OakNorth Bank – Written evidence (SCG0020)

Background to OakNorth

OakNorth was launched in September 2015 with one fundamental purpose: to serve and empower the lower mid-market (businesses with £1m-£100m turnover) seeking to scale but were routinely underserved or overlooked by traditional banks. Our founders, Rishi Khosla and Joel Perlman, had experienced this first-hand while scaling their previous company, Copal. In 2005, three years after launching that business, they applied for a bank loan and the 'computer said 'no'', despite their business being profitable and having strong cashflow. As entrepreneurs, their response was to build the digital bank for entrepreneurs, by entrepreneurs, ensuring businesses like they had been get the products, services, and experience they need to succeed and scale.

To date, we have lent over £12bn, directly helping with the creation of 29,000 new jobs and 47,000 new homes – the majority of which are affordable and social housing.

Over the years, we've been fortunate to work with businesses across a variety of sectors, from healthcare and specialist education, to hospitality and leisure, and SME housebuilding. We've supported well-known brands such as: Sticks n Sushi, Mamas & Papas, Storal, Deliciously Ella, F1 Arcade, Z Hotels, Third Space, and The Heartwood Collection, as well as well-known property businesses such as: Galliard, Frogmore, Verto Homes, Bruntwood SciTech, and Scarborough Group International.

Rather than overwhelming these customers with a menu of products and services, and leaving them to figure out a combination that may work for them, we start with their pain points and work backwards from there to help them find value and efficiencies. No off-the-shelf products, cookie-cutter services, or computer-says-no decisions, as we understand that the needs of every business are unique. We think and operate in their terms – "launch a new location," "optimise my cash," and so on – rather than "here is a loan" or "try opening this savings account." We deploy financial solutions comprehensively in service of their needs, as we strive to empower their success and delight them at every interaction. And we do this through economic cycles, being a trusted banking partner come rain or shine.

By taking a highly granular, data-driven, and forward-looking approach to serving our customers, we're able to provide insight-driven solutions that speak directly to their jobs to be done, solving for what they need to do to run their businesses today, and grow it tomorrow. This is the opposite of what most banks do which is to offer products based on where a business has been vs where it's going.

We’re able to do this because of our unique approach to looking at the business world - rather than splitting the economy into a dozen or so sectors, we’ve developed an analytical framework powered by hundreds of billions of pounds’ worth of commercial loan data from around the world, covering over 270 industries. By looking at businesses through this lens, we’re able to identify the winners which is why our credit quality stands apart from other lenders, and why the businesses we support continue going from strength to strength every year they’re with us. Other banks simply don’t have the willingness or wherewithal to analyse these businesses in this way, which is why they’ll often veto or pull out of entire sectors at different points in the cycle.

While our journey began in the UK, we know that the challenges faced by scale-ups is a global phenomenon. So, we see a huge opportunity and potential to help these businesses scale up. This is why we began supporting businesses in the US in 2023, starting with lending as we did in the UK, completing over $550m in lending there to date.

Response

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

Prioritising opportunities and changes for effective SGCO implementation

To effectively meet their secondary growth and competitiveness objectives (SGCO), the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), should prioritise the following opportunities and changes:

- **Moderating MREL requirements**: Whilst it is encouraging that the Bank of England (BoE) is consulting on changing MREL requirements, their proposals do not go far enough. The current and proposed MREL requirements, especially for mid-tier banks, create a significant barrier to growth and competitiveness.
    - The current MREL thresholds (£15bn to £2bn) are considerably lower than in the US and Europe, where only much larger systemic banks are captured.
    - This discrepancy puts UK banks at a competitive disadvantage, as reaching the MREL threshold significantly increases capital requirements (effectively doubling them).
    - The asset trigger in the UK should be moved up to £40bn to £50bn and the transaction account balance should be

    removed, or significantly increased (there is no such requirement in any other comparable international jurisdiction), given that most customers (retail and business) have transaction accounts with several banks.
  - This adjustment would allow mid-tier banks to grow their activities more smoothly, boosting competition, and increasing lending to businesses and customers.

- Whilst the PRA has a new SGCO objective, the BoE's Resolution Authority does not. It seems counterintuitive to have one part of the BoE covered by the SGCO but not another, which also has an instrumental impact on competition in the banking sector. This should be rectified as a matter of priority.

- **Proportionate, risk-based regulation:** The current regulatory framework often adopts a "one-size-fits-all" approach, which fails to consider different banks' unique characteristics and risk profiles.

  - For example, across the sector, Basel 3.1 changes are likely to lead to small and mid-tier banks having to hold more capital per £ of risk, than they do under current requirements. Since small and mid-tier banks now provide 60% of all SME lending in the UK, this could impact the amount and/or cost of lending to this sector.
  - The regulatory burden on banks is increasing year-on-year (for example, with the implementation of consumer duty, operational resilience, solvent wind-down, etc.), which is particularly hard for small and mid-tier banks to accommodate. A line should be drawn to ensure that the volume of regulation does not increase materially without a withdrawal of previous requirements (a one-in, one-out type policy).

- **Promoting cultural change within the regulators**: Embedding the SGCO requires a fundamental cultural shift within the FCA and PRA.

  - Regulators, by their nature, are risk-averse. No one wants a repeat of the financial crisis, but it can be argued that the pendulum of regulation has swung too far. In fact the Chancellor in her recent Mansion House speech in November 2024, made this same point.
  - To ensure the SGCO is embedded in the cultural fabric of the regulators and to ensure change, there must be a robust training program for all staff at the FCA and PRA that goes beyond occasional sessions and e-learning modules.

    - This should include targeted additional training (for example, for senior management, policy specialists and those regulators who are at key international decision-making committees such as Basel)
    - All senior management (Head of Department/Division level and above), must have an SGCO embedded into their annual performance review with remuneration linked to those objectives.

- **Demonstrating greater ambition and delivering tangible policy outcomes**:

    - Regulators must be encouraged to move beyond "business as usual" activities and showcase significant policy changes resulting from the SGCO.
    - Initiatives such as 'SDDT/Strong and Simple' will have a limited impact on the SGCO, other than simplifying the capital setting process. Regulators must be encouraged to go further and think how they can trim regulation in a risk-based way.
    - A particular focus should be placed on scaling financial services firms, removing barriers to growth, such as MREL, and providing dedicated and additional resources at regulators to supervise this important group of firms.
    - The regulator has a New Bank Start-Up Unit – why not have a dedicated team / unit for scaling banks that have passed the start-up phase, but are equally not one of the five largest banks in the country?
    - By prioritising these opportunities and changes, the FCA and PRA can move towards a more balanced regulatory framework that considers financial stability and the importance of fostering a competitive and innovative financial sector to support economic growth.

2. 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?

The regulators' focus on international competitiveness and growth

Regulators have acknowledged the objective of promoting international competitiveness and growth. However, their focus on this secondary objective may be constrained by their primary objectives, creating tension and potential barriers to its full realisation.

Evidence of focus on competitiveness and growth

- **Acknowledgement of SGCO:** Both the FCA and PRA have publicly stated their commitment to the secondary competitiveness and growth objective (SGCO), outlining initiatives and metrics in annual reports, which is welcomed.
- **Policy changes reflecting SGCO:** There have been instances where the regulators have claimed to have implemented policy changes that appear to consider the SGCO. The PRA's final Basel 3.1 decision, for example. However, whilst reducing capital from the initial proposal, the main, small, and mid-tier banks will still end up holding more capital than they do presently. Therefore, claims must be probed fully, and evidence must be provided by regulators to substantiate them.

Constraints and challenges

- **Prioritisation of primary objectives:** The regulators' primary objectives, such as ensuring financial stability and consumer protection, will always take precedence. This inherent prioritisation can limit their ability to pursue the SGCO, especially when perceived trade-offs arise.
- **Risk-averse culture:** The risk-averse culture within the regulatory bodies is a significant constraint. This caution, amplified after the financial crisis, can lead to overly conservative approaches that stifle innovation and hinder growth.

Specific areas of constraint

- **MREL requirements:** The MREL regime is a prominent example of how the regulators' primary objective of financial stability can constrain their ability to promote growth and competitiveness. The current MREL thresholds, are significantly lower than those in the EU and the US, and are disproportionately burdensome for mid-tier banks, impacting their expansion and potentially limiting business lending.
- **Enforcement proposals:** the FCA's recent enforcement proposal did not adequately consider its impact on growth and competitiveness.
- **Basel 3.1** - despite strong lobbying by the industry and other stakeholders, the PRA kept its proposal to remove the SME support factor in the final Basel 3.1 policy changes. The PRA has promised to compensate by adjusting a bank’s P2a requirement. However, this process is opaque, and the methodology for this adjustment remains unclear and is subject to supervisory discretion.
- **Proposed removal of the refined approach to P2a setting** – many small and mid-tier banks have benefitted from a clever

approach from the PRA, whereby if the firm could prove it was holding too much capital under P1, under the standardised approach, it could request an offsetting reduction under its P2a requirement. This is a great example of risk-based, proportionate regulation. However, the PRA is now proposing to remove this approach, given that it claims that B3.1 is now more risk-sensitive. However, the impact of B3.1 across the sector is likely to lead to higher levels of capital being held per £ of risk, which the holistic approach could have helped alleviate. An innovative regulatory solution that fits with the spirit of the SGCO is being scrapped at the time it is needed most.

Potential solutions

- **Cultural shift within regulators:** There needs to be a significant cultural shift within the FCA and PRA to balance their focus on risk and compliance with a greater appreciation for growth and competitiveness. This shift requires robust training programs, leadership commitment, and a move towards more outcome-based assessments of regulations.
- **Increased transparency and engagement:** Enhanced transparency in the regulators' decision-making processes, coupled with more proactive engagement with industry stakeholders, could help address concerns about subjectivity and ensure that growth and competitiveness considerations are adequately factored into policy decisions.
- **Realignment of MREL requirements:** Addressing the concerns surrounding MREL, particularly by raising thresholds and implementing a system of individualised assessments, would remove a significant barrier to growth for mid-tier banks and better align the UK with international standards.
- **Regulatory transparency -** ensure the PRA produces on an annual basis an impact analysis of its application of the SME adjustment, so it is adequately held to account.
- **Retain the holistic approach:** the current approach is sensible, risk-based, and encourages competition through a fairer application of capital requirements. It is completely at the PRAs discretion to apply, so removing this tool, just as the SGCO, seems counterintuitive and unproductive.

3. 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?

Regulator capability, capacity, and culture

Achieving the right capability, capacity, and culture at the FCA and PRA is critical in those organisations fulfilling their secondary objectives on growth and competitiveness:

- **Ensuring the right culture within the regulators is vital to the success of the secondary objective.**
- For example, the recent enforcement proposals from the FCA did not appear to reference the SGCO. These proposals would have impacted the international competitiveness and attractiveness of the UK as a jurisdiction. This demonstrates that the SGCO is not yet adequately embedded in policy process.
- **The PRA should strengthen its internal culture regarding the new objective by clarifying its vision, extending training to more staff, refining external engagement mechanisms for more effective feedback, and enhancing governance reporting.** These recommendations would also apply to the FCA.
- **Cultural change at the FCA and PRA will be needed to embed the secondary objective into their activities.** The regulators should prioritise this with a robust training program.
- Including regulatory staff's contribution to the objective in performance reviews or executive scorecards was suggested as a way to deliver change.
- It is difficult to know definitively if the new objectives are causing changes in regulator behaviour. Existing good relations with supervisory teams at the PRA predate the secondary competitiveness objective.
- The focus should be on whether the regulators' thinking on competitiveness and growth translates into action.
- The MREL situation is a good test case as it is governed by the Bank of England, which does not have a secondary competition objective, but is still part of the Bank of England's management team discussions.
- There is a need for **cultural change** within the FCA and PRA relating to the SGCO, including the need for practical training, clearer vision, and robust reporting and accountability mechanisms to ensure they are well-equipped to fulfil their secondary objectives on growth and competitiveness. The effectiveness of these changes can be evaluated by observing policy outcomes and the regulators' actions in situations such as the MREL discussions.

4. In delivering their secondary objective on growth and competitiveness, what opportunities are there for the regulators to help to promote and support innovation in the financial services sector? How effective has the FCA's regulatory sandbox been for supporting greater innovation in the financial services industry?

In order to promote and support innovation in the financial services sector, regulators have opportunities to:

- Replicate the success of the PRA/FCA New Banks Start-Up Unit by creating a dedicated scale-up unit across both the PRA and FCA. This would help ensure a more focussed regulatory approach to scale up firms, with more frequent capital and liquidity assessments, to ensure requirements are up to date and an openness to scaling and innovation. Ensure cross-pollination between the scale-up units and the regulator's policy areas to reduce cultural silos and link up with innovative approaches, including the use of AI in financial services.
- Work at pace to ensure the UK is at the forefront of setting the policy standards in innovative areas such as AI, crypto assets and payments and scaling firms. Make the UK the most attractive jurisdiction to open and scale an innovative financial services business in a well-regulated but progressive environment.
- Promote the UK as a leading centre for Green and Sustainable Finance: Regulators can take concrete policy and regulatory steps to deliver this vision and foster a competitive environment.

5. Are the existing accountability measures around the secondary growth and competitiveness objective adequate?

- There are a number of new initiatives that should improve accountability measures around the SGCO. For example, The Financial Services and Markets Act 2023 (FSMA 2023) introduced useful new accountability mechanisms, such as creating the Lords Financial Services Regulation Committee.
- However, more can be done. For example, the CEOs of each regulator should be required to report separately on the delivery of their secondary objectives and deliver that report to Parliament on an annual basis.
- An independent body, such as the National Audit Office or another suitable entity, should audit the regulators' performance against the SGCO regularly and provide its report to Parliament.
- Overall, the new accountability measures introduced by FSMA 2023 are a step in the right direction, but require further development

and refinement to ensure the secondary growth and competitiveness objective is adequately addressed.

29 November 2024