ClearBank Limited – Supplementary written evidence (SCG0059)

1. **In response to Lord Forsyth's question on the cost of compliance (p. 3) the Committee would be grateful if you were able to share any data on these costs, whilst noting that some of this data may be confidential or market-sensitive:**

   a. If you are able, ClearBank's total compliance spend for FY 2023, understood as the sum of staffing costs of ClearBank's compliance department and the spend on compliance IT infrastructure, either in absolute terms or as an approximate proportion of ClearBank's total operating expenses.

      [Figure submitted separate to this document, as not for publication.]

      The most significant compliance cost for us as a bank is regulatory capital, particularly in a scenario where the regulators acknowledge the group is holding more capital than it needs to – see the recent decisions on Basel 3.1 where the delay in implementing the new rules means that there is an additional £8 million of capital tied up that could be released to fund innovation or be passed back to investors to incentivise future investment. Further, the longer that capital is held without being deployed the more disincentivising it is to investors to invest in banks, an example of this being that an investors' rate of return naturally declines the longer the investment is held. This forces investors to either not invest in banks or to seek early returns which could incentivise the management to the wrong behaviours to create returns. The same principles also disincentivise investors from investing further.

   b. Your sense of the regulatory requirements that are most burdensome to comply with, both in terms of spend and amount of executive time taken.

      The MREL capital requirement presents the largest financial burden, due to its scale and the fact that it is not relevant to our business model. MREL is a substantial capital requirement (equal to 100% of a bank's total basic regulatory capital requirement) which applies when a high growth bank most needs capital to scale up its business. Also, our unique business model does not present any risk of customer losses, therefore in principle MREL is not mitigating against any risk.

UK financial services rules such as these must be updated to align to innovative business models such as ClearBank and exempt requirements which are no longer relevant. We are advocating that all payment banks such as ourselves, banks which do not invest or lend customer funds, should be exempt.

c. Your sense of whether the cost of compliance has increased over the last 5 years, whether you expect it to increase, and if so at what rate?

   Financial services rules, compliance, reporting and related obligations have grown significantly with the introduction of new consumer protection (Consumer Duty) and financial crime regimes (sanctions, AML and APP Scams). The APP scams mandatory reimbursement regime introduces not just substantial customer reimbursement costs (£460m in losses in 2023 as a benchmark for industry reimbursement costs) but also substantial fraud prevention costs for every payment firm. We further note that the volume of legislative and regulatory consultation has also growth dramatically in recent years, with 17 APP scam consultations alone between 2021-2024. The industry is also flooded with consultations, which require valuable staff and management time to address. There must be a more efficient way to engage with the industry.

   It is concerning that Santander, a large firm with substantial financial resources, has stated its reasons for considering quitting the UK are the total cost of compliance and APP Scams liability. But the government and regulators appear to now recognise the cumulative costs to firms and the long term impact that this is having on competition, international competitiveness, growth and innovation.

2. **In response to Lord Forsyth's question on specific regulatory reforms the UK could and should make to improve its competitiveness and growth (p. 3), the Committee would be grateful if you could provide further specific examples, particularly those that would support scale-ups in growing and ensuring innovative firms can bring new products to market:**

   a. Mr McManus expressed support for an accelerated approvals pathway for innovative firms but noted that in discussions with the

FCA they had expressed concerns around the fairness of such a proposal (p. 11). Given this, how else can the FCA and PRA ensure that innovative firms bringing new products to market are authorised quickly and with the necessary rigour?

We stand by our recommendation for the FCA and PRA to create Scale Up units dedicated to supporting high growth firms. Richard Davies's explanation later in Q196 addresses regulators' fairness concerns:

"My perspective would be not to do it as a "pay for a fast-track visa" type of scheme. We should define what a scale-up firm is and have a levy on those firms that [which wish to participate] to fund extra regulatory resource that covers the gamut of policy and specialist supervisory activities. I know many firms would be happy to pay that. That would give the regulators the resource to focus on this area."

We further recommend FCA and PRA continue to work to reduce the average authorisation time periods to average decision time periods not just within the statutory periods, but substantially within the statutory time periods. Most the stats focus on the number of applications approved within the full statutory time period – that demonstrates regulators' compliance but not efficiency.

b. Mr McManus suggested the regulators create a "sandbox for scale-ups," (p. 2) to support new and growing firms, what support would this provide that the current regulatory regime does not; how would the regulators determine admittance to the sandbox; and at what point should a firm exit the sandbox?

The "sandbox for scale ups" is another description for the "scale up support unit" proposal discussed above.

c. Please provide any further suggestions for regulatory changes that the UK could make to improve its competitiveness and growth, beyond reforms to MREL and the current APP Fraud approach noted in your written response.

Extending the secondary objectives for growth and international competitiveness to the BoE Resolution Directorate and PSR. The Bank's resolution regime, of which MREL capital requirements is a component, has significant commercial considerations affecting growth, international competitiveness, competition and investment in the UK banking sector. The PSR's payment system policies

(eg digital asset settlement systems) also have significant implications in these areas.

Reducing regulatory complexity (reporting consolidation). We advocate for a multi regulator review of regulatory reporting, in particular with a view to consolidating reporting requirements where sensible and removing those which currently serve little or no purpose (eg COVID reporting). There should be more collaboration between regulators to consolidate reporting and other operational requirements.

Improving supervisory staff training and retention. Well trained, experienced and stable supervisory staff are required to support new and complex products and services. Regulators should implement staff retention schemes to ensure that staff with necessary experience and seniority are available.

Bringing the FS sector under the Regulatory Innovation Office. This body is being established to oversee regulators in high growth industries, and will support and encourage them to update regulation, speed up approvals, and ensure different regulatory bodies work together smoothly. This body would ensure that regulators are effectively supporting high growth firms.

3. **In response to Lord Forsyth's question regarding what the FCA and PRA could learn from the Dutch regulators (p. 3), Mr McManus referenced the 12 to 15 month mobilisation period that exists in the UK after a banking licence is granted but noted that the ECB does not have an equivalent regime. The Committee would be grateful if you could follow up on this:**

    a. The Committee would be grateful if you could set out in more detail your experiences of authorisation in the UK and EU, noting particularly the relative amount of data requested, any especially burdensome requirements, and the amount of guidance offered by the regulator.

    As one would expect, the core documents to operationalise a bank were the same across the UK and Europe so in actual fact the amount of data requested across both markets was relatively consistent.

The UK and Europe differed in their approach to communication throughout with the UK regulators opting for a more personal and tailored close and continuous contact (usually in person pre covid) than the European regulators did who took the view that all submissions / correspondence ought to be in writing.

Similarly, the UK regulators offered assistance in interpreting regulation where ClearBank did not quite fit within the spirit of the text as opposed to in Europe where little to no assistance was offered in this regard.

When comparing the regimes, ClearBank had a positive experience in both the UK and European markets albeit there was invariably greater complexity and formality to our European application owing to corresponding with both the DNB in the Netherlands and the ECB holistically.We would also point out that given the timing of our UK application in 2016 as opposed to 2023 in Europe the UK regulators were comparatively better at dealing with new innovation and, by way of example, authorised ClearBank as the first new bank operating solely in the cloud

It is with the benefit of this supervisory regime in the UK for new banks that the comparison to not having the same level of support for growing banks becomes even more stark.

b. To what extent does the UK's mobilisation period inhibit the growth of a new authorised firm? As a firm that has gained authorisation in both jurisdictions, what is your impression of how this requirement affects the attractiveness and competitiveness of the UK as a destination for innovative new firms?

We endorse the UK mobilisation period and believe that it offers unique advantages for new firms given the impacts to consumers in avoiding a substantive issue materialising immediately post authorisation. The mobilisation period offers firms the benefits of close supervision, which supports new firms to get it right in the early stages of their development, setting up a strong foundation and given it is time boxed to 12 months does not, we would say, create a significant impediment to early growth. Similarly, a newly authorised bank may exit mobilisation more expediently if they can demonstrate that they are ready, which in our views is good incentivisation to doing things properly and instilling the right cultural behaviours at the outset.

One would also point out that whilst there is no official mobilisation period in Europe it is accepted that a period of time post authorisation is required to operationalise your business, effectively creating an informal mobilisation period for new entrants on the continent.

c. Can you provide any further examples where UK regulators are not aligned with, or could learn from, their European counterparts?

We would respectfully submit that the European regulators have more to learn from the approaches taken in the UK than the opposite, particularly for new banks.

4. **In response to Lord Sharkey's question regarding the extent to which the PSR has been successful meeting its Secondary Objective to promote innovation and what else it could do to fulfil this (p. 11), Mr McManus noted that the PSR has not been successful and agreed to follow up in writing.**

   a. The Committee would be grateful if you could expand on Mr McManus' comments.

   The PSR's Annual Report 2023/24 lists only one initiative related to innovation out of nearly 40 initiatives: *"Engage with industry to support innovations in cash access".* The report does not identify any outcomes of this initiative or pro-active proposals. The PSR also states in this report its role as fostering conditions for innovation, but does not specify any such conditions. The PSR's 2024/25 Annual plan and budget likewise is bereft of ideas, again stating only that staff are seeking to understand industry led market developments: "*Driving innovation in payments is another important priority for the PSR. We are actively exploring new developments in payments in the UK and globally to understand the implications for UK payment systems and our objectives*." These reports fail to report any meaningful action.

b. Additionally, if you are able please share examples where the PSR has failed to meet its objective to promote innovation and set out where this has impacted the UK's competitiveness and growth; for instance, where the PSR has hampered innovation or missed opportunities to promote it, where it has introduced additional cost or compliance burdens, and your impression of the PSR's performance as a regulator compared to previous bodies that have regulated payments.

The PSR's aim of fostering conditions for innovation seems at odds with its objective last year of transferring the policing of online fraud from UK law enforcement to the payments industry and imposing an unfunded consumer compensation obligation on firms (APP scams regime). This radical policy gave no meaningful consideration to the impact on growth, competition, the invest-ability or international competitiveness of the sector – all of which are conditions for fostering innovation.

c. In your written evidence, you recommended transferring the PSR's responsibilities and powers to the FCA, which would likely require Primary Legislation. Failing this, what internal reforms should the PSR undertake to improve its efficiency and meet its Secondary Objective?

Please note that our written submission recommends transferring the PSR's responsibilities only in relation to <u>payment firms</u>. We are not recommending the transfer of regulatory powers relating to the <u>payment systems</u>, as we have no experience of how they regulate these bodies.

The PSR appears to have very limited statutory authority to direct payment firms under the Financial Services and Bank Reform Act 2013 ("FSBRA") powers. In s54, the PSR is granted power only to "direct" firms; the wording does not use the word "regulate" and the FSBRA 2013 recitals are so limited as to interpretation of this power that it implies that the "directions" were not intended to amount to material policy decisions. The Chancellor's remit letter on payments to the FCA and PSR seems to make clear that material policy decisions relating to payment firms are now under the mandate of the FCA. We recommend that the upcoming clarification of regulatory mandates under the Memorandum between regulators should make clear the PSR's very limited remit of FSBRA s54 "directions".

24 January 2025