FSA Statement on Capital Approach Utilised in UK Bank Recapitalisation Package

United Kingdom: Financial Services Authority
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The Tripartite Authorities announced on 8 October that they would implement a comprehensive £500 billion plan to support the UK banking system. The plan addressed both capital and funding liquidity together, not one in isolation from the other. The plan:

- Doubled the funds available for the Bank of England’s Special Liquidity Scheme to £200 billion;
- Instituted a guarantee programme of approximately £250 billion for new wholesale debt issuance by banks that either already have or have a plan for raising Tier 1 capital in the amount and in the form the Authorities consider appropriate;
- Indicated that the Government had allocated at least £50 billion to act, if need be, as an underwriter or capital provider of last resort to enable banks to meet the capital standard required for participation in the Credit Guarantee Scheme.

The combination of higher capital and credit guarantee is designed to limit the risks to the taxpayer.

Within the Tripartite structure, the FSA was responsible, in consultation with the other two authorities, for determining the appropriate level of capital for each individual institution. In reaching this determination two factors were taken into account:

1. Ensuring that the amount of capital for each institution would sustain confidence in that institution.
2. Ensuring that each individual institution would have a sufficient capital buffer over minimum capital requirements both to absorb losses that might ensue from a recession and to continue lending on normal commercial criteria.

To ensure broad consistency between different institutions, the process included utilisation of a stress test based on some standard assumptions but with weightings tailored to the specific institutions. The FSA used as common benchmarks within this framework ratios of capital to risk weighted assets of total Tier 1 Capital of at least 8% and Core Tier 1 Capital, as defined by the FSA, of at least 4% after the stressed scenario.

It is important to recognise that this methodology was not intended to set new minimum capital ratios. It was adopted in the context of implementing the Tripartite’s support package with the intention of securing (1) and (2) above.

As the FSA has already announced, it will be addressing the longer term capital regime for deposit takers in a discussion paper in the first quarter of 2009, the expectation being that this document will form part of the wider review of the global regulatory environment, which the FSA along with the other regulatory authorities, will be participating in.

HM Treasury set out its approach to recapitalisation of banks in its statements of 8th and 13th October.

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