Banks. Stress tests

BoE set to raise the bar on resilience

Institutions to be checked against long-term challenges and consumer credit risks

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The UK's largest banks face their toughest test of resilience yet after the central bank unveiled an extra assessment of their business models and separately launched a review into lenders' consumer credit standards.

The Bank of England will put the seven largest lenders — including Lloyds Banking Group, HSBC, Barclays and Royal Bank of Scotland — under further examination alongside its annual stress test, which measures how banks would fare in certain conditions, at the end of this year.

The new "exploratory" test, which will be carried out every other year, will assess banks' resilience to a wider range of risks beyond those emanating from the financial cycle — such as persistently low interest rates and high costs.

The longer-term test involves banks submitting projections for seven years and will help the BoE identify how the financial system will be reshaped if, for example, there are persistent headwinds to bank profitability. The BoE will not publish details of the results on a bank-by-bank basis.

The new assessment will include weak global growth, continuing low interest rates, falling world trade, increased competitive pressure on large UK banks and misconduct costs.

One adviser said no other central bank had launched such a test before and that it was "uncharted waters for both the BoE and banks".

David Strachan, a head of regulatory strategy at Deloitte, said of this year's assessment: "I think the way that it tests business models and capital levels . . . in terms of organisation and administration and logistics then it is more challenging this time around."

Lee Thorpe, a manager at SAS UK and Ireland, an analytics company, added there would be more pressure on banks as a result of the new test. "A substantial change in approach to identify risks in the business model may require an alternative methodology, further challenging banks to deliver in tight timeframes," he said.

The BoE also said yesterday that its Prudential Regulation Authority would launch a review into banks' lending standards in relation to consumer credit following soaring growth in the sector.

The review will focus on underwriting standards and the risk models employed by banks.

Consumer credit is one of the largest risks on a bank's balance sheet. Last year, UK banks had £19bn of impairments on credit cards, compared with £12bn on mortgages.

Going gets tough: The Bank of England will put the UK's seven largest lenders under further examination alongside its annual stress test — Leon Neal/Getty

Consumer credit is one of the largest risks on bank balance sheets

The BoE's Financial Policy Committee said it would also oversee banks' contingency plans to mitigate risks as the process for withdrawing from the EU unfolded. It said: "Risks to financial stability will be influenced by the orderliness of the adjustment to the new relationship between the United Kingdom and the European Union."

The BoE is including for the first time an "anchor" on levels of severity used within its annual stress test. This means it will only get more severe in areas where the BoE thinks risks have increased. The test, the results of which will be published in the fourth quarter, will examine how lenders deal with a rise in UK unemployment to 9.5 per cent — the same as last year — and a 33 per cent drop in house prices, slightly more than the previous year's scenario.

The bank is testing against a hypothetical 40 per cent decline in commercial real estate, compared with 42 per cent the previous year.

But the global economic scenario will be made more severe, with global gross domestic product contracting by 2.4 per cent and Chinese GDP by 1.2 per cent, implying that the BoE sees global economic hurdles as a greater threat.

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