10th January 2014

Dear Mr. Madouros,

“A framework for stress testing the UK banking system”
A Discussion Paper - Bank of England (BoE) – October 2013

The British Banker’s Association and the Building Societies Association are pleased to respond to the discussion paper.

We are supportive of the need to conduct stress-testing and thank the Bank for setting out in detail their current thinking on the approach. This first coordinated and concurrent exercise will be an important learning exercise for banks¹ and the Bank, the FPC and the PRA and its board.

The purpose of this paper is to provide the Bank with its response to the Discussion Paper “A framework for stress testing the UK banking system” published in October 2013. Our response is structured in two parts:

1. An executive summary that provides high-level comments on each of the sections.
2. A response to each of the questions set out by the Bank in Section 12 “Feedback on the Discussion Paper”.

Yours sincerely

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¹ For ease of reference, the term ‘banks’ refers to the following holding companies, banks and building societies: Barclays Group, The Co-operative Bank plc., HSBC Holdings Group, Lloyds Banking Group, Nationwide Building Society, Royal Bank of Scotland Group, Santander UK plc. and Standard Chartered Bank Group that are the focus of the Bank’s 2014 stress testing of the UK banking system
From an operational perspective, the Bank is keen to ensure that the annual stress tests are conducted in a manner that reduces any unnecessary 'peak-load' problems for banks in scope. It would therefore welcome respondents' views on the proposed annual stress-testing cycle.

What are respondents' views on the proposed coverage of the concurrent stress tests? Should medium-sized banks be included in the proposed framework?

What are respondents' views on the merits of a stress-testing framework for other financial institutions, in particular central counterparties?

What are respondents' views on the proposed approach to scenario design, especially on the extent to which the severity of shocks should vary through the cycle?

What are respondents' views on the Bank's proposal to use a suite of models to assess the impact of scenarios on banks' capital ratios? How do respondents trade off the benefits of reduced reliance on a single model against the potential costs of the need to synthesise different model outputs?

What are respondents' views on the necessary degree of granularity of stress-test disclosures to help strengthen the credibility of the stress-testing framework and facilitate accountability of the FPC and the PRA Board?
Executive Summary

Key Points

1. **Section 3: Frequency and timing of stress tests.** We recognise that the Bank has decided upon its time-lines to publish the variables, baseline and common scenarios and has provided banks with supplementary information on timelines.

   We believe that before the timings for future year stress-testing processes are decided there should be a review of the 2014 process. As well we believe that there is need for the Bank and PRA to work together with other regulators in order to strive for harmonized processes for banks that are engaged in cross border business and are subjected to stress tests in multiple jurisdictions for material subsidiaries on a solo and consolidated basis.

2. **Section 4: Coverage.** We note that the title of the discussion paper is “Stress-testing the UK banking system”. The Bank and PRA will be aware that the structures of the groups within the scope range from single point of entry single bank to multiple point of entry multiple bank models. We believe that there should be a consistent approach to the stress testing approach to enable comparability.

3. **Section 5: Scenario design.** Members opinion is that of the alternative options proposed by the Bank, an explicitly countercyclical approach to scenario design should be adopted. Specifically we interpret this to mean that the severity of the scenario should be constant over time.

   But the shocks relative to the baseline that are required to deliver that scenario should vary through time:

   - when the economy is strong, the shocks required to produce the “plausible yet severe” scenario (e.g. deep recession, high unemployment, sharp falls in real estate prices) will be large;
   - but when the economy is already weak the shocks required to produce the same scenario will be small.

   We believe that when the Bank publishes its scenarios it would be mindful to take into account the FPC’s secondary objective to support the economic policy of the UK Government. We believe that there should be clear “day-light” i.e. between “plausible yet severe” stress-test outcomes and reverse stress-tests outcomes. Therefore we welcome the Bank setting out soon the scope of the severity to achieve that objective.

4. **Section 6: Asset quality reviews (AQR) and stress testing.** We recognise that asset quality reviews form an important component of stress-testing. However, we would not wish to change end of year audited and publically available financial statements. We also believe that to do so would increase the likelihood of double-counting as well as creating unnecessary reputation risk and uncertainty with respect to 31st December 2013 annual report and accounts and Pillar 3 disclosures.

5. **Section 7: Modelling of scenarios.** We believe that the Bank must be mindful to ensure that the level of granularity does not reach a point such that the model risk from the outcome invalidates the modelling process.
6. **Section 8: Outputs of stress tests.** We believe that the outputs from stress-testing including expectations with respect to comparability of the severity of level of stress for common and bespoke scenarios should take into account the current point in the cycle. This in turn requires further clarification as to how the FPC and PRA intend to set the hurdle rate for each bank.

There are now a number of buffers that fall within the definition of the “Combined Buffer” and there could be other buffers including systemic, sectoral and countercyclical buffers. The EU CRD sets out the restrictions on distributions.

We would welcome greater clarification with respect to how the restrictions could apply in practice in times of stress and the extent to which the Pillar 2B buffer can also be utilised.

It is our understanding that the Leverage Ratio is considered to be a “back-stop” and a breach of the Leverage Ratio from a stress-test should not be seen as breach of prudential regulatory requirements. We therefore seek confirmation of this understanding.

7. **Section 9: Remedial and policy actions.** We would like to express concern with the statements set out on page 31 that indicate that the bank / PRA might take actions such as withdrawing certain permissions or changing banks’ management as a tool to ensure weaknesses identified in banks’ stress testing and capital planning processes and governance are addressed. In addition, we would invite the Bank / PRA to reconsider its approach to the upfront provision of immediately executable management actions. We believe that a more proportionate alternative would be to give those banks that are in need of further management actions time to develop and submit revised capital plans in line with the disclosures.

8. **Section 10: Disclosure.** We have a number of concerns with respect to disclosure that we believe need to respect the processes and standards that exist with respect to AR&A, Pillar 3, interim announcements, and that respect for close-periods is observed. In conclusion, we wish to have detailed meetings to agree the format of and timing of the reporting of the outcomes.

We encourage the Bank / PRA to disclose at the onset of the exercise the common standards banks will be judged against and disclosure of outcomes of the assessment should be against those standards, to ensure it is objective and consistent.
Section 12 “Feedback on the Discussion Paper”

From an operational perspective, the Bank is keen to ensure that the annual stress tests are conducted in a manner that reduces any unnecessary ‘peak-load’ problems for banks in scope. It would therefore welcome respondents’ views on the proposed annual stress-testing cycle.

The general consensus is using 31\textsuperscript{st} December data is the most appropriate starting point in order to ensure reconciliation of and consistency of data.\textsuperscript{2}

If the stress-testing is to be expanded to other banks, it has been suggested that the Bank might want to designate 31\textsuperscript{st} March or 30\textsuperscript{th} June data as the starting point. The primary reason for this proposal is to spread the workload for the Bank / PRA throughout the year for these other banks leaving the starting point of 31\textsuperscript{st} December unchanged for those participating in the 2014 stress-testing.

2014 Stress-testing time-lines

We refer to proposals set out in Box 3 and Box 7.

We understand that the Bank has decided not to change the timelines as set out in the DP.

We understand that that the Bank has clarified the timelines as follows:

- The PRA will provide comments on the high-level risks to be explored by 31st January 2014.
- Banks are required to complete worked-up bespoke scenarios by 24th February 2014.
- The Bank will provide the lists of variables for the common scenario by the end of February 2014.
- During March 2014 banks are required to provide a high-level narrative.
- The Bank will publish its common scenarios by 31st March 2014.
- Deadline for submission to the Bank of internally approved bespoke scenarios is 4th April 2014.
- The PRA Board will review and either approve or decline the bespoke scenarios by 30th April 2014.

Based upon discussions between the banks and the Bank / PRA it appears that in 2014 the Bank envisages publishing the common scenario only by 31\textsuperscript{st} March 2014, with no advance release to the banking groups actually using that scenario, while these banks are expected to submit their bespoke scenario - designed to be more severe than the common scenario - by 4 April.

This timeline seems very challenging and more importantly is contrary to what is said in the DP (Box 3 on page 16): "Given the expectation that the bank-specific scenarios should be more severe than the common scenario, banks will have a further month to calibrate their own scenario after they receive the common scenario." We urge the Bank to provide the common scenario to banks in good time.

\textsuperscript{2} We recognise that this adds some complexity for the Nationwide Building Society that has a different end of year reporting period.

BBA & BSA comments on the Bank’s DP “Stress-testing UK banking system” 10/1/2014
The bank has clarified that the following dates will apply with respect to the FDSF.

- Data requirements and templates will be finalised during December 2013 and provided to banks by 31st December.
- 31st December 2013 data will be used.
- For Retail Credit, Wholesale Credit, Structured Finance and Projections the FDSF format templates will be used.
- A high level risk template will be provided to banks that will include RWA data, credit risk data that is out of scope for FDSF, conduct and operational risk
- Information must be submitted to the Bank by 12th March 2014 (utilising 31st December 2013 data) including narrative commentary on “unstructured data”.
- New FDSF “projection templates” will be provided to banks by 31st December 2013 that will include Balance Sheet, Profit & Loss and Pension risk for submission of outputs on 30th June 2014.

**Asset quality reviews and stress testing**

Contrary to the view expressed in the DP, we consider that applying stress testing scenarios on top of asset quality reviews can result in an element of double counting and that the baseline should be the capital position disclosed in the balance sheet, based on existing provisioning, but without pre-adjustment for the results of any AQR.

All bank and building society financial accounts include appropriate provisioning for asset impairment, which necessarily involves making suitably prudent assumptions about expected asset performance.

An AQR typically superimposes a different, more severe, set of assumptions, and (not surprisingly) may generate an adjustment to capital resources. When this occurs, the AQR is functioning, in effect, as a limited, specific stress test.

We agree that AQRs can help design stress scenarios and aid assessment of the impact of an adverse scenario. But we do not agree that stress tests should be applied after adjusting the capital position for the output of AQRs, beyond what may already be reflected (from previous AQRs) in the bank’s financial accounts.

**Future years**

Banks with cross-border businesses in single and / or multiple point-of-entry (SPE / MPE) structures face unique challenges to conduct stress-testing. When regulators have different base-line and different common scenarios, this adds to the operational complexity and governance process which in turn may well have unintended consequences that makes comparability very difficult.

With respect to the timing for future years, we suggest that a separate discussion takes place during 2Q2014 with the objective to promote international harmonisation on list of variables, frequency, timing, coordination of baseline, and the severity of scenarios etc.

We strongly urge a thorough ‘lessons learned exercise’reviewing what worked, and what didn’t work, in the 2014 process, before firm decisions, especially as to time-line, are made for 2015 and beyond.
What are respondents’ views on the proposed coverage of the concurrent stress tests? Should medium-sized banks be included in the proposed framework?

Introductory comments

As the DP rightly recognises (page 18), stress testing is neither new, nor confined to the largest banks only. It has been a requirement for all banks and building societies, as part of the FSA/PRA prudential regime, since at least FSA’s PS 09/20 at the end of 2009. Indeed, it could be said that stress testing has already become an essential component of the prudential framework, alongside capital and liquidity standards, explicit in PS 09/20. So we reiterate that any consideration of the appropriate coverage for the new framework needs to take as a baseline that all banks and building societies already perform their own regular stress testing, reporting outcomes to the PRA as well as informing their own capital planning, and will continue to do so regardless of falling outside the regime – as confirmed on page 18 of the DP.

So we consider the choice on coverage is not between other banks doing stress testing under the new framework, or those banks doing nothing, but between other banks continuing to do their own stress testing as hitherto, or taking part in a concurrent and coordinated exercise under the new framework.

Scope and coverage

Carrying out stress-testing requires a concurrent and coordinated governance and operational process of the common and bespoke scenarios. We therefore agree with the key proposition in the opening paragraph of section 4 of the DP:

“The stress-testing framework outlined in this Discussion Paper is expected to focus on those banks whose activities are judged most likely to pose risks to UK financial stability. Aiming for coverage of all institutions in the financial system would be unnecessarily costly, with small marginal benefits from policymakers’ perspective beyond a certain point.”

The inclusion of the largest eight banks/building societies and the exclusion of small banks/building societies is therefore not at issue. Rather, the debate focuses on whether and how to include medium-sized UK banks and building societies. The DP canvasses two options:

1. Including medium size banks in the steady state concurrent stress testing regime, but on a cut-down proportionate basis, or

2. Including them only from time to time, where justified by the risks being explored by the FPC and the Bank in a given year.

The DP clearly accepts that if the regime were to be extended to smaller and smaller banks, diminishing returns would set in. We think those may already be apparent if the regime were to be rolled out to all medium sized banks.

The information and oversight demands of the full scale framework (as required for the banks in scope) are massive. If the scope is extended, then the Bank/ PRA will expect firms to direct resources to ensure the tests are performed. But this will impact medium sized organisations disproportionately, possibly diverting effort and senior management attention from other priority tasks at the bank. So the result may, even from a prudential perspective, be sub-optimal.
Taking the figures from the DP’s Table A, the total assets of the 30 largest UK banking groups amount to approx. £ 6,595 billion, of which £ 6,329 billion (or 96%) is already accounted for by those eight large institutions.

The next eight in size contribute a further £ 211 billion, or 3.2% of the total, while the smallest 14 in the table contribute, together, a mere £ 55 billion, 0.8% of the total.

Pure asset size is not a perfect proxy for impact on financial stability: We believe that factors such as complexity and interconnectedness also matter.

We suggest that a more consistent approach might be based instead on the PRA’s existing impact categories (which, as set out in its approach document for banking supervision, already take account of complexity and interconnectedness):

Category 1 firms will already be covered by the existing 2014 exercise, while Category 4 and 5 firms would already be excluded.

We suggest that Category 2 and 3 firms could be approached as follows

- Category 2 firms (regarded by the PRA as “significant”, and capable of causing “some disruption” – but not “very significant disruption” – to the UK financial system, could be exempted from the concurrent stress tests under normal circumstances, but privately asked in their own stress testing to “shadow” at least the baseline and common stress scenarios, so that in a period of heightened concern, these firms would readily be able to take part in concurrent stress testing if required.

- Category 3 firms (regarded by the PRA as being capable of causing only “minor disruption” to the UK financial system) need not in the BSA’s view be brought into the concurrent stress testing regime at all – rather, their resilience can continue to be monitored by PRA through their own existing stress testing practices.

If Bank/PRA prefer to avoid explicit linkage to the 1-5 impact categorisation, an alternative approach might be to make the lower size threshold the same as for statutory ring-fencing, viz. £ 25 billion.

**What are respondents’ views on the merits of a stress-testing framework for other financial institutions, in particular central counterparties?**

We believe that the stress testing of centralised counterparties is highly desirable, given the new concentration of systemic risk that they come to represent, as derivative users (such as our members) are compelled to route their normal derivative business through CCPs.
What are respondents’ views on the proposed approach to scenario design, especially on the extent to which the severity of shocks should vary through the cycle?

Page 19 of the DP explores the fundamental question of whether the severity of the stress scenarios should broadly stay the same over time and across the economic cycle (resulting, as the DP admits in amplification of inherent pro-cyclicality), or should vary in severity in an expressly countercyclical manner.

Members opinion is that of the alternative options proposed by the Bank, an explicitly countercyclical approach to scenario design should be adopted. While the DP recognises that this would require judgements by policymakers on the state of economic and financial conditions, part of those judgements will already be required on an on-going basis in order for the FPC to set, increase and release the new countercyclical capital buffers and sectoral capital requirements.

Specifically we interpret this to mean that the severity of the scenario should be constant over time.

But the shocks relative to the baseline that are required to deliver that scenario should vary through time:

- when the economy is strong, the shocks required to produce the “plausible yet severe” scenario (e.g. deep recession, high unemployment, sharp falls in real estate prices) will be large;
- but when the economy is already weak the shocks required to produce the same scenario will be small.

We believe that when the Bank publishes its scenarios it would be mindful to take into account the FPC’s secondary objective to support the economic policy of the UK Government. We believe that there should be clear “day-light” i.e. between “plausible yet severe” stress-test outcomes and reverse stress-tests outcomes. Therefore we welcome the Bank setting out soon the scope of the severity to achieve that objective.

The consequence of this analysis would justify releasing some or all of the countercyclical buffer and sectoral capital requirements in a downturn and would also justify attenuating the severity of stress scenarios – and for the same fundamental reason.

Bespoke vs Common Scenarios

We are keen to affirm and establish the principle that the bespoke stress scenario is quite different, conceptually, from the reverse stress test. Indeed we would expect there to be clear daylight between the bespoke stress test outcomes (notwithstanding they may be more severe than from the common scenario) and reverse stress test outcomes.

We believe that the Bank faces a challenge to develop a common scenario that takes into account the strengths and vulnerabilities of each of the participating banks / banking groups that are quite different in size, scope and structure. In box 3 it is stated that the outcomes of bank-specific stress scenarios should be more severe than the common scenario, yet in chapter 11 (page 35) it states “at least as severe”. We believe that it will be quite difficult for the Bank to assess the relativity of the severity of the bespoke scenarios given the different impact of the common scenario.
The outcome is not just a matter of stressed losses, but it is also the changes to the capital ratio, that inter alia incorporates the impacts of losses, changes in provisions, expected losses and risk weighted assets.

Bearing these matters in mind, it seems to banks that it might be difficult to know the outcome of bespoke stress-tests before they are conducted.

**International harmonization**

A number of those participating in the process are exposed to other economies. We observe that some regulators have published variables for their own economy (such as the US FRB) that reflect their own level of severity. No doubt the Bank will publish its projections for variables for the UK and the US economy that will be different. Next year the ECB will publish its variables.

For banks that have operations in different jurisdictions and are subject to multiple stress-tests on material subsidiaries as well as on a consolidated basis, the absence of international harmonization is an impediment to the establishment of an efficient coordinated stress testing process. We encourage the Bank and PRA to pursue with the principal regulators a harmonized process as soon as possible.
What are respondents’ views on the Bank’s proposal to use a suite of models to assess the impact of scenarios on banks’ capital ratios? How do respondents trade off the benefits of reduced reliance on a single model against the potential costs of the need to synthesise different model outputs?

We support the proposal that there should be a suite of models since it is beneficial to benchmark outcomes from different models.

We believe that the Bank must be mindful to ensure that the level of granularity does not reach a point such that the model risk from the outcome invalidates the modelling process.

Leverage Ratio

We recognise that the outcome of stress-testing to the extent that it impacts a CET1 ratio will in turn impact the Leverage Ratio, which without any resulting de-leveraging could cause a breach. It is our understanding that the Leverage Ratio is considered to be a “back-stop” and a breach of the Leverage Ratio from a stress-test should not be seen as breach of prudential regulatory requirements. We therefore seek confirmation of this understanding.

Outputs of stress-testing

The Bank sets out its proposal that from the range of outcomes from each scenario, it will synthesise the model outputs into a “single view of each bank’s performance in each scenario”. We note that the Bank plans that “its judgment will play a crucial role in combining model outputs”.

Whilst we agree on the one hand that judgment is crucial, we believe that care should be taken to ensure that “judgmental” does not change into “conservative” and or “worst outcome”. We seek reassurance that there will be an open dialogue on the strengths and weaknesses of each model.

Any discussion of stress testing and its outputs, especially where this may include disclosure, requires complete clarity and consistency about the distinction between minimum capital requirements and capital buffers.

The PRA’s approach is already clearly set out in PS7/13, based in turn on “CRD 4” - binding European law that comes into force in January 2014. PS7/13 makes clear that capital buffers are not minimum requirements, and are therefore capable of being used – and indeed designed to be used – in stressed circumstances. The construction of the CRD 4 buffers also involves the self-correcting mechanism of the distribution constraints: where a bank (actually) dips into its CRD 4 buffers, restrictions on dividends and bonuses automatically come into play to help replenish the buffers by earnings retention. The more the bank’s capital position descends into the buffer zone, the more aggressive these automatic restrictions become, whether or not a supervisor takes other actions.

In the context of stress testing, we believe that the same should apply, that is the buffers may prospectively be used to absorb the losses forecast to arise from the severe stress, leaving the bank with (at least) the minimum capital requirement. The DP broadly accepts this analysis (page 28, bottom left paragraph), but makes the reasonable point that Pillar 1 minima do not cover some important risks, such as interest rate risk in the banking book.

These are, however, covered by Pillar 2A. So it would be conceptually difficult, and inconsistent, for a uniform post-stress hurdle rate to be set which was higher (for a given bank) than the sum of its Pillar 1 and Pillar 2A.
We are also concerned that any such uniformly applied hurdle rate would inevitably turn the concurrent exercise into a pass-fail test, contrary to the expressed intentions of the DP. The decision taken by the FPC and PRA with respect to the setting of the hurdle rate is an important aspect of the stress-testing process.

Again, the DP recognises this difficulty (pages 28, bottom right paragraph, running onto page 29), as follows:

“Moreover, individual banks’ idiosyncrasies (such as their resolvability, the extent to which they can raise external equity capital or the size of risks not covered by Pillar 1 capital requirements) suggest that required post-stress capital ratios are likely to vary across banks. Further, as set out in Section 9, this is not intended to be a ‘pass-fail’ regime, but one that takes a graduated approach to remedial actions required in response to the stress tests,…”

The DP mentions, earlier on page 28, 7% CET1 (being 4.5% Pillar 1 minimum plus 2.5% minimum capital conservation buffer) as a possible hurdle, observing that perceived creditworthiness could be affected if a bank’s capital ratio were expected to fall below 7%. But as footnote (2) on the same page makes clear, the 2.5% CCB is capable of being used (and, if used, triggers the automatic restrictions on distribution). Moreover, in the same space, a bank’s additional tier 1 capital would also demonstrate loss absorption as the high level trigger (which could be set at 7%) would operate to write-down AT1 instruments or convert them to CET1. This loss absorption also needs to be taken into account in assessing post-stress resilience, but this could be frustrated by a high common hurdle rate.

We support these observations and thus oppose a single hurdle rate.

**Independent review of the models used by banks**

Risk of ‘arbitraging’ models has substantially reduced as banks have developed their own stress testing capabilities. We support the requirement that the “internal audit functions (in the banks) will be expected to attest that appropriate processes and controls are in place to ensure data quality, appropriate model controls and robust challenge of results”.

**Comprehension of the models used by the Bank**

Disclosure of regulatory models is highly desirable in order to increase accountability of FPC / PRA Board in respect of remedial actions taken and to improve the credibility of stress testing results. Sufficient level of disclosure around regulatory approaches should be provided to the banks and to the market. This will ensure transparency of the regulatory approach and provide context for the stress results when they are announced.

We would therefore welcome disclosure of the Bank’s models at a sufficiently detailed level - either publicly or to the banks involved - as this would help provide context around the stress outcomes they intend to publish and improve their own credibility / accountability.

In addition we believe that the Bank should consider establishing its own ‘special model validation group made up of experts who do not work on the stress tests’ to conduct reviews of the Bank’s own models and stress-testing consistent with the approach that has been recently adopted by the US Federal Reserve.
What are respondents’ views on the necessary degree of granularity of stress-test disclosures to help strengthen the credibility of the stress-testing framework and facilitate accountability of the FPC and the PRA Board?

Disclosure of the outcome of the stress-tests

The DP identifies both benefits and risks from the disclosure of policy outcomes and the approach / methodology, and aggregate / individual results.

We consider that the benefits (especially in a retail bank environment, “market discipline”) may be overemphasised, and the risks (especially of self-fulfilling expectations, and moral hazard) underestimated.

Moral hazard also operates in a more damaging way than identified by the DP.

Whereas (page 32) publishing of stress test results might be read as a clean bill of health to an individual bank, and to the system as a whole, it is also probable that the regular publication of stress test results for a small number of systemic banks will confer an appearance of official approval on those systemic banks in contrast to the rest of the banking sector.

We see no difficulty with disclosure of the approach / methodology and aggregated results but advise caution (once the banking sector has fully implemented Basel 3) over routine disclosure of individual results.

We believe that the complications and overlaps with banks’ own existing disclosures – both financial accounts and Pillar 3 – and their existing timetables should not be underestimated.

We believe that it would be beneficial to have detailed meetings during 2Q 2014 to agree the format of and timing of the reporting of the outcomes and the Bank’s and the PRA’s expectations with regard to the subject of bank-specific disclosures.

We support disclosing a narrative explanation that explains the process.

We do not support publication of the details of stress-test models used by the banks participating in the stress-testing.

We do not support disclosing the outcomes of bespoke scenarios and stressed losses at all. Not only is such information commercially sensitive, but it is merely a plausible scenario and thus is not expected to happen.

We urge caution in the level of disclosure so as to not undermine the processes and standards that exist with respect to AR&A, Pillar 3 and interim announcements, and that respect for close-periods is observed.

No matter the decision on the subject of disclosure, our preference is that any disclosure is firstly announced by banks. This will enable banks to make additional commentary with respect to the outcomes. This can then be followed by the Bank’s announcement later on the same day.
Values to be disclosed

We recognise that banks conduct stress-testing projections out to 5 years (20 quarters).

However, it is the practise of banks to project the end of year values. We therefore recommend that whatever results are published that they are for only the year end 2014 and 2015.

Other reasons for limiting the publication to 2 year-ends are as follows.

1. The Bank will be aware that within a few years the banks within the stress-testing process will begin the process to comply with ICB requirements in compliance with the Banking Reform Bill and secondary legislation. This will add a complexity to long-term solo stress-testing. Thus we consider that care needs to be exercised with respect to publication of the results of bank subsidiaries for timeframes that will include structural changes to those entities subjected to the stress-testing.

2. The Basel 3 framework includes actions that the FPC (and other regulators) would be expected to take through a cycle in order to counter excessive growth and or recessions. Thus the publication of projections in excess of 2 years might lead to challenging questions to the Bank that it may find will be very difficult to answer with regard to the actions that FPC would take in the event that the scenarios were to occur.

Remedial and policy actions

We recognise the requirement that if the outcome requires bank-specific and or financial sector remedial and or policy actions, that credible action is taken, taking into account actions already set out and communicated within the Recovery & Resolution Plan.

However, we urge caution in placing an over-reliance on only this process to take such action. This aligns with the need to ensure that process is not intended to be a ‘pass-fail’ regime, but one that takes a graduated approach to remedial actions required in response to the stress tests, depending on FPC and PRA Board views around the adequacy of banks’ capitalisation and the threats to the UK banking system.

We would like to express concern with the statements set out on page 31(Policy responses beyond bank capital) that indicate that the bank / PRA might take actions such as “withdrawing certain permissions, or changing banks’ management”. We consider that there are dangers in making it explicit in a public document that such actions could be contemplated from reviewing the outcomes of stress testing. We do not believe that these actions should be associated with stress-testing outcomes, which are designed to encourage debate and formulation of mitigation strategies including updates to Recovery Plans in the unlikely event such scenarios were to transpire.

In summary we would invite the Bank / PRA to reconsider its approach to the upfront provision of immediately executable management actions. We believe that a more proportionate alternative would be to give those banks that are in need of further management actions a period of time to develop and submit revised capital plans in line with the publication of the results.

END of the response.