Alasdair Smith
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By email to; retailbanking@cma.gsi.gov.uk

6 May 2016

Dear Alasdair,

We are writing in response to the CMA's 15 April A*ddendum to provisional findings: The capital requirements regulatory regime*.

It is positive that the CMA acknowledges the impact of capital requirements on banking competition and wishes to engage with the PRA and HM Treasury on competition issues, as outlined in the Addendum's conclusion. This aligns with the Chancellor's statement at the Budget that the Government will pursue more proportionate capital requirements for smaller banks.

Nonetheless, we are disappointed that the CMA does not intend to further consider this issue as a part of the ongoing review, or intend to take any action beyond liaising with HM Treasury, the Bank of England and the PRA after making its final report.

We acknowledge that the CMA's powers are limited and that forcing changes to capital requirements set by international institutions is not directly possible. This limitation might give the impression that the matter is not worth pursuing further. Similarly, given the CMA's statutory focus on the SME and PCA markets, capital rules relating to mortgages might seem less relevant.

We disagree with this assessment.

Although mortgages are not the focus of the CMA review, the impact of the capital rules extends more widely. A key motivation for offering BCAs and PCAs is as a source of low cost funding, in particular so as to fund low risk lending. However, if smaller banks cannot engage in low risk mortgage lending economically due to the prevailing capital rules, this reduces the incentive on them to seek low cost sources of funding such as PCAs and BCAs. Conversely, proportionate capital rules that allow smaller institutions to provide low risk mortgage lending economically will increase their need for low cost funding sources and increase competition to attract PCA and BCA customers.

Furthermore, as we have stated previously, the lack of a proportionate regime is a key constraint on challenger banks' ability to compete with incumbents that have access to historical data and employ IRB risk weights. Even assuming that it is feasible to develop and transition onto an IRB model, until a challenger bank is able to accumulate the necessary data, its shareholders must for a long period accept lower returns. This will be further compounded by the Counter Cyclical Buffer from March 2017. Although the Financial Policy Committee intends to reduce Pillar 2 capital requirements in order to achieve capital neutrality, smaller banks tend to hold lower amounts of Pillar 2b capital. Challengers will therefore likely need to hold higher aggregate capital, unlike their larger competitors.

This hampers challengers' ability to attract investment and expand their business across the board, including in the PCA and SME markets.

Tackling this underlying issue is vital to achieving a genuine step change in banking competition.

The CMA should therefore continue its work in this area with a view to making a clear recommendation in its final report that the PRA and HM Treasury should actively pursue a proportionate capital regime with international institutions. A clear recommendation from the CMA will help add momentum to the project to improve the proportionality of capital rules and ensure that competition issues are put at the top of the reform agenda.

We would be happy to assist if you have any questions on this matter.

Yours sincerely,

Phillip Monks
CEO, Aldermore Bank

Ian Lonergan
CEO, Charter Savings Bank

Preben Prebensen
CEO, Close Brothers

Graeme Hartop
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Craig Donaldson
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Richard Doe
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Paul Lynam
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