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From: Alasdair Smith
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Market Investigation

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All by email

Dear Sirs

Retail Banking Market Investigation

Thank you for your letter of 23 May. I recognise the importance of your concerns about capital requirements and the cost of funding and will continue to do so as we come to our final decision in August. I therefore thought it would be helpful if I, as chair of the CMA Retail Banking investigation, responded directly and publicly to you in the meantime.

First of all I would like to assure you that your submissions have not been discounted. As your letter notes and as our analysis in our Addendum on capital requirements confirms, there is much on which we agree: the capital requirement differentials in low loan-to-value mortgages are greater than can be justified on prudential grounds; mortgages are the most profitable lending products for banks; and new entrants and smaller banks who do not benefit from lower risk weights in residential mortgages under the internal-rating-based approach are at a competitive disadvantage. As our provisional findings set out incumbent banks also have funding advantages over new banks.

I also agree with you that in this market, as in others, competitive challenge from new entrants and expanding smaller providers plays a central role in ensuring good outcomes for customers.

The prudential regulation regime is international, and its reform is a live issue among the relevant international bodies, as well as national governments and regulators. The Bank of England has publicly stated in response to European consultations that it supports a more proportionate approach, and the Prudential Regulation Authority and HM Treasury too are supportive of pro-competitive reform of the regime.

As we wrote in our Addendum on capital requirements, we believe it is essential that the impact on competition is given due weight by all relevant authorities, national, European and international. It is clear that the prudential regulation of banks has the potential to impact on competition in retail banking in a range of areas and the CMA will play an appropriate role. As we had already set out this position in that earlier consultation document, it was not necessary to revisit the matter in the Provisional Decision on Remedies, which is a consultation on remedies that have yet to be finalised.

In our view the issue should be taken forward by the bodies which have primary responsibility for the safety and soundness of the banking system and who have publicly stated that they share the CMA's view about the importance of competition. It would be in no one's interests to create ambiguity about regulatory responsibility in this area in particular given the international context in which reform will be required. This is also the case for addressing the 'Too Big To Fail' issues you raise, which are being tackled by the Bank of England and the Financial Stability Board's reforms to the resolution regime for global systemically important banks.

Finally, it is an important provisional finding of the CMA investigation that the funding advantages of the incumbent banks derive in large part from the inertia in the customer base. I believe that the remedies package we have put forward will create a more fluid market in which new entrants and smaller providers will be able to compete on their merits and to reap the benefits of their investment and innovation, to the benefit of customers, providers, and the wider UK economy. We will continue to refine our package of remedies in light of responses from parties such as yourselves and other stakeholders in the remaining months of the investigation.

Yours faithfully

(signed)

Alasdair Smith
Inquiry Chair