BANK OF ENGLAND

Speech

Bank share rating: buy!

Remarks given by

Bob Jenkins, Member of the Financial Policy Committee, Bank of England

At the ABI Annual Investment Conference, London

12 December 2012

Last night I had a dream. I was at a shareholders' meeting of a major global bank. The high profile CEO took the podium. He electrified the audience. Here is what he said:

"*Fellow shareholders, welcome.*

As you know we have weathered the crisis reasonably well. Loss-making quarters have been few. Earnings are recovering. Our balance sheet is stronger. By the standards of the industry we have much of which to be proud. There is only one not-so-small problem. Loyal shareholders – you, have made no money.

Why have you made no money? Because the dividend was cut by us and bank share prices were cut by the market. Why did we cut the dividend? Because we wished to re-build capital. Why were bank share prices "cut?" Because the market fears that the capital we have built is insufficient. Why might our capital be insufficient? Well there is concern about the past and worries about the years to come. Investors fear that losses from the past will drag down earnings in the future. And in thinking about the future they are more conscious of the risks that financial firms take and the leverage with which they take them. Finally, there is uncertainty over the regulatory playing field on which banks will compete. Are these perceptions likely to change soon? Not unless we change.

What must such change accomplish? It must lay to rest worries of vulnerability. It must remove to the extent possible the threat of surprise. It must clarify the earnings we hope to achieve and the risks we must take in order to achieve them. It must prove to prospective shareholders that management will do what is necessary to create shareholder value. And it must convince investors that such value will include a dependable dividend.

So what is the plan?

1) we will invite independent specialists to review our holdings and confirm our valuations. They will publish the results.

2) we will increase provisions to the extent permissible;

3) where the accounting standards do not permit prudent provisioning, we will ensure that in capital excess to regulatory requirements is there to absorb the losses;

4) we will cut fixed costs where revenues are most volatile and pare back sharply the share of annual earnings which flows to employees;

5) we will remove Return on Equity as a target for anything other than longer term performance and substitute short term measures which more clearly adjust for the risks we take;

6) we will raise all necessary equity within 12 months;

7) and we will commit to a minimum dividend payout ratio of 60% for the three years thereafter.

How will we reduce fixed costs? Not by job cuts alone. Much of this we have already done. Rather, we will invite all bank officers at the level of VP and above to accept a sharp and permanent cut in fixed pay in return for a one time grant of deferred stock. As of last night, most seniors have been asked and all those asked have signed up.

How will we increase shareholder equity? Two ways: first, for this year and next, conventional bonuses will cease. Subject to your approval, deserving bonus recipients will receive stock options with an exercise price well above the current share price. Second, we will issue new equity. The first action will inspire the market confidence necessary to take up the second.

Will we lose talent? Ladies and gentlemen, our key people are well paid but a big portion of that pay is in bank shares. Like you, they are tired of underperforming paper. They are also committed to the firm and its clients. We are among the best in the banking business. But the business of banking is not being rewarded by the market. We will change market perceptions of at least one major financial firm. All stakeholders will benefit as a result.

Will more equity raise our cost of capital and funding? I used to think so. I have changed my mind. The world remains a risky place. More equity in our capital structure will reassure both current and future shareowners and debt holders. Innovative but hard-to-value debt instruments will not be necessary. Our credit rating will rise. Our cost of debt and equity will fall. Whatever the resultant cost of capital and funding, it will be lower than that of our competitors and lower than it would otherwise have been over time. Finally, it should make us stand out further as the financial partner of choice for professional counterparties and our wealth management clientele. Last but not least, this approach will put us well out ahead of the regulators. They will cease to be a factor in our planning.

Ladies and gentlemen, no one likes dilution. The question is: to what extent does the current market price discount it and will we attract new buyers once it is behind us? I am convinced we will. Investors no longer strive for high short term returns unadjusted for risk. They strive for attractive relative risk-adjusted returns. The market will reward balance sheet strength, greater transparency, lower volatility and a predictable dividend - ***with a higher earnings multiple****.*

Fellow shareholders, these measures will put to rest any concerns that the market may have about the past and our commitment to you the shareholder in the future. They will make us the leading bank share to own and the premier bank with which to do business. Most of all, we will get back to creating shareholder value. You have not only my commitment but that of our employees. I hope you will support these initiatives.

I shall now hand over the presentation to our Finance Director who will describe in more detail our earnings projections and the degree of leverage assumed in the targets."

Following these announcements, the CEO received a standing ovation. The share price soared.