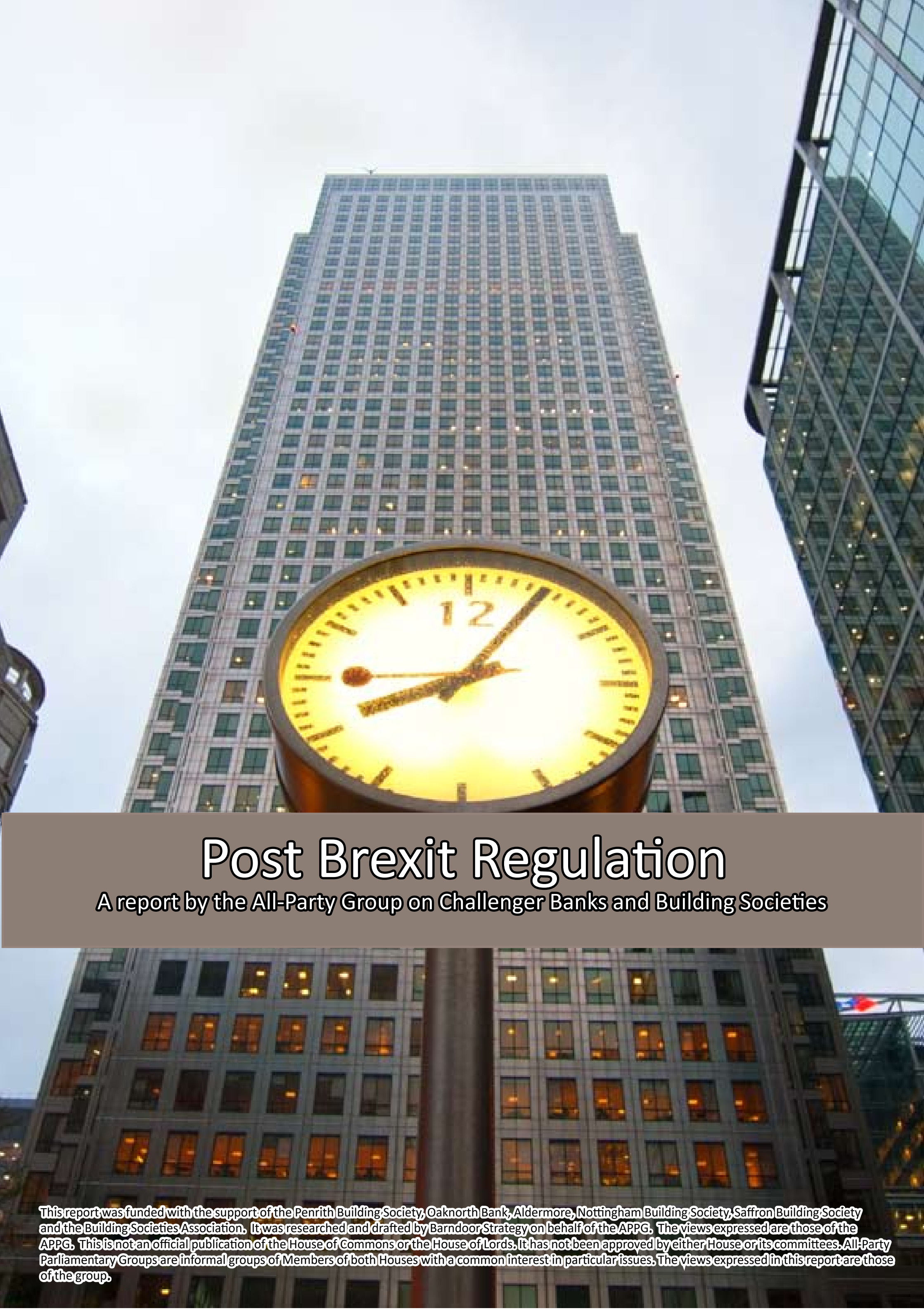


Post Brexit Regulation

A report by the All-Party Group on Challenger Banks and Building Societies

This report was funded with the support of the Penrith Building Society, Oaknorth Bank, Aldermore, Nottingham Building Society, Saffron Building Society and the Building Societies Association. It was researched and drafted by Barndoor Strategy on behalf of the APPG. The views expressed are those of the APPG. This is not an official publication of the House of Commons or the House of Lords. It has not been approved by either House or its committees. All-Party Parliamentary Groups are informal groups of Members of both Houses with a common interest in particular issues. The views expressed in this report are those of the group.

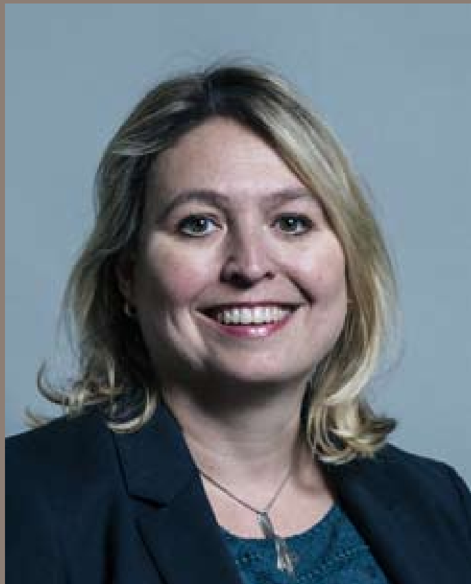
Foreword

One of the most striking things about the UK banking sector is that if you travelled back in time 100 years to 1921 you would find the same big four banking institutions dominating the UK banking market. The UK has seen wars, recessions, the rise and fall of empires, but the major UK banking institutions have stayed broadly the same.

The UK is a very different country now from what it was in 1921. So, why then do we have the same dominant financial institutions? Moreover, why does the UK have so few regional banking institutions or indeed new mid-size institutions taking on the leviathans? After all, there has been no shortage of new banks launched. The UK is also home to a vibrant building society sector. With all these potential competitors out there why are the big four so dominant?

Back in 2019, the APPG on Challenger Banks and Building Societies decided to take a look at financial regulation of challenger institutions with a view to making recommendations about the shape of the post regulatory landscape in 2021.

We've not been alone in our concerns. Our investigations have coincided with the Bank of England's very welcome Strong and Simple Discussion Paper DP 1/21 and also their less ambitious July 2021 consultation paper on MREL reform. In fact, what we've found



most striking is the agreement between both the regulated and the regulators that the rules in this area are not fit for purpose. Worse still, the regulatory regime established since the 2008 crash has in many ways been counter-productive.

A regime designed to protect consumers has ended up protecting them from competitive institutions which might be able to offer them a better deal.

While we are pleased to see that regulators have started to listen to firms and policymakers, the response so far has been a case of 'too little, too late'.

Brexit has been the cause of some of the more recent delays. It can also hopefully also be a catalyst to create better solutions if regulators can successfully embrace their newly found regulatory freedoms and make changes which will benefit the growth of a healthy banking sector.

In this report we put forward some ideas which we hope will help build a positive consensus in favour of change.

Rt Hon Karen Bradley MP
November 2021

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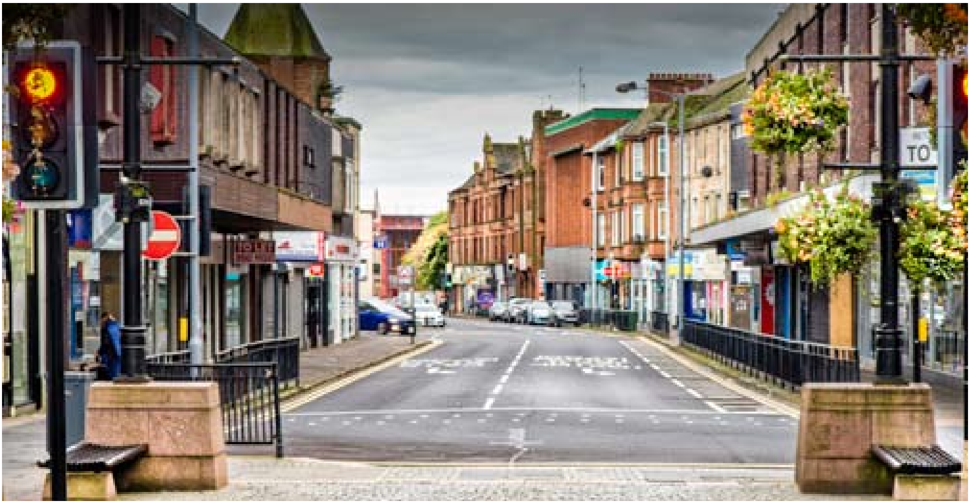


What has emerged during our investigations, through both oral and written evidence, is that there is considerable support for the Bank of England's endeavours and a consensus across a wide range of institutions that the present regulatory regime is not fit for purpose.

The interplay of cautious UK regulation overlaid with prescriptive and inflexible EU regulation has proved a toxic mix for many start-ups and smaller financial institutions. We found that, in many ways, the UK regulatory landscape seems to be uniquely restrictive and hostile, not so much to the establishment of challenger institutions, but to their growth where this might lead them to challenge the major banks and provide effective competition for the benefit of consumers.

We have been provided with some stark examples of UK institutions who have suffered negative effects as a result of the present regulatory regime, primarily from the unintended consequences of financial regulation, which theoretically exists to safeguard financial stability and protect consumers. These have ranged from the imposition of MREL capital requirements through to reporting requirements.

However, the common thread is the way this regulation, although well-intentioned, has been applied in such a way in the UK that its effect has been counter intuitive and detrimental to growing new challenger institutions.

The UK Financial Services Industry is the jewel in the UK's economic crown and many of our witnesses felt that the UK sector had the ability to be world beating and to take on Silicon Valley.

However, the attitude of both regulators and the big four had resulted in restraints being placed on challengers as they took on the big banks on the basis that they should not overstretch themselves. This is plainly the wrong approach if the UK is to continue to foster a world leading financial sector.

While we welcome the change in attitude signalled by the Bank of England in recent months the slow pace of change is in danger of damaging the Government's ambitions to keep London as a leading global financial centre.

Moreover, we would like to strike a note of caution with regard to the Bank of England's MREL Consultation Paper of July 2021. This consultation ignores the advice and counsel of UK firms and in particular the UK Mid-Tier Group as well as international best practice.

As an APPG, we don't believe that the Bank of England has done enough to explain this large divergence from international standards on MREL and other regulatory barriers. If the UK's regulatory community is incapable of addressing the barriers to competition in the UK banking sector, then it must fall to HM Treasury and Parliament to take action.

APPG Challenger Banks and
Building Societies
November 2021

Recommendation 1:
End 'too small to trust'

Non-systemic institutions are being severely disadvantaged as they are being lumped together with major global firms when it comes to a whole host of regulatory capital or reporting requirements.

Recommendation 2
Swift action to make regulation fit for purpose

Bank of England and the Financial Conduct Authority need to take swifter action to rationalise the regulatory regime and to facilitate more competition at the top of the industry while providing a regulatory landscape that facilitates innovation at the bottom.

Recommendation 3
Radically revise MREL

MREL rules need radical revision. In other jurisdictions, the threshold is much higher; for example the EU (€100bn) and the United States ($250bn). This might make life easy for financial regulators but it is a nightmare for challenger banks trying to scale, particularly in the mid-tier.

Recommendation 4
Introduce measures to bring forward effective competition to boost the economy

A lack of effective competition in the UK banking sector means poorer availability of lending for both consumers and small businesses and acts as a significant brake on the economy.

Recommendation 5
Break the banking glass ceiling

There are in effect structural glass ceilings in the banking market. Only mergers can allow firms to leapfrog through this regulatory ceilings. The point has been well made to us that this leaves a notable absence of mid-tier competitors of scale that can support SMEs, drive regional growth and investment and level-up the country.

Recommendation 6
Introduce a proportional approach to regulation

The key issue as far as the APPG is concerned is one of proportionality. Time and again when it comes to the regulation of challenger banks and building societies there seems to be a distinct lack of proportionality in the approach of regulators. It is almost as if the UK's regulatory authorities would prefer to deal with a few behemoths rather than a competitive panoply of diverse institutions.

3 Introduction

The APPG has looked at several aspects of regulation in the past. The focus of this inquiry however was post Brexit regulation. The APPG, its Associate Members and many of the witnesses we have spoken to share an ambition to see the UK maintain its position as a leading global financial centre post Brexit.

Therefore, this inquiry sought to take evidence from leading UK challenger institutions about the difficulties they face due to UK regulation.

There is a degree of irony in all of this. Had the UK remained a member of the EU, then it is likely that regulatory change would already have started to take place. There has been a belief for some time in the financial sector that the capital and regulatory regimes introduced since the 2008 crash have been insufficiently proportional. The EU regulatory authorities have recognised and moved on this. In the UK however, parts of the financial sector have been allowed to languish with the burden of rules and regulations which are blunt instruments, barriers to growth and damaging both to UK consumers and UK plc at large.

We held two evidence sessions 13th April and 6th July 2021 which are detailed in the appendix. The evidence we gained through these, as well as the evidence submitted to the APPG in writing, have helped inform this report.

4 What are the issues around post Brexit Regulation?

Barriers to growth – from too big to fail to too small to trust

From our work we have found that the key barriers to challenger institutions such as smaller challenger institutions, building societies, and mid-scale banks, are the current regulatory and capital requirements.

Part of these are being addressed by the Bank of England's Strong & Simple discussion paper, much of the remainder is dealt with in the Bank's most recent consultation on MREL which is set to close in October 2021.

Too small to trust?

A point made repeatedly at our evidence sessions has been that if anything the banking sector is now more consolidated than it was before the crash with higher barriers to growth and achieving scale. We have found a pattern whereby mid-size institutions are seeking to grow through mergers and acquisitions as this is the only way an institution can grow to overcome the capital and regulatory barriers which have been placed in its way.

Moving to the other end of the spectrum, 'too big to fail' has been replaced by **'too small to trust'. Non-systemic institutions are being severely disadvantaged as they are being lumped together with major global firms when it comes to a whole host of regulatory capital or reporting requirements.** Due to their size and scale they do not have the means to adequately address these. While some of these issues are dealt with in the DP1/21, several are not.

In the view of the APPG, the **Bank of England and the Financial Conduct Authority need to take swifter action to rationalise the regulatory regime and to facilitate more competition at the top of the industry while providing a regulatory landscape that facilitates innovation at the bottom.**

We have had the point made to us that the pace of change is too slow given the huge shifts in the economy caused by Brexit and the pandemic and that the work of the regulators needs to be more joined-up or holistic in its approach when looking at regulatory barriers and how they interact and result in unnecessary burdens and consequences.

Ultimately, **a lack of effective competition in the UK banking sector means poorer availability of lending for both consumers and small businesses and acts as a significant brake on the economy.**

Anne Boden, CEO of Starling Bank, pointed out that despite their vital role in the economy which included SME lending, the squeezed middle of the British banking sector faced a range of artificial regulatory cliff edges and some 53 different regulatory thresholds as institutions grew.

Nick Lee, Head of Regulatory Affairs at OakNorth Bank, reiterated this point in his evidence to the APPG flagging MREL, operational resilience, IRB, stress testing, and ring fencing among other things.

Given the challenges of rebuilding post COVID in the view of the APPG more thought needs to be given to rapid change to break some of the log-jams in the regulatory system. After all, this has been precisely the approach adopted in other areas of the economy – for example the streamlining of the driving license system to address the shortage of HGV licensed drivers. Just as firms need drivers to haul their goods, they also need capital to finance their business ventures.

As we set out in our response to the Bank of England's consultation on Strong and Simple regulation, the APPG supports the vision of the Bank of England with regards to the regulatory framework. We have spoken widely to financial institutions of all sizes and there is a consensus that the changes envisaged in the discussion paper are beneficial.

Where there is criticism is that the process is moving too slowly and is still failing to strip out a lot of unnecessary complexity with sufficient rapidity.

Many of our witnesses have also questioned why the Bank has chosen to deal with just the smallest institutions in the first instance, rather than creating a roadmap for the sector as a whole to provide more clarity and certainty for those mid-sized institutions that would like to challenge the big Four.

5 MREL – what is it and why it matters

MREL stands for the “Minimum requirement for own funds and eligible liabilities”. In layman’s terms this means the minimum amount of cash an institution has to set aside in reserves to meet its liabilities in case of disaster. As such, it is a key element of the Bank of England’s Resolution regime.

The idea behind MREL is that should a large systemic firm run into trouble – as happened in the 2008 crash – it has sufficient capital to absorb losses and therefore allowing the business to be recapitalised without resort to public funds. The idea is that, if it is carrying sufficient capital, a systemic firm should be able to be wound down or recapitalised as a going concern without causing widespread economic damage.

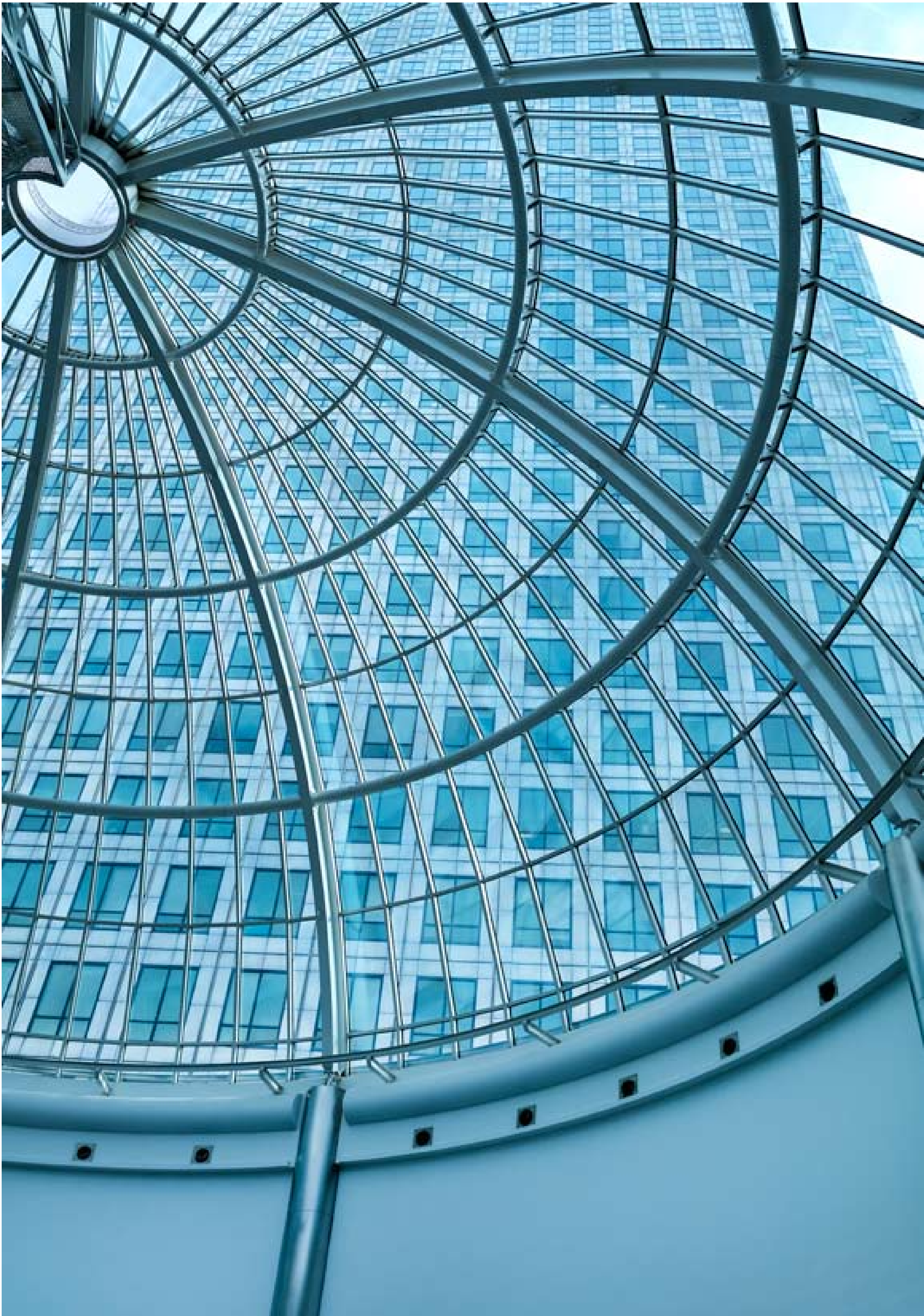
Crucially, MREL supports financial stability because it helps to remove the “too big to fail” paradox whereby because an institution is so large and systemic Government is forced to intervene if its future is in danger. Consequently, this creates a funding distortion of such firms in the market.

MREL has been raised with us on several occasions by a number of different commentators and institutions. The present regime applies bail-in requirements to lenders with more than £15bn in assets, which creates a significant disincentive to growth and means that some well-known but not large institutions, including notoriously the Co-operative Bank (£25bn) and Metro Bank (£22bn) among others are captured. **In other jurisdictions, the threshold is much higher; for example the EU (€100bn) and the United States ($250bn). This might make life easy for financial regulators but it is a nightmare for challenger banks trying to scale, particularly in the mid-tier.**

Moreover, since the crash, the ratcheting up of capital and other regulatory controls has made growing and scaling institutions considerably more difficult for most and virtually impossible for those directly competing with the big banks who effectively have access to cheaper capital. Hence the situation where new institutions now exist in the UK banking sector, created in part thanks to a liberalisation of the listing rules. However, the CBBS APPG does not see these firms growing to challenge the major institutions.

The APPG has also received persuasive written evidence on MREL from the Mid-Tier Banks. They made three key points that:

- Reforming MREL could unlock capital for future lending
- It would enhance competition drive growth and speed recovery



- MREL reform would also encourage investment by renewing the UK's position as a global financial hub

They expanded on these points as follows:

Unlocking future lending

The Mid-Tier banks estimate that MREL reform could unlock £24bn to £28bn of additional lending capacity over the next five years. Furthermore, they argue that due to structural imbalances in the debt market, mid-tier banks have relied more on retained earnings to meet their MREL requirements than the capital markets.

Consequently, reforming MREL would allow these institutions to put this capital to good use. Similar arguments have been made to us in the past by building societies in the context of their raising capital from their members.

While the APPG must rely on the mid-tier banks for the calculation of this figure, we nevertheless find this a compelling argument because it is clearly the case, and even tacitly admitted by the Bank of England itself, that the present MREL regime is tying too much capital up in institutions and distorting the market. This neatly leads to the Mid-Tier institutions second contention.

Enhancing competition

MREL is arguably a dead hand on competition and growth in the challenger sector. There are several reasons for this. Firstly, because it limits the lending some firms can undertake, and secondly, other institutions are forced to remain below a certain size to avoid being caught by the regime.

We believe that this is part of the reason the UK has not seen more organic growth and competition from the new challenger institutions. **There are in effect structural glass ceilings in the banking market. Only mergers can allow firms to leapfrog through this regulatory ceilings. The point has been well made to us that this leaves a notable absence of mid-tier competitors of scale that can support SMEs, drive regional growth and investment and level-up the country.**

One point which the Bank of England mentions on page 7 of its MREL consultation and which was also raised in evidence by Nick Lee of OakNorth Bank is that the resolution authority does not have a statutory competition duty.

The APPG considers this an error which should be rectified in future financial services legislation as the resolution regime can have a profound effect on the competitiveness or otherwise of institutions.

Renewing the UK's position as the world's financial hub

The Mid-Tier banks and others have made clear that the US and EU have set MREL threshold levels at much higher levels than the UK. Again, as far as the

APPG is concerned it would seem that UK regulators have engaged in some gold-plating activity.

Undeniably, in the opinion of the APPG, this places UK institutions at a competitive disadvantage when investors are weighing up the best jurisdiction to start a new bank or invest in an existing firm. We therefore agree with the Mid-Tier institutions prescription of removing this MREL handicap. Surely, if the Government is to succeed in its aim of ensuring that the UK remains one of the best places in the world to invest and start a new business this is just the sort of competitive barrier which needs to be removed.

The key issue as far as the APPG is concerned is one of proportionality. Time and again when it comes to the regulation of challenger banks and building societies there seems to be a distinct lack of proportionality in the approach of regulators. It is almost as if the UK's regulatory authorities would prefer to deal with a few behemoths rather than a competitive panoply of diverse institutions. Just as in other areas of regulation it cannot be proportionate to subject UK firms, competing in a global marketplace, to disproportionately heavy burdens of MREL requirements.

The Bank of England's July MREL Consultation

Overlapping with the APPG's work in this area has been the Bank of England's consultation on MREL reform. While there is clearly something to be welcomed in the fact that the Bank has recognised the need to reform MREL. There is much to be criticised in the Bank's current approach.

As we set out in our response to the Bank of England's consultation, we believe MREL reform is a huge missed opportunity.

It is plainly ridiculous for the UK to be both seeking to maintain its position as a global financial centre yet imposing MREL and bail-in requirements on our firms at a much lower level than is the norm internationally. David Arden, Chief Financial Officer of Metro Bank and Nick Lee of OakNorth made the point strongly in their submission to the APPG that the UK's bail-in threshold compares unfavourably to the £85 billion threshold in the Euro zone and the $250 billion dollar threshold for TLAC in the United States. How can UK institutions compete with just a £15 billion threshold?

Moreover, the point was made to us that larger banks can dip into overseas capital sources bypassing the UK's thresholds. This left the UK's mid-tier at a particular disadvantage.

We therefore call on the Bank of England or failing that the UK Government to take a bolder approach. If the UK is to maintain its status as a global financial centre we must not tie up our firms in red tape, driving up their cost of capital and undermining their ability to compete with foreign rivals.

Moreover, greater attention should be given to the needs of mid-tier and smaller institutions who can drive effective competition in the UK market and potentially become the global banks of the future.

The Bank of England's present approach to MREL will in the view of the APPG ossify the UK banking sector reducing the availability of capital to SMEs and consumers and holding back the City compared to its international competitors.

We consider it a gap in the Bank of England's statutory underpinning that a competition objective is not more thoroughly included in its resolution regime. The Bank may argue it isn't operating a zero failure regime with regards to MREL. But it may well be operating a zero competition regime when all the barriers to competition and growth are considered.

Time to set smaller firms free: A separate prudential framework for non-systemic banks with a simpler approach to the smallest institutions.

Overall, on the basis of the evidence we have received, the APPG agrees with a layered approach as set out in the Bank of England's Strong and Simple consultation. That is, with some important caveats.

The key question we believe is not whether there should be layers but how many layers there should be and whether the proposals as they stand leave a squeezed middle. Certainly, there is a need to separate out the smallest institutions and greatly simplify their regulation and compliance regimes. This would include the smaller building societies and many of the smaller challenger banks and fintech start-ups.

The complexity comes in the mid-market where there are many smaller institutions ranging to reasonably large banks which are still minnows compared to the Big Four UK banks. However, they are still subject to the lion's share of regulatory and financial reporting requirements that the Big Four are.

We think this is profoundly wrong and anti-competitive. It prevents these mid-size institutions from growing to a point when then could provide meaningful competition and challenge to the likes of HSBC, Barclays, NatWest or Lloyds.

The APPG has heard from banks such as Aldermore, OakNorth, Paragon, Metro and Starling Bank who detailed the issues they have had with competing with their larger rivals whilst at the same time finding it more difficult to raise capital at the same rates. They have rightly pointed out to us the damaging

effect this has both on the ability of these institutions to lend to support economic growth and the deadening effect this has on competition.

The Nottingham Building Society have also made the point to us that in terms of that sector there are many different sizes of organisation and Building Societies don't have to get very large before they are subject to a whole range of additional regulatory barriers way below the MREL thresholds.

Layering is therefore a complex question for institutions wherever they find themselves in the mid-tier. Finally, whatever approach is taken it should be graduated so that new cliff-edge scenarios are not created for firms which are seeking to grow and scale their operations.

Moreover, it has been suggested to us by the Building Societies Association that some flexibility in terms of thresholds should exist so that a certain number of years above a threshold would be the trigger for a greater regulatory burden rather than simply crossing an absolute figure, when the institution might fall below it the following year. Further dynamism could be inserted by ensuring that transition points retain real values such as a percentage of the assets of the entire sector or that they keep pace with the growth of the market.

From our evidence sessions the APPG has concluded that a simpler prudential regime for the smaller banks is definitely the correct approach. The question is, how simple should this be?

We would like to see a regime that makes it as easy as possible for challenger institutions such as banks and building societies to be started and grown at least to a small scale. Given the limited systemic risk posed by such firms, we do not think that they need a prudential regime on anything like the scale of that which exists at present. There should be a new proportionate light-touch regulatory regime for such firms until they start to expand and become more significant players.

The APPG is strongly in favour of a new simpler regulatory vision. Members of our APPG have time and again expressed strong views that the UK has too few banking institutions and too few that are able to scale. A simpler prudential regime would be a key part of resolving this.

Given the diverse range of building societies, particular attention does need to be given to designing a regime for the smallest institutions which is genuinely proportional to the prudential risk they present.

These small institutions should not be burdened unduly nor should they in the case of building societies be forced to seek out mutual capital because of a one-size-fits all structure whether this was the present regulatory landscape or the future layered regime.

Domestically focused firms such as building societies

One of the issues raised by the Bank of England was whether the domestic focus of a firm had any bearing on its regulation. It is often forgotten by legislators and regulators that under the Building Societies Act there is a requirement for building societies to be domestically focused.

Sam Woods, Deputy Governor for Prudential Regulation at the Bank of England and Chief Executive Officer of the Prudential Regulation Authority has set out in his speech to the Building Societies Conference in May 2021 how he envisages regulating building societies in the future with much stress on the Strong and Simple regime. While the APPG welcomes the approach that Woods is bringing to regulation as he set out in his speech and in his oral evidence to the APPG, we do wonder whether it goes far enough and is universally shared across the regulatory community.

Moreover, given the complexity of the Building Society sector both in terms of the size and business models of different Societies we would question whether there would be a possibility of Societies choosing which regulatory regime to follow if a more flexible system could be developed. One size fits all regulation is a growing anathema but in a sector where there are many unique business models avoiding it can be problematic.

In our discussions and our evidence to the Bank of England, the APPG has put forward the view that given the way that the Building Societies Act operates to specify a domestic focus for building societies, we would suggest that the Bank looks at similar criteria in assessing domestic or international operation.

The criteria set out by the Bank and suggested to us by our witnesses include proportion of the market, balance sheet size but also size relative to the rest of the market as key arbiters of where a firm or Building Society should sit in terms of a simpler regime.

There does, however, need to be a move away from excessive concern over ensuring institutions do not fail with a more permissive approach to competition. Realistically, there will not be effective competition in the market unless there is a more liberal approach to what firms of a certain size and scale can do. While the Bank certainly maintains that it is not seeking to see a zero failure regulatory regime; In practice, we do question whether the overlapping nature of the UK's regulatory landscape achieves just that.

While it is clearly important to ensure sound prudential regulation of the banking market as an All Party Group, we are concerned that the balance has moved to an overly conservative position.

6 The Bank of England's work around 'Strong and Simple'

Regime design and simplification

The Bank of England posed the question as to whether a more 'focused' or a more 'streamlined' design approach best deliver the objectives of the simpler regime.

The APPG feels that the answer may be a bit of both. There needs to be major root and branch reform of the regulatory landscape and it may be that a hybrid approach is necessary placing some firms in a simpler regime entirely while taking a more streamlined approach with the rest of the market.

This is a complex regulatory area and much will depend on the nature of the Bank of England's final proposals.

Moreover, the point was made to the APPG by both Aldermore and Starling Bank that the rules are currently not very accessible. Institutions or individuals seeking to establish new institutions are faced with a smorgasbord of overlapping legacy EU rules, PRA rules and other issues which make the establishment or scaling of firms more complex than it could be.

This is particularly detrimental to small firms who don't have the resources of the big four. We would suggest that the Bank of England needs to sit down with other regulators and HM Treasury to look at how the entire regulatory landscape can be simplified. Moreover, the long-standing anomaly of building societies' statutory basis being separate and amended more slowly than that of Banks which are companies needs to be addressed by rule-makers and lawmakers respectively. Institutions which do ostensibly the same things should operate on a similar basis.

Finally, we would suggest that there needs to be a full review of the roadmap to provide clarity and certainty for institutions of all sizes as to what the next steps will be.

The APPG believes that the policy options outlined in DP 1/21 would be substantially beneficial in reducing the complexity of regulation for smaller institutions.

However, the question we were left pondering is how this would affect the mid-market and whether the changes would go far enough to allow for more competition.

Time to cut down on useless regulatory reporting

With regards to reporting requirements the point has been made to us by the Building Societies Association and others that there is considerable scope for simplifying regulatory reporting. Clearly, this is something which is unduly burdensome for smaller organisations and we would urge the introduction of a de minimis regime for smaller players.

In the past, concerns have been expressed to us also as to what use is being made of much of the data gathered during reporting and whether this is actually a useful resource for regulators. We believe that the way forward would be a more risk based approach to regulatory reporting which takes account of the difficulties smaller institutions may have in satisfying reporting requirements.

We call on the regulatory authorities to examine what data they are gathering and evaluate whether the process of gathering it and the utility of possessing it are appropriately balanced against the administrative burden and the diminution in competitiveness which results from this.

The Future of Challenger Sector

The APPG would like to see co-ordinated reforms progressing at pace across the sector to strip out barriers to growth and competition and to remove cliff edge barriers which many firms face as they start to scale.

The point has been made strongly to the CBBS APPG that it isn't sufficient to simply strip out the barriers to smaller institutions but that the whole market needs to be tackled as a whole and as a priority for regulators.

While the Bank of England's work on a simpler regime is very welcome there is clearly considerable scope for change to allow for more competition in the middle market.

In the evidence we took from the industry there were several mid-size firms which raised the concern that the proposals might make matters worse for them in the short-term by opening up competition with a host of smaller firms on one side of the business whilst still not allowing them to compete on a level playing field with the larger institutions.

We recommend that more thought needs be given to rapid changes which could help strip away the competitive barriers to growth of the UK financial services industry.

Avoiding new cliff-edges

The Bank of England asked a range of detailed questions about the design of a new regulatory landscape and the different layers it would require.

The APPG is of the view that there is no straightforward response to the layering question. This is because it depends on the way that the framework is structured. From the evidence we have received there would clearly need to be at least three layers.

However, there might need to be more depending on how the layer dealing with the mid-size institutions functioned in practice. There are a huge range of institutions in the market from the very small to the large global firms.

In the view of the APPG, any new structure should be able to accommodate a range of institutions in the mid-tier. This would include larger building societies, challenger banks and others who might have a significant presence in the UK's nations or regions or operate in particular segments of the market. Clearly therefore a number of layers will be necessary to accommodate a diverse range of firms and to ensure that there are no artificial cliff-edges created by the layered structure.

The main issue the APPG sees here is the danger of the creation of cliff-edge regulatory barriers where there is a sudden introduction of a significant change in the regulatory burden.

One suggestion that has been made to us by the Building Societies Association is for the introduction of layers with share of market and capital fixed as a proportion of the market as a whole so that firms don't find themselves held back in a growing market.

Another suggestion from the Building Societies Association was that a firm would need to be in a new layer for a few years before necessary becoming subject to the burdens of that layer if it was just beyond the threshold.

Timing

In terms of how any new Strong and Simple or MREL regulatory regime should be implemented key to the APPG's concerns is the speed, or the lack of it, with which it is being pursued.

The point has been made to us several times during our oral evidence that given the nature of consultations on regulatory changes it may be months or even years before proposals in discussion paper become rule changes. This may be too late for some existing institutions. It may also be too late for the City as it faces growing competitive pressures post Brexit.

3 Conclusion

In our view the Bank of England, HM Treasury and the UK Government must act faster and more decisively to streamline regulation and safeguard both the future of the City and encourage greater competition to benefit consumers.

It could not be clearer from the evidence we have received both in writing and at our two oral evidence sessions that major change is needed to enable challenger institutions to compete in the 21st century banking market.

Whether they are building societies or challenger banks smaller and mid-size firms face a disproportionate burden or regulation and capital requirements.

In the view of the APPG, this is stifling competition and acting as a brake on recovery from COVID. It goes without saying that in the position which the UK finds itself in post Brexit it is also dangerous for UK plc as a whole. British banks and building societies should be able to complete with other global institutions on an equal footing. It is clear from the consultation work being undertaken by the regulators themselves as this report was being written that this is not the case.

While many firms have been raising concerns about the regulatory regime for years it now seems that finally regulators and Government are prepared to listen.

The UK and its consumers need a diverse lending market. Only government and regulatory action to strip away unnecessary and disproportionate regulation can achieve this.

Recommendation 1:
End 'too small to trust'

Non-systemic institutions are being severely disadvantaged as they are being lumped together with major global firms when it comes to a whole host of regulatory capital or reporting requirements.

Recommendation 2
Swift action to make regulation fit for purpose

Bank of England and the Financial Conduct Authority need to take swifter action to rationalise the regulatory regime and to facilitate more competition at the top of the industry while providing a regulatory landscape that facilitates innovation at the bottom.

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Radically revise MREL

MREL rules need radical revision. In other jurisdictions, the threshold is much higher; for example the EU (€100bn) and the United States ($250bn). This might make life easy for financial regulators but it is a nightmare for challenger banks trying to scale, particularly in the mid-tier.

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Recommendation 6
Introduce a proportional approach to regulation

The key issue as far as the APPG is concerned is one of proportionality. Time and again when it comes to the regulation of challenger banks and building societies there seems to be a distinct lack of proportionality in the approach of regulators. It is almost as if the UK's regulatory authorities would prefer to deal with a few behemoths rather than a competitive panoply of diverse institutions

Post-Brexit Regulatory Reform – Oral Evidence Session
13.30 Tuesday 13th April 2021
Online via Microsoft Teams
Minutes of Meeting
Attendees

APPG Members:

Rt. Hon Karen Bradley MP (KB) (Chair)
Baroness Kramer (SK)
Lord Flight (HF)
Jane Hunt MP
Havard Hughes (Secretariat)
David Spencer (Secretariat)
Apologies
Peter Gibson MP
Julie Marson MP

Witnesses
Part One (13.30-14.00 – approx.)
i. Sam Woods (SW), Deputy Governor for Prudential Regulation, Bank of England
ii. Vicky Saporta (VS), Executive Director Prudential Policy, Bank of England
Part Two (14.00 – 14.30 approx)
i. Robin Fieth (RF) – Chief Executive, Building Societies Association (BSA)
ii. Nick Lee (NL), Head of Regulatory Affairs, OakNorth Bank
iii. Mike Harrison (MH) – Public Affairs Manager, Aldermore Bank

Observing

Melissa Lynes – Bank of England
Hannah Schraer – Bank of England
Catherine Glover – UK Finance
Valentina Kristiensen – OakNorth Bank
Robert Fleming – Virgin Money
Matthew Oakes – Allica Bank
Kate Creagh – BSA
Minna Moody-Stewart
Carys Davis – The Other Place PA

Minutes

APPG Chair Karen Bradley MP (KB) opened the session setting out the APPG's overall objectives and introducing the parliamentarians that were present.
KB asked what the key issues were and what had changed?
Sam Wood (SW): Started by saying this is an important topic and noting that we are at a point of big change. However, so far, nothing has changed. This has been deliberate. As we sit here, we have what we would have had if we were still in the EU. But we are at the beginning of a path which will lead to considerable divergence which would be helpful to the UK financial services sector. We can tailor legislation to suit our needs.
Vicky Saporta (VS) – Confirmed that a big body of the EU law has been retained. What has been on-shored as PRA rules in our rule book are the binding technical standards which we can change. Essentially this is what the EBA or ESMA or EIOPA could change. As you know, the Government is consulting on a future regulatory framework. To transfer some of the retained laws into

UK regulatory rules.

KB – Asked where the UK can diverge from EU laws and regulations moving forwards, noting industry concerns about scalability, growth, and entering different markets?

SW – Noted that the UK has been particular successful at lowering the hurdles to authorisation. We've authorised 25 new banks since the new regulatory framework came into place. Not all of these will succeed. We are going to stick with this policy but there is not much more we want to do in terms of lowering barriers to entry.

The single biggest thing that I wanted to ensure that the APPG had in its sights is that the regulators are looking to introduce a simpler regime for smaller banks. 'Strong and Simple' is the term being used for the proposed new regime for small banks. This will not be a weak regime, but weaker than that applied to the big banks.

The approach of the EU in applying all legislation with its full weight to all banks is not something that the UK would be taking forward. It makes sense for the EU because there are such widely differing institutions and countries within it. But it doesn't make sense for the UK with Switzerland, Australia, Canada and the US being a better comparison.

SW confirmed that a discussion paper was due in the next few weeks on this new regime.

KB: Confirmed that the APPG would be very interested in this

Baroness Kramer (SK): Raised the issue of accountability that have come up as a consequence of exiting the EU. Asked SW and VS what he thought about this and the Financial Services Bill.

She said the new proposed regime would be the lightest on the globe by a large stretch and amount to a few Treasury Select Committee meetings a year. She wondered what the consequences will be?

She said without frequent parliamentary intervention we would not have any of the Challenger Banks and alternative lenders that we have now. She is concerned with the disengagement between Parliament and regulators. She also noted that all secondary legislation will be repealed and high-level skeleton bills will be introduced with all the regulations in the rule book.

SW: Said we have been doing a lot on this and we have been following very closely what SK and others have been saying in the Lords. He said he would like to meet with Baroness Kramer, Baroness Bowles and others who have expressed concern in person to discuss it further. He described the Financial Services Bill as an enabling piece of legislation and not about the new financial services regime. That will follow.

The main point he wanted to make in the context of the APPG session was that the Bank of England's rule-making powers have been expanded as a result of Brexit. But he added that he expected Parliamentary oversight to increase too. It is just a question of how that scrutiny would be delivered without the EU institutions.

SW said he was particularly robustly

held to account by the Treasury Select Committee on a day-to-day basis. However, it is the case that the Treasury Select Committee focussed on issues of the day.

Whether this was an issue with a bank, an insurance firm or something which had gone wrong in regulation. He said if Parliament did go forward to give the regulators more powers then there would be more for him and other regulators to do in Westminster.

Lord Flight (HF): Recalled the 1970s banking crisis and observed that when economic and business conditions got rough it was the smaller banks were badly hit. He noted that he didn't know how many of the Bank of England were around then but hoped the lessons hadn't been forgotten.

HF added a point about impact of capital cost on small banks which is hugely more than on the larger banks and which he said was particularly unjustified.

VS: Agreed with SW that the Financial Services Bill which was meant to be an enabling piece of legislation and not about the new financial services regime. She said it was designed to enable the PRA and FCA to update the rule book for some international standards such as BASEL not to consider the future regulatory framework. She agreed with SW that accountability needed to be greater and said the Bank of England have done work on this for other non-EU institutions.

She added that if you count the number of times that the policymakers were in front of parliamentary committees this compared very favourably [with other jurisdictions]. She noted that it was quite typical to allow regulators to implement policy as seen in Canada, the US or Australia saying there was nothing particularly atypical internationally about the proposed new UK regulatory regime.

On HF's question, she confirmed that she had studied the 1970's financial crisis and she joined the Bank of England after the BCCI failure when there were other smaller banks which had similar characteristics to BCCI. She agreed that we do have a history in this country of smaller banking institutions failing every now and again.

She agreed with HF that there was a tendency for the non-systemic banks to have higher capital ratios. There is in the history with the Bank of England as a regulator for a requirement for smaller firms to have higher ratios because they were thought to be riskier and the risks more concentrated.

With the new "strong and simple" approach, we don't forget this which is why it is strong as well as simpler. The idea is to make the sector resilient but to reduce the levels of complexity and make capital cheaper.

SK: Said she was looking forward to the 'Strong and Simple' paper and agreed with the notion of a lighter-touch approach. She noted that historically, secondary legislation would have been required for financial regulations. But as she understands the regime going forward, there will be no direct reference to parliament which is a fundamental difference and changes the role of the regulator. Scrutiny would be reduced to a couple of sessions of the Treasury Select Committee. Parliament would be able to raise its voice but nothing more. Parliamentarians would not really have an opportunity to exercise accountability in a meaningful way.

KB: Said her first job in accountancy was winding up BCCI. She noted that there appeared to be a difference between what Parliament wanted to see and Regulators wanted to see in terms of parliamentary accountability. She suggested that once the "strong and simple" paper was out, the APPG could invite Se and VS back to discuss it in more detail.

SW: Said it was fundamentally a decision for Parliament to make in terms of how the rules were made. Does it want to stick more with the EU model or the more international model? He said his view was that the later route was the natural route to go but absolutely there needed to be a means of including parliament's voice in this process and there were all sorts of shades of grey to this.

He stressed that the regulator rushing off and doing things in a non-accountable way was not on the minds of regulators in any way.

KB: Thanked SW and VS for their time and invited them to stay on to hear part two of the session.

Part II

KB: Introduced the witnesses, Robin Fieth (RF) from the Building Societies Association (BSA), Nick Lee (NL) from OakNorth Bank, and Mike Harrison (MH) from Aldermore Bank.

She asked what those working in the sector were looking for in terms of changes and what impact Brexit has had on their organisation so far.

RF: Thanked the APPG for the opportunity to contribute to this inquiry. He said that the impact of Brexit so far had been very limited and nothing had really changed, as SW had said earlier.

He noted that Building Societies are UK domestic players so there was never going to be a major change. Even for the largest societies using European bond markets. there were other sources of capital available in the US or elsewhere. The only area where there was friction at the moment is the continued maintenance of ex-patriot lending. UK property, but where the owner has moved overseas for work or retirement but still had a UK mortgage.

NL: Explained that OakNorth lends to growth businesses in the UK and not internationally. The business model was born it a bit of chaos from the 2016 Brexit referendum to the pandemic now. He said that OakNorth are looking for something more proportionate for regulators. They wanted to see a system that was more fleet-of-foot.

He said that the way the regulatory regime worked was as if the smaller instructions had mountains to climb to get to the standards of the larger players. Yet experience showed that it was more often the larger systemic players who had these issues.

He said OakNorth would like the mood music to continue looking at removing the barriers to scaling as has happened with barriers to entry.

MH: Said Aldermore would welcome what has been mentioned by previous witnesses. He said the question was how many institutions went on to be successful and offered true competition in the market. It is these barriers which institutions like Aldermore looked forward to seeing removed.

The CEO of Aldermore, Philip Monks, wants to see a regulator which didn't just say what the steps are that banks need to take to make them successful, but provided a route map. It would be good to see more proactivity from the regulator to drive competition and competitive lending. He also said competitive lending would be increasingly important as the UK came out of the COVID crisis.

SK: Asked if they were talking about rules about MREL? Said her understanding about the decision to apply the capital requirements was not Brexit-related. Across most of Europe, these requirements didn't apply, unlike in the UK. She asked if this was a Brexit issue or a change in philosophy.

SW: Raised his hand to comment on this session. He said this wasn't a Brexit thing but it was a choice which the UK had made before Brexit and we had chosen to draw the line lower. He said the Bank of England was currently consulting on what it should do on this. He agreed that the way it was currently framed does leave a sharper cliff-edge and said this was a live discussion. He noted that something which the Bank of England worried about was consistency, adding that if a few started to fail, there would be huge concerns among those who bore the losses.

MH: Said the IRB based system and the barriers which Aldermore Bank was going through to get IRB rating were very complex. He noted that the end result of this had meant that it was not completely signed off. He said Aldermore wanted to see changes and know what the regime which the regulators wanted to deliver in the future was.

NL: Said the MREL point was about regulation and super-equivalence of regulation. It was £100 billion in the EU but in the UK, it was between £15-25billion of assets and 40,000 transactional accounts. As a result, a whole group of firms were captured in the UK but not in the EU or in the US.

He said from the competitive risk perspective, banks in the UK and their investors are placed on the back foot. Having a regime that was more stepped in its approach rather than this cliff edge at the moment would be better. He said OakNorth have argued for a higher step for MREL that would help the cohort of 5-10 banks at the moment who wanted to complete with the bigger firms but were unclear what their capital and MREL requirement would be.

He said we want to ensure that there was no super equivalence where the regulators were gold plating their requirements. He added that this is a debate needed across the sector and across Parliament as well. He said it shouldn't be a zero-failure regime but there needed to be safeguards to protect people but there is a need to bring in new capital, people and ideas into the banking system.

RF: The BSA's perspective is not very different from OakNorth and Aldermore. The BSA had been working with the Bank on its consultation around the flightpath in the mutuals sector. There is a concern that societies should be able to generate their own capital but not to be forced to seek non-mutual capital. On Bail-In, Building Societies lost their status as they were then owned by a bunch of hedge funds not by their members. There is a need to give societies the ability to build this capital up through retained profit rather than to go to the markets for this capital.

The differences between the standardised approach and the IRB approach is another area. The initial approach of the PRA had been welcomed as it was applying BASEL floors to the larger banks to carry more capital. We had also encouraged the PRA to look at the standardised ratings to reduce the minimum capital requirement for some of the small banks while increasing it for the big ones. It could be 7 times the capital for a smaller institution than a larger one.

NL: Said the devil was in the detail on a lot of this. You have to dig into the rule book to see why there was such a difference between standardised and IRB rating. To be fair to the PRA, it has a competition objective. The resolution authority in the Bank of England which set MREL didn't need to take competition into account. Its objectives should be changed to include competition.

VS: Raised her hand to thank NL for the clarification. She added that it was the Bank which set MREL requirements not the PRA. She said NL was quite right that the statutory framework and the objectives were different for the resolution board and the PRA.

She noted that the Financial Services Bill, if it passes, will allow the rule book to be updated for the latest BASEL III for mortgages where there is a decrease from 35% risk-weight to 20% for low-LTV mortgages. This is on top of the proposals on the floors which the Bank of England have received a lot of feedback on and are currently finalising.

SK: Noted that the discussion was very helpful. She said that one of the problems is that it is not a level playing field. Smaller players don't have the access to raise loss-absorbing capital easily. Whereas the larger institutions do.

She asked if there are any further Brexit related issues?

NL: Said equivalence is the key issue for banks like OakNorth (MH concurred for Aldermore). He said they want to know what is going to happen with equivalence moving forward. Where Brexit could allow more fleet-of-foot and innovative regulation, this would be good.

He said the UK didn't have to follow the needs of 27 other states which should help with innovation in the banking sector and lending in the economy. He said OakNorth await with interest the "strong and Simple" proposals and look forward to freeing up the regulatory

framework.
RF: Said if Brexit hadn't happened, then BASEL IV would have come through the single European rule book. Across 27 states, having a more focussed regime was not necessarily achievable. Brexit gives the opportunity to create a more proportionate UK-focussed regime. The smart approach is to have a layered regime which allows though wanting to trade internationally to have equivalence
but not necessarily for those whose operations are UK-only.
SK: Commented that on the relative cost of MREL issuance for large firm's vs small ones, there is a lot of truth in what you say. However, the picture is a bit more nuanced - some small deposit-takers have been able to issue at very low coupons, others much higher.
Thanked everyone for taking part in the session.
SW: Commented that "Strong and Simple" would not have been possible if it were not for Brexit and said that SW, VS, and the Bank of England are at the disposal of the APPG..
KB: Agreed with SK that it had been a very useful discussion and thanked everybody for their time and for the comments made in the chat.
She said, Let's get this right and get this working for the smaller financial institutions that we want to see flourish. We will definitely speak again after "Strong and Simple" has been published.
The session ended at 14.30

Post Brexit Regulation and the CBBS APPG's response to the Bank of England's Strong and Simple Consultation

13:00 – 14:30, Tuesday 6th July 2021

Attendees:

APPG:

- Rt. Hon Karen Bradley MP (Chair)
- Kevin Hollinrake MP
- Jane Hunt MP (R)
- Baroness Kramer MP
- Lord Holmes of Richmond
- Havard Hughes (Barndoor Strategy - Secretariat)
- David Spencer (Barndoor Strategy - Secretariat)

Witnesses

- Alison Scott (Bank of England)
- Jeremy Palmer (Building Societies Association)
- Nigel Terrington (Paragon Bank)
- Anne Boden (Starling Bank)
- David Arden (Metro Bank)
- David Marlow (Nottingham Building Society)
- Nick Lee (OakNorth Bank)
- Matthew Oakes (Allica Bank)
- Zayna Ali (Aldermore Bank)
- Mike Harrison (Aldermore Bank)

Karen Bradley opened the session welcoming all the guests, outlining the APPG, and explaining the Inquiry on Post Brexit Regulation.

She then invited Alison Scott from the Bank of England to make some comments on the Strong and Simple discussion paper

Alison Scott – Explained that the aims of the discussion paper were to set out the PRA's current thinking about ways prudential regulation could be simplified for smaller banks and building societies while maintaining those firms' resilience, and to do this while not creating further barriers to growth and continuing to meet commitments standards such as the Basel Core Principles for Effective Banking Supervision. Alison went on to say that the paper built on PRA actions designed to support a dynamic and diverse banking sector in the UK.

She noted a recently finalised simplified prudential regime for credit unions and an approach to new and growing banks designed so that firms can understand how and PRA expectations increase as they grow and mature. . She also explained that the paper is written in an open way as there are many ways that the system can be simplified.

She noted that costs for smaller entities tend to be higher relative to size and scale' and said the Basel Committee' has designed the standards with international firms in mind. Simpler and less costly requirements could have been used for smaller firms, she said.

Given the diversity in the UK sector, Scott noted that it is difficult to have a single set of rules for all non-systemic which are simpler and retain resilience. So the Strong and Simple paper envisages a system in which prudential requirements become more sophisticated and exists in layers. She noted that implementation will take a number of years.

Going into more detail, Scott explained that Chapter 4 looks at what the regime might look like for the smallest banks and building societies and the arrangements for firms to come in and out of the regime . She said the chapter highlights a key design choice between a simpler regime based on a narrower but more conservatively calibrated set of prudential requirements (what [the paper] called a focused approach) and a regime that takes the existing prudential framework as a starting point and modifies those bits that appear be over complex for small banks and building societies (what [the paper] called a streamlined approach).

Scott concluded by saying that the feedback on the paper the PRA receives will help the PRA decide which way to go and how many layers to have. She explained that they also wanted to know-how requirements in higher layers could helpfully be simplified.

Jeremy Palmer (Building Societies Association) – Noted that the discussion paper on Strong and Simple is a very high quality piece of work and asked the right questions. He said a formal response would also be coming from the BSA which had discussed it at board level. Palmer noted that the BSA was very impressed with the openness and liked the fact that, instead of being given a ready-made proposition, it was good to be able to play a part in the development of the new regime.

The BSA had been advocating a more proportionate approach for eight or nine years. He noted that this wasn't possible before Brexit because of the EU's capital requirements but was impressed that the PRA had seized the initiative post-Brexit.

He said the majority of Building Societies could benefit from a Strong and Simpler approach and intimated that the BSA fitted quite well into the space into which the discussion paper set out. He noted in passing that the approach behind "strong and simple" could usefully have been applied to the current BEIS consultation around (inter alia) what counts as a public interest entity.

Palmer noted that he has had about three videoconferences in the last few days with small, medium and large Building Societies and said the smaller ones would like a more focussed approach.

But he also asked, if we go with a focussed and a more conservatively calibrated approach, what would the price tag be? He suggested too many layers would make it very complex but said there would need to be at least two. Something for quite small banks and building societies but another for larger and more systemic. Palmer described this as a 'marzipan layer'.

He also noted issues of whether to go down the IRB route for some firms and said the BSA supported the option/ suggestion to start this process with the smallest firms.

Karen Bradley MP (APPG Chair): The issue of scalability comes up time and again and the APPG is also very interested in the question of a focussed versus streamlined approach. A one-size-fits-all approach lacks scalability but a more focused approach is potentially complicated and could incur more risks.

Nigel Terrington (Paragon Bank): It was an excellent step the PRA had taken to provide a more simplified approach. The regulatory regime was largely designed around the big banks. The gradation between the big banks and the small banks was not steep enough and this process would go a long way to remedy this.

He questioned whether there was missed opportunity, noting that the Strong and Simple regime seems to be designed for very small banks sitting in the layer above the credit unions. This is not where Paragon Bank and some of the other witnesses are at.

Terrington noted that Paragon Bank had a £15 billion balance sheet and was looking for something more far-reaching. He is concerned about how long this process might take to reach institutions of the scale of Paragon.

He noted the 'marzipan layer' description and suggested Paragon would feel like 'squashed marzipan' with big banks and smaller ones seeing changes, but the mid-sized banks still stuck with the old system.

As the rules relaxed around the very small banks they would have the ability to grow and complete with a lower cost structure which would then apply.

Terrington noted that Paragon Bank is in the mid-sized category challenging the big banks – half way through IRB – and facing significant barriers to growth, most notably MREL.

Terrington noted that £15 billion put Paragon on the edge of the MREL regime. He said MREL would take £30-40 million out of the bank's capital base per annum which was money the bank could not lend. He said the Bank of England and the Treasury had received Paragon's analysis which showed that MREL would cost between £24 and 28 billion in lending to small businesses or other part of the economy over the next 5 years.

He noted that one day you were not in it and the next day you were. MRL is what he described as a "cliff-edge" event.

He chaired a group of 11 banks which had engaged with the Bank of England and the Treasury recently on this issue. They had noted that there was a danger with all of these different layers that once you tripped over a threshold you were stuck in it even if you slipped below the qualifying threshold again. He suggested we need to smooth the processes and that the calibrations between those thresholds was important.

Alison Scott: Responded to these points saying the Bank of England was very much alive to these barriers and cliff edges but told Terrington he would have to wait to see where the Bank arrived on MREL. She did note that analyses of barriers to growth featured in a number of pieces published by the Bank as it analysed risk. As well as Sam Wood's Mansion House speech in 2019.

Jeremy Palmer: Suggested that one area where the Bank could help was on the acuteness of the cliff edges. He suggested that instead of setting a single figure threshold, they could be made dynamic to retain real values or set as a percentage of the assets of the entire sector so they kept pace with the market and there was not an inflationary drag.

He suggested that perhaps you would only need to transition if you were above the threshold for 3 financial years in a row to ensure there was no flip-flopping.

Palmer also supported what Terrington said about MREL noting that this was the big missing piece at the moment.

Zayna Ali (Aldermore Bank): Mentioned ring fencing which came in at £25 billion. She also discussed the impact and governance around the leverage ratio and other thresholds making the point that there wasn't just one cliff edge but multiple cliff-edges.

Nigel Terrington – Complimented the regulator on its leverage ratio announcement last week which he said was a very positive statement. He particularly noted clause 9.6 which set out the rational for why the threshold should be £50 billion to reduce barriers to growth and said it was also an acknowledgement that small and medium-sized banks had a significantly extra cost of raising capital including MREL capital. This, he said, was a very welcome step.

Anne Boden (Starling) – Noted that she was impressed by so many busy people being concerned about Challenger Banks and participating in this session. She said challenger banks are a movement giving actual competition to the big banks.

Starling Bank is in the squeezed middle or squashed marzipan layer and could really give competition to the big banks. Boden noted that it was important that mid-sized banks were allowed to grow and not have all these cliff edges noting that the Bank of England once said that there were 53 different thresholds in the system for banking regulation. She said there needs to be a more coherent and consistent approach.

She noted that in 2013 a new bank authorisation process was implemented that took time to figure out because it was so complicated. No-one could give clear instructions so the process took years. She said we don't need to make things even more complicated.

New regulations have to be simple to understand and some of the 53 different thresholds need to be removed. Boden was also concerned that it would take many years before the current process got as far as the mid-tier institutions.

Nick Lee (OakNorth) – Thanked Alison Scott for working hard on the Discussion Paper saying there were many sensible things in it but he also wanted to reiterate some of the comments made already.

He noted that there was nothing more for scaling firms and said this was the big gap. Lee questioned why we needed an approach of looking at the smaller bank sector before moving onto the next layer saying it would be better to look at in the round at all systemic and non-systemic banks.

Lee recognised Anne Boden's 53 thresholds and other points made on MREL, operational resilience, IRB, stress testing, ring fencing etc. but we are only looking at one tiny segment of the market at the moment; the smallest banks.

He said there was an aspiration to grow and nobody wanted to box themselves into being a small bank for a long period of time. Why not be more ambitious and look at the advantages Brexit could deliver. Otherwise he said there was a glass ceiling which could lead to scaling banks like OakNorth to question longer term growth plans.

David Arden (Metro Bank) – Noted that Metrobank was the first new bank in the UK for 100 years when it launched in 2010 and it has a strong aspiration to grow. Unfortunately, he said, competition in the UK banking sector had worsened during the last 10–15 years and market share was now more concentrated than it was in the 1990s.

While he welcomed the proposals made in Strong and Simple, he didn't see them having a short-term effect on competition.

Arden explained that the most significant pressure for Metro Bank was MREL which he said was a real barrier to growth. He explained that Metro Bank directly experienced the MREL cliff-edge in 2019, which took its capital requirement from 13% to 21.5%. The initial raise failed, and this led to deposit outflows and real instability for the Bank.

He explained that they managed to raise the capital but only at a punitive coupon rate of 9%. MREL is a significant issue for the firm and for its growth aspirations.

Arden stated that if the MREL barrier was addressed, £3bn more small business lending, 40 new branches and 1,000 new jobs could result from Metro Bank alone.

Alison Scott: Thanked everyone for all of the very interesting and valid points. She said that the Bank of England was very interested in hearing about all parts of the regime and said everyone should put in responses with views on ambition. She also picked up on Anne Boden's comments about making the rule book it more accessible saying they were working so that it was all in one place and accessible.

Jeremy Palmer: Said there was the same issue around MREL for the very largest non-systemic building societies too adding that, at the moment, this was the priority in terms of regulation.

He said the BSA agreed strongly with the concerns that were raised. There was a combination of an EU prescription on MREL which was then linked with the leverage ratio and this was problematic as it produced an extremely prejudicial and unsatisfactory result.

Palmer appreciated the need for a simpler regime for the smallest firms as they suffered greater from complexity and would make the bigger changes. But he also said the larger firms needed some visibility about what would happen even if it could not happen yet and would benefit from a general plan for the longer term.

Baroness Kramer: Said she was very exercised by MREL which she felt had very little to do with Brexit. She noted that the UK has set ourselves in a very different position to everybody else in the EU by taking a position on MREL and it needed to be addressed. She felt MREL could be dealt with quickly and simply.

She added that the change in the pattern of lending that was taking place post-Covid was a playing field which needed to be rapidly levelled otherwise there would be long-term scarring. She also said the challenger sector needed collective action to ensure it was in a good position.

A number of SMEs had taken on debt which they would not normally have been taken on. They were now going back to growth and it was really important to get them out of this crunch.

Lord Holmes of Richmond – Thanked the speakers and said that in terms of MREL, all the points were well made. He noted that one of the things which had happened during the pandemic was rediscovering the meaning of local and that Brexit and COVID gave us a chance to reimagine aspects of the system such as Mutuality.

He added that the key point here as around layering or scaling. When you were in the space you wanted to be able to move at pace and have a funding and regulatory model which supported that. He added that this was the case in other parts of the world, such as Silicon Valley and wondered why more couldn't be done here to look across all those layers

Kevin Hollinrake MP: Noted that the political priority was trying to solve the twin problems of lack of choice for SME finance and financial exclusion.

He suggested that HM Treasury didn't see that there was a problem noting that Chancellor Rishi Sunak said in 2016 that businesses in the UK were worried about taking finance to grow. He said this was a big problem for the UK and for the whole economy.

He cited the work of his APPG on Fair Business Banking and said that they were looking at different types of provider such as regional mutuals. He said every other G7 country has a layer of mutual banks who were more patient with SME's than the UK's.

Hollinrake noted that the EU threshold for bail-in requirements was €100bn the UK's was just £15bn and asked why it was so low. He also said there was an issue with creativity in the UK and not challenging the big players adding that this was something the Treasury needed to look at. The UK needs to be the best place to grow a business and succeed in a business as well as start, he added.

David Marlow (Nottingham Building Society) Said that to add to the marzipan analogy, the Nottingham is a top 10 building society with a £4bn balance sheet. He said that when he looked at this consultation paper, he felt that they were caught in another layer some way off from the £15 billion threshold.

Marlow added that the layering question was even more complex and said that while there were some obvious layers, others were less visible.

One point he would like to raise was the diversity which Building Societies could add to the sector.

Baroness Kramer – Noted that the UK set a much lower MREL threshold because the economy here was so dominated by financial services and it was such a large part of the economy. She suggested that what was needed was a more intelligent way of managing risk rather than something which put off growth.

She said that regulators were so focussed after the crash on stability and safety but they needed to make a shift in the direction of growth. Achieving growth was not something that the regulators focussed on and they should be. There was a lot of cultural work to do to tackle this big question as to how to deal with risk with such a dominant financial services sector.

David Arden (Metro Bank) – Said he wanted to support the point about the £85 billion Euro and US $250 billion TLAC thresholds compared to the UK MREL threshold. He said the £15 billion UK MREL threshold was unique. He noted there was also a poorly functioning UK debt market – larger banks could bypass this and raise MREL overseas, but mid-tier banks could not. This had proved to be a big problem which needed to be addressed for mid-tier firms trying to raise debt in the UK.

Kevin Hollinrake MP: Agreed that the UK economy was dependent on financial services and said this was a good reason to diversify.

Anne Boden (Starling Bank): Commented that we have the chance here for a whole industry to break through. She said that Starling Bank had loaned £2billion to UK businesses and has 6% of the SME market. She also noted that they had built a new technology.

She said the UK had the opportunity to take on Silicon Valley and lead the world with Fintech but an artificial cap was being placed on this. We are being told 'don't grow any faster – don't come near the big banks – don't overstretch yourself.'

She said that if we don't do this, we won't have the opportunity to take on the big banks and create new market share for banks with intelligent business models. At the moment we were putting a cap on businesses and putting an artificial barrier in place. It was not good for the economy, it was not good for jobs and it was not good for SMEs, she concluded.

Nigel Terrington (Paragon Bank) – Noted that there had been lots of conversations pointing fingers at the Bank of England but said the Treasury had a role to play here too. He said we need to decide what sort of economy we wanted to have noting that 59% of lending in the US is done by the mid-tier.

He said that by leaving the structures and layers we had in place we would see no shift in this direction. Nothing really had changed despite the competition agenda and said that if we really want to create a mid-tier which could support SMEs, the Treasury needed to take action.

Terrington noted that an 8% penalty surcharge on corporation tax was hitting mid-tier banks. By the time their corporation tax went up, the mid-tier banks with the 25 million profit threshold would be paying 33% corporation tax which was the same level applied to Lloyds Bank. In other words, a third of their profits would go just on tax. This, he noted, is less capital to support growth in the economy.

He reiterated that MREL was the biggest barrier to growth Paragon Bank face and he said it had left them questioning, 'do we want to grow and go over this regulatory cliff edge which would hit profits'. He said it was crazy that they were even having to have this conversation.

Nick Lee (OakNorth Bank) – Noted that one thing we have a sense of is that the bigger banks have taken a bigger share of the SME Lending market from CBILS etc. This had pushed the market towards the bigger banks again. OakNorth wants to offer innovation and new technology. But they also have to question if they take a dip in profit to go over this threshold and continue to complete when they couldn't benefit from the economies of scale of the bigger banks. He concluded by asking what kind of banking sector did the UK want in the next decade?

Mike Harrison (Aldermore Bank) - Noted the point that the Chancellor made at the Mansion House last week about setting our own future post Brexit. He asked what should the financial sector look like in 5-10 years' time?

He said we need to look at this regulation and send out a message beyond the UK that the future is bright. Without a vision there was a worry in terms of what was happening in the UK post-Brexit.

Lord Holmes – Made a quick points around the caps which were not unique to this sector. He said the VAT threshold was ludicrously low and also acted as a cap on growth saying lots of small businesses won't go above the £84K threshold as it was disproportionate to go above and they also didn't want to put 20% on their prices.

Jeremy Palmer: Agreed with the points that have been made and said one element that hadn't been touched upon was regulatory reporting. Palmer said this was one of the biggest areas of burden and waste.

He suggested many on this call would be thoroughly fed up with COREP and suggested there was an opportunity to do this better and to be more focussed.

Karen Bradley MP (Chair): Thanked everybody for their comments and said we need to look at this in the round with corporation tax, MREL and the collective situation being thought about. Otherwise, we would end up with one part of the system looking great and other parts failing.

She said she had found this fascinating and was very grateful to everybody who has taken part.

She noted that the APPG will continue to work on this issue and looks forward to what comes next. Especially, when what we finally see what comes out on MREL.

Ends

Appendix 2

Sources of evidence submitted in response to our call for evidence are to be found on the APPG website https://www.cbbsappg.org.uk

- Aldermore
- Allica
- Metrobank
- OakNorth
- Penrith
- EY Briefing on MREL
- Letter to Rt Hon Karen Bradley MP from the Mid Tier Banks

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