Capital buffering

The design of capital buffers
Key decisions

• Size of conservation buffer & CCyB
  – Assessing the appropriate usability of capital buffers

• Dividend restrictions & supervisory actions
  – How gradualist should we be?

• Transition period
  – Longer transition for small banks?
Composition of the capital buffer

- 16% Tier 1 capital ratio
- Normal buffer = 10%

Options
- More conservative
  - More certainty buffer will be there when needed
- More useable
  - More likely to support lending in crisis
Degree of conservatism

- **CCyB = 2.5% on average**
  - Cut to 0% in crisis
  - Risk of cutting too early or face sequence of shocks

- **Conservation = 7.5%**
  - Minimum + conservation buffer = 13.5% T1 capital
  - 1/100 crisis probability
Degree of lending support

• In theory, could support up to 15% more lending
  – Based on leverage ratio ($10.50 of lending for every $1 of capital) and assumes linear relationship between capital and lending

• In practice, may be closer to 2%
  – Around $1 capital for $1 of lending
  – Based on empirical study of the impact of changes in BoE Pillar 2 reqs
  – Likely to be an underestimate
Dividend restrictions & supervisory actions

<table>
<thead>
<tr>
<th>Supervisory actions</th>
<th>Dividend restrictions (% of earnings that can be paid out)</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>Option A (graduated)</td>
</tr>
<tr>
<td>None</td>
<td>7.5%+</td>
</tr>
<tr>
<td>Require capital plan</td>
<td>5 - 7.5%</td>
</tr>
<tr>
<td>Supervisory actions*</td>
<td>2.5 - 5%</td>
</tr>
<tr>
<td>Make directions / prepare for OBR or stat manager</td>
<td>0 - 2.5%</td>
</tr>
</tbody>
</table>

* For example, issue instructions to a bank’s board, change CoRs to strengthen other risk buffers.
Transition period

- 5 year transition period

<table>
<thead>
<tr>
<th>Year</th>
<th>Conservation</th>
<th>CCyB</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>2.5</td>
<td>0</td>
</tr>
<tr>
<td>2020</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>2021</td>
<td>5.5</td>
<td>0</td>
</tr>
<tr>
<td>2022</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>2023</td>
<td>7.5</td>
<td>1</td>
</tr>
<tr>
<td>2024</td>
<td>7.5</td>
<td>2.5</td>
</tr>
</tbody>
</table>
Transition period – impact on profit

- Includes capital impact of risk weight changes for IRB banks
If 10yr transition for small banks

* Includes capital impact of risk weight changes for IRB banks