BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

August 2025 update:
This review is historical. See What we publish for more information and current views.

A review of requirements for firms entering into or expanding in the banking sector: one year on

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Foreword

In March 2013 the Financial Services Authority (FSA) and the Bank of England published their review of requirements for firms entering or expanding into the banking sector. This review set out changes in two key areas: reforms to the authorisation process for bank applicants; and a major shift in the approach to the prudential regulation of banking start-ups. These changes were designed to reduce the barriers to entry and expansion in the banking sector and enable increased competitive challenge to existing banks.

Since their inception in April 2013, the FSA's successor bodies, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), have worked together to implement these changes. This has led to a number of positive developments including:

- a substantial increase in the number of firms discussing the possibility of becoming a bank. In the twelve months following the publication of the original review the PRA authorised five new banks;

- both regulators have greatly increased the level of pre-application support they offer firms. In the twelve months to 31 March 2014 the regulators held 47 pre-application meetings with over 25 potential applicants;

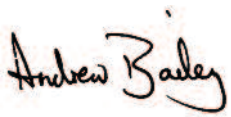
- the application pack for banks has been reviewed and restructured and both regulators have streamlined the material and information applicant firms have to submit;

- a new 'mobilisation' option — where authorisation is granted when a firm has met essential elements but with a restriction on its activities due to some areas needing to be completed — has been advantageous for applicant firms that would previously have faced challenges in seeking additional capital or investing in IT systems. The first new bank to use this option has now opened; there are also a number of other new banks in the mobilisation stage and significant interest from firms in pre-application discussions with both regulators; and

- capital and liquidity requirements for new entrants deemed resolvable with no systemic impact are now lower than before. These changes, which in themselves represent a tangible reduction to the barriers to entry, have been supplemented by a reduction in the minimum amount of initial capital required by small credit institutions and an assessment of a new bank's capital requirement on an annual basis.

Both regulators remain committed to working closely with all interested parties to build on the positive developments since these measures were introduced to ensure that the regulatory requirements and the authorisation process remain proportionate and fair, and to reduce further the barriers to entry and expansion.

In addition, since the previous review the responsibilities of both regulators with respect to competition have been enhanced — the PRA has a new secondary objective to facilitate competition and the FCA will be given concurrent competition powers from April 2015.



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Introduction

Background

1. After the Office of Fair Trading (OFT)[1] and the Independent Commission on Banking[2] published reports into competition and barriers to entry in the banking sector, HM Treasury asked the FSA and the Bank of England to review the prudential and conduct requirements for new entrants to the banking sector to ensure they were proportionate and did not pose excessive barriers to entry or expansion.[3]

2. In March 2013 the FSA and the Bank of England published a review of the authorisation process and of the prudential and conduct requirements that apply to new entrant banks.[4] The review stated that the FSA's successor bodies, the PRA and the FCA, would implement change along two dimensions: reforms to the authorisation process; and a major shift in the approach to the prudential regulation of banking start-ups. The main features of the changes were:

- reduced capital requirements at authorisation;
- reduced liquidity requirements for all new entrant banks;
- removing barriers to expansion;
- improvements to the existing authorisation process;
- an additional option for the authorisation process, referred to as 'mobilisation';
- streamlining the information requirements; and
- additional measures related to the introduction of the CRD IV,[5] which subsequently came into force on 1 January 2014.

3. This review acknowledged that while regulation is only one of the barriers facing new banks, regulatory processes and requirements should be proportionate and not pose excessive barriers to entry or expansion. However, this objective needs to be achieved alongside continuing to ensure new entrant banks meet basic standards that prevent undue risks to the safety and soundness of the UK financial system (the PRA's primary objective when supervising banks), and securing an appropriate degree of protection for consumers and promoting effective competition in the interest of consumers (two of the FCA's operational objectives).[6]

Purpose

4. This joint report from the PRA and FCA includes an update on progress in implementing these changes and clarifies some issues that have arisen following the original review. Feedback from applicant firms, recently authorised firms and key stakeholders is reflected in this report.

5. This report will be of primary interest to UK-incorporated firms that are considering applying to become retail banks. Also, as discussed in the March 2013 review, the PRA's objective is that successful banking applicants must be capable of being resolved in an orderly way with no systemic impact on the UK financial system. This has not changed, and the PRA continues to have a low-risk appetite for new entrants where the PRA does not see a clear exit path for the bank.

6. Given the limited time, between March 2013 and the publication of this review, for both regulators to implement the changes, this report does not include any new proposals but it does seek to offer further details and clarifications. It also does not repeat material previously published in the March 2013 review but includes specific references where these may be useful for the reader.

Update: one year on, the measures introduced by regulators

7. The March 2013 review set out the changes to the prudential requirements at authorisation and to the authorisation process designed to deliver better outcomes for applicant banks. Reducing both the liquidity and capital required at authorisation and the time taken to obtain authorisation has reduced the cost incurred by applicant firms, and given new banks a period of three to five years to match the requirements facing their incumbent peers.

8. In the first year, there have been some key developments and changes made which firms and other stakeholders have welcomed. These include:

- **A reduction in the initial minimum capital requirement** — banks that meet the definition of a Small Specialist Bank (SSB)[7] are able to hold an absolute minimum amount of capital equal to €1 million or £1 million (whichever is higher), plus a capital planning buffer (CPB), rather than the previous minimum level of €5 million plus a CPB.

- **Engagement in pre-application** — building on the theme of engagement, positive comments have been received from potential applicants about the regulators' willingness to engage during pre-application, the usefulness of the discussions and the access to specialists. In the twelve months to 31 March 2014, 47 pre-application meetings were

(1) *Review of barriers to entry, expansion and exit in retail banking*, Office of Fair Trading, November 2010; http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/personal-current-accounts/oft1282.
(2) *Final report recommendations*, Independent Commission on Banking, September 2011; https://hmt-sanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report%5B1%5D.pdf.
(3) *Banking reform: delivering stability and supporting a sustainable economy*, the Treasury, June 2012; www.hm-treasury.gov.uk/d/whitepaper_banking_reform_140512.pdf.
(4) *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013; www.fca.org.uk/static/documents/barriers-to-entry.pdf.
(5) The Capital Requirements Directive (2013/36EU)(CRD) and the Capital Requirements Regulation (575/2013)(CRR), jointly 'CRD IV'.
(6) Both regulators' objectives are available on their respective approach documents; www.bankofengland.co.uk/PRA and www.fca.org.uk.
(7) To be considered an SSB, banks have to carry out one or more of the following activities: providing basic banking services which could include current and savings accounts; lending to SMEs; and residential mortgage lending. Banks are still expected to be fully resolvable and to meet both regulators' Threshold Conditions at all times.

held with over 25 potential applicants. This is in contrast to a total of 48 pre-application meetings in the 36 months between 2010 and 2012.

- **Pre-applicants and business models** — since the original review was published there has been a marked increase in the number of firms in pre-application discussions with both regulators. These firms have a range of different business models from wholesale banking to FCA-regulated payment services firms who are looking to enter the banking market and offer deposits and lending to their current client base (including small and medium-sized enterprises (SMEs)), to others who are proposing to offer a mixture of SME or mortgage lending funded by retail and SME deposits.

- **Take up and interest in the mobilisation option** — in the twelve months to 31 March 2014 three of the five entities authorised as banks used the mobilisation option, and a number of firms in the pre-application stage had also shown an interest in this option.

- **Improvements to the application pack** — a comprehensive review of the application forms and supporting notes has resulted in one stand-alone pack and a single document of supporting notes aimed at delivering clarity and efficiencies to both the prospective entrant firm and the regulators.

9. These developments will support both regulators in continuing to deliver a pragmatic and proportionate approach that does not pose an excessive barrier to entry. In some areas, it is too early to say the extent to which the outcomes and benefits envisaged by the review will be realised. However, both regulators will continue to monitor whether the quality of applications received has been improved by the engagement during the pre-application phase and, over time, whether mobilisation is being used effectively by new entrants. The PRA intends to publish statistics regarding bank authorisations annually.

Competition objectives

10. The FCA has had a specific objective to promote competition since its creation. In that time, the FCA has completed a market study into general insurance add-ons,(1) it has launched market studies into cash savings(2) and retirement income products(3) and, specifically on banking, it has collaborated with the Competition and Markets Authority (CMA) and one of its predecessor bodies, the OFT, to investigate the banking services provided to SMEs.(4) Market studies represent just one tool that the FCA has been using and it will issue further guidance on its approach to promoting competition this year.

11. The FCA is currently undertaking a review of its Handbook to assess whether any current rules, which might create barriers to competition, should be modified or removed, and to assess whether alternative and more pro-competitive solutions can be identified.

12. In addition to the FCA's competition objective, the PRA acquired a new secondary objective to facilitate effective competition on 1 March 2014. As a secondary objective, the PRA's requirement to facilitate competition is subordinate to its general objective to promote the safety and soundness of the firms it regulates. The PRA is, in response, making changes as necessary to the prudential regime to further its competition objective without undermining its primary objective. The work done on reducing the barriers to entry and expansion supports the facilitation of competition in that the actions taken will help to facilitate entry, expansion, and ultimately competition, in those markets in which PRA-regulated firms operate, while ensuring that the general objective of safety and soundness is not undermined.

(1) www.fca.org.uk/news/general-insurance-add-ons-market-study.
(2) www.fca.org.uk/news/market-studies/cash-savings-market-study.
(3) www.fca.org.uk/news/market-studies/retirement-income-market-study.
(4) www.fca.org.uk/news/market-studies/market-study-into-sme-banking.

1 Progress review: one year on

13. This section gives a progress update on each of the key changes and includes feedback from pre-applicant firms, applicants, recently authorised banks and other stakeholders.

Authorisation process

14. This subsection provides an update on the implementation of the revised approach to authorisation contained in Chapter 5 of the March 2013 review and progress made to address concerns and feedback raised by applicants, firms and other stakeholders, in particular the:

- authorisation process where they said that there was a lack of certainty in the process and the way in which it was executed; and

- potential for the authorisation process to become more onerous with the creation of the two new regulators.

Structured approach

15. The March 2013 review set out how the authorisation process would be separated into stages to provide a clearer and more structured approach to authorising new banks. There would be two or three distinct stages depending on the applicant's circumstances:

- pre-application;
- assessment; and
- for some applicants, mobilisation.

16. As part of that process, both regulators also clarified the areas of focus on the firm's business for each stage of the process and confirmed whether the firm or the regulators would lead.

17. This has been well received at initial meetings with prospective applicants, where the end-to-end authorisation process, the purpose of each stage, the information sources available to help potential applicants, the distribution of responsibilities and expectations of firms are clearly communicated.

Pre-application support

18. The March 2013 review made a clear commitment to a more robust pre-application process designed to increase the likelihood of a firm submitting an application of the quality required by both regulators to allow them to complete their assessment.

19. Both regulators have significantly increased their engagement with potential applicants. The revised approach originally included two meetings as part of the pre-application process. This has evolved over the first year so that an additional initial informal meeting is offered to potential applicants for them to set out their high-level business plans and for the regulators to explain the authorisation process. This is followed by one or more feedback meetings and a challenge session — which may also be split over a number of meetings either by topic or by regulator depending on the circumstances.

20. The challenge session, in particular, is seen as a very positive development, giving pre-applicants access to experts at both the PRA and the FCA prior to the submission of an application.

21. In line with the commitment made in the March 2013 review, both regulators have made materials and information available on their websites.(1)

22. Firms have identified one area where the information provided could be clearer, ie what constitutes a 'complete' application and how the delivery of IT systems fits in with this. A complete application is one which contains all the information necessary for both regulators to complete their assessment without the need to refer to the applicant for further information or clarification. With regard to IT systems, where an applicant is not using the mobilisation option, the applicant must have all its IT systems in place when the application is submitted. Where an applicant is using the mobilisation option, the applicant will be required to have a high-level outline of the IT systems that will be implemented during the mobilisation phase.

Mobilisation

23. As well as clarifying the overall structure of the authorisation process, the March 2013 review also proposed a significant change to the process itself, with different options available to firms in recognition of the fact that a flexible approach is required to cater for firms' differing circumstances.

24. The original review proposed an alternative route to authorisation which included an additional mobilisation stage as a way to address firms' desire for greater certainty regarding authorisation before committing to the more expensive parts of their setup (for example, investing in IT systems and recruiting staff) and to be able to engage with third-parties who insist on regulatory approval as a pre-requisite.

25. Under this option, firms are offered the same extensive pre-application support with the submission of a shorter application which, provided the information is of the required quality, both regulators would work together to determine within six months. If successful, firms would be authorised with a restriction on the business they can undertake to reflect

(1) See www.bankofengland.co.uk/pra/Pages/authorisations/newfirm/banking.aspx and www.fca.org.uk/firms/about-authorisation/dual-regulated-firms/banking-applications.

the lack of infrastructure and controls in place during mobilisation.

26. This certainty should then allow management to complete the build-out of the bank and once the firm is confident that its mobilisation activities are complete, including its IT systems being fully operational, it should apply in the normal way (via the relevant electronic system) for a Variation of Permission to remove the restriction. Both regulators will then finalise their assessment and if both agree that the firm meets their respective threshold conditions, the restriction will be lifted and the firm will be able to carry out the full range of regulated activities for which it is authorised.

27. The review also confirmed that mobilisation could not continue indefinitely and a twelve-month cap (from authorisation) was placed on the length of the mobilisation stage to ensure the currency of the information received from the firm. While a small degree of flexibility could be applied, if at the end of twelve months the firm was judged not to be meeting the conditions necessary for the removal of the restriction, steps would be taken to remove the new bank's authorisation.

28. Overall, the option of a mobilisation stage has been widely welcomed by firms, trade bodies and other market commentators as addressing the concerns raised in the original review. Three of the five firms authorised as banks between 1 April 2013 and 31 March 2014 were authorised through this mobilisation option. However, as with the pre-application stage, firms have identified a number of areas where the information provided by both regulators could be clearer:

- **Those activities that can be deferred to the mobilisation phase and as such are not required to be completed prior to authorisation**. The March 2013 review[1] set out what both regulators expected applicants to have in place at application when using the mobilisation option and this remains the case:
  - business plan — fully developed;
  - recovery and resolution plan — partially developed;
  - financial resources (ICAAP and ILAA)[2] — fully developed;
  - governance/structure/board/senior management — high-level structure with the key guiding minds in place. Senior management roles critical to mobilisation identified and ready for recruitment;
  - infrastructure/IT systems — high-level outline of IT systems developed; and
  - material outsourcing — high-level outsourcing plan developed.

  Depending on the nature of the firm or its business model it may be necessary for some elements to be developed further prior to application. If this is the case, the firm will be made aware of this during the pre-application stage. All other activities can be deferred until the mobilisation phase. However, the March 2013 review also noted that, depending on its circumstances and risk appetite, an applicant could, at its own risk, start mobilisation activities earlier.[3]

- **The detail expected in a firm's mobilisation plan prior to authorisation**. As discussed above, new entrant banks are expected to complete mobilisation within twelve months of authorisation. As such new entrant banks should have a project plan, in which the Board has confidence, to become fully operational within twelve months. The timescales for the mobilisation stage will be largely driven by the firm, and the PRA and the FCA will monitor progress and plan their review work based on the bank's key milestones.

- **The scale of business that a newly authorised bank can undertake during mobilisation**. As set out in the March 2013 review, the purpose of mobilisation is to enable a new bank to complete its build-out with the certainty of authorisation.[4] The restriction will limit the scale of deposit-taking to reflect the lack of infrastructure and controls in place during mobilisation.

- **The status of a firm's IT systems prior to lifting the restriction**. Prior to exiting mobilisation all of a new bank's IT systems must be operational.

Information requirements

29. In the review both regulators committed to streamlining the material that firms would have to submit at application to focus on the relevant information, to the required standard, without the need for further iterations or extended requests. By doing so, the burden and cost would be reduced for all involved in the process. Since the March 2013 review, both regulators have worked with two applicant firms and actively sought the most appropriate route to discuss and resolve issues without engaging in lengthy written correspondence.

30. Overall, however, it is too early to say whether the increased pre-application engagement and streamlined information requirements will in future deliver consistently good quality applications and both regulators will keep this under review so that positive outcomes and benefits are achieved.

(1) See Annex 10 in *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013; www.fca.org.uk/static/documents/barriers-to-entry.pdf.
(2) Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA).
(3) See Chapter 5 (page 32) in *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013; www.fca.org.uk/static/documents/barriers-to-entry.pdf.
(4) See Chapter 6 (page 48) in *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013; www.fca.org.uk/static/documents/barriers-to-entry.pdf.

Application pack

31. The application pack forms a fundamental part of the information that firms submit and both regulators undertook a comprehensive review to re-structure and align it with the new regulatory regime (including areas with an increasing importance to regulatory decisions, eg recovery and resolution planning) and the revised process. The revised forms were published in November 2013.

Clarity and de-duplication

32. Three areas have been addressed to provide greater clarity and remove duplication:

- Four separate forms, which an applicant was required to complete, were combined into a single stand-alone application form. While there was no substantive duplication across the forms, the creation of one combined form has removed some low level duplication.

- A new introductory section clearly signposts what applicants need to submit depending on the authorisation option being followed.

- Detailed supporting notes have also been combined into a single supporting document.

Focused information

33. Over time, the application pack had fallen out of line with a number of regulatory developments resulting in predictable requests to firms for further information. The review of the pack presented an opportunity to rectify this and consequently:

- the CRD IV impacts on certain areas, such as capital, are highlighted;

- the Controller section is more clearly signposted and updated with CRD IV requirements;

- the Financial Resources section has been overhauled and there is guidance on capital, recovery and resolution;

- the Approved Persons section has been made clearer; and

- the Fees and Levies section has been fully updated.

34. While feedback has been limited, both regulators are committed to the regular review of the application forms and the associated notes and will continue to ensure that they remain focused on the information critical to the regulatory assessment and any new requirements are covered in an appropriate, proportionate and timely manner.

Impact of dual regulation

35. Over the last year both regulators have remained mindful of the need to minimise the potential for an additional burden on firms as a result of the dual-regulatory environment. The PRA leads and co-ordinates the authorisation process so that, wherever possible, joint meetings are held with applicant firms, provided it is appropriate or helpful for the firm involved.

36. Feedback suggests that the revised approach adopted since the creation of the dual-regulatory system has minimised the impact on applicant firms. However, both regulators remain alive to the concerns raised in the original review and will continue to work closely and seek feedback from applicant firms and other stakeholders.

Capital requirements

The new capital measures in practice

37. The March 2013 review detailed the revised approach to setting capital requirements for new entrant banks that the PRA judge can be resolved in an orderly fashion with no systemic impact.

38. Since then, the new entrant banks that were assessed as resolvable with no systemic impact have benefitted from the more flexible approach to setting the CPB and it has been set based only on the wind-down costs of the bank. In addition, these firms were not subject to capital add-ons simply because they were new.

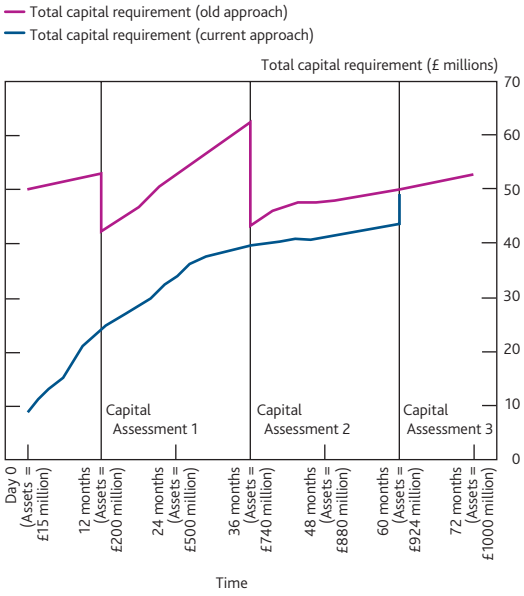
39. The March 2013 review included a number of graphs that demonstrated the expected impact of the revised approach to setting capital for new entrants; the PRA's implementation of the review has delivered in accordance with those projections. **Graph 1a** from the initial review is copied below for ease of reference (for further detail of the inputs to **Graph 1a**, see page 47 of the March 2013 review).(1)

Internal ratings-based approach

40. The March 2013 review discussed the internal ratings-based (IRB) approach to calculating credit risk versus the standardised approach (the default position) for all new and existing banks. Firms wishing to apply to use the IRB approach to calculate the credit risk capital requirement in whole or in part are referred to Chapter 6 of the review. The PRA has taken steps to address underestimation of risk that can result from applying the IRB approach to certain types of exposures. The PRA will continue to monitor this issue and, where justified, will take further steps to ensure banks using an IRB approach hold appropriately conservative levels of capital.

(1) *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013; www.fca.org.uk/static/documents/barriers-to-entry.pdf.

Graph 1a Example of the PRA's approach to setting capital requirements for a new bank



41. Addressing underestimation of risk that can occur through IRB modelling contributes to reducing a source of competitive distortion between IRB firms and firms that cannot satisfy the conditions to use the IRB approach and which are undertaking similar business. The PRA will continue to consider the impact of its policies on competition as required by its competition objective, although regulatory capital requirements are to a large extent determined by the relevant EU legislation over which the PRA has little or no discretion.

Clarification of some detailed elements of the March 2013 review

42. **Period between capital assessments**: the PRA will conduct a supervisory review and evaluation process (SREP) for new entrant banks on a yearly basis rather than at 12, 36 and 60 months post-authorisation as set out in the March 2013 review. This is to ensure a new bank's capital requirements better reflect its balance sheet on an ongoing basis and reduce the risk that firms' capital requirements are disproportionate and inhibiting expansion. The PRA will expect to revert to bi-annual SREPs after an initial five-year period, although this will be assessed on a case-by-case basis.

43. **Approach to setting capital requirements for new banks**: in setting new banks' individual capital guidance (ICG) at the point of authorisation, the PRA makes its judgements based on the risks inherent in banks' projected balance sheets twelve months post-authorisation. This is because at the point of authorisation, new banks have little or no assets on which the PRA can base its assessment. The ICG, which is set as a percentage of the Pillar 1 capital requirement, is then applied to the bank's actual balance sheet as an input to its capital requirement. In setting ICG during subsequent SREPs, the first of which will be twelve months post-authorisation, the PRA will make its judgements based on the point-in-time balance sheet, as is the case for existing firms.

44. **Glide path**: the March 2013 review referred to the need for new entrants to transition to the 'normal' approach to CPB calculation (ie that for incumbent firms) after a period of time, via a glide path. The PRA does not anticipate setting a glide path for most firms twelve months post authorisation, but will expect the banks' boards to consider both when the bank should move to the 'normal' approach and the appropriate glide path. Once a year, as part of the SREP, the PRA will assess for each new entrant bank when is the appropriate time to set a formal glide path.

Minimum capital requirement for SSBs

45. In late 2013, the PRA consulted(1) on and implemented a lower required amount of initial capital for small credit institutions — a discretion Member States can adopt under CRD Article 12(4). The effect of this implementation is that new entrant banks that meet the definition of an SSB are now initially required to hold an absolute minimum amount of capital equal to €1 million or £1 million (whichever is higher), plus a CPB, rather than the previous minimum level of €5 million plus a CPB.

46. We expect this change to be of particular benefit to two types of new entrant: (i) those that plan to operate small balance sheets that generate capital requirements of less than €5 million plus a CPB; and (ii) those that are taking the mobilisation approach to authorisation and are planning to raise the additional capital required to support their planned balance sheets prior to exiting the mobilisation period.

47. The PRA's assessments of new entrant banks' regulatory capital requirements (including those firms which meet the SSB criteria), will continue to be conducted through the SREP and applying the framework outlined in the March 2013 review. In conducting its SREP for SSBs that benefit from the lower initial minimum capital requirement, the PRA will review the appropriate transition path to the €5 million minimum applicable to existing banks, since the €1 million or £1 million (whichever is higher) minimum requirement applies to initial capital requirements only.

Ongoing developments and CRD IV implementation work

48. The PRA published its policy statement, rules and supervisory statement on CRD IV capital buffers on 30 April 2014.(2) As indicated in Chapter 3 of *Policy Statement*

(1) *PRA CP8/13 Occasional Consultation Paper*, October 2013; www.bankofengland.co.uk/pra/Documents/publications/policy/2013/ocp8-13.pdf.
(2) *PRA Policy Statement PS3/14*, 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pra/Documents/publications/policy/2014/capitalbuffersps314.pdf and *PRA Supervisory Statement SS6/14*, 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pra/Documents/publications/policy/2014/capitalbuffersss614.pdf.

7/13,[1] the PRA also expects to consult on its revised approach to Pillar 2 capital requirements and supporting methodologies later this year. The PRA will consider applying similar principles as those that are in place currently for the treatment of resolvable banks' firm-specific buffers under the revised approach. The current regime will remain in force until revisions to PRA rules and supervisory statements arising from the consultation take effect.

Liquidity requirements

49. The March 2013 review confirmed that the starting point for individual liquidity guidance (ILG) for new resolvable banks on the standard liquidity regime had been reduced in line with that for incumbent banks, with no automatic premium being added to ILG on the basis that a resolvable bank was newly authorised.

50. The approach to liquidity set out in the March 2013 review remains unchanged. New banks will continue to be subject to the same liquidity standards as existing banks. The shift in regulatory focus from the existing BIPRU[2] regime to CRD IV will alter the way in which the PRA sets liquidity standards for all firms. Until the implementation of the CRD IV Liquidity Coverage Requirement (LCR), the PRA will continue to set new banks' ILG as now. By way of reminder:

- the PRA will continue to exercise its supervisory judgement (in a consistent manner across all firms) when setting ILG and will set liquidity add-ons as required on a case-by-case basis to cover specific risks; and

- no automatic premium will be applied to ILG simply because the bank is new.

Liquidity Coverage Requirement in CRD IV

51. The Capital Requirements Regulation empowers the European Commission to adopt legislation to define and phase in the LCR. This will require banks, including new banks, to hold sufficient liquid assets to cover their expected net cash outflows under a 30-day liquidity stress scenario. The legislation is expected to come into force during 2015. Member States can choose the transition path that their banking sector must follow, but firms will have to meet at least 60% of the LCR standard when it first comes into force, rising to 100% of the requirement by 2018.

52. Following the introduction of the LCR as the Pillar 1 standard, the PRA will continue to carry out supervisory reviews of liquidity risk and, as provided for in CRD IV, will continue to have the ability to take appropriate measures, including the ability to impose specific liquidity requirements. New banks will continue to be subject to the same liquidity standards as all other banks. As described in the initial review, without adequate liquidity a bank, whether new or established, can fail in a period of days. This contrasts with solvency-driven threats to viability, which in general materialise over significantly longer periods. The PRA acknowledges it is difficult to assess liquidity adequacy of incumbent firms and new banks in the same way; nonetheless the PRA will perform liquidity reviews that result in proportionate outcomes and do not penalise new banks while ensuring that requirements take into account the risks inherent in banks on a case-by-case basis.

Net Stable Funding Ratio

53. The Basel Committee has recently consulted on a revised version of the Net Stable Funding Ratio (NSFR). The NSFR is designed to ensure that banks maintain a stable funding profile in relation to the characteristics of their assets and off balance sheet activities. The Basel Committee intends to introduce the NSFR as a minimum standard from 1 January 2018. The PRA intends that the NSFR will be implemented consistently for all banks, including new banks.

Other feedback

Board structure and the role of non-executive directors

54. Feedback suggests that firms are unclear about the regulators' expectations of board composition, non-executive directors (NEDs) and independent non-executive directors (iNEDs) — including whether shareholders can serve as iNEDs.

55. With regard to composition, firms are referred to the Financial Reporting Council's UK Corporate Governance Code ('the Code')[3] which states that the board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the firm's activities to enable the board to discharge its duties and responsibilities effectively. The Code also states that the board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

56. With regard to shareholders serving as iNEDS, the Code[4] also confirms that when considering if a director is independent the board should determine whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement and this includes being a significant shareholder.

(1) *PRA Policy Statement PS7/13*, 'Strengthening capital standards: implementing CRD IV, feedback and final rules', December 2013; www.bankofengland.co.uk/pra/Documents/publications/policy/2013/strengthening capitalps713.pdf.
(2) Prudential Sourcebook for Banks, Building Societies and Investment Firms.
(3) See Section B, 'Effectiveness', (page 9), in *The UK Corporate Governance Code*, Financial Reporting Council, September 2012; www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf.
(4) See Code Provisions B1.1. (page 14), in *The UK Corporate Governance Code*, Financial Reporting Council, September 2012; www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf.

57. In determining their board and governance arrangements applicant banks should also take account of recent and ongoing developments affecting this area. This includes the governance requirements under CRD IV which have resulted in new Handbook rules (SYSC 4.3A) and also the development of the new Senior Managers and Certification Regimes which were legislated for in the Banking Reform Act 2013 and which are intended to improve individual accountability within firms. The PRA and FCA intend to consult on rules to implement the new regimes over the summer of 2014.

58. Ultimately, there is no 'one size fits all' and overall composition will be assessed proportionately as part of the application process on a case-by-case basis.

2 Further progress in addressing barriers to entry

59. This section provides an update on progress in addressing other barriers to entry or expansion for banks, some of which were identified in the March 2013 review.

Cost of agency banking and transactions

60. In March 2013, HM Treasury published a consultation[1] on implementing regulation of UK payment systems. The consultation proposed the introduction of competition-focused, utility-style regulation of payment systems. In December 2013, the Government introduced legislation through the Banking Reform Act to require the FCA to establish a new regulator for payment systems in the United Kingdom.

61. The Payment Systems Regulator (PSR) will have its own statutory objectives distinct from those of the FCA.

- **The competition objective** is to promote effective competition in the market for payment systems and the markets for services provided by payment systems in the interests of service users or likely users of payment services. This may include promoting competition between different operators of payment systems, different payment service providers and different infrastructure providers.

- **The innovation objective** is to promote the development and innovation of payment systems in the interests of service users and likely users of payment services, with a view to improving the quality, efficiency, and economy of payment systems. This includes promoting the development and innovation of payment systems infrastructure.

- **The service-user objective** is to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of service users and likely users of payment services.

62. The HM Treasury consultation in 2013 identified a number of issues related to current ownership structures, in particular the reliance of smaller players and new entrants having to seek access to systems jointly owned by their most significant competitors, and the limited incentives to develop new or more efficient services to which the ownership structures give rise. Progress on this issue has the potential to reduce barriers to entry further.

63. Since before its incorporation, the PSR has been engaging with the industry including:

- Releasing a *Call for Inputs* in March 2014. The PSR will consider the responses to help it formulate its policy proposals. For further information, see the FCA's *Call for Inputs* published in March 2014.[2]

- On 10 April 2014, the PSR held a stakeholder event at which there was an open discussion between industry stakeholders on some of the issues raised in the 'Call for Inputs: Innovation, Competition, and Open Access'.

64. As the PSR starts to formulate policy proposals using the insights gained from the *Call for Inputs* responses and industry engagement, it will continue to communicate with a wide range of stakeholders in order to achieve the best outcome for the industry as a whole. To make sure that payment systems work effectively and efficiently in customers' interests, the PSR will be guided by its strategic vision and values:

- ensuring open, fair, non-discriminatory access to payments infrastructure and systems;

- promoting ongoing development and innovation in payments;

- understanding the needs and priorities of payment systems, users and customers;

- ensuring its regulation has regard to the ongoing stability of the UK financial system;

- targeting its regulation in a proportionate way, keeping markets under review, and ensuring that its regulation evolves with changing market conditions;

- being expert and knowledgeable in payment systems, having the skills to make effective use of its competition and regulation tools; and

- listening to, working with, and being responsive to stakeholders, including dealing effectively with complaints.

Barriers in the banking market

65. The March 2013 review also highlighted a number of barriers to the banking sector that were not the result of regulation. These included the difficulties in attracting new customers, encouraging customers to switch from their existing bank, the lack of a wide branch network as a barrier to capturing customers, and the convenience customers may find by buying a number of products from the organisation with which they have (historically) chosen to deposit their money.

(1) *Opening up UK payments*, HM Treasury, March 2013; https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221903/consult_opening_up_uk_payments.pdf.
(2) *Payments Systems Regulation Call for Inputs*, FCA, March 2014; www.fca.org.uk/static/documents/psr-call-for-inputs.pdf.

66. There have been a number of developments since the original review was published to help to address these barriers:

- in September 2013, the Payments Council launched a new account switching service. The Current Account Switch Service[1] is a free-to-use service for consumers, small charities, small businesses and small trusts, and is designed to make switching current accounts from one bank or building society to another, simpler, reliable and hassle-free. The Current Account Switch Service is also backed by a new Current Account Switch Guarantee supported by UK banks and building societies. This new service aims to increase competition in the high street, support the entry of new banks in the current account marketplace and give consumers a greater choice if they are choosing to switch from one bank or building society to another.

- The Government's MiData project[2] is working with the major banks to give customers their account data in a simple, standardised format that can be used in comparison sites. The objective is to enable customers to compare the market and find the best current account for their usage pattern, encourage switching, and therefore promote competition.

- The OFT's 2013 review of personal current accounts[3] identified the lack of a wide branch network and an established brand name as a barrier to entry. Major developments in this area include the divestment of branches from Lloyds Banking Group to create TSB Bank and the planned divestment by Royal Bank of Scotland.

- The FCA has been working closely with the OFT on the market study into banking for SMEs, and continues to do so with the CMA. The analysis, which is ongoing, suggests that, despite positive developments such as proposals to increase the availability of credit information to help newer or smaller providers of finance to compete, other barriers may be contributing to these providers finding it difficult to enter and expand their business across the core business banking products.

- The FCA is assessing whether it can do more to promote competition and innovation in financial services by making it easier for smaller firms, and firms with innovative business models, to enter financial services markets. As a first step, the FCA has launched Project Innovate, which will work to ensure that new and innovative developments are supported by the regulatory environment.[4]

- The CMA is also undertaking an update of the OFT's 2013 review of personal current accounts as part of the programme of work on retail banking, and will publish the findings of its work during the summer of 2014, including the CMA's provisional decision on whether or not to make a market investigation reference.[5]

- The FCA also launched a market study on cash savings.[6] This study will examine barriers to entry and expansion in the market, including where these are created by consumer behaviours when shopping around or looking to switch to better products. If the FCA finds that remedies need to be introduced to encourage shopping around and switching, then these may have an impact on the barriers to expansion to the extent that they encourage consumers to consider and possibly switch to the smaller players in the market.

FCA Handbook review

67. The FCA is also reviewing the relevant parts of the Handbook inherited from the FSA to ensure consistency with its competition mandate. The FCA is carrying out this review to ensure that its rules promote effective competition in the interests of consumers wherever this is compatible with its other objectives.

68. If the FCA identifies opportunities to do this by reducing regulatory barriers to entry, it will do so. It is possible that some sets of rules taken independently may not pose a barrier to entry, but the cumulative effect of some requirements might be found to raise entry barriers in banking. It might then be possible to reduce these barriers while achieving the original policy goals.

Off-the-shelf banking solutions

69. The March 2013 review acknowledged that the implementation of IT systems formed a major part of the establishment of any new bank and that the options available to firms range from building their own systems through to outsourcing virtually all IT systems and their operation.

70. While the review noted that developing IT systems from scratch can be difficult, costly and time consuming, it also acknowledged that there are technology companies which offer off-the-shelf banking systems that have the potential to make a significant difference to some applicants.

71. These off-the-shelf solutions typically offer a core banking platform which includes a range of pre-configured products and services, pre-configured roles and a set of end-to-end

(1) www.paymentscouncil.org.uk/switch_service/.
(2) Department for Business, Innovation and Skills, April 2014; www.gov.uk/government/policies/providing-better-information-and-protection-for-consumers/supporting-pages/personal-data.
(3) *Review of the personal current account market*, OFT, January 2013; http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1005rev.
(4) *Making innovation work for firms and consumers*, speech by Martin Wheatley, Chief Executive, FCA, May 2014; www.fca.org.uk/news/making-innovation-work.
(5) Competition and Markets Authority, April 2014; www.gov.uk/cma-cases/personal-current-accounts-market-review-update.
(6) *Cash savings market study terms of reference*, FCA, October 2013; www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-tor.pdf.

processes. The system is then tailored to accommodate the needs of the UK market and the specific requirements of the firm.

72. Since the original review was published both regulators have continued to monitor developments in this market and gather feedback from both technology companies and applicant and pre-applicant firms. This feedback indicates that a number of the recently authorised banks and the current pre-applicants have used, or plan to use, off-the-shelf banking systems rather than develop their own. In addition, many of these firms also have outsourced, or plan to outsource, the hosting and operation of their core banking systems to third parties.

73. The PRA's and FCA's remits do not, under current legislation, extend to the direct oversight or authorisation of technology companies and their solutions. However, both regulators remain committed to engaging with the suppliers of these off-the-shelf solutions and with regulated firms to help them understand the requirements and to ensure that the potential for these solutions to reduce barriers to entry and boost competition is fully exploited.

74. Where regulated firms are considering the use of third-party software and/or support for their core banking systems, or third-party hosting of the supporting technology infrastructure, these will be regarded as material outsourced services and subject to general outsourcing regulatory requirements.

75. In these circumstances, an applicant will need to demonstrate that it meets the regulators' Threshold Conditions[1] and the requirements specified in 'Senior Management Arrangements, Systems and Controls (SYSC), chapter 8.1, General outsourcing requirements', within the FCA and PRA Handbooks.[2]

76. The overarching principle in these outsourcing requirements is that a regulated firm remains accountable and fully responsible for the execution of all aspects of its business operating model including any critical operational function, such as IT, which is outsourced to a third party. In particular, the regulators require that:

- a firm takes reasonable steps to avoid undue additional operational risk when relying on a third party for the performance of critical operational functions;
- the effectiveness of a firm's internal control framework is not reduced by the use of a third party; and
- the use of a third party does not reduce the ability of the regulators to monitor the firm's compliance with its regulatory obligations.

77. In practice, this means regulators require applicants to have effective processes to identify, monitor and manage risks and internal control mechanisms for all critical outsourcing service provider relationships. Applicant must be able to provide reasonable assurance that regulated functions, services or activities will be delivered by the third-party service provider to the requirements and standards the applicant has set and that regulatory obligations will be met.

(1) The PRA's Threshold Conditions are: legal status, location of offices, business to be conducted in a prudent manner, suitability, and effective supervision. The FCA's Threshold Conditions for dual-regulated firms are: effective supervision, appropriate non-financial resources, suitability and business model.
(2) http://fshandbook.info/FS/html/handbook/SYSC/8/1.

Annex: Banking authorisation statistics

Authorisations

In the period from 1 April 2013 to 31 March 2014 the PRA has authorised five new banks:[1]

- Axis Bank UK Limited.
- FCMB (UK) Limited.
- Paragon Bank plc.
- UBA Capital (Europe) Limited.
- Union Bank of India (UK) Limited.

No applications have been refused or rejected by either regulator in this same period.

Annex 2 of the March 2013 review[2] includes a list of banks authorised between 2006 and 2012.

Mobilisation

At 31 March 2014, three firms were in mobilisation:

- Paragon Bank plc.
- UBA Capital (Europe) Limited.
- Union Bank of India (UK) Limited.

Pre-application engagement

In the twelve months to 31 March 2014 the regulators have held 47 pre-application meetings with over 25 potential applicants.

(1) The definition of a bank is a firm adding the permission to accept deposits either via a new authorisation or a Variation of Permission.
(2) *A review of requirements for firms entering into or expanding in the banking sector*, FSA and Bank of England, March 2013: www.fca.org.uk/static/documents/barriers-to-entry.pdf.