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Rt Hon John Glen MP
Treasury Committee
House of Commons
Westminster
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27th June 2025

Cc: Treasury Committee Clerk

Dear Mr Glen,

Follow-up to TSC evidence session on 21 May 2025

At the Treasury Committee oral evidence session on 21st May, I offered to follow-up with more detail regarding the issue of how the PRA proposes to implement Basel 3.1 with regards to SME lending, and firm specific Pillar 2A capital add-ons.

I noted that the PRA's initial Basel 3.1 proposals consulted on in Q4-22 were 'fairly adverse to SME lending'. This is because the PRA proposed removing the support factor for loans to SMEs (which allows a bank to hold lower capital against SME loans than is required against loans to large businesses). In September 2024 the PRA published its policy statement that proposed replacing this with another mechanism which had not been fully clarified at the time of the Committee.

Since the oral evidence session, the PRA has published an update on this topic (PRA Policy Statement 7/25[1]). In this, the PRA has set out details of the alternative mechanism via the Pillar 2A capital requirements. I have subsequently discussed this with the Director of Prudential Policy at the PRA, and can confirm we are satisfied this successfully resolves the issue by maintaining the overall capital requirements for SME lending as they were pre Basel 3.1.

The other points I raised in the evidence session still stand. Namely:

1. **The need for a PRA Scale Up Unit**: Many challenger banks have reported delays and uncertainty on capital related processes, and this deters potential investors in challenger banks. Building on the success of the PRA's Start Up unit, a Scale Up unit should be introduced to increase the frequency, and timely delivery, of capital-related processes for scaling up challenger banks. Reported metrics for the PRA should be expanded to include frequency of capital supervisory reviews (for fast growing firms these should be every two years at a minimum); and speed of authorisation of capital instruments such as securitisations (this should be within 3 months, as with other capital instruments that require non-objection, and in line with the EU). Fast growing banks are willing to pay a levy to pay for the increased specialist resource required.
2. **The geographical capital add-on should be removed**: Banks that only lend in the UK receive a Pillar 2A capital requirement add-on for 'geographic concentration risk'. This capital add-on is generally one of the largest elements of a bank's capital add-ons, and it duplicates with a separate and further capital add-on for credit risk, which is based on a very severe UK macroeconomic

[1] PS7/25 – Update to PS9/24 on the SME and infrastructure lending adjustments
https://www.bankofengland.co.uk/prudential-regulation/publication/2025/may/sme-and-infrastructure-lending-adjustments

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event. In the light of the enhanced small bank resolution capabilities, having additional capital requirements for UK domestic focus also does not seem to support the push for UK economic growth. We believe this add-on must be removed. Instead the PRA should measure diversification on a UK regional basis which would help encourage growth across the whole nation and disincentivise regional concentrations of lending. We understand the PRA may consult further on the Pillar 2A capital methodology in the near future, and so there is the chance for this change to happen by 2026.

3. **The MREL thresholds must be raised**: The Committee will be aware that the Bank of England consulted on MREL earlier this year, but this is such an important issue for challenger banks that it bears repeating once again: the MREL asset threshold should be increased materially (we would propose aligning to the ringfencing asset threshold), and revising the transactional account definition (nine transactions within a three month period is far too low to qualify an account for what is meant to protect ‘critical economic functions’. With the rise of electronic payments, the typical account is making 3x the debit card payments and 10x the faster payments they were in 2015 when the transactional account definition was set).

I hope you and the Committee find this helpful.

Yours sincerely,

Richard Davies
Chief Executive Officer, Allica