



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Rt Hon Andrew Tyrie MP
Chairman
Treasury Select Committee
House of Commons
7 Milbank
London

Andrew Bailey
Deputy Governor, Prudential Regulation
CEO, Prudential Regulation Authority
T 020 7601 4293
andrew.bailey@bankofengland.co.uk

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Dear Andrew

Thank you for your letter of 7 October regarding the announcement in the Budget of a corporation tax surcharge and its potential impact on new banks.

Your letter sets out a number of questions relating to your concern over the perceived competitive disadvantage of newly authorised banks regarding the calibration and calculation of existing capital requirements and how, in your view, HMT's new tax surcharge may further distort the playing field.

As a general matter, the Bank of England and the PRA do not comment on specific tax measures or the policy that lies behind them. These are matters for the Government and the Treasury. I have therefore limited the comments below to the potential impact of the change in policy, as well as commenting on bank capital requirements, an area that is of course very much our responsibility.

I have set out below a response to the five questions in your letter.

1. You asked whether, in the PRA's view, the new corporation tax surcharge makes the retail banking sector more or less open to competition from new entrants.

It is too early to point to consequences since the new tax arrangements will not apply until 1 January 2016. As regards your specific concern on new entrants, our understanding is that the tax will only apply to firms with profits in excess of £25m, and therefore new entrants in the start-up and early growth phases will not be materially impacted and some small banks will not be impacted at all. However, we expect the surcharge to apply to larger challenger banks.

Prudential Regulation Authority, 20 Moorgate, London EC2R 6DA T +44 (0)20 7601 4444 www.bankofengland.co.uk

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2. You asked how effective the PRA's adaptations have been in overcoming the competitive disadvantage that new banks face in not being able to use internal rating based (IRB) models approach for calculating their credit risk capital requirements - the approach used by established banks.

We are active in this field. We have introduced a more tailored approach to calculating firm specific capital planning buffers for newly authorised banks based on the (lower) costs of wind down rather than on forward looking losses in a stress (the more normal approach for established banks). This was introduced to ensure that new banks with fast growing balance sheets were not disadvantaged by our buffer calculation. The result is more proportionate capital requirements to reflect the particular characteristics and circumstances of these banks. The PRA and FCA will also be jointly setting up a New Banks Unit (NBU) which will help challenger banks better navigate our requirements.

These initiatives are all part of a broader policy agenda to promote the safety and soundness of the financial system (the PRA's primary objective) whilst facilitating effective competition (the PRA's secondary objective) and having regards to proportionality.

I further note that the introduction of a leverage requirement for the largest banks will also narrow the gap between the capital requirements for small banks and the larger ones that use internal models. This is particularly the case where banks have a larger concentration of assets such as mortgages.

3. You asked whether the PRA intends to make further adjustments to its capital requirements for new banks in light of the new tax regime.

No. The PRA will make its judgements on capital requirements on the basis its statutory objectives, not Government tax policy.

4. You asked how the PRA may be prevented from making further adjustments to newer bank's capital requirements under CRDIV.

CRR/CRDIV is a maximum harmonising regulation and hence there are limitations to the discretion the PRA currently has. Mindful of our secondary objective given to us by Parliament (which, as I mentioned in my Mansion House speech, requires us to act in respect of the competitive implications of our own actions and inactions where we are satisfying our primary objective for banks), we recently published our response to the European Commission's consultation on the impact of the new capital regime.

In this response, we state that a "one size fits all" approach of common binding rules for all banks, no matter what their size, complexity or level of cross-border activity, can cause distortions given that the costs of regulation tend to bear more heavily on smaller banks. Rules that are more proportionate, are more likely to enable banks of different sizes and business model to compete on an equal footing across the EU than an approach which applied the same rules. This is an important issue and one that matters if we are to have growing new entrants and viable challenger banks. We want to put such a regime into effect and we will work closely with the European authorities to achieve this.

My view is that progress in this way on CRR/CRDIV is the most important element of removing distortions in the capital regime.

5. Finally, you also enquired as to whether there has been a reduction in the level of demand for new applications since the announcement of the new regime in July.

There continues to be a strong pipeline of prospective new banks with whom the PRA and FCA are engaging. It is too soon to know whether the tax changes will have any impact on the from pipelines conversion rate into newly authorised banks.

I hope these answers help.

Yours Sincerely
Andrew

Andrew Bailey