TUTOR CONFERENCE – ADDITIONAL MARK PLAN FOR QUESTION 1

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1 - Robinson

Total Marks: 42

1.1

a) Calculation of total regulatory capital requirement and CET1 capital requirement

Risk weighted assets (RWA)			**£m**
Operational risk	14,244 x 15% (½) = 2,137	x 12.5 (½)	26,708
Market risk	898	x 12.5 (½)	11,225
Credit risk - Internal ratings based (IRB) - Standardised approach	170,582 x 2.6% (½) = 4,435	x 12.5 (½) (½)	55,439 22,341
Total RWA			**115,713**
			Total: 3

Total capital requirement %		**%**	Marks
GSIB buffer		1.50	½
Capital conservation buffer		1.25	½
Countercyclical buffer		0.50	½
Individual capital guidance (ICG)		9.50	½
Total %		**12.75**	Total: 2

Total regulatory capital requirement = Total capital requirement % x total RWA
= 12.75% x £115,713m
= £14,753m (½ FT)

CET1 capital requirement %		**%**	Marks
Minimum CET1 capital		4.50	½
GSIB buffer		1.50	½
Capital conservation buffer		1.25	½
Countercyclical buffer		0.50	½
Pillar 2A: 56% of excess of ICG over 8% must be CET1 (56% x (9.5-8))		0.84	½
Total %		**8.59%**	Total: 2½

CET1 capital requirement = CET1 capital requirement % x total RWA
= 8.59% x £115,713m
= £9,939m (½ FT)

b) Calculation of Robinson's total regulatory capital and CET1 capital

Note: because there is no tier 2 capital in issue; tier 1 capital is equal to total regulatory capital.

Ordinary share capital	4,355	
Share premium	4,888	

Retained earnings (Note 1)	29,883	
	39,126	½
Adjustments:		
Deferred tax asset	(6,342)	½
Goodwill and intangibles	(16,329)	½
Excess of expected loss over allowance for impairment (IRB approach to credit risk) (14,430-11,234)	(3,196)	½
Holding in Steel Bank	(2,345)	½
CET1 capital excluding investment in Steel	10,914	
Add: Steel Bank adjustment (Note 2)	1,213	½
Total CET1 capital	**12,127**	
Additional tier 1 capital	3,505	½
Total capital	**15,632**	Total : 3½

Note 1: Current year profits should not be included unless externally verified. Without further information, the entire retained earnings figure is included. (½)

Note 2: An adjustment is required for the holding in Steel Bank plc, despite it being an insignificant holding, as the holding exceeds 10% of Robinson's CET1 capital. The adjustment must reflect a deduction for the excess above 10% of Robinson's CET1 capital. This is achieved by deducting 2,345 and adding back the amount that does not exceed 10% of CET1 of 1,213 (10/90 x 10,914)).

Robinson's capital ratios:

Total regulatory capital ratio	=	Total capital / total RWA
	=	15,632/115,713
	=	13.51% (½ FT)
CET1 capital ratio	=	CET1 capital / total RWA
	=	12,127/115,713
	=	10.48% (½ FT)

This indicates that as at 31 October 2017 Robinson satisfies the capital requirements for both total capital (12.75% minimum) and CET1 (8.59% minimum). (½ mark for conclusion)

Total possible marks Maximum full marks	14 11
1.2	

The settlement of the fine is likely to be between the £1,200 million already provided for and the £10,600 million cited by the Department of Justice (DOJ). (½)

If the fine were settled today for the full amount of £10,600 million rather than the provided amount of £1,200 million, the impact of fine would be to reduce capital by £10,600m -£1,200m = **£9,400m.** (½)

Adjusted total regulatory capital (15,632 – 9,400) = £6,232m (½ FT)
Adjusted total regulatory capital ratio (6,232/115,713) = 5.39% (½ FT)

Adjusted CET1 capital (12,127 – 9,400) = £2,727m (½ FT)
Adjusted CET1 capital ratio (2,727/115,713) = 2.36% (½ FT)

However, since the level of CET1 would fall below 7%, the trigger level on the coco bonds, the bonds will convert to equity in accordance with the terms of the instrument. (½)

Therefore, the CET1 ratio would be the same as that calculated for total regulatory capital above of 5.39%

as AT1 instruments would become equity. (½)

This means that if the penalty of £10,600 million is levied, Robinson would fall below its regulatory capital minimums for both total capital and CET 1. (1 mark)

Robinson will need to report this matter urgently to the PRA because breaching the minimum capital requirements could mean that Robinson would no longer meet the threshold conditions of the PRA. (1 mark)

In the absence of a credible capital adequacy plan that is approved by the PRA, Robinson could face restrictions on its activities and ultimately face a prohibition on carrying out regulated activities. (1 mark)

Total possible marks Maximum full marks	7 6

1.3

These credit downgrades signal increased uncertainties around future expected cashflows which increases the probability of default and is reflected in higher risk weightings. (1 mark)

This would result in an increase in RWA as calculated below.

Commercial lending in Mediterranean countries

Amount of loans £m	Corporate risk weight 31 Oct 2017 %	RWA 31 Oct 2017 £m	Corporate risk weight 4 Dec 2017 %	RWA 4 Dec 2017 £m
22,307	20%	4,461 (½)	50%	11,154 (½)
30,102	50%	15,051 (½)	100%	30,102 (½)
9,239	100%	9,239 (½)	150%	13,859 (½)
		28,751		55,115

Wakanda loan

Amount (net of impairment allowance) £m	Sovereign risk weight 31 Oct 2017 %	RWA 31 Oct 2017 £m	Sovereign risk weight 4 Dec 2017 %	RWA 4 Dec 2017 £m
1,400 (½)	50%	700 (½)	150%	2,100 (½)

Total RWA at 31 October 2017 = 28,751 + 700 = 29,451
Total RWA at 4 December 2017 = 55,115 + 2,100 = 57,215

The increase in RWA due to the credit deteriorations is: 57,215 – 29,451 = £27,764 million. (½)

This increase in RWA requires additional capital required as follows:

Total capital 27,764 x 12.75% = £3,540m (½ FT)
CET1 27,764 x 8.59% = £2,385m (½ FT)

Total regulatory capital ratio = Total capital / total RWA
= 15,632/(115,713+27,764)
= 10.90% (½ FT)

CET1 capital ratio = CET1 capital / total RWA
= 12,127/(115,713+27,764)
= 8.45% (½ FT)

The increase in RWA as a result of the credit deterioration results in Robinson not meeting its total

regulatory capital minimum of 12.75% nor its CET1 minimum of 8.59%. (1 mark)	
Total possible marks	9
Maximum full marks	8