aldermore | Charter Savings Bank | paragon bank | Hampden & Co. BANKERS
METRO BANK | Secure Trust Bank Straightforward transparent banking | one Savings Bank | SHAWBROOK BANK

Alasdair Smith
Chairman
Competition and Markets Authority,
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By email to; retailbanking@cma.gsi.gov.uk

23 May 2016

Dear Alasdair,

As the CEOs of many of the UK's challenger banks, we simply don't feel that the CMA's provisional remedies get to the heart of the issue of banking competition and feel our previous testimony has been discounted.

We are in favour of transparency and providing useful information to customers at the right time to help them make an appropriate choice when looking for a current account or other banking service. However, contrary to the assertion in the CMA's press release, the ability to promote our offers is not the main impediment to challenger bank growth and the creation of real competition in the marketplace. We are concerned that the CMA's assertion that this is what is really holding us back has the potential to mislead the public and key opinion formers.

Our written and verbal testimony to the CMA has been consistent on two fronts. Firstly, that the challenger banks are looking for no special treatment or favours, all we seek is a level competitive playing field. Secondly, that the main impediments to faster growth are the huge disadvantages suffered by challenger banks in respect of the higher cost of funding and disproportionate capital requirements relative to the largest banks. These are the banks which Mr Osborne has previously referred to as 'an oligopoly'.

For convenience we have set out below extracts from the CMA's paper on capital treatment. In a nutshell for every £1 of capital set aside to cover credit risk, a large bank can do 10 times more low LTV mortgage lending than a small bank or building society. Put another way, <u>for taking exactly the same credit risk the smaller lenders have to set aside ten times more capital than the 6 biggest firms that control 80% of the mortgage bank.</u> As capital is a bank's most expensive resource this is a huge competitive impediment.

Lending product	**Capital treatment**		
	Small bank risk weights %	Average big bank weights %	Small bank capital disadvantage
Mortgages – Prime			
<50% LTV	35	3.3	- 960%
Mortgages – BTL			
<50% LTV	35	3.5	- 900%

The CMA's own analysis notes the following:

- The PRA has confirmed that the capital requirement differentials in low LTV mortgage lending is larger than can be justified or considered appropriate on prudential grounds.
- Smaller banks have to charge more for low LTV mortgage lending than the biggest banks do.
- Since the introduction of the Basel II capital regime, the largest banks have written proportionately more lower LTV mortgages and the smaller banks are writing proportionately more higher LTV mortgages.
- Mortgage lending is the most profitable part of the UK lending market and the profitability of the dominant incumbent banks is materially higher than that of the small banks.

This stranglehold on the low LTV mortgage market and on other lending markets gives the dominant banks massive funding advantages. High quality / low risk lending assets are used as collateral to support low cost wholesale funding lines. For example, of the £69.4bn total Funding for Lending Scheme utilisation as at 31/12/15, Lloyds Bank alone was using £32.1bn or 46% of this scheme. An ability to use low risk loan assets to access low cost funding which is used to originate new low risk loans, coupled with their huge capital advantages, represents a virtuous circle for the big banks and enables them to price competitors out of markets. It is a vicious circle for other lenders. These are exactly the sort of issues the CMA should be dealing with.

We do not believe that in an effectively functioning market banks taking the lowest risks would generate the highest levels of profitability.

Having noted that smaller banks need to charge more for lower risk lending than bigger banks do, it is frankly naïve of the CMA to then suggest *'What's really holding them [challenger banks] back is their ability to highlight to customers how new offerings compare with their current deal.'* It stands to reason that being able to highlight a higher price than the bigger banks' is unlikely to be a compelling offer. As an aside, it's also worth noting that the annual marketing budget of just one of the dominant banks is probably more than the sum of the annual profits of all the challenger banks.

We note that in the 1990s nearly 30 banks, including BCCI and Barings, failed. There was no banking crisis in the 1990s and the taxpayer lost no money bailing out banks. This was because a level competitive playing field ensured that the banking market was highly diversified and banks could be allowed to fail without doing systemic damage. During the 2000s a 'Too Big to Fail' paradigm grew and persists to this day. Indeed the 6 largest firms now control more of the market than they did before the failure of Northern Rock. In the last two months the Office of Budget Responsibility and Sir Nick MacPherson have stated that the taxpayer stands to lose billions of pounds on the bailouts of Lloyds and RBS. Some would no doubt argue that allowing the 'Too Big to Fail' paradigm to persist is not in the public interest.

For the record, as the leaders of challenger banks offering greater choice to consumers and UK businesses and aspiring to do more, we want to reiterate our core message to the CMA. The most effective and sustainable way to foster competition across the board in the UK banking market is to create a truly level competitive playing field, especially in respect of capital and funding. This will allow normal competitive forces to work for the benefit of consumers and businesses, and potentially the taxpayer.

Although we acknowledge that the CMA cannot force a change to the regulations unilaterally, it is a core part of the authority's competition mandate to address areas that inhibit true competition. In his letter to you of 21 April 2016, Rt Hon Andrew Tyrie MP and Chair of the Treasury Select Committee stated that *'it now falls to the CMA to ensure there is a level playing field for all market participants'*. We are disappointed that your latest report does not set out the actions needed by HM Government to create a level playing field. We therefore expect the CMA's final report to address the challenge from the Treasury Select Committee and include a detailed roadmap setting out the path to a truly level playing field. Given in his most recent Budget Statement the Chancellor said he '*would make the case for a more proportionate approach to the regulation of small banks, especially in respect of capital'*, the CMA should be pushing on an open door.

We are sharing this letter with the Treasury Select Committee and putting it in the public domain. As ever we would be happy to help your team in the development of a path to a level competitive playing field.

Yours sincerely,

Phillip Monks
CEO, Aldermore Bank

Ian Lonergan
CEO, Charter Savings Bank

Graeme Hartop
CEO, Hampden and Co

Craig Donaldson
CEO, Metro Bank

Andy Golding
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Richard Doe
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Paul Lynam
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Steve Pateman
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