BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Consultation Paper | CP9/20

Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks

July 2020

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Responses are requested by Wednesday 14 October 2020.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: CP09_20@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:
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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out its proposed approach to supervising 'new[1] and growing'[2] non-systemic[3] UK banks[4] (collectively referred to as 'banks'). All the proposals are clarifications of the PRA's current supervisory approach, with the exception of: (i) proposed changes to the calculation of the PRA buffer for new banks; and (ii) setting expectations in relation to solvent wind down plans.

1.2 This proposed approach to supervision of new and growing banks is a follow-up to the 2013 joint Bank of England (the Bank)/FSA[5] publication 'A review of requirements for firms entering into or expanding in the banking sector' ('the 2013 report').[6] The proposals are not a fundamental change, but formalise the current PRA policy approach. Any changes from the current approach are clearly signposted in chapter 2 of this CP.

1.3 This CP proposes to:

- create a new supervisory statement (SS): 'Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks' (Appendix 1);
- reference the new SS in paragraph 5.25 of SS31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)' ('SS 31/15') (Appendix 2); and
- reference the new SS in paragraph 9.45 of the Statement of Policy (SoP) 'The PRA's methodologies for setting Pillar 2 capital' ('Pillar 2 SoP') (Appendix 3).

1.4 The purpose of the proposals is to:

- help banks understand how and why PRA expectations increase as they grow;
- clarify the expectations of a new and growing bank as it matures;
- clarify that in a competitive environment it is normal to see both the entry and exit of banks (the PRA does not seek to operate a zero-failure regime and works with the Bank as resolution

1 New banks refers to firms that are in the 'mobilisation stage' (authorisation with restrictions) and those that have received authorisation without restrictions within the past 12 months (e.g. exited mobilisation or authorised without using the mobilisation period).
2 Growing banks refers to banks that are typically between one and five years post-authorisation without restrictions. These banks often share many of these characteristics: rapid growth; loss making; reliant on regular capital injections; significant and rapid changes in strategy and business model; and immature controls.
3 Non-systemic banks are those which are not designated as systemically important through the O-SIIs (other systemically important institutions) Identification process. These banks are mainly category 2–5 UK-incorporated deposit takers, whose size, interconnectedness, complexity, and business type give them the capacity to cause some (category 2), minor (category 3), very little capacity individually (category 4), and almost no capacity individually (category 5) to cause disruption to the UK financial system by failing, or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption.
4 UK bank means a UK undertaking that has permission under Part 4A of FSMA to carry on the regulated activity of accepting deposits, and is a credit institution, but is not a credit union, friendly society, or a building society.
5 The Financial Services Authority (FSA) was the predecessor organisation to the PRA and Financial Conduct Authority (FCA).
6 https://www.fca.org.uk/publication/archive/barriers-to-entry.pdf.

authority, if necessary, to ensure banks are able to fail in an orderly way, without threatening financial stability); and

- communicate the PRA's aim for banks to have positive regulatory relationships through open, constructive, and forward-looking communication.

Relevancy

1.5 This CP is primarily relevant to new and growing non-systemic UK banks, though not all, as some banks in this category will have sufficient experience and resources to be able to move quickly to the standard expected of most established banks. This determination will depend on a number of factors, notably on: (i) whether the bank is part of an established domestic or international banking group; (ii) the size and complexity of its activities; and (iii) the extent of its available financial and non-financial resources. The PRA would consider each case on its merits and apply supervisory judgement to ensure that the policy is applied appropriately. See box 1 of Appendix 1 to this CP 'Supervision of UK bank subsidiaries of international groups' for relevant examples.

1.6 This CP is relevant to the following types of banks:

- banks in their first few years of being authorised by the PRA as a deposit taker (typically less than five years post-authorisation); and

- prospective banks interested in and currently applying for authorisation as a deposit taker (UK applicant banks).

1.7 Chapter 6 of Appendix 1 to this CP is relevant to non-systemic UK banks that are 'established' (typically beyond five years post–authorisation and in the 'without restrictions' stage of their lifecycle).

1.8 There are a number of types of banks and other PRA-authorised firms that are not covered in this CP. These include:

- banks incorporated outside of the European Economic Area (EEA) authorised to accept deposits through a branch in the UK;

- banks incorporated in the EEA entitled to accept deposits through a branch in the UK;

- systemically important firms, referring to firms that are designated under the other systemically important institutions (O-SII) identification process;

- building societies;

- credit unions; or

- UK designated investment firms

1.9 While this CP is not directly relevant to these firms, it may be of interest to them, and the PRA welcomes comments. This CP also does not propose changes to the change in control process for buying an existing bank.[7] If you are unsure of how this CP applies to your firm, please discuss with your supervisor.

1.10 This CP should be read in conjunction with:

- the PRA's approach to banking supervision published in March 2018;[8]
- the following joint Bank/FSA publications: the 2013 report, and 'A review of requirements for firms entering into or firms expanding in the banking sector: One year on' ('the 2013 report plus one year');[9]
- SS 31/15; [10] and
- Pillar 2 SoP.[11]

1.11 This CP additionally draws upon previous publications from the Bank and the PRA on new firm authorisation,[12] various SSs and SoPs (see table 1 in Appendix 1), and the Bank's approach to resolution.[13]

1.12 Expanding on the PRA's framework as set out in its approach to banking supervision document, [14] the draft SS is informed by: (i) lessons learned since the new approach to the bank authorisation process was launched in 2013; (ii) the Bank's analysis considering barriers to entry and competition implications;[15] and various reviews by the PRA, including the fast growing firms review.[16]

1.13 The Financial Conduct Authority (FCA) is the conduct regulator for all firms operating in the UK. The policy in this CP does not affect the application of the FCA's rules or requirements to international banks operating in the UK. The SS would sit alongside the PRA's requirements and expectations as published in the PRA Rulebook[17] and its policy publications.[18]

Purpose

The PRA's approach to new and growing banks

1.14 Since the PRA's approach to authorising new banks was established in 2013, it has authorised 22 new UK banks. These new banks display a wide variety of business models, competing with

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7 https://www.bankofengland.co.uk/prudential-regulation/authorisations/change-in-control.
8 The PRA's approach to supervision, October 2018: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018.
9 https://www.fca.org.uk/news/news-stories/review-requirements-firms-entering-or-expanding-banking-sector-one-year.
10 PRA Supervisory Statement 31/15 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP), July 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.
11 The PRA's methodologies for setting Pillar 2 capital, July 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-methodologies-for-setting-pillar-2-capital.
12 https://www.bankofengland.co.uk/prudential-regulation/authorisations/new-firm-authorisation.
13 https://www.bankofengland.co.uk/financial-stability/resolution.
14 https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018.
15 https://www.bankofengland.co.uk/news/2014/july/review-of-barriers-to-entry-for-new-banks.
16 Letter from Melanie Beaman: Review and findings: Fast growing firms, June 2019: https://www.bankofengland.co.uk/prudential-regulation/letter/2019/review-and-findings-fast-growing-firms.
17 http://www.prarulebook.co.uk/.
18 https://www.bankofengland.co.uk/news/prudential-regulation.

established banks in many segments of the banking sector. The competition created by these new banks is positively spurring wider innovation within the established banking space, improving the banking experience for many stakeholders.

1.15 At the same time, the PRA has noticed that many of these new banks have underestimated the development required to become a successful and established bank. Often, these banks are focused on the ambition of becoming authorised and lose the longer term focus of becoming a sustainable business, or fail to appreciate the ongoing need to invest in systems and controls to ensure they remain commensurate with the evolving needs of the business.

1.16 This CP and draft SS set out some of the key issues the PRA has observed regarding new and growing banks, and proposes how the PRA's expectations would apply to banks as they grow and mature. This path to maturity is necessary for new banks as, while they must meet the PRA's Threshold Conditions,[19] they are unlikely to meet all the expectations the PRA has of an established bank from inception, and in many cases will require time to build and demonstrate capabilities, and to meet the requirements for authorisation.

1.17 Through the draft policy proposed in this CP, the PRA intends to help new and growing banks understand what is expected of them as they consider their future growth objectives and strategy. In doing so, the PRA aims to communicate a way for banks to have a positive regulatory relationship with the PRA through open, constructive, and forward-looking communication.

PRA capital buffers for new banks

1.18 The PRA's capital buffer is currently based on a wind down cost calculation.[20] In the PRA's experience, a number of banks have interpreted this inconsistently and taken different approaches to this calculation. In response, the PRA is clarifying the purpose of the buffer and outlining a simpler approach to its calculation. The PRA is proposing that the PRA buffer for new banks will be calibrated to allow such banks time to find alternative sources of capital or make business model adjustments, in the event of a loss of investor support. The PRA is of the view that a reasonable amount of time for banks to pursue alternative options is around six months. Therefore, the PRA proposes in this CP that new banks calculate their PRA capital buffer as six months operating expenses.

1.19 Competitive markets involve firms being able to enter and exit. The likelihood of failure may be higher during the early years of a firm's development;[21] however, the orderly failure of a new or growing firm at an early stage of its life is likely to have no or minimal impact on financial stability, and is a natural part of a competitive economy. In this CP and draft SS, the PRA explains why it is important for banks to have credible and comprehensive recovery and solvent wind down plans, and to prepare for resolution. This is to ensure that disruptions, including to depositors, are reduced and minimised should banks fail, and that banks support an orderly exit. A series of conditions must be met before a bank may be placed into resolution, and these are detailed in chapter 5 of the draft SS (Appendix 1).[22]

19 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-bank/thresholdconditionsfactsheet

20 https://www.bankofengland.co.uk/news/2014/july/review-of-barriers-to-entry-for-new-banks.

21 This is common across industries, see for example: Geroski, P.A. (1995) 'What do we know about entry?' *International Journal of Industrial Organisation*, 13 421–441; or Kücher, A. et al. (2020) 'Firm age dynamics and causes of corporate bankruptcy: age dependent explanations for business failure', *Review of Managerial Science*, 14: 633–661.

22 The Bank of England sets preferred resolution strategies for all banks. For smaller banks that do not supply transactional accounts or other critical functions to a scale likely to justify the use of resolution tools, the preferred resolution strategy is the applicable insolvency procedure. Usually, this is the Bank Insolvency Procedure (BIP).

Related topics

1.20 While not addressed in this CP, the PRA is aware of the importance of resolution policies for new and growing banks. Resolution reduces the risks to depositors, the financial system, and to public finances that could arise due to the failure of a bank. It also reduces the unfair competitive advantage of large banks that investors consider 'too big to fail', and creates the conditions for a banking sector in which both entry and exit is easier.

1.21 In line with PRA Fundamental Rule 8,[23] banks should prepare for resolution by developing the capabilities necessary to enable them to fail in an orderly fashion without causing excessive disruption to the UK financial system and, where applicable, provide continuity of access to depositors'.[24] As per SoP 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL),[25] the Bank, as resolution authority, sets MREL for all institutions. MREL is an institution-specific requirement, and the Bank will set MREL with the goal that individual institutions and groups can be resolved in line with the resolution objectives under a preferred resolution strategy.

1.22 As set out in paragraph 9.5 of the aforementioned MREL SoP, the Bank will, before the end of 2020, review the calibration of MREL, and the final compliance date, prior to setting end-state MRELs. In doing so, the Bank will have particular regard to any intervening changes in the UK regulatory framework, as well as firms' experience in issuing liabilities to meet their interim MRELs (see paragraph 1.6). The review may also lead the PRA to consider adjustments to the scope, functionality, and necessity of the rules on Continuity of Access to deposits.

1.23 Furthermore, outside the scope of this CP the Financial Policy Committee and Prudential Regulation Committee intend to conduct a review of the UK leverage ratio framework.[26]

Implementation

1.24 The PRA proposes that the amendments set out in this CP would take effect in the first half of 2021.

Responses and next steps

1.25 This consultation closes on Wednesday 14 October 2020. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP09_20@bankofengland.co.uk.

1.26 The proposals set out in this CP have been designed in the context of the UK's withdrawal from the EU and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the EU take effect.

23 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-bank/Fundamentalruleprinciples
24 PRA Supervisory Statement 18/15 'Depositor and dormant account protection, April 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/depositor-and-dormant-account-protection-ss.
25 https://www.bankofengland.co.uk/paper/2018/boes-approach-to-setting-mrel-2018.
26 Financial Stability Report, December 2019: https://www.bankofengland.co.uk/financial-stability-report/2019/december-2019 (page 42).

1.27 The PRA has assessed that the proposals would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018'[27] for further details.

2 Proposals

2.1 The proposals in this chapter are structured according to the chapters in the draft SS:

- expectations of new and growing banks;
- capital expectations of new and growing banks;
- orderly exit: recovery and resolvability; and
- the PRA's approach once banks are established.

Expectations of new and growing banks

2.2 In this CP, the PRA proposes that, as banks grow and mature following authorisations, they should:

- have greater clarity over the path to profitability, including how they will meet all relevant loss absorbing requirements;
- strengthen governance and increase the independence of the board as they mature; and
- expect to invest significantly in risk management and controls, and have a mature control environment typically by five years after authorisation.

Capital expectations of new and growing banks

2.3 The PRA proposes a change in the approach to calculating the PRA buffer for new banks. This would:

- be calculated as six months' operating expenses; and
- require banks to move onto a buffer set on a stress test basis at five years after authorisation, or when they reach profitability, whichever is sooner.

2.4 The PRA proposes that, as banks grow and mature following authorisation, they should develop their stress testing capabilities so they are prepared to transition to a PRA buffer set on a stress test basis.

2.5 The PRA clarifies that it expects new banks to maintain capital levels to meet Pillar 1 (P1), Pillar 2A (P2A), if applicable (subject to the resolution strategy) any MREL above Total Capital Requirements (TCR), and buffers, for at least the 12 months following exit from mobilisation (or

27 April 2019: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.

upon authorisation if a firm does not follow the mobilisation route), in addition to meeting actual capital requirements and buffers.

2.6 The PRA reiterates its expectations in SS31/15[28] that capital buffers are not to be used in the usual course of business, and clarifies its expectation that new and growing banks adopt a forward looking approach to capital management, ensuring that planned capital injections are received sufficiently in advance to avoid the firm entering its buffers.

2.7 Banks should expect the PRA to investigate whether any firm in breach or likely breach of its MREL is failing, or likely to fail, to satisfy the Threshold Conditions, with a view to taking further action as necessary. However, a breach or likely breach by a firm of its MREL does not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.[29]

2.8 The PRA expects firms to meet both MREL and maintain an amount of Common Equity Tier 1 (CET1) capital that reflects their risk-weighted capital and leverage buffers (if applicable). The PRA expects firms not to double count CET1 towards both MREL and the amount reflecting the risk-weighted capital and leverage buffers (if applicable). While firms can meet MREL with CET1, they do not have to meet it with CET1.[30]

Orderly exit: recovery and resolvability

2.9 The PRA proposes that new banks should have solvent wind down plans in place at the point of authorisation (or upon exit from mobilisation), and maintain these until they move onto a PRA buffer set on a stress test basis.

The PRA's approach once banks are established

2.10 The PRA aims to have positive regulatory relationships with banks through open, constructive, and forward-looking communication, from pre-authorisation, to beyond their new and growing phase of development, to becoming established banks.

2.11 Table 1 illustrates the PRA's expectations of banks as they mature. This is not intended to be a comprehensive list; instead, it is indicative of a general development pathway.

28 July 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

29 https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel-ss (3.2)

30 https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel-ss (2.A)

Table 1: The PRA's expectations of banks as they mature

	Year 0[31]	Year 3	Year 5
Business model	Untested business model, most banks loss making	Business model refined based on experience Forecasts are more accurate Clearer path to profitability	Settled business model Either profitable or clear path to profitability with definite capital support to achieve that Realistic forecasts
Governance	Minimum two independent non-executive directors, with strong preference for independent chair[32]	Minimum three independent non-executive directors, including the chair[33]	Meets best practice including, dependent on size and complexity, having a majority independent board
Risk management	Framework and policies in place Untested as firm has not yet operated as a bank	Bank is testing and refining framework and policies in light of experience Risk management is fit for purpose, with a focus on developing risk management and controls for the most material risks	Mature control environment Fully embedded risk management framework linked into stable business model Framework provides forward-looking view across all risk types Continuous improvement to ensure framework remains fit for purpose given business and regulatory developments
Capital	Buffers set on new bank basis (6 months forward operating expenses) In addition to buffers, banks hold enough capital to meet business plan while remaining above buffers for 12 months Internal Capital Adequacy Assessment Process (ICAAP) in place but untested	Buffers set on new bank basis (6 months forward operating expenses)[34] Undertaking advanced stress testing and a clear plan for transitioning to stress test buffer Forward-looking view of capital to ensure buffers are not used in the usual course of business ICAAP meets minimum standards and is fit for purpose	Buffers set on stress test basis Sophisticated capital management with credible capital models ICAAP is a robust document which is an integral part of the firm's management process and decision making
Liquidity	Internal Liquidity Adequacy Assessment Process (ILAAP) in place but untested	ILAAP meets minimum standards and is fit for purpose	ILAAP is a robust document which is an integral part of the firm's management process and decision making

31 Year 0 refers to the time at authorisation or exit from mobilisation.
32 These are minimum expectations and are dependent on the size and complexity of the firm. It may be appropriate for it to meet best practice at an earlier stage of its maturity.
33 These are minimum expectations and dependent on the size and complexity of the firm. It may be appropriate for it to meet best practice at an earlier stage of its maturity.
34 However, the PRA buffer could be set on a stress test basis by this point if the bank has reached profitability (see paragraph 4.8 of Appendix 1).

Operational resilience	Design operational resilience into business processes and controls from the outset, and follow all relevant policies
Recovery and Resolvability	Credible recovery plans in place - sufficiently detailed and practical to ensure they would be useable in a stress Board approved solvent wind down plan in place (while bank is on the new bank buffer approach) Undertake a forward-looking, realistic assessment of how its preparations for resolution would enable the bank to achieve the outcomes for resolvability Meet the PRA rules on depositor protection

3 The PRA's duty to consult

3.1 The PRA has a statutory duty[35] to consult when introducing new rules and, when not making rules, has a public law duty to consult widely where it would be fair to do so. When doing so, the PRA provides the following in relation to the proposed policy:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with the PRA's duty to act in a way that advances its general objective,[36] and secondary competition objective;[37]
- an explanation of the PRA's reasons for believing that making the proposed policy are compatible with its duty to have regard to the regulatory principles;[38] and
- A statement as to whether the impact of the proposed policy will be significantly different to mutuals than to other persons.[39]

3.2 The PRC should have regard to aspects of the Government's economic policy as recommended by HM Treasury.[40]

3.3 The PRA is also required by the Equality Act 2010[41] to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions.

Cost benefit analysis

3.4 The PRA is not obliged to provide a cost benefit analysis of the proposals in a draft SS but considers it good practice to do so in qualitative terms. The proposals in this CP could lead to additional costs to banks, both one-off and ongoing. The costs may rise in line with banks' size and complexity and will be partly dependent on an individual banks' specific choice as to how to meet the PRA's expectations.

35 Section 2L of FSMA.
36 Section 2B of FSMA.
37 Section 2H(1) of FSMA.
38 Sections 2H(2) and 3B of FSMA.
39 Section 138K of FSMA.
40 Section 30B of the Bank of England Act 1998.
41 Section 149.

3.5 Banks might already be following the expectations set out in the draft SS, in which case any incremental costs resulting directly from the PRA's proposed expectations would likely be minimal.

3.6 On the basis of the existing business structures and the capability of being effectively supervised by the PRA, including the level of supervisory co-operation already in place, the proposals should not significantly affect existing new and growing banks.

3.7 The proposals in this CP are expected to generate economic benefits by improving banks' understanding of the PRA's expectations at different points in their lifecycle, including their path to entry, growth, and exit. Setting capital for new banks based on operational expenses clarifies expectations, but could also create a disincentive to invest (as higher expenses lead to higher requirements). The PRA considers this to be a secondary concern when banks have substantial capital resources to support growth. This will enhance the stability of the financial system.

3.8 The PRA considers that the approach set out in this CP generates incremental benefits by ensuring that the activities undertaken by new and growing banks are compatible with the PRA's objective of promoting the safety and soundness of the banks it supervises. The approach should also facilitate preparation for resolution, in line with PRA Fundamental Rule 8.[42]

3.9 This would be subject to the PRA having appropriate levels of supervisory co-operation, assurance, influence, and visibility over banks' activities, so far as it is relevant to the safety and soundness of the banks and necessary to meet the PRA's objectives, among other factors. This will benefit banks by allowing them to use their resources more efficiently and effectively.

Compatibility with the PRA's objectives

3.10 In discharging its general functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of PRA-authorised persons;[43] and in the context of insurance, to contribute to policyholder protection.[44] By setting out its proposed expectations on new and growing banks at different points in their lifecycle, the PRA seeks to advance its statutory objective of promoting the safety and soundness of the banks it regulates through ensuring they have appropriate governance, risk management and controls, stress testing, and recovery planning capabilities, allowing them to compete effectively within the regulatory framework.

3.11 When discharging its general functions, the PRA is legally required, so far as is reasonably possible, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.[45] The PRA considers that the proposals in this CP facilitate effective competition by the adoption of a proportionate approach to setting the PRA's expectations of banks throughout the early phases of development, and by facilitating banks' preparation for resolution, if necessary, to ensure banks are able to fail in an orderly way without causing excessive disruption to the UK financial system, in line with PRA Fundamental Rule 8.

Regulatory principles

3.12 In developing the proposals in this CP, the PRA has had regard to the regulatory principles as set out in Financial Services and Markets Act 2000 (FSMA). The PRA considers that six of the regulatory principles are of particular relevance to this CP.

42 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-bank/Fundamentalruleprinciples.
43 Section 2B(1) and Section 2B(2) of FSMA.
44 Section 2C of FSMA
45 Section 2H(1) of FSMA.

3.13 The need for the PRA to use its resources in the most efficient and economical way: the proposals prioritise the PRA's resources towards the supervision of banks that pose the greatest risks to the PRA's objectives.

3.14 That a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden: the PRA's proposals have been developed to be proportionate to the risk posed by banks, and allow banks to adopt a proportionate approach to meeting the PRA's proposed expectations.

3.15 For example, the PRA buffer for established banks is calculated based on the amount of capital needed to remain above TCR under a severe but plausible stress scenario. For new and growing banks, the amount of capital needed to survive such a scenario would generally be very large, as it would need to cover: (i) ongoing losses; (ii) Risk Weighted Assets growth associated with continued business expansion; (iii) additional losses arising from the stress scenario; and (iv) limited access to external capital because of the adverse market conditions. This could give rise to a disproportionate level of capital relative to the financial stability risks posed by new banks, as these banks should be able to exit the market easily if required. In recognition of this, an alternative approach to calculating the PRA buffer for new banks was introduced. This CP is proposing that this alternative and proportionate approach, calibrated as being equal to six months projected operating expenses, is applied to new and growing banks.

3.16 The desirability of sustainable growth in the economy of the UK in the medium or long term: the proposals lay the foundations for new and growing banks to become established banks and contribute to medium and long term growth in the economy, and where not achieved exit without disruption (including to depositors).

3.17 The desirability of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, business carried on by different persons: the PRA has presented the draft policy in the form of expectations in an SS, to allow banks' supervisors to apply supervisory judgement in assessing how the policy would apply to a firm, given the nature, scale, and complexity of their business.

3.18 That the PRA should exercise its functions as transparently as possible and sets out the key information relevant to its proposals, giving respondents the opportunity to comment. The proposals outlined in this CP are intended to bring greater clarity to the PRA's approach to new and growing banks' supervision.

3.19 In discharging its functions the PRA must have regard to the responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting consumers, in relation to compliance with those requirements. Chapter 3 of the draft SS in particular expands on the PRA's expectations of the board and senior management for new and growing banks.

Impact on mutuals

3.20 The PRA considers that the impact of the proposed rule changes on mutuals is indirect and minimal. It is expected to be no different from the impact on other established non-systemic deposit takers. The exclusion of mutuals and credit unions from the proposals in this CP is designed to ensure proportionality and take into consideration the structure of these institutions and their specific regulatory requirements.

HM Treasury recommendation letter

3.21 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.[46]

3.22 The aspects of the Government's economic policy most relevant to the proposals in this CP are competition, growth, competitiveness, and innovation.

3.23 Improving new and growing banks' understanding of, and ability to plan for, the PRA's approach to supervision on their path to entry, growth, and exit should support the above aspects of the Government's economic policy, by helping ensure these banks are clear about the PRA's expectations and the support the PRA can give them as they seek to meet those expectations.

3.24 The PRA considers that an outcome of the proposals would be allowing smaller banks to expand and new entrants to compete with incumbents, while acknowledging the impact of their growth on systemic risk, thereby ensuring the diversity of business models.

Equality and diversity

3.25 The PRA has considered the equality and diversity issues that may arise from the proposals in this consultation. The PRA considers that the proposals in this consultation do not raise any concerns with regards to equality and diversity.

46 Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at https://www.bankofengland.co.uk/about/people/prudential-regulation-committee.

Appendices

1 Draft SS 'Non-systemic UK Banks: The Prudential Regulation Authority's approach to new and growing firms'

Please see full draft available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks.

2 Draft amendments to Supervisory Statement 31/15: The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)

In this appendix deleted text is struck through and new text is underlined.

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The SREP

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5.25A 'The PRA expectations for P2B of new and growing banks are set out in the SS on new and growing banks', please see: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks

3 Draft amendments to Statement of Policy: 'The PRA's methodologies for setting Pillar 2 capital'

In this appendix deleted text is struck through and new text is underlined.

New entrants and expanding smaller banks

9.45 ~~The PRA will continue to apply a more flexible approach to new entrants and expanding smaller banks when setting the PRA buffer. This is set out in the July 2014 FCA and PRA publication 'A review of requirements for firms entering into or firms expanding in the banking sector: one year on'.[55] RMG is reviewed as part of the authorisation process. There is no presumption of RMG deficiencies simply because the management team and board are new. The PRA will exercise its supervisory judgement to apply an RMG scalar or other capital add-on as deemed necessary on a case-by-case basis.~~

9.45 The PRA expectations for P2B of new and growing banks are set out in the SS on new and growing banks', please see: https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks