Treasury Committee

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Andrew Bailey Esq
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Bank of England
Threadneedle Street
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Dear Mr Bailey,

On Tuesday 22nd September, the Financial Times reported that a group of 'challenger banks' had written to the Chancellor, calling for the creation of a working party to engage with the Treasury on ways to help them lend more in the context of the new bank corporation tax surcharge.

According to the report, one idea floated in the letter was a reconsideration of the approach used to calculate the capital requirements of challenger banks. Challenger banks have long argued that the difficulties of satisfying the conditions required to use the internal ratings-based (IRB) approach to calculating credit risk puts them at a competitive disadvantage. In particular, the letter cited recent analysis conducted by the Competition and Markets Authority (CMA) in its report *'Barriers to entry and expansion: capital requirements, IT and payment systems'*, which concluded that, on a like-for-like basis, the IRB approach is likely to lead to significantly lower capital requirements than the standardised approach. Indeed, if it did not, established banks would not use it. The CMA report also acknowledged that measures implemented by the PRA and FCA to reduce barriers to entry and expansion in banking have partially counterbalanced this advantage.

Among the changes made by the PRA to tackle barriers to entry and expansion is an adaptation to capital requirements, designed to reduce the disadvantage that new entrants have been facing—which has amounted in effect to a higher capital requirement—during their first three to five years in operation. Given that this was put into effect before the changes to the tax regime for banks in the Summer Budget, I would be grateful if you could tell me:

- In the PRA's view, does the new corporation tax surcharge for banks make the retail banking sector more open to competition from new entrants, or does it further entrench the large incumbents?

- How effective does the PRA think that the adaptations it has made to its capital requirements for new banks will be in overcoming the competitive disadvantage that they face through being unable to use the IRB approach to risk-weighting – the approach used by the established banks?

- Bearing in mind its competition objective, does the PRA intend to make further adjustments to capital or other requirements for newer banks in the light of the new tax regime?

- How far and in what ways would the PRA be prevented from making further adjustments to newer banks' capital requirements under EU legislation, particularly CRD IV?

- In its *'Review of requirements for firms: one year on'*, the PRA reported that there had been a marked increase in the number of firms in pre-application discussions with both it and the FCA. Has the PRA noticed a reduction in this demand since the announcement of the new tax regime in July?

I will be placing this letter, and your response, in the public domain.

Yours sincerely,

James Rhys

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RT HON ANDREW TYRIE MP
CHAIRMAN OF THE TREASURY COMMITTEE