Why Bank had to crack whip to get dividend ban

The steps that led to the lenders bowing to pressure

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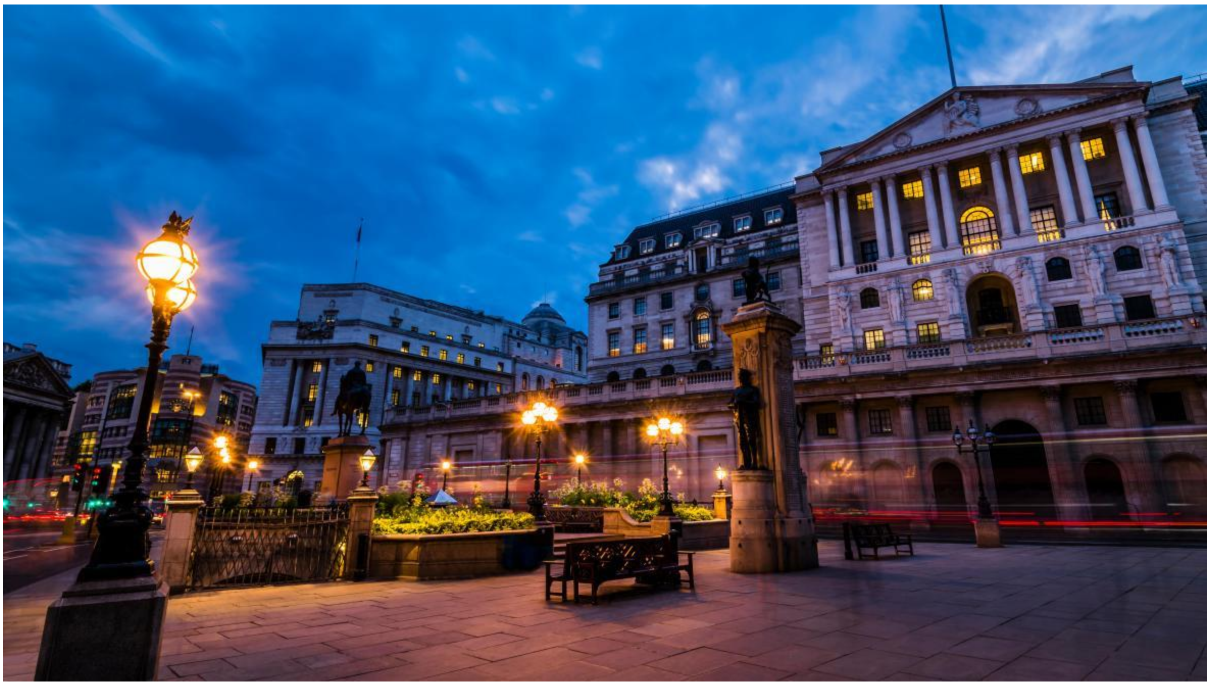

Britain's biggest banks have finally succumbed to what many in the City increasingly felt was inevitable.

On Tuesday night the Bank of England's Prudential Regulation Authority said that it had effectively ordered the country's leading lenders to cancel the dividends they had proposed for 2019 and secured pledges from them not to make investor payouts this year, including share buybacks.

In letters sent to Barclays, HSBC, Lloyds Banking Group, Standard Chartered and Royal Bank of Scotland, as well as to Nationwide, the building society, and to Santander's British division. Sam Woods, the PRA chief, also barred lenders from paying cash bonuses to senior staff in the months ahead.

Last night the Bank’s intervention was said to have angered directors of HSBC, which has about one million retail investors in Asia, and to have reopened the question of whether it should move the group’s legal base to Hong Kong, according to the Financial Times.

The dividend ban is a blow to shareholders of all the banks, who range from pension funds to private investors. Lloyds alone has about 2.4 million retail shareholders. Thus shares in the London-listed lenders fell yesterday. HSBC closed 9.5 per cent down, Standard Chartered was off by 7.2 per cent and Barclays slid 12 per cent. Lloyds fell by 11.7 per cent and RBS by 5.2 per cent.

The PRA is trying to preserve commercial banks’ cash as they brace to shore up an economy effectively frozen by the coronavirus pandemic — yet some City analysts were disappointed. Those at Jefferies said that the regulatory uncertainty caused by the PRA could hamper banks if they needed to tap investors for funds should the economic crisis worsen, because it “weakens prospective investment propositions”.

The cash bonus ban also creates an uncomfortable dynamic between rewards for shareholders and senior bank staff. While investors have now been deprived of their final dividends for the lenders’ performance in 2019, top bankers will already have been paid some of their cash bonuses for the same year, which would be difficult to claw back, and share-based rewards will continue to be allowed.

However, it is understood that the PRA ban applies to any deferred cash payments, which are an element of bonus schemes.

The Bank of England first turned to the issue of dividends and bonuses on March 11, when interest rates were cut from 0.75 per cent to 0.25 per cent and the countercyclical capital buffer was reduced to zero, boosting credit capacity by up £190 billion. At the time the Bank said that lenders “should not increase dividends or other distributions such as bonuses”.

The following week the PRA recognised that it might need to take more draconian action. Internal discussions were opened about suspending 2020 dividends, as well as the thornier issue of cancelling final dividends for 2019. A decision was needed by today, at the very latest, because tomorrow Barclays was set to become the first bank to pay shareholders, with a payout of £1.04 billion.

Having lined up its arguments, the PRA engaged with the leading banks at the start of last week. The commercial lenders accepted that their 2020 dividends should be suspended and that no further cash bonuses should be paid, but the issue of the 2019 dividend was not so clear-cut.

For some banks, two issues were a concern: their retail shareholder base and the message that cancelling a contract sent to financial markets. Some of the 2019 payouts had gone ex-dividend and there is little if any precedent of banks being blocked from making disbursements at that point.

In the meantime, the issue was beginning to be discussed openly in the City. The Systemic Risk Council, an unofficial but heavyweight group of ex-central bankers including Sir Paul Tucker, former deputy governor of the Bank of England, was one of the first to raise concerns. It called for all banks to suspend dividends, bonuses and buybacks as early as March 19.

By Thursday of last week prominent former regulators were starting to speak out. They included Sir John Vickers, former Bank chief economist, who told *The Times*: “For the sake of the health of the financial system, dividend payouts by banks should now be totally out of the question.”

On March 27, the European Central Bank said that lenders “should not pay dividends for the financial years 2019 and 2020 until at least October 1, 2020”, a decision that came after more than a dozen had made final dividend payments for 2019 already. The US Federal Reserve declared that buybacks set for 2020 would be stopped.

This gave the Bank of England the chance to see how markets responded. Share prices for European banks fell but spreads did not blow out, suggesting that investors had priced in the lost income and did not interpret the intervention as a sign of bank weakness. That strengthened the PRA’s hand.

Still, support for a cancellation of the 2019 final dividend was not unanimous among British banks. The PRA wanted to use moral persuasion to convince them to take the action themselves. It was decided that the policy had to be safety first and to persuade banks that it was in their own interests to keep hold of capital in case the crisis deepened.

On Tuesday afternoon the PRA decided that the final 2019 dividends had to be cancelled and it wrote to the banks at 5pm, demanding a response by 8pm and that lenders issue statements within the following hour. And it was deemed necessary to pull out one of the regulator’s lesser-used powers as a threat. Under Section 192C of the Financial Services and Markets Act 2000, the Bank can order banks to act.

“The PRA stands ready to consider use of our supervisory powers should your group not agree to take such action,” Mr Woods wrote. That clinched it. At 9pm, a time chosen because both London and Hong Kong markets were shut, the Bank made its announcement.