

29 April 2021

APPG for Challenger Banks & Building Societies

Post-Brexit Financial Services Regulation Inquiry

1. What is the regulatory landscape post Brexit like?

As an exclusively UK focused bank (with a South African parent company in FirstRand), the transition of regulatory rules, with messaging from the PRA on the direction of travel, has been a smooth one to date. Though there are signs of unexpected divergence from the EBA rules in relation to credit risk capital requirements as described within recent PRA publications on Slotting. However, it's too soon to tell how the landscape will look beyond 2021 following the onshoring of EU regulation for 15 months after trade deal was agreed at the end of last year. In addition, the UK / EU memorandum of understanding published in March, gave little indications of the future relationship and rules as it was by-and-large an agreement to continue to hold talks.

There is currently some uncertainty over Basel 3.1. Europe have consulted on this, giving some indication as to how this will be applied but the UK has yet to do so fully. This hinders capital planning for UK banks. Theoretically, the post Brexit landscape should ensure that the UK regulatory landscape is more nimble, given EU rules require sign off from different bodies, whereas UK rules only require consultation and then rule making from the PRA/FCA, with oversight from the UK parliament.

This new found responsibility and freedom is also an optimum opportunity for the UK Government and UK regulators to have a change in focus and priorities to create a truly competitive market from a *'these are the hurdles you (a bank) need to overcome to be more competitive against the big banks'* to a *'this is the competitive market we want to create in x number of years and this is how we'll do it'* approach. There is commonly held misconception that the UK has a competitive market because 25 new banks have been created since the financial crisis. In fact, from a lending perspective, many of the challenger banks are only able to compete with each other rather than offer a truly competitive alternative to the more established banks.

Post-Brexit, there is a real opportunity for the UK to set out a positive vision and strategy as to what the UK financial services sector will be going forward and in particular, how it will distinguish between globally significant banks and those domestically orientated financial institutions which provide financial services diversification for the benefit of the UK economy . The UK needs to portray this vision to indicate to international investors and financial institutions as to how it will continue to be the premier financial world hub, whilst being outside of the EU trading bloc.

One recommendation we'd like to see implemented is for the PRA codifying rules to take a similar in approach to the FCA's rulebook. Currently the rules are a mixture of legacy EU rules and PRA rules and this makes them harder to follow. A more accessible approach would ensure easy understanding of the latest regulation rules and expectations, and would help challenger banks, who don't have the significant resources of the Big Banks, to monitor and react to regulatory updates and changes.

2. Should we diverge from EU rules?

As a UK focused bank, we don't have to consider any equivalence regimes. However, our view is that there is unlikely to be significant divergence from existing EU rules and in fact there's likely

to be alignment albeit with different interpretations, because of the Basel international regulatory frameworks. We'd also not be in favour of initially diverging significantly from existing rules as it would add unnecessary and significant costs and burdens on banks. Some EU rules have also been beneficial in stimulating lending to SMEs, such as the SME factor and we would welcome the PRA continuing to include this within its regime.

However, we would welcome clarity from the PRA as to which legacy EU rules are sacrosanct and where the PRA will take some discretion in interpreting the rules going forward. Information on the BoE website is often hard to navigate and should be presented in a more clear and transparent way. Ideally this would be codified so that for challenger banks, such as Aldermore with fewer resources, it's easier to navigate.

The UK though has a reputation for arguing for tougher banking rules, both in EU lobbying, in capital setting and in early adopting/accelerating implementation. It's unlikely UK regulators will want to relax that, so any divergence may take place in the form of an EU+ or EU++ route

3. What changes would foster greater competition?

Changes to Internal Ratings Base process

Aldermore is going through a process for permission to use the Internal Ratings Based (IRB) approach to calculate capital requirements for credit risk. Once achieved, this will allow us to price more appropriately at a granular level for the risk undertaken. However, the IRB process is burdensome and comes down to the point made in question 1 around changing the priority and focus of the regulatory environment to a more positive vision for the creation of a truly competitive market.

We believe that the IRB process should facilitate phased approvals, recognising key points along the journey and the progression towards meeting IRB requirements. We're a stable bank, having operated for over 12 years, and therefore have experience that we can utilise to begin the transition from Standardised to IRB.

If there were greater flexibility within the application process, for example, by allowing the initial IRB portfolio coverage to be lower, matched by an extended rollout period, it would allow smaller firms to utilise focused feedback from regulators on initial submissions to improve subsequent ones. This should help provide greater confidence to regulators in the organisation's capabilities, as it works to close the gap between Standardised and IRB in a phased approach across various portfolios.

Capital requirements

We currently have a greater amount of capital than we need to hold because as a UK only bank, we're not seen as geographically diversified. This is a PRA rule, on credit concentration, but one that nonetheless happens to most challengers who've entered the market since the financial crash. Whilst it is understandable at the time after the financial crisis tough new rules were established to protect customers, these now need revising. A more proportionate regime is needed that drives more competitive lending for the benefit of consumers especially small and medium size enterprises, who'll need significant support as we recovery from the pandemic.

MREL

Aldermore was one of a number of challenger banks that wrote to the APPG on this as a standalone issue, so we won't go into too much detail here. However, one of the biggest barriers for growth in the banking sector is the MREL regime cliff edge. The current regime disincentivises

growth and significantly increases costs. Unlike bigger banks, challenger banks don't have as much access to capital markets to fund MREL at lower costs.

4. Do you think that there are benefits from the adoption of a more UK focussed regulatory regime?

Our focus is on the UK market, but we benefit hugely from the strength of the UK as a premier global financial hub. We believe that the UK needs a regime that both protects this status but is also a beacon for a truly competitive financial market around the world.

As outlined in answer to question 2, the Basel rules mean that our regulatory regime won't differ hugely from the EU, it will be more about interpretation. However, as outlined in answer to question 1, onshoring responsibility of regulations and scrutiny will allow the UK to be more nimble and agile in responding to live issues as well as addressing legacy issues.

5. Do politicians understand financial regulation?

In short, no. However, with the onshoring of the responsibility and scrutiny of regulations it is imperative that the UK Parliament is set up for success in holding the Government and regulators to account. This means that UK parliamentarians need to have a greater understanding and an interest in financial services, beyond when things go drastically wrong.

A recent example we would cite of when politicians and even civil servants don't appreciate or understand the implications of their actions, can be viewed through the lens of the Covid-19 pandemic. The key support announcements made by the Chancellor around debt payment supports last March, required a response on a significant and unprecedented scale. While the public needed a strong and swift response to support them through lockdowns, the ability for lenders to respond not only by getting their systems and processes in order but also providing messaging to frontline colleagues, without pre-warning was a huge task especially for challenger banks with limited resources. This was also at a time when lenders were also trying to protect the wellbeing of their colleagues who were now working from home.

In addition, the Government announcements meant regulators also had to respond quickly to come up with rules as to how these things should be treated. Banks required clarity and guidance so the regulators had to turn things around quickly, but this meant that rules were then having to be updated as the reality of implementation and interpretation was realised, including the significant reporting demands set by the regulators.

The response by the UK financial sector whilst not perfect, has been significant and lessons will have been learnt, but the post-Brexit environment offers an opportunity for politicians to have a greater understanding and appreciation of the financial sector and its role in society and the economy.

Thank you for the opportunity to provide evidence to the APPG and for the work you do on behalf of challenger banks.