BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

20 June 2013

Prudential Regulation Authority (PRA) completes capital shortfall exercise with major UK banks and building societies

At its March meeting, the interim Financial Policy Committee recommended that:

1. "The PRA should assess current capital adequacy using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights."

2. "The PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies hold capital resources equivalent to at least 7% of their risk weighted assets, as assessed on the basis described in Recommendation 1."

The PRA has now concluded its work with the eight major UK banks and building societies in relation to the FPC's recommendation. The eight firms are:

- Barclays
- Co-operative Bank
- HSBC
- Lloyds Banking Group
- Nationwide
- Royal Bank of Scotland
- Santander UK
- Standard Chartered

The methodology used to calculate the capital shortfalls, originally published in March by the FSA, has been republished today - see Key Resources. The document outlines the three adjustments that were made. For a more prudent valuation of assets, there was a specific focus on material vulnerable portfolios on firms' balance sheets; and for conduct costs, the FSA (now FCA) provided analysis on the potential future costs that firms may incur. For the prudent calculation of risk weights, the primary focus was on the risk weights applied to corporate and institutional loans, and UK mortgages.

The PRA has judged that, after these adjustments have been made, each firm should target a risk-weighted capital ratio based on the Basel III definition of at least 7%.

The PRA's assessment is that, at the end of 2012, five of the eight banks (Barclays, Co-operative Bank, LBG, Nationwide and RBS) fell short of this standard. They had an aggregate capital shortfall relative to this standard of £27.1bn. When the FPC made its announcement in March this shortfall was provisionally estimated to be around £25bn. At that time, five firms had in place plans to take actions that generated the equivalent of approximately £12.5bn of capital during 2013. The final figure for these actions is £13.7bn. A number of these intended actions will require regulatory approval before being implemented. As such, they cannot be assumed to have contributed to meeting the requirement until approval is given. In the event that they are either not carried out or fail to be approved, other actions will be required of those firms in order to reach the specified standard.

After these planned actions, the PRA assesses that four of the five firms will have a shortfall against the 7% standard. (Nationwide's shortfall was already accounted for in its planned 2013 actions.) These firms have been required to submit plans for additional actions. All of the firms have been informed of their requirements and have produced for the PRA plans to meet them. It is for the firms themselves to announce the actions they plan to take. In aggregate, the additional actions, which include disposals and restructurings, will generate the equivalent of an additional £13.4bn of capital. The PRA believes that these plans can be put into effect. The vast majority of actions are due to be completed by end-2013, but the PRA has allowed some limited flexibility for a small part of these actions to be delivered during the first half of 2014. (In the case of Co-operative Bank the firm will complete £1bn during 2013 and the rest during 2014.) The PRA will hold firms to these plans, and will require additional actions to be taken if capital to cover the full shortfalls is at risk of not being delivered by any firm.

The table in Key Resources sets out the PRA assessment of the capital position of each firm.

The FPC also recommended that:

3. "The PRA should consider applying higher capital requirements to any major UK bank or building society with concentrated exposures to vulnerable assets, where there are uncertainties about assets not covered in the FSA's assessment of future expected losses or risk weights analysis, or where banks are highly leveraged relating to trading activities."

4. "The PRA should ensure that major UK banks and building societies meet the requirements in Recommendations 2 and 3 by issuing new capital or restructuring balance sheets in a way that does not hinder lending to the economy. Any newly-issued capital, including contingent capital, would need to be clearly capable of absorbing losses in a going concern to enable firms to continue lending."

For most firms it is the case that meeting the recommended 7% risk-weighted capital standard after adjustments will be sufficient for their leverage ratio, after adjustments, to be no less than 3%. However, the estimated leverage ratios, after adjustments, consistent with that 7% risk-weighted ratio are 2.5% for

Barclays and 2.0% for Nationwide. Consistent with the FPC recommendations, the PRA Board requires a plan to reach 3% CET1 leverage after adjustments to be submitted by Barclays and Nationwide by end-June. The PRA will consider those plans in early July and will report publicly on whether it has agreed the plans or whether revisions have been requested. The PRA has signalled to firms that plans must be agreed no later than end July. The actions they will be required to take to reduce leverage are over and above those necessary to reach a 7% risk-weighted capital ratio after adjustments.

The PRA has asked firms to ensure that all plans to address shortfalls do not reduce lending to the real economy. In line with the FPC recommendation, the PRA has accepted restructuring actions which, by reducing risk-weighted assets, will credibly deliver improvements in capital adequacy.

To complement this action, the PRA Board is also announcing its intention to require banks to deduct from Common Equity Tier 1 (CET1) significant investments in insurance companies above threshold allowances under its implementation of CRD IV/CRR - see Key Resources. Where relevant, this treatment has been factored into the capital assessment outlined above.

The PRA will hold firms to the plans they have agreed to deliver. The PRA will ensure firms' capital positions accurately reflect the realities of their individual circumstances, including by using a regular process of stress testing.

N.B. No breakdown is available for these statistics on a regional or local authority basis.