HOUSE OF LORDS

Financial Services Regulation Committee

Corrected oral evidence: The FCA and PRA's secondary competitiveness and growth objective

Wednesday 16 October 2024

11 am

Watch the meeting

Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Baroness Donaghy; Lord Eatwell; Lord Grabiner; Lord Hill of Oareford; Lord Hollick; Lord Lilley; Baroness Noakes; Lord Sharkey; Lord Vaux of Harrowden.

Evidence Session No. 8 Heard in Public Questions 122 - 136

Witness

I: Nigel Terrington, Chief Executive Officer, Paragon Banking Group.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.

Examination of witness

Nigel Terrington.

Q122 **The Chair:** Nigel Terrington, thank you so much for coming to the committee. You were here when I read out the rigmarole, so I will not repeat it because we want to use your time more wisely. I will begin with the first question. You are an experienced chief executive; you have been chief executive of your bank for more than 20 years, which must be a record, so you have seen regulation come and go. You heard the earlier session. What do you think could change, in terms of the imposition of regulation or the relationship with regulators, that would make a difference to ensure growth and competitiveness to get our economy firing on all cylinders?

Nigel Terrington: Thank you for the invite to appear here today. I have been CEO for nearly 30 years, not 20. You call it "experienced", which is very kind; my children call it "old".

The Chair: We all have that problem.

Nigel Terrington: I will spend a minute explaining the relevance of why I am here. I am the CEO of Paragon Banking Group. We are a specialist bank, one that does not have branches. We have a focused strategy, lending into areas of the SME world, backed by deposits. A lot of it is property-related lending; we finance housebuilders, landlords and a number of other areas. We are very focused and, as a consequence, we are very engaged with the PRA in our activities. I have another role which gives me a different level of engagement with the PRA. We have much less to do with the FCA, so when you are thinking about questions, I am happy to try and answer whatever you want, but the route of my experience will link more with the PRA than the FCA.

The banking market is very competitive. We have seen the PRA do a number of things to create more competition in the banking sector, like the introduction of the new bank start-up unit after the financial crisis. It was a good introduction: 39 new banks were authorised post the financial crisis. Where we see a problem, a glass ceiling has emerged in enabling those newer, younger banks to grow to maturity, to enlarge, to become more of a challenge—not a challenger bank, which is a different model. They are banks that look like the clearers, but smaller.

Part of the problem is that banking is a high fixed-cost model. To be a bank, you cannot just open the doors; you must have a certain level of infrastructure and costs. Therefore, scale is important. You need to achieve a certain level of scale to generate the income to cover fixed costs, some of which are going to be regulatory related. I have been on the board of UK Finance, so I know David very well. Once upon a time, I was chairman of the Council of Mortgage Lenders and on the board of the Finance & Leasing Association. I also chair a group of mid-tier banks; it is not a lobby group per se but comes together to discuss, and to work with the authorities on, quite specific issues, such as MREL, Basel 3.1 and the like, where its particular interests are concerned. They are all mid-tier banks and have the same problem: they want to grow and support the economy, yet we feel that there are constraints as to how we can achieve that. Some of those will be born out of regulations, although that is not the only thing. Those are the pertinent aspects that will help to tailor, or at least help you to understand, my answers.

The Chair: Thank you for that. So, could you answer my question as to what are the things that your group feel could change that would allow for growth and for more capital to be provided for housing, small businesses or whatever?

Nigel Terrington: Capital is homogenous, so it is used in whatever way it can be used for. If you look at some of the specific issues, a large bank, such as the clearers or some of the large building societies, will use a model called IRB—internal ratings basis—which is a method of looking at the capital you need based on the nature and quality of your assets and the experience that you have had. Banks that fall below a certain level can join that club, but they have to go through an authorisation process. It is long, arduous and costly; I speak from experience because we are in the middle of that process. It enables you to move you from the standardised approach to IRB. If you have a good-quality loan book, which many banks in our space have, you are able to align your capital to the good-quality loan book. Otherwise, your capital is pre-determined by the Basel rules and their one-size-fits-all approach. That would be something that would help the mid-tier banks compete with the larger banks, create more capital and therefore provide additional support.

MREL has obviously been a topic of conversation—

The Chair: Sorry to interrupt you, but, before you leave that subject, you said that would be something. What is the something? That the process is made simpler or less expensive or what?

Nigel Terrington: The process is very complicated, because it deals with really high levels of data and models, such that we employ what we call astrophysicists to work our models. I kid you not; we always wanted to hire rocket scientists, and now we have. A high level of governance and a high standard are required, all of which is fine. We were a bit unlucky with the process because, as we started it, the PRA commenced an overhaul of all the banks that it already authorises, so we just had to join in that process and join our place in the queue. There are banks behind us in the queue; they are kind of in a waiting room, where they have been told, "You have to wait".

Q123 **Lord Eatwell:** If you are a regulator, you look at the way that banks have used IRB. I can point you to statements by leading banks where they spoke to journalists off the record and said, "We needed to have a little bit less capital, so we changed the weightings in the IRB ourselves". In other words, the regulator says, "These guys are using this to get away with having less capital than they should, given the systemic risks to which our particular system is subject". So you cannot be surprised that regulators have a degree of extreme caution in permitting the use of IRB rather than a standardised approach.

Nigel Terrington: I understand the question, but I think it is a bit of a misnomer. The IRB, the internal ratings basis, simply means you use your data and your analysis—

Lord Eatwell: And your model.

Nigel Terrington: And your model, but that model then gets independently verified by an external agency—in our case, one of the audit firms. Separately, the PRA has its own model team. They are bright and capable, and they crawl all over those models intensely. There are numerous levels of feedback. You cannot just set your own risk weighting. That might be a desire for some, but you cannot just do it.

The move under the IRB from point-in-time models to hybrid models, which is the process that the PRA is going through at the moment, means there will be an increase in the risk weights in all banks' IRB models as a consequence. There is a longer-term desire to align closer the standardised approach to IRB. If you have a good set of customers with a good-quality loan book, then you should see a better reflection in the capital requirements; otherwise, you are overstating your capital needs.

For us, just take the last 10 years. Our average bad-debt charge—impairment charge—through our P&L account has been 10 basis points per annum, or 0.1% per annum. That is very low, but presently we are on the standardised approach and there is no reflection in the capital measurement of how good our loan book is. That is why we are keen to move towards the IRB method.

Baroness Noakes: Are there any things that the PRA can do to streamline that for smaller banks—that is, potentially to accept a slightly higher degree of risk in banks?

Nigel Terrington: They are dealing with a lot because they are overhauling all the bank models. Something I have said—sometimes slightly tongue-in-cheek but sometimes not—is that maybe they should reprioritise and, instead of dealing with the big banks first, deal with the mid-tier banks as a priority.

Baroness Noakes: That just allows you to go through the change process faster.

Nigel Terrington: Not necessarily quicker but, if they have a finite set of resources, they cannot do everything all at the same time.

Q124 **Lord Hollick:** I have a couple of question. First, how long does the journey to IRB status take and how costly is it? Secondly, I rather got the impression that the move to a hybrid world, with more data requirements and everything like that, would potentially increase the amount of capital to support the current loan book. That would in fact head us in the wrong direction when it came to growth.

Nigel Terrington: The answer to the second question is yes. The hybrid models would typically see a higher level of capital required, compared to current models or those that have been used, although very few banks have gone through that process yet.

Lord Hollick: So you are on a process that is likely to reduce the assets in your loan book.

Nigel Terrington: Okay. To start with, you have standardised, which currently on mortgages has a 35% risk weighting. One of our products is buy to let. That will probably go up under Basel 3.1 to 45%, which is quite a step up in capital. We will come back to that point because it is a bit of a bugbear with me. The point-in-time models currently being used, or those that have historically been used, could get you down to maybe a 10% or 15% risk rating. We suspect under the hybrid models the capital requirements will be somewhere north of 20%, so there is a step-up in capital taking place for IRB banks and for the clearers, but a step-up in capital is also required under Basel 3.1.

On Basel 3.1, to be fair, the PRA's response to the consultation was positive, in that the capital requirement was quite a step-up compared to what it was. A lot of engagement took place, the PRA listened and it has reduced it in a number of areas. We were expecting a reduction in our CET1 ratio by 2.1%, but now it is going to be 0.83%. That is better, but it is still more.

There is a perception that the effect of Basel 3.1 was broadly neutral. I would say it is not neutral on the mid-tier banks. Those banks will almost certainly be seeing a step-up in their capital requirements as a result of Basel 3.1.

On IRB, yes, there will be additional set of capital. You asked about the time, effort and cost. It has been a long process.

Lord Hollick: Months or years?

Nigel Terrington: Years. We are currently in year four.

Lord Hollick: Why did it take that long?

Nigel Terrington: Because there is a huge amount of data, along with a high level of detailed engagement that has to take place. The PRA does not have infinite resources and it is dealing with every bank that is going through an IRB process all at the same time. That is a massive workload for the PRA. I have spoken to Sam Woods a number of times about this, and I get the PRA's problem—I do not want to sit here and just criticise—but there are only so many people that it can employ all at the same time to deal with a seismic change in bank capital regulation. Basel 3.1 is being changed, and IRB is being changed at the same time.

Lord Vaux of Harrowden: Is there a solution?

Nigel Terrington: We have made much better progress in the last six to nine months than in the previous three years. The engagement we have had has stepped up because the PRA, which has had a resource capacity constraint, given that it is dealing with all the big banks, is getting some of those banks through the process and that has freed up capacity. It will land; it is just a little painful.

The Chair: Lord Hollick made a point about cost, but perhaps you do not want to disclose that.

Nigel Terrington: I cannot give you an exact number, but several million pounds have been spent on external advisory work, ignoring management time, which has been extensive. We have a team of modellers and astrophysicists. It sounds like we have 100 people, but we do not; it is a modestly sized team, but models are not cheap, either.

Q125 **The Chair:** You were going to deal with MREL.

Nigel Terrington: Over a number of years, I have had active engagement with the Bank of England through Andrew Bailey, Sam Woods and Sir Dave Ramsden, who is in charge of the resolution authority, where MREL rests—it does not rest with the PRA—but also with the Treasury. We had a high level of engagement in 2021 when they looked at the rule changes. They did not change the thresholds, but they gave you longer to raise the debt.

The Chair: I am sorry to interrupt again, but one or two members of the committee may not be completely familiar with that. Could you just explain it?

Nigel Terrington: Post the financial crisis, central banks around the world looked at the risk that the banking system could bring to the financial system and the taxpayer. It was rather in the context of "Never again do we want to go there". They introduced the concept of TLAC—total loss-absorbing capacity—which basically says, "You have your shareholders' capital, but it is not enough in a crisis", so things like stress tests get used. You then work out what you need under stress, in the event of a crisis, that enables you to take that additional capital, and that capital comes in the form of debt that you raise. You might think that is not capital, but it is if it becomes bail-inable. In the event of a crisis, you take that additional capital and basically write it off, so it becomes almost equity within the business. The whole idea is that, if this happens on a Friday, by Monday morning, that is written off, the doors stay open and the bank continues to trade.

This was introduced after the financial crisis and it was done globally, but there have been different interpretations around the world. In America, the threshold at which you enter MREL is $100 billion of balance-sheet assets. In Europe, it is €100 billion. In the UK, it is £15 billion to £25 billion. You can immediately see quite a big difference there. We have spent time looking at it and talking to the authorities about the fact that we need to be more aligned internationally here, because it creates a competitive disadvantage for mid-tier banks like us. Our balance sheet total is £19 billion, so we are in the kill zone.

Q126 **Baroness Noakes:** Do you not have MREL?

Nigel Terrington: We do not have MREL. To be fair, there has been some really good engagement with the resolution authority. Once upon a time, we used to ask, "When does it apply? Is it £15 billion or £25 billion? What number does it apply at?". It would not say anything, but it does now; there is a much more transparent discussion. We have good guidance as to where it is likely to apply for us, and it is not £19 billion; it will be a reasonable bit higher than that.

But it creates certain behaviours as a consequence. We have to think, "Do we want to grow any more than we do today?" If we did and we found that we suddenly get a letter from the resolution authority to say, "You need to now raise MREL", we have a good glide path to raise it. However, the cost of raising that debt could be anywhere between a 7% and 9% coupon, for which, for a balance sheet of our size, we would probably need £1 billion, so that would be £70 million to £90 million straight out of our P&L.

It also brings another question. We would like to expand and grow our business. You make an acquisition and then that automatically puts you into the MREL regime. You look and say, "Great, we've just added £70 million-worth of profits", and you end up giving it away to bondholders. We are a public company, so our shareholders might call me up and say, "What did you do that for?"

I described it as a glass ceiling because, as a consequence, as you get close to that number, you think, "Do I hold back on my growth aspirations here?" I am talking about it in the first person as though it is just us, but it is the whole mid-tier sector. That is one of the things that we have wanted them to do. We have been talking to the Bank of England and the Treasury for some time because we knew, post SVB last year, that there was going to be some reconsideration potential.

Since 2021, we have had a tightening of regulation in this area. First, we got Basel 3.1, which has increased capital requirements. Secondly, we have had the introduction of the solvent exit framework, which goes live next year. That basically is a construct that makes banks more easily resolvable. The big banks are already there, and this would apply to smaller banks like us. It enables you to be more easily resolvable.

Finally, and perhaps most significantly, the recapitalisation Bill is going through Parliament at the moment. Post the SVB crisis, it has probably been understood that the most likely resolution of a bank failure, which usually happens over a weekend, involves selling it to another bank. But you might end up trying to sell a bank that becomes worth less than its equity par value. In SVB's case, it had tier 1 debt and tier 2 debt as forms of capital, it had its equity all written down to zero, and it was sold to HSBC for £1. If HSBC had said it was not worth £1, who would have paid for it?

There was not really a good mechanism to sell it over a weekend. It is a smart bit of thinking by the resolution authority and the Treasury to come up with this construct, where, basically, the FSCS makes a loan or injects funds into the failed bank to bring its value back to £1. It gets sold to a third-party bank, but that means the FSCS ultimately then says, "Where do I get my money from?" Temporarily it is from the Treasury, but that is then recovered through a levy against the banking system.

Effectively, what it has done is to create an additional layer of insurance, a bit like MREL, that enables a bank to be closed down and resolved over a weekend, sold to a third party and the cost of that is borne by the industry. It is very smart, clever and effective. It reduces the systemic risk that a mid-tier bank could cause the system because it dilutes the risk among the whole banking sector.

However, three additional levels of regulation and protection for the system have come in. We saw in yesterday's announcement that, under the consultation, they have proposed increasing the thresholds from £15 billion-£25 billion to £20 billion-£30 billion, in line with GDP, which has not been a great measure because it has not been very high. It is just indexed; it has not moved us on any further. We were contacted yesterday by the Treasury and the Bank of England resolution authority, which invited us in for discussions—it is fantastic that they are keen to do that. I had a brief conversation with Andrew Bailey last week and he said that they were keen to talk to us. I am absolutely delighted that they want to talk. The starting point is better than it was, but probably has not moved far enough.

The Chair: To summarise, you are saying that the limits should be more aligned with those of Europe or the United States, and the consequences of not doing that are to ration the resources available for SMEs or builders, and make them more expensive.

Nigel Terrington: Yes. The step in between that is that it is likely to cause mid-tier banks to reduce their growth expectations. They would therefore be unwilling to extend credit or to ration it by increasing the funding costs.

The Chair: It is going in completely the opposite direction from the secondary objective.

Q127 **Lord Sharkey:** How is that at all compatible with the secondary objective? What can be done to make it compatible?

Nigel Terrington: It is part of the regulators' trade-off: the safety and soundness of the financial system versus competitiveness. The one caveat is that the resolution authority, which is basically the owner of this policy and framework, does not have a secondary competition objective.

Lord Hollick: What would it be in terms of the requirement of capital to cover this? There are two ways you can deal with it. You can put more capital in to meet it, or you can reduce your loan book. Can you give us an indication of what you are thinking?

Nigel Terrington: You basically have to double your capital. We have a more technical description: it is the Pillar 1 plus Pillar 2A, so it is not your total capital because there are additional buffers on top of that. For us, Pillar 1 plus Pillar 2A would be around £1 billion.

Lord Hollick: Of additional capital?

Nigel Terrington: Of additional capital.

Lord Hollick: Or you can reduce your loan book?

Nigel Terrington: Yes.

Baroness Bowles of Berkhamsted: Can I clarify that it is the resolution authority that has the say over the MREL level?

Lord Sharkey: The resolution authority seems to have the power to frustrate the PRA's no doubt deep attachment to the growth objective. It is not clear to me what can be done in conversation with this quasi-independent or independent organisation.

Nigel Terrington: It is part of the Bank of England, so it is not stuck out on a limb. However, the competition objective vests with the PRA and FCA; it does not vest with the resolution authority.

Q128 **Baroness Donaghy:** My question is going to sound really mundane after all that. Going back to the PRA's first annual report, which is regarded as quite a model for how to implement growth and competitiveness—it even had some external scrutiny—do you think that building on that kind of annual reporting on how it is implementing it would help the industry? Going back to Lord Sharkey's metrics, there are other areas to consider; the one you have just mentioned seems to be a classic that the PRA might want to put in its next report, for instance. Can you think of any other metrics that might be useful to your industry?

Nigel Terrington: We have looked at the metrics and I was invited to talk to the Independent Evaluation Office, so I provided feedback on that directly to them. It is very early days. With due regard to the PRA, we have to give it a bit of a chance to iterate from these steps. Separate to that, when I looked at the metrics, some of them are fairly static. They measure the CET1 ratio and the liquidity coverage ratio. There is no objective measurement as to what is good and what is bad; it is what it is. There is little regard to international comparison that asks what our CET1 is compared to the US or Europe; it could do with that. Granularity would also be helpful. It is an average for the whole of the banking system. There is a little bit of granularity in there, but it could do with more. There are three groups that we should look at: the big banks, the mid-tier banks and the small banks. Each have different dynamics and would be regarded as having different measures of success. I would suggest that better international comparisons, looking at outcomes rather than just at static data and granularity would be welcome.

Q129 **Lord Vaux of Harrowden:** I am encouraged by the comments you have made about the meetings and communication between the regulators and yourselves. Has that improved as a result of these new objectives? Have you seen a change of behaviour from the regulators in that respect? To what extent does that spread down into the organisation? It is one thing if the senior people are doing it, but to what extent are you seeing a change in behaviour throughout the organisation to take these objectives into account?

Nigel Terrington: It is difficult to know about cause and effect in terms of behaviour. We have incredibly good relations through our supervisory teams. We have always had that, predating the SCO and the SCGO. We have always had good engagement through my little mid-tier bank group, partly because they want to listen and partly because I will not give up; I make a nuisance of myself—"If you don't ask, you won't get" sort of thing.

There is some element of seeing it happen in the thinking. The big question is whether thinking turns into action. The MREL will be a good test case. Going back to the earlier point, I appreciate it is not part of the competition objective group, but it is still governed by the Bank of England. There is a very tight management team there, so just because they do not have a competition objective, it is not immune from the discussions within the Bank of England, whether that is within the management team or through the court. It will be a really good test case and I am hopeful that they might do more than they have done so far, although I appreciate it is 24-hours old and there is a wealth of pages to read in these documents, as always.

Lord Vaux of Harrowden: And in terms of pushing that competition and growth objective culture down to the people who are doing the day-to-day work at the PRA, are you seeing that happen or is there less of that?

Nigel Terrington: I would describe that as a fairly positive environment anyway, with their day-to-day engagement with the supervisory teams. I am not unduly concerned by that; I would be more concerned about policy.

Q130 **Lord Hill of Oareford:** Lord Vaux has just nicked my question. I will ask you to reflect and say whatever you want here. You have been in the job for nearly 30 years—let us take the last 10. What is the difference in what the regulatory and supervisory environment has meant to you doing your job? How have you seen broad trends going?

Nigel Terrington: One point worth bringing up in connection to that is that I would say that, post financial crisis, there is a very different risk culture everywhere, within government, probably in Parliament—though you will be much better judges of that than me—with the regulators and in management. I do not mean bank managers in the traditional sense, but bank management teams today are very different animals from what they were pre financial crisis. Bank boards are different as well. This issue has never really been studied that hard, but I would not be surprised if we found that the UK population as a whole had a different risk attitude today compared to pre financial crisis. Now, I am sure that will change in time because inevitably history passes and we forget our lessons, but that is a more general observation that I would make. I would not lay the blame purely at the feet of the regulators.

Lord Hill of Oareford: By extension, if one wants to change how society thinks about risk, we need to address those multiple audiences.

Nigel Terrington: I think that is right. When I look at the kind of the risk appetite that the regulators take, I realise that they get their risk appetite from someone, and that is Parliament. The new Government are talking more about a growth agenda than has been done in the past. Again, maybe MREL is a good test case. Yesterday, the Bank of England and the Treasury published their papers. Those papers would not have been produced without the Treasury being actively involved, so presumably as we sit here today they think that is okay. If that is the case then it reflects their risk appetite. Again, I come back this point: if it needs to change then it needs to do so on both the government side and the regulatory side.

If there is blame, we should put it—actually, I do not really mean blame; it is not necessarily blame—at our own door. Are we as businesses not taking enough risk? David made the point earlier about buffers on buffers and, yes, they all exist. We have 60 risk appetite measures that we share with the board once a month. There is a red zone, which you do not cross. Then there is an amber zone; the minute you get into the amber zone, people ask, "What's going on?" So you are constantly living life in the green zone. When you look at it that way, you realise that it is us creating the buffers. We have a capital requirement, but we build a management buffer on top of the minimum regulatory requirements, plus we have countercyclical buffers and conservation buffers—and then we put a management buffer on top of that. The PRA says the buffers are there to be used, but you do not want to use them because that is seen as showing that something has gone wrong.

The Chair: Did you not have to increase the countercyclical buffer at a time when the economy was not doing particularly well? That seemed contradictory.

Nigel Terrington: I think that is the idea. It is the fruit bowl analogy: they take away the fruit bowl when the party is buzzing.

The Chair: Do you mean the punchbowl?

Nigel Terrington: Yes, the punchbowl. The fruit bowl is the non-alcoholic version. The relationship is that the countercyclical buffer is there to act as a counter to the economy. At the moment it is in the middle of its range, meaning that things are all right, but it has been down to zero and it could go higher—we will see. The point is that we then layer another buffer on top.

Q131 **Lord Grabiner:** I am just an ignorant lawyer, so you will forgive the naivety of any question that I put to you. You have been very focused on the mid-tier, understandably, which is on a sort of one-size-fits-all basis. However, from the regulator's perspective, I suppose that one size does not fit all. The regulator will look at the lowest common denominator because some parties in the mid-tier will be incredibly efficient—I get the impression that that is your position—but there will inevitably be others who are just not up to snuff. When it gets to working out the buffers and how to deal with the problem, the regulator is, understandably, going to be extremely careful. Is that right? If so, is there anything that can or should be done about that? It means that you are being held back in favour of others who are, in effect, being inappropriately protected.

Nigel Terrington: The Basel rules are a one-size-fits-all approach. However, the PRA requires each bank to do an annual ICAAP and ILAAP—that is, an internal assessment of what you think your capital risks are and what your capital requirements should therefore be; the same is done for liquidity. The PRA takes that and reviews it, and either it agrees with you or it does not. If it does not, it will add more capital requirements. So in your example of a bank that is not necessarily meeting the various standards that it has set, the regulator will add more capital or more liquidity requirements that the bank has to hold in order to protect their depositors as a consequence. So there is individual assessment.

It may sound as if I am a one-trick pony when talking about MREL, but with MREL there is no individual assessment; you are either in or out. If you are in, then you end up doubling your capital requirements, but if you are out, then you do not. That is a big jump. We will be suggesting in the consultation that the resolution authority should look at each bank individually which might be in what they call the boundary zone—those that are close to being in MREL—to consider whether they are in or out, make an individual assessment and say, "Looking at your business, you're actually quite a safe business. You've got good assets and you could resolve yourself quite easily over a weekend. You have good liquidity to protect yourself and good contingent liquidity as well. I am less worried about you, so instead of two times your capital maybe you are just at 1.2 times or 1.3 times". If you are perhaps of a size that you present a risk but do not have all those positive attributes that I have just described, maybe you are a 2 as a consequence. There is no calibration at present based on what type of organisation you are. The range is too narrow. If it is £20 billion to £30 billion, I would suggest maybe keeping the £20 billion for those that you think are not up to much, but perhaps raise it to £50 billion or £85 billion, or whatever the number is. But it is still at the discretion of the resolution authority to decide when you go in.

Q132 **Baroness Bowles of Berkhamsted:** I want to go back to the punchbowl or fruit bowl. We do not have one at all at the moment, in the sense that everything has been made so risk-averse. If you were to encourage banks to dynamically use their buffers instead of just leaving them there, not to be touched, how could that be done? Would it need legislation to say that was the purpose? How could that be encouraged? If you did start using them, are you saying that, as a consequence, you would end up with more capital requirements because the PRA would be saying, "Hey, you're using your buffers; you obviously haven't got enough capital". How do you stop that loop?

Nigel Terrington: I do not think you need any legislation or regulatory change to use your buffers. They are there to be used under the PRA's current rules; it is about the management's willingness to use them. It would then be down to the management's willingness to go into the buffers. If you went in, I am sure you would immediately get a phone call from the PRA, saying, "Okay, you're in your buffers; what are you going to do to get out of them?" That is fine, but, going back to the earlier point about risk culture, the management of banks' risk culture is such that you do not want to go into the buffers because you do not want to live life on the edge. After all, we are bankers, not serial entrepreneurs.

The Chair: We are grateful to you for making it clear that it is the management who take these decisions and not the non-executive directors.

Q133 **Lord Hollick:** Thank you for the journey we have made through this data thicket. I infer from what you said that the approach of the European Union is, from a growth point of view, more helpful and benign. Have I got the wrong end or the right end of the stick?

Nigel Terrington: Obviously, a lot of things can happen within the European Union. It's a regulatory and legislative environment that could cause all sorts of other issues, but the specific point around MREL is that the EU's threshold is €100 billion, and ours is £15 billion to £25 billion, at present.

Lord Hollick: Where is the EU on the resolution side of the debate?

Nigel Terrington: I would say that it operates in a similar way, but to be honest I do not know whether it has competition objectives within its resolution system. We can find out and I will let you know.

Q134 **Lord Sharkey:** I would like to ask about the use of buffers and the phone call from the PRA. Are there any restrictions, apart from the PRA's anxiety, on how you use them and for how long?

Nigel Terrington: No. The buffers are there to be used. To be honest, the first call would be from my chairman rather than the PRA, but everyone would know. If you operate normally here at one level but you go to another, they will want to know what you are going to do to get back. It is not as though you have to get back there within 24 hours, but you have to have a plan to get back there. That sounds all very civilised and neat, but you have to explain yourself and I think you would rather not. You would rather not get to the point of being a little too close for comfort.

The Chair: Is there also an issue of how the analysts might interpret it and how it might affect your share price?

Nigel Terrington: As a public company, yes.

Q135 **Lord Hill of Oareford:** As a follow-up to Lord Hollick's point about the different levels here and in the EU, is there any evidence that the level of €100 billion has led to any more problems or failures or middle-sized banks getting into difficulty in the EU?

Nigel Terrington: I am not aware of any. In any jurisdiction, there is always an ability to say, "I don't like what you're doing. We're going to find a way of adding capital to you", either by adding to your core capital requirement or your minimum regulatory capital requirement, or by saying, "You know what, although it's applied on €100 billion, we're going to change that and bring it down to €50 billion for you". Central banks or supervisory authorities everywhere will always have that level of authority and control.

Q136 **The Chair:** I began the previous session by complaining about people in the industry not being prepared to tell us what they think. You have certainly done that, but you have also illustrated that the decisions on how much capital you require are very subjective. Do you think that kind of ability to make big differences to people's businesses might be behind the reason why some people have been reluctant to come out and make the arguments? I realise that you are the wrong person to answer this question because you have been really helpful to the committee this morning.

Nigel Terrington: I am slightly worried now; can we erase these tapes? I think there is just a natural reluctance to suddenly being put in a fairly daunting forum such as this. People may feel reluctant to speak their mind. I have not had that problem—not here today or previously. What I have said to you today I have said to Sam Woods and others in the past.

The Chair: Could you encourage the people in your group? I am not sure why they find this a daunting experience, but we are very happy to take written evidence. Unlike the committees in the other place, Lords committees will proceed only on the basis of evidence we have received, and we proceed on a consensus basis, so the quality of the evidence we get is absolutely crucial to the conclusions that the committee might reach. We are really grateful to you for helping us this morning and explaining so lucidly some of the issues. Thank you very much.