needed to make banks better able to withstand losses, and easier and less costly to sort out if unfortunately they still get into difficulties. Then the risks run by banks will also be better disciplined.

Banks will then be less a source of risk, and better at dealing with risk – which will remain with us no matter how well macroeconomic policies are conducted.

In broad terms there are two ways to make banks safer – by increasing their ability to bear losses and/or by reforming their structure.

Bank leverage soared in the run-up to the crisis, and when the crunch came, so-called 'risk-weighted' assets turned out to be no such thing. One approach, therefore, is to require banks to hold a great deal more capital and (unlike in the crisis) to have truly loss-absorbing debt. An important step in this direction is the 7% baseline ratio of equity to risk-weighted assets in the Basel III agreement. The international community is considering enhancing this for systemically important banks. Some analyses support doubling the Basel III baseline capital ratio.

Structural reform, in sharp form, would end universal banking and require retail banking and wholesale and investment banking to be carried out by separate banks.

CHECK AGAINST DELIVERY

This would aim to isolate retail banking services and taxpayers from the risks of global wholesale and investment banking.

The Commission's focus is on a *combination* of these capital and structural approaches, in moderate form.

First, we estimate that systemically important banks should have an equity ratio of at least 10% provided that they also have genuinely loss-absorbing debt. We believe this should be agreed internationally. But whether or not it is, we believe that it should apply to UK retail banking. Then international standards would apply to the wholesale and investment banking activities of UK banks, so long as the taxpayer is not on the hook if they fail.

Second, and in structural support of that approach to capital, the Commission sees merit in a UK retail 'ring-fence'. This would require universal banks to maintain the UK retail capital ratio – that is, not to run down the capital supporting UK retail activities below the required level in order to shift it, say, to global wholesale and investment banking. Our current view is that such a limit on banks' freedom to deplete capital would be proportionate and in the public interest, and would preserve benefits of universal banking while reducing risks. Without it, capital requirements higher than 10% across the board might well be called for.

Competition

As well as having more capital support, UK retail banking needs to be more competitive. The damage to competition done by the crisis will not be remedied by the divestitures of RBS and Lloyds assets required by the European Commission. But now there are opportunities to make competition work better for customers.

First, the Lloyds divestiture could be strengthened to create a more effective challenger to the incumbent banks.

Second, the ability of customers confidently to switch between banks could be greatly improved. Together with better conditions for customer choice, this would make banks compete more effectively to deliver what customers want.

Third, current reform of UK regulatory institutions must ensure that effective competition can at last be a central force in UK financial regulation.

The Commission's current view is that all three opportunities to promote competition should be seized.

Competitiveness

Some banks may resist the idea that they maintain a capital ratio for their UK retail operations. But for a country so engaged in international finance, safeguards for

retail banking, on which we all rely, are common sense. They are also good for national competitiveness in global markets, because a safe banking system is a cornerstone of a competitive economy, including a competitive City. The reform options discussed in today's report should make the City no less attractive as a global financial centre.

Next steps

A further round of consultation starts now and concludes in early July, in good time for us to publish our final report and recommendations to Government in September.

Thank you for your attention, and we will now be happy to take questions.

END