Capital and the Mortgage Industry

BARCLAYS

Raheel Ahmed, MD, Mortgage Product & Customer
5th October 2015

Why are we talking about capital today?

The increasing capital regulation is seen as necessary to guard against a repeat of the same mistakes of 2008:

Failures in market discipline

Vulnerability to financial contagion

Loss of depositor and market confidence

BARCLAYS

If you thought MCD and MMR were complex…

- Focus of industry has been heavily on conduct regulation such as MCD and MMR.

- Yet, the upcoming capital regulation could have far-reaching ramifications for the industry.

$$\frac{\text{Adjusted Profit}}{\text{Equity}}$$

BARCLAYS

Capital in the banking sector

Management of capital has become increasingly complex since the Financial Crisis

A larger, more complex capital stack…

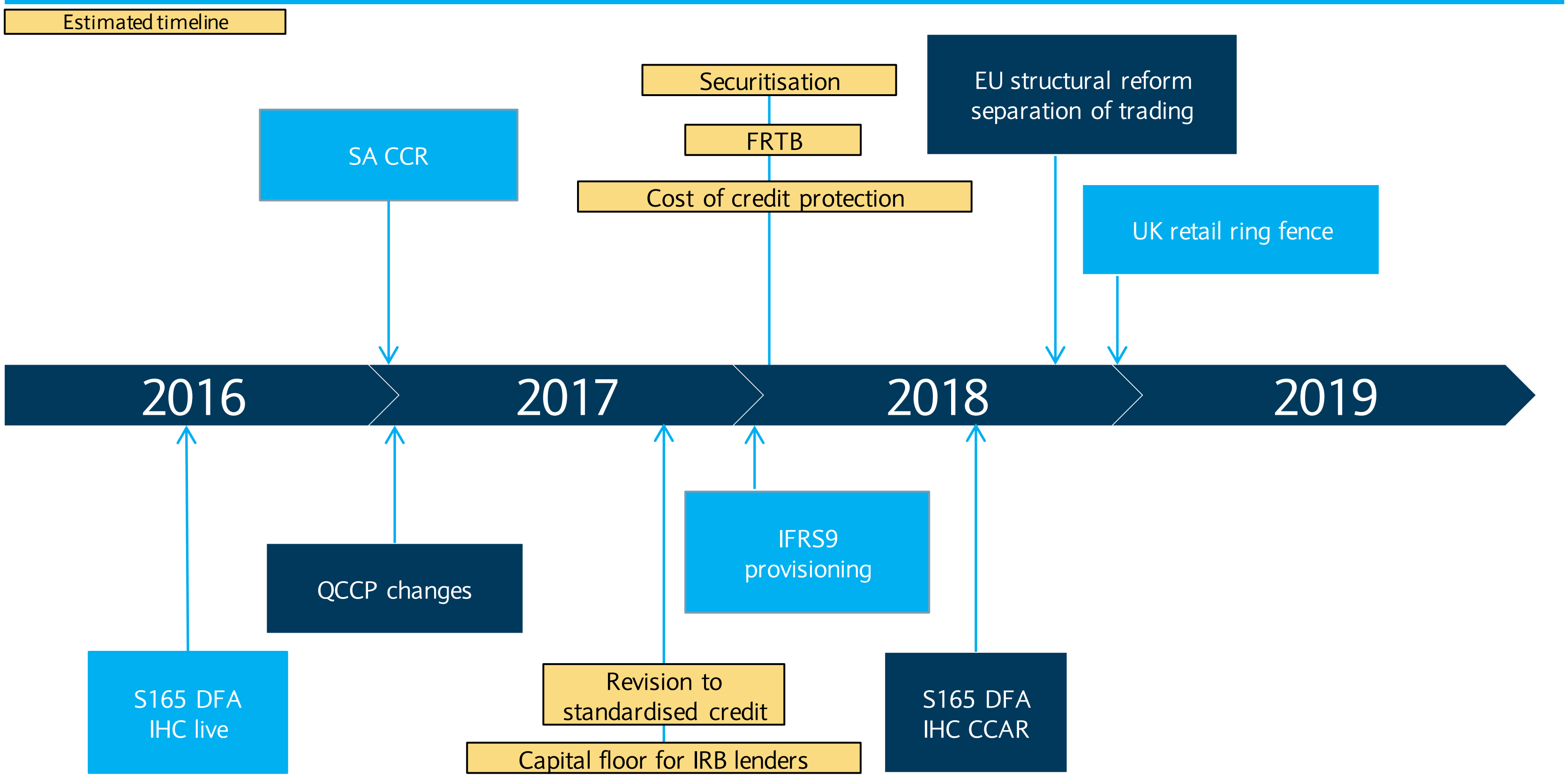
…and a broader regulatory capital toolset

- Heightened focus on capital planning
- New buffers introduced on capital - including higher minimum requirements
- Binding regulation on leverage ratios
- Focus on loss-absorbing capacity
- Regular stress testing.

BARCLAYS

What’s coming up…

Upcoming regulatory timeline is packed with measures impacting banks’ capital requirements



Why does capital matter?

The capital regulation has an impact across the high-level return on equity model

$$\frac{\text{Adjusted Profit} =}{\text{Equity} \uparrow} = \text{Return on Equity} \downarrow$$

BARCLAYS

How do we currently calculate RWAs?

For standard lending…

- By default exposures are risk-weighted at 100%
- If some requirements are met, residential mortgages can be risk-weighted at 35%
- Regulators have some discretion over the risk-weights to be applied.

For Internal Ratings Based lending…

- Internal Rating Based risk-weights are mainly a function of the nature of the counterparty, probability of default and loss given default
- This gives a more nuanced, complex calculation
- However, general summary is that RWAs are significantly lower.

BARCLAYS

The BIS Consultation


Basel Committee
on Banking Supervision

Consultative Document

Standards

Revisions to the
Standardised Approach
for credit risk

Issued for comment by 27 March 2015

BANK FOR INTERNATIONAL SETTLEMENTS

Residential real estate: Risk weights based on loan-to-value ratio and the borrower's debt-service coverage ratio with risk weights ranging from 25% to 100%

BARCLAYS

The model proposed by BIS - LTV

***Residential real estate: Risk** weights based on loan-to-value ratio and the borrower's debt-service coverage ratio with risk weights ranging from 25% to 100%*

Using LTV as a risk weight indicator

- LTV is not necessarily a driver of customers defaulting but it does give a strong indicator of potential losses
- Valuation is a static valuation from origination
- Clear that at a higher LTV much stronger risk weight applied. This will create a challenge for mortgage providers and their customers.

LTV	Proposed risk weight
<40%	25%
<60%	30%
<80%	40%
<90%	50%
<100%	60%
100%+	80%

Source: BIS consultation – 'Revisions to the standardised approach for credit risk' (Dec 14)

BARCLAYS

The model proposed by BIS – debt-service coverage

Residential real estate: *Risk weights based on loan-to-value ratio and the borrower's debt-service coverage ratio with risk weights ranging from 25% to 100%*

Using DSC as a risk weight indicator

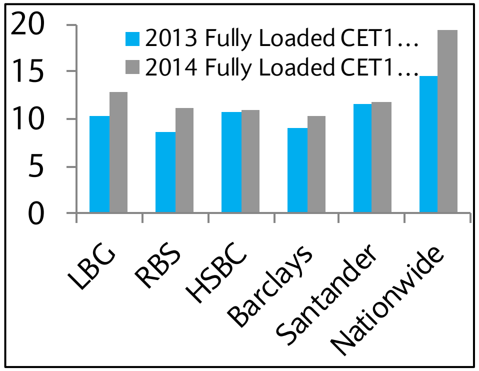
- DSC is proposed as a binary evaluation of the borrower
- The BIS consultation proposes a threshold of 35%
- This would be static throughout the lifetime of the mortgage.

LTV	<40%	<60%	<80%	<90%	<100%	100%+
Loans to individuals with DSC ≤ 35%	25%	30%	40%	50%	60%	80%
Other loans	30%	40%	50%	70%	80%	100%

Source: BIS consultation – 'Revisions to the standardised approach for credit risk' (Dec 14)

BARCLAYS

What else is happening?



Push towards holding of greater amount of 'high quality' capital through 'Common Equity Tier 1 ratios'

Introduction of higher corporate taxation rate

IFRS9 – pushing impairment to the front of the balance sheet

BARCLAYS

Wider impact on the customer

The squeezing of the RoE, with the large adjustments in capital, could have widespread implications for the customer

Higher rates

Restrictions in lending

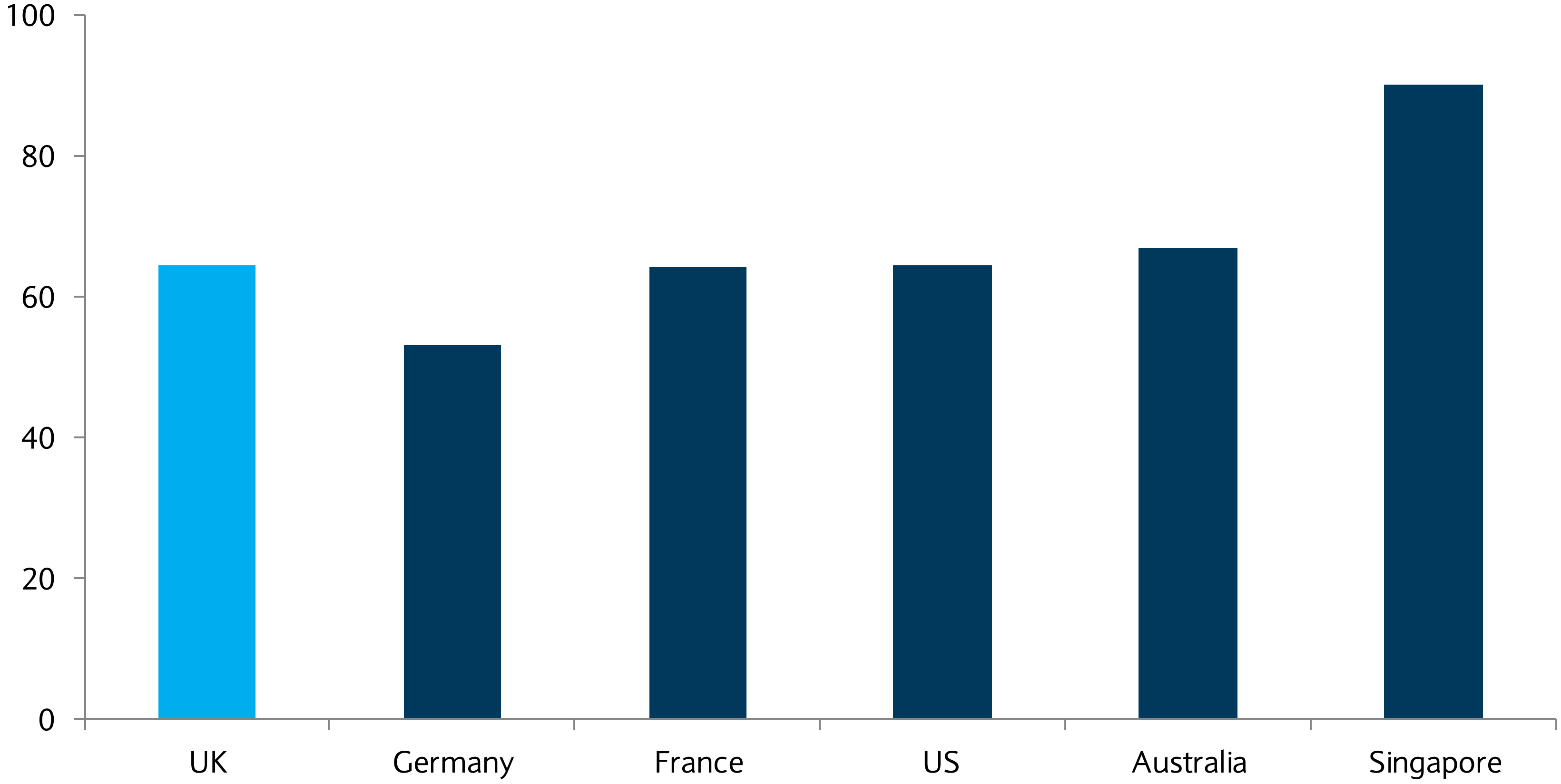
Alternative sources of credit

Contrast between capital regulation and the political landscape

"Make the dream of home ownership a reality for many who would otherwise have been shut out" *David Cameron, October 2013*

BARCLAYS

The UK's home ownership



BARCLAYS

Conclusions

- Capital regulation will have a very real impact of the mortgages industry
- There is a potential dichotomy between regulation and political pressure
- Important that affected lenders understand, consider and plan for changes in same detail as conduct regulation
- Changes could squeeze RoE to the detriment of customer rate and availability of lending
- Important that potentially adverse customer impacts are highlighted in a coherent and accessible manner by the industry.

BARCLAYS