



BANK OF ENGLAND

News release

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Bank of England publishes approach to stress testing the UK banking system

The Bank of England has today published its approach to stress testing the UK banking system. This approach aims to provide clarity for firms and the wider public about our plans for stress testing for the next three years until 2018.

Stress testing is a core part of the capital framework which sits alongside risk-based capital and leverage requirements. Stress tests provide an integrated forward-looking assessment of resilience and aim to ensure that banks can continue to support the real economy even in difficult economic conditions.

This approach has been informed by the lessons learned during the concurrent stress tests conducted in 2014 and 2015, as well as by feedback to the Discussion Paper published by the Bank in 2013.

Key features of the Bank of England's approach are:

- The introduction of an annual cyclical scenario that will link the severity of the test to the financial cycle systematically. This scenario will include domestic, global and markets elements. Its severity is likely to be greater in an upswing, for example when growth in credit is rapid or asset prices unsustainably high.
- A biennial exploratory scenario covering risks unrelated to the financial cycle that policymakers judge to be emerging or latent threats to financial stability or individual banks.
- A systematic and transparent hurdle rate framework with clear hurdle rates for each firm reflecting minimum capital requirements and additional requirements for globally systemic banks.
- The stress test will include banks with total retail deposits greater than £50 billion – at present this covers the same set of firms included in the 2015 stress test. Amongst this group of firms, coverage may vary for the exploratory scenario if that scenario is unlikely to impact some firms. UK subsidiaries of foreign-owned investment banks will not be brought into scope at this time, but this will be kept under review.
- The Bank of England will develop its own modelling capabilities further, to enhance its ability to challenge aspects of firms' own results and to include in the test results the impact of feedback mechanisms across the banking system. The approach will ensure there continues to be a range of modelling input into stress testing.

Mark Carney, Governor of the Bank of England said

“The United Kingdom needs banks than can weather shocks without cutting lending to the real economy. Our first concurrent stress tests run in 2014 – centred on the housing market – gave us assurance that the banking sector as a whole was well-placed to withstand such a severe scenario. We have also recognised however the need for our approach to evolve.

“The Bank of England is taking steps to ensure we can assess a range of future risks from a number of different sources to inform our micro- and macro-prudential policy decisions. Our approach embodies a comprehensive and detailed approach, a desire to deepen and strengthen our analysis, and the flexibility to respond to changing risks.”

The Bank of England will publish further information in due course on its approach to stress testing beyond 2018. The Bank of England’s stress testing framework is likely to evolve further to reflect regulatory developments, including structural reform of the banking sector.

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