

British banks highly vulnerable to future shocks, Bank of England warns

Britain's banks remain over-indebted, highly vulnerable and harbour growing funding gaps which leave them susceptible to future shocks, the Bank of England has said.

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Bank of England: The UK remains highly vulnerable to potential shocks.

In a warning to bankers and consumers after months that have seen large jumps in share prices and hopes that the banking system is recovering, the Bank used its Financial Stability Report to emphasise that the UK remains highly vulnerable to potential shocks.

With the Government poised to deliver its White Paper on financial regulation next week, the Bank also cautioned that life for financial institutions was about to change forever, with big banks facing a whole spectrum of new restraints on their size, structure, business plans and lending.

The report, published today, said: "While pressures on the major global banks have stabilised over the past few months, their balance sheets remain impaired. Banks' leverage remains high, with the possibility of further impairment of assets placing continued pressure on profitability and capital ratios. Future revenue generation will need to balance the desire to deleverage with the need to generate new business at profitable spreads.

"At the same time, the major UK banks maintain a high and rising customer funding gap. The withdrawal of overseas funding and competition for domestic deposits has added to these funding pressures."

The report revealed that the funding gap – the shortfall between what banks have in deposits and what they lend out to customers – has further widened in the past year to more than £800bn. The increase underlines the scale of adjustment that they will have to undergo before life returns to relative normality. The report also pointed out that the amount banks have in liquid assets remains low, while the leverage ratios remain high, saying: "As long as these balance sheet vulnerabilities persist, there is a risk to the banking system from further adverse economic or financial sector developments, which could in turn affect lending and economic recovery."

In a sign of the strain facing nations' public finances – including the UK's – the report also revealed that the threat of a sovereign debt default has become one of the biggest concerns for investors. A survey put together for the report identified sovereign risk as a financial stability concern for the first time.

The report also laid out a number of key criteria banks will have to fulfil in the future – reforms which could transform the structure of the financial system. Among its recommendations were that in future banks should "face a credible threat of closure or wind down", should have a "risk-based, pre-funded deposit insurance system", should increase their levels of capital and liquidity, depending on their size, and should

provide a "will" which explains how to dismantle them in the event of insolvency.

Banks must also provide the authorities with more information about their interlinkages, to ensure that the collapse of one will not bring down a whole series of institutions, the Bank said.

<http://www.telegraph.co.uk/finance/financetopics/financialcrisis/5639474/British-banks-highly-vulnerable-to-future-shocks-Bank-of-England-warns.html>