

Stress testing the UK banking system: 2016 results

Bank of England (BoE)

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Introduction

Context

In November 2016 the Bank of England (BoE) published the results of the third stress test of the UK banking system

Introduction

- In March 2016, the BoE launched its 2016 stress test of the UK banking system, which covered 7 major banks accounting for around 80% of PRA-regulated banks' lending to the UK real economy.
 - The stress test, which is the first conducted under the BoE's new approach to stress testing, examined the resilience of the system to a more severe stress than in 2014 and 2015. The 2016 stress test incorporated a synchronised UK and global recession with associated shocks to financial market prices, and an independent stress of misconduct costs.
- In this context, the Bank of England published in November the **2016 stress test results of the UK banking system**. These results include aggregated data and also the individual results of the 7 banks participating in the exercise.
 - Overall, the stress scenario is estimated to lead to system-wide losses of £44 billion over the first two years of the stress, around five times the net losses incurred by the same banks as a group over 2008–09. Moreover, the 2016 stress scenario would reduce the aggregate CET1 capital ratio across the seven participating banks from 12.6% at the end of 2015 to a low point of 8.8% in 2017.
 - In any case, the BoE judged that the UK banking system is in aggregate capitalised to support the real economy in a stress scenario.

This document analyses the main results of the 2016 stress test.

Introduction

Sample of banks

7 UK banks participated in the test: Barclays, HSBC, Lloyds, Nationwide, RBS, Santander UK and Standard Chartered. Performance was assessed against the BoE's hurdle rate framework, comprising elements expressed both in terms of risk-weighted capital and leverage ratios

Sample of banks and hurdle rate framework

Sample of banks

- The 2016 stress test covered **7 banks**, accounting for around 80% of PRA-regulated banks' lending to the UK real economy.
 - Barclays
 - HSBC
 - Lloyds Banking Group
 - Nationwide
 - Royal Bank of Scotland Group
 - Santander UK
 - Standard Chartered
- Banks need to have a minimum of **£50 billion in retail deposits** to be included in this stress test.



BoE's hurdle rate framework

- Performance in the test was assessed against the BoE's hurdle rate framework, comprising elements expressed both in terms of risk-weighted capital and leverage ratios.

Capital

The framework comprises two elements:

- 1 Hurdle rate**
Minimum CET1 (4.5%) + any Pillar 2A CET1 uplift set by PRA
- 2 Systemic reference point**
Hurdle rate + G-SIB capital buffer (phase-in)

Leverage

The framework comprises two elements:

- 1 Hurdle rate**
Minimum Tier 1 leverage ratio (3%)
- 2 Systemic reference point**
Hurdle rate (3%) + G-SIB leverage buffer (35% of G-SIB capital buffer)

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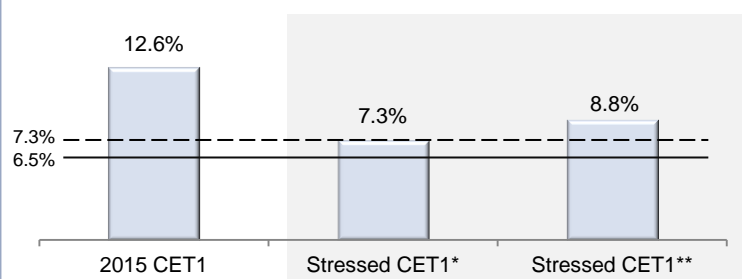
Main results

Capital

The stress scenario would reduce the aggregate CET1 capital ratio from 12.6% at the end of 2015 to a low point of 8.8% in 2017, after factoring in the management actions, including the conversion of AT1 instruments. At an individual level, the impact differs across banks

Capital

CET1: aggregated results

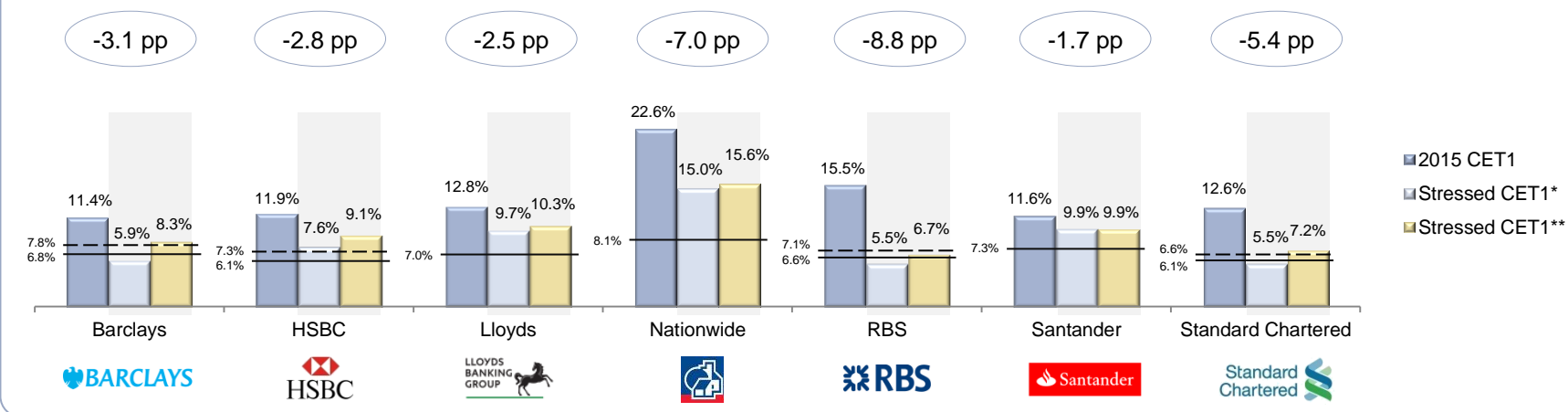


*Before strategic management actions or conversion of AT1

**After strategic management actions or conversion of AT1

- As a result of the stress scenario, the aggregate CET1 ratio is reduced from **12.6%** in 2015 to a low point of **8.8%** in 2017, after considering the impact of management actions and the conversion of additional Tier 1 instruments.
- The low-point CET1 of 8.8% is **well above the average hurdle rate (6.5%)** and the **average systemic reference point (7.3%)**.
- At individual level, **RBS** does not meet the systemic reference point after taking into account the strategic management actions; while **Barclays and Standard Chartered** do not meet the hurdle rates before factoring in those actions.

CET1: individual results¹



(1) The variation in percentage points is calculated from the 2015 ratio to the stressed 2017 ratio after factoring in the strategic management actions of banks.

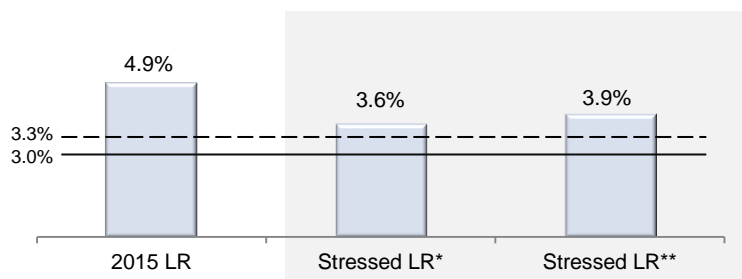
Main results

Leverage

In the stress scenario, the aggregate leverage ratio (LR) would be reduced to a low point of **3.9%**. Thus, it would be above the hurdle rate and also above the average systemic reference point. RBS is the only institution that does not meet the hurdle rate

Leverage

LR: aggregate results

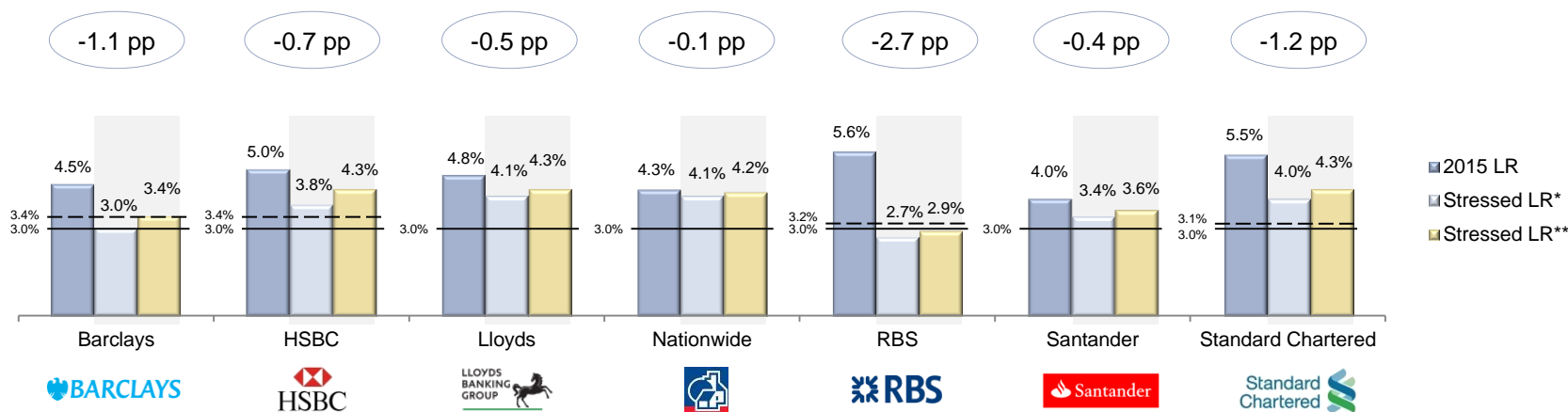


*Before strategic management actions or conversion of AT1

**After strategic management actions or conversion of AT1

- The aggregate Tier 1 leverage ratio falls from **4.9%** at the end of 2015 to a low point of **3.9%** in 2017, after considering the strategic management actions.
- This minimum level is **above the hurdle rate (3%)**, and also above the **average systemic reference point (3.3%)**.
- At individual level, **RBS** does not meet neither the hurdle rate nor the systemic reference point. All other institutions meet the 3% minimum requirement and also the systemic reference point, under the stress scenario.

LR: individual results¹



(1) The variation in percentage points is calculated from the 2015 ratio to the stressed 2017 ratio after factoring in the strategic management actions of banks.

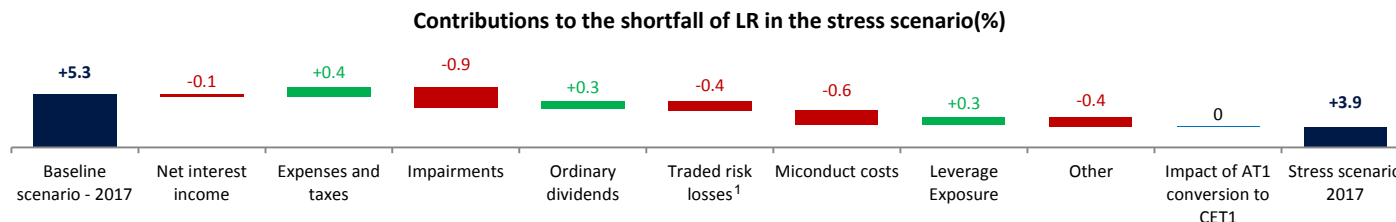
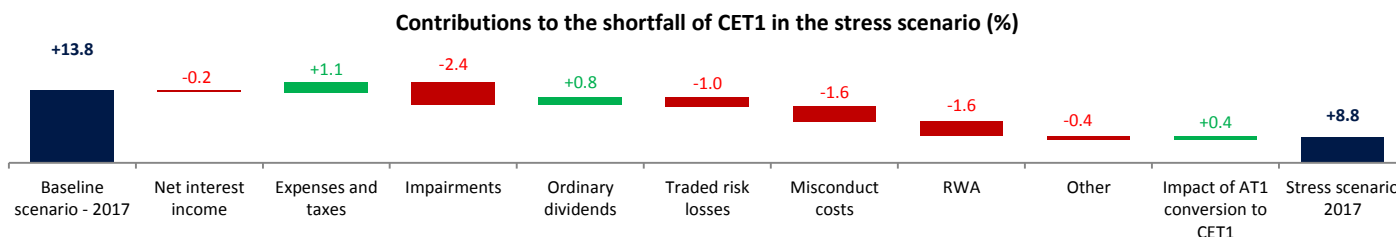
Main results

Contributions to the shortfall of CET1 and LR

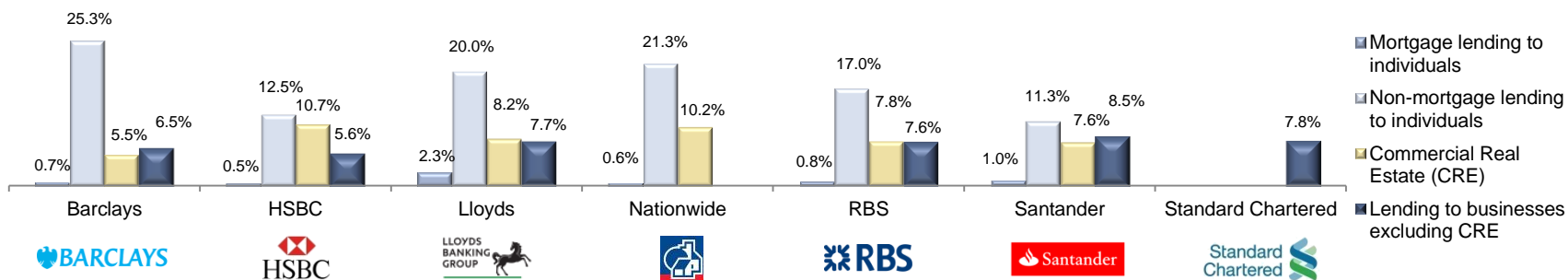
The following graphs explain to which extent diverse factors contribute to the increase or decrease of CET1 and LR metrics (e.g. net interest income, expenses and taxes, impairments, dividends) under the stress scenario

Contributions to the shortfall of CET1 and LR / Cumulative impairment rate

Contributions to the shortfall of CET1 and LR



Cumulative impairment rate to exposure (%)²



(1) Including Net trading income, CCR, CVA, AVAs, and AFS and FVO (excluding securitisations).
 (2) 5-year total impairment charge / Average gross on balance sheet exposure (in stress scenario).

Main results

Conclusions

The BoE judges that the UK banking system is capitalised. At individual level, HSBC, Lloyds, Nationwide and Santander UK do not have capital inadequacies; whereas RBS, Barclays and Standard Chartered need to take certain actions

Conclusions of the BoE and the PRA

At aggregate level

- The BoE judges that, the banking system is in aggregate **capitalised** to support the real economy in a severe, broad and synchronised stress scenario.
- In general, the stress scenario has the **greatest impact** on those banks with **significant international and corporate exposures**.
- As in previous concurrent tests, the BoE also undertook a **qualitative review** of banks' stress-testing capabilities. The PRA judged that banks in aggregate **have made progress this year**, although the rate of improvement has been slower and more uneven than expected.

At individual level



- For HSBC, Lloyds Banking Group, Nationwide Building Society and Santander UK, the stress test **did not reveal capital inadequacies**. ●
- RBS **did not meet the hurdle rates** (CET1 and LR) before AT1 conversion. After AT1 conversion, RBS **did not meet its systemic reference points** (CET1 and LR). ●
- Nevertheless, RBS has already **updated its capital plan** to incorporate further capital strengthening actions and this revised plan has already been accepted by the PRA. ●
- Barclays **did not meet the CET1 systemic reference point** before AT1 conversion. Nonetheless, in light of the steps that it had already announced to strengthen its capital position, the PRA did not require Barclays to submit a revised capital plan. ●
- Standard Chartered meet all of its hurdle rates and systemic reference points, although it **did not meet its Tier 1 minimum capital requirement** (including Pillar 2A). However, in light of the steps that it is already taking, the PRA did not require to submit a revised capital plan. ●

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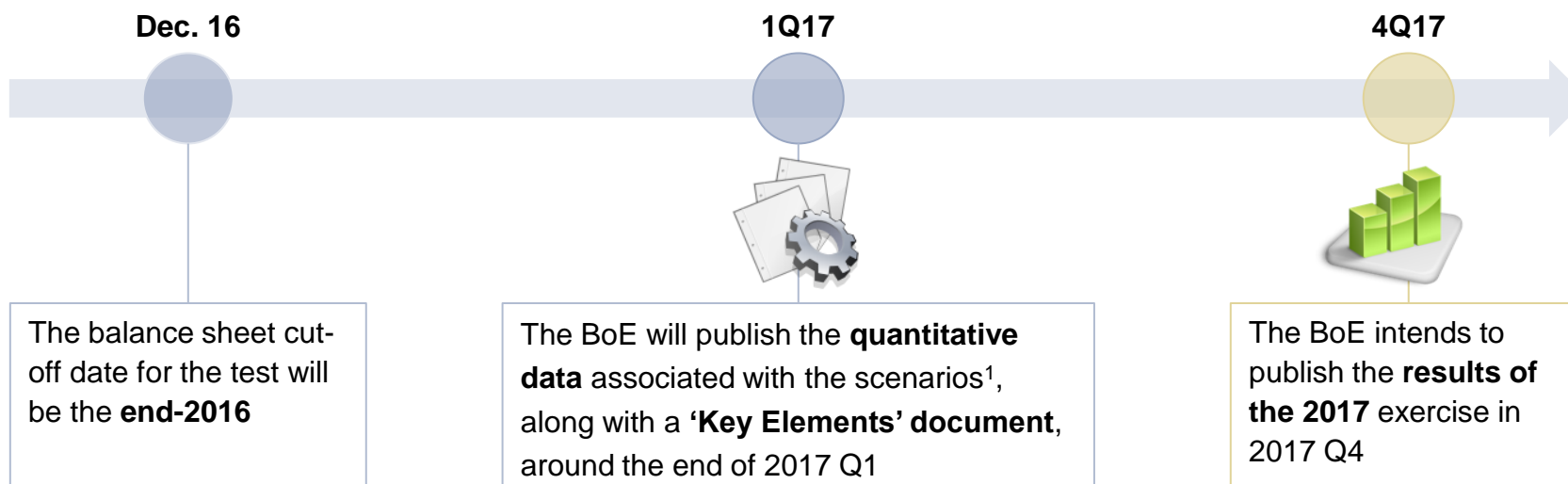
The stress test results will be used by the BoE and the PRA to co-ordinate their policy responses, including setting capital buffers. The BoE will detail the 2017 stress test by the end of the first quarter of 2017

Next steps

Use of the 2016 stress test results

- The **stress test results**, together with the stress tests that banks conducted as part of the ICAAP and the results of the EBA stress test, are used by the BoE and the PRA to **co-ordinate their policy responses** to ensure that banks have sufficient capital to absorb losses and maintain the supply of credit to the real economy in a stress.
- In particular, the BoE and PRA use to inform the setting of **system-wide capital buffers** and the **bank-specific capital buffers** (the PRA buffer).
- The qualitative review will be considered in the BoE's broader assessment of banks' **risk management and governance arrangements**.

2017 stress test



(1) In the 2017 test, the BoE will for the first time include a second 'exploratory' scenario, in addition to the regular 'cyclical' scenario