ClearBank Limited – Written evidence (SCG0006)

ClearBank Limited ("ClearBank" or "we") welcomes the opportunity to respond to the House of Lords Financial Services Regulation Committee's Call for Evidence on the FCA and PRA's secondary competitiveness and growth objective ("SCGO").

Introduction to ClearBank

ClearBank is a payment clearing and settlement bank established in 2015 to provide a "Tech First" approach to wholesale payment services. We serve over 240 financial institutions and cleared more than 200 million payments in 2023. As the UK's first so called "narrow bank" we do not lend or invest customer deposits, holding nearly £10bn in customer deposits at the Bank of England ("BoE"). Our resilient, scalable, cloud-based technology is among the first clearing bank platforms to operate 24/7, delivering payments around the clock to small businesses and consumers.

State of play regarding regulation and FinTech

Over the past 15 years FinTech has become a vibrant UK success story with new entrants, such as ClearBank, transforming the financial services sector with innovative, faster and lower cost services, delivering growth and competition in the UK Financial Services market.

This revolution was ushered in by positive action from UK Government and regulators. The Payment Servies Regulations 2017 created new types of regulated payment firms and services, and the BoE undertook several forward-looking decisions, such as providing non-banks access to settlement accounts and approving the narrow bank business model. These measures combined to catalyse a wave of innovation, competition, and growth, making UK FinTech a global leader, second only to the US in investment.[1]

In the years since, we have seen a shift in the UK environment. UK regulation is now more focused on eliminating consumer loss, resulting in the increasing transfer of risk from consumers to firms. This has increased compliance costs and liabilities, contributed to the overlap of financial services regulatory mandates, and decreased regulators' consideration of the commercial drivers for firms and impacts on competition. It is not a level playing field among firms in their ability to meet increasing compliance costs and liabilities, with the largest firms most able to absorb increasing cost and complexity.

---

[1] H1 2024 FinTech Investment Landscape, Innovate Finance, July 2024

The Prudential Regulation Authority ("PRA"), and Financial Conduct Authority ("FCA") published their first annual reports on meeting their SCGO in July[2] and September[3] respectively. We commend the detailed initiatives. However, there are several in-train regulatory initiatives that are entirely or partially contradictory to this new objective. Across HM Treasury's ("HMT") Slowing Down Payments rules, the FCA's Safeguarding proposals and 'Name and Shame' plans, as well as the Payment Systems Regulator's ("PSR") APP ("Authorised Push Payment") Fraud measures, we would value more engagement with the FinTech community and assessment from regulators of the impacts on competition, international competitiveness and growth.

We welcome the FCA and PRA's SCGO, and hope that in the long term it drives a shift in their approach.

What opportunities or changes should be prioritised in order for the regulators to meet their secondary growth and competitiveness objectives effectively?

There are several live initiatives integral to the continued success of UK FinTech that we feel have the capacity to boost the sector. We urge government and regulators to progress at pace and with due consideration for international competitiveness and growth in the following areas:

- HMT's New Payment's Vision, in particular:
  - Progressing Pay.UK's New Payments Architecture
  - Simplifying the payments regulatory landscape
  - Putting Open Banking on commercial footing
- Developing cross-sector approach to fraud prevention
- The FCA's Review of the Payment Servies Regulations 2017
- HMT legislation and the FCA and PRA's regulatory framework for digital-assets

To what extent are the regulators focused on the objective to promote international competitiveness and growth? Are there areas where the ability of the regulators to fulfil their secondary objectives might be constrained by having to fulfil their primary objectives?

Many capital and regulatory requirements for banks are aligned to international standards, but we note two significant requirements that remain outliers and undermine the growth of UK banks and other firms.

---

[2] Competitiveness and growth: embedding the PRA's new secondary objective | Bank of England

[3] Secondary International Competitiveness and Growth Objective report 2023/24 (fca.org.uk),

Minimum requirements for own funds and eligible liabilities (“MREL”). The SCGO does not apply to the BoE’s actions as a resolution authority, however an area in which the BoE may not have achieved a balance between the promotion of stability with the need for growth and international competitiveness and is in the setting of MREL thresholds, which determine the capital that a bank must maintain to facilitate its resolution. The level of total assets at which this significant additional capital requirement starts to apply is substantially lower in the UK than international competitors (UK £15-25bn, EU €100bn, US $250bn) meaning many UK challenger banks are drawn into the regime when their international counterparts are not. An ongoing BoE consultation on this issue proposes a modest increase to £20-30bn, which is still materially lower than international comparisons. Imposing additional capital requirements at the stage when challenger banks most need to be investing in their businesses and can least afford the burden creates a barrier for growth. This makes the UK a less desirable home for this type of firm.

Additionally, how the threshold is calculated is not aligned to innovative business models, in turn hampering growth. ClearBank does not lend or invest customer deposits, keeping all funds at the BoE. This presents a lower level of business and deposit risk to our customers than many banks operating under the fractional reserve model.

The MREL calculation has not taken account of this. It is an inefficient capital requirement for narrow banks and needlessly diverts our resource away from investment and innovation.

APP Fraud. Tackling APP fraud requires a coordinated approach to prevention and enforcement involving all commercial sectors, relevant regulators and law enforcement. Yet what has been delivered is an unfunded compensation regime which transfers liability for 99.98% of claims onto the payments sector. This simplistic and unrealistic approach damages the attractiveness of the sector for investment and is unique internationally in the scale of the financial burden it places upon the payments sector. Indeed, the European Commission’s June 2023 proposed Payment Services Regulation states that, “It would however be disproportionate and financially very costly to payment services providers to open every fraudulent transaction, authorised or unauthorised, to a systematic refund right. It might also cause moral hazard and a reduction in the customer’s vigilance.”[4]

We need tougher action to tackle fraud origination, specifically from online platforms like Meta and telecommunication companies. The

[4] eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52023PC0367, recital 79

regulators and government must explore how liability could be split in a fair and equitable manner.

What are some of the barriers in the current regulatory framework (including the role and responsibilities of other regulators and bodies such as the Payment Systems Regulator, The Pensions Regulator and the Financial Ombudsman Service) that could hinder efforts to drive economic growth and international competitiveness in (a) the UK economy and (b) the financial services sector?

The UK's complex payments regulatory environment was cited as constraining growth in both the Kalifa Review (2021) and the Future of Payments Report (2023). It is particularly complex for banks which must toggle between multiple regulators: FCA, PRA, BoE and PSR. This environment is inherently inefficient for all parties, but particularly disadvantages smaller firms who are less able to adapt to varying processes and extensive, sometimes duplicated, reporting requirements.

Under the Financial Services Authority there was a more cohesive regulatory approach given both prudential and conduct supervision were carried out by the same supervisor. The split increases workload for firms, and overall engagement has become more disjointed. We would recommend much closer alignment between the PRA and FCA to avoid duplication, and sometimes confusion, for smaller firms. We further recommend transferring the PSR's rule making, reporting, supervision and enforcement powers over payment firms to the FCA, which supervises payment firms' for all other economic crime (sanctions, AML) obligations.

<u>Overlaps of Digital Assets Regimes</u>. An example of this lack of cohesion can be seen in emerging digital assets regulatory regimes. Differences between the FCA and PRA approaches have created inconsistent guidance and made it difficult for banks to understand how these might impact planning for future products. These issues have stalled innovation in an area of intense international competition.

Do the regulators have the right capability and capacity to fulfil their regulatory objectives on growth and competitiveness? To what extent might the culture of the FCA and PRA influence their ability to fulfil their growth and competitiveness objectives?

We do not believe that regulators have adequate capabilities and capacity to support the FinTech sector, as demonstrated by the following challenges.

<u>Reactive approach.</u> We note that the FCA appears to have become more reactive in its approach to some areas of the market in recent years,

moving away from the ‘close and continuous’ model of the past, to a more ad hoc and issue led engagement. This lack of ongoing contact reduces the FCA’s insight on the firms and the broader market.

Slow adaptation to new business models. It is also our view that the regulators have been slow to adapt to emerging innovative business models being pioneered by FinTechs, for example digital assets, and Embedded Banking/Banking as a Service. This is most evident post authorisation when, specifically for Embedded Banking, regulators have struggled to understand how to best oversight the model. Regulators devoting the resource to fully embrace newer business models will improve standards of supervision, facilitate growth and help the UK to remain internationally competitive.

Authorisation timelines. The work to date to address authorisation delays is welcome, but more can be done to speed up timeframes. While important that appropriate steps are taken to ensure only proper firms gain authorisation, the system as it currently operates has created a significant barrier to entry to the market for innovative new firms.

Additionally, vague timelines for updates during the approval process impedes firms’ ability to plan, and stifle investment as a result. A quicker and clearer process would drive growth in UK financial services.

How effectively have the FCA and PRA consulted or engaged with industry in relation to the new secondary growth and competitiveness objective?

While regulators have published some updated statements demonstrating actions, regulators rarely engage with smaller firms over and above standard supervisory relationships. Additionally, FinTech supervisors are often more inexperienced individuals. We would value more regular senior engagement.

This would equip the regulator at a decision-making level with a better understanding of the smaller more innovative end of the market, lead to better rule making, and the development of broader understanding of implications of policies with regards to the secondary objective.

How should the regulators ensure that any measures introduced to meet the secondary growth and competitiveness objectives work for businesses of all sizes across the sector, including startups, scaleups, and incumbents?

Both the FCA and PRA should ensure there is greater FinTech and small firm representation on practitioner panels. At present the FCA Smaller Business Panel is predominantly populated by non-FinTech firms and the main FCA Practitioner Panel is skewed to large incumbents. Neither are

representative of the UK financial services landscape. Further, no small firms are represented on the newly created FCA and PRA Cost Benefit Panels, which are designed to play a critical role in analysing and estimating the impact of proposals on different groups in industry, among other stakeholders. If small firms struggle to offer resources to participate, then we suggest that representatives from FinTech related associations could serve as proxies.

Does the requirement within the secondary growth and competitiveness objectives to align with international standards create any constraints to fulfilling those objectives?

Alignment core requirements, such as net capital and reporting supports growth and competitiveness as consistency between jurisdictions reduces operational complexity and business planning when firms seek to expand internationally.

22 October 2024