

Direction to the Prudential Regulation Authority to investigate the prudential regulation of the Co-operative Bank plc during the period 2008 - 2013

The Treasury give the following direction in exercise of the powers conferred by sections 77(1) and (2) and 78(5) and (6) of the Financial Services Act 2012 (“the Act”).

In accordance with section 77(1) of the Act, the Treasury consider that it is in the public interest that the Prudential Regulation Authority (“the PRA”) should undertake an investigation into the relevant events relating to the Co-operative Bank plc (“the Co-op Bank”) and it does not appear to the Treasury that the PRA has undertaken or is undertaking an investigation into those events.

Direction

The Relevant Events

1. In this direction, “the relevant events” means the prudential supervision, with reference to the specific matters set out in paragraph 3 below, of the Co-op Bank—

- (a) by the Financial Services Authority (“the FSA”) during the period 1st May 2008 to 31st March 2013; and
- (b) by the PRA during the period 1st April 2013 to 22nd November 2013.

The Investigator

2.—(1) The PRA must appoint an independent person (“the Investigator”) to carry out an investigation (“the Investigation”) into the relevant events and the circumstances surrounding the relevant events.

(2) Before appointing the Investigator, the PRA must obtain the approval of the Treasury to the appointment.

Scope of the Investigation

3.—(1) The Investigation must assess the actions, policies and approach of the FSA and the PRA as the institutions with statutory responsibility for the prudential supervision of the Co-op Bank for the period 1st May 2008 to 22nd November 2013.

(2) The investigation must focus on—

- (a) whether the FSA could or should have developed more effective arrangements for stress-testing the Co-op Bank’s ability to withstand challenging operating conditions sooner than it did;
- (b) whether the application of more effective stress-testing arrangements would have led to the Co-op Bank’s loan impairments being identified sooner than was in fact the case;
- (c) whether the Co-op Bank’s loan impairment profile, which appeared to differ from that of other banks, should have led the FSA to investigate it more closely before 2012 than was in fact the case;
- (d) why the FSA’s analysis in October 2008 to January 2009 of the suitability of the proposed merger of the Britannia Building Society (“Britannia”) with the Co-op Bank failed to properly account for the prudential risks attached to Britannia’s assets that were subsequently identified by the PRA;
- (e) whether, in the FSA’s view, the Co-op Bank had sufficiently comprehensive and reliable financial information at its disposal at the time of the proposed merger between the Co-op Bank and Britannia to allow it to make a properly informed decision as to the suitability of the merger in prudential terms;
- (f) whether the FSA was made aware by the Co-op Bank of the change in the accounting treatment of the cost of the replacement of the Co-op Bank’s IT platform that took place in 2010, and if it was, whether the FSA should have acted to postpone the effect of the IT programme on the Co-op Bank’s capital position;

- (g) whether the FSA should have intervened on prudential grounds to halt the Co-op Bank's bid to acquire 632 branches from Lloyds Banking Group, known as "Project Verde"; and
- (h) the record held by the interested parties of contacts between the seller, the bidders and the interested parties relating to the Verde bid.

(3) In sub-paragraph (2)(h)—

"the seller" means Lloyds Banking Group plc and UK Financial Investments Ltd.;

"the bidders" means the Co-op Bank, the Co-operative Group and NBNK Investments plc;
and

"the interested parties" means the FSA and the Treasury.

The conduct of the Investigation

4.—(1) The PRA must cooperate with the Financial Conduct Authority and the Treasury to facilitate the disclosure to the Investigator of such information as the Investigator considers is relevant to the scope of the Investigation.

(2) The duty in sub-paragraph (1) does not apply in respect of any information which is subject to any legal restriction on its disclosure.

5. The Investigation must be conducted in accordance with the statement of policy that the PRA has prepared in accordance with section 80(1) of the Act.

6.—(1) The Investigator may rely upon any conclusions reached relating to the relevant events and circumstances surrounding the relevant events set out in—

- (a) the report of the independent review into the events leading to the Co-op Bank's capital shortfall by Sir Christopher Kelly published on 30th April 2014;
- (b) the report of the independent governance review carried out into the Co-operative Group by Lord Myners published on 7th May 2014;
- (c) the report of the House of Commons Treasury Committee on Project Verde published on 21st October 2014; and
- (d) such other reports, notices or other publications as the Investigator considers appropriate.

(2) The Investigator may rely on any evidence gathered during the preparation of the documentation referred to in sub-paragraph (1)(a) to (d) above.

The duration of the Investigation

7.—(1) Subject to sub-paragraph (2), the Investigation must be completed within a period of 1 year beginning on the date upon which the Investigator is appointed.

(2) If the Investigator considers that it will not be possible to complete the Investigation within the 1 year period mentioned in subparagraph (1), the PRA must inform the Treasury of—

- (a) the reasons for the delay in the conclusion of the Investigation; and
- (b) a revised target date for the conclusion of the Investigation.

Reporting

8. On completion of the Investigation, the PRA must as soon as reasonably practicable make a written report to the Treasury—

- (a) setting out the Investigator's findings and conclusions;
- (b) setting out the lessons (if any) that the PRA considers that it should learn from the Investigation; and
- (c) making such recommendations (if any) as the PRA considers appropriate.

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Her Majesty's Treasury