Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Retail banking team
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

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Dear Sir/Madam,

CMA retail banking market investigation: interim report

This is the Financial Services Consumer Panel's response to the CMA retail banking interim report.

The Panel believes that the proposed remedies are unlikely to lead to a market that works better for consumers. The CMA places great emphasis on switching. However switching in itself is not proof of a well-functioning market. Personal current accounts and business bank accounts are not like commodities. Quite often, consumers want a relationship with their bank. They want an account and a service that works well for them and suits their needs, from a bank that will treat them fairly. They also want loyalty to be rewarded and hope that if they face financial difficulties their bank will be sympathetic; or believe that a relationship with their bank may help them get a loan or mortgage later on.

Further, while the Panel supports the desire for switching to be easier and hassle free, providing more information and a few prompts will not overcome consumers' perception that the potential benefits of switching to another bank are simply not worth it.

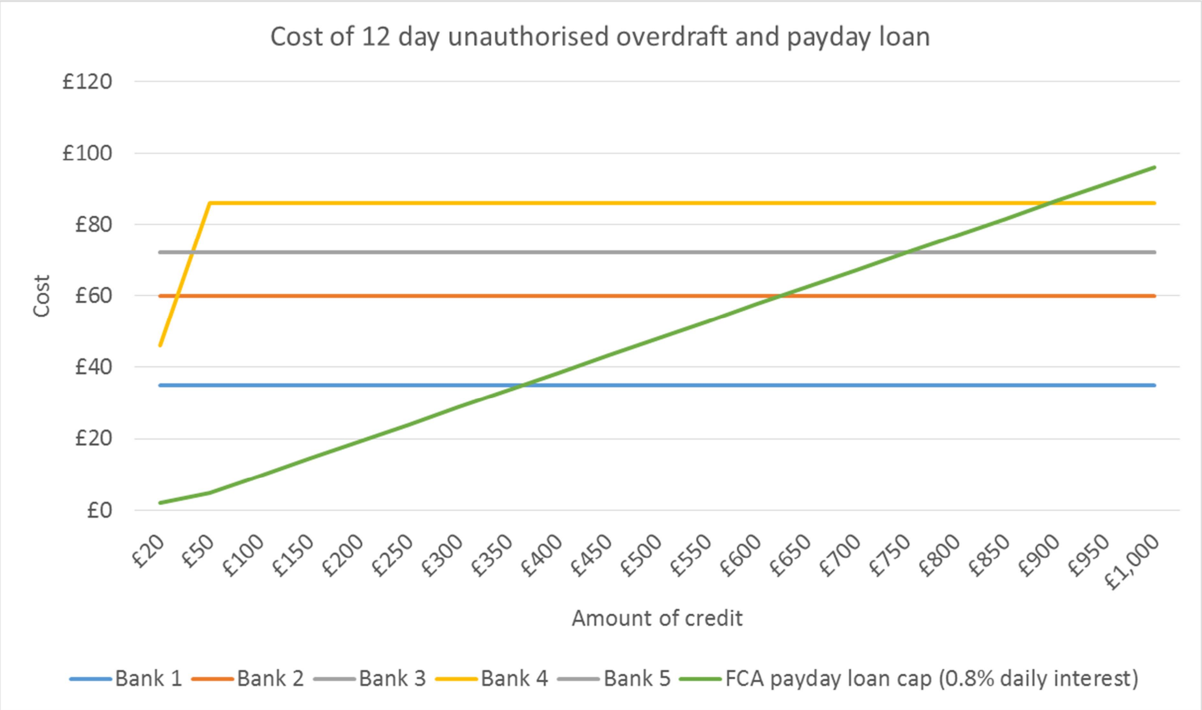
Perhaps more to the point, how are consumers supposed to switch away from high prices when they do not know what they are paying? The CMA has provisionally concluded that 'free if in credit' (FIIC) banking does not inhibit switching. If the CMA believes that FIIC is not relevant, then it needs to explain how consumers' decisions based on non-price factors will drive better, cheaper, products and services.

Cross-subsidisation, coupled with murky pricing structures and contingent charges, obscures the true cost of having a bank account, and, by definition, there are winners and losers. The Panel commissioned research on cross-subsidisation last year, this concluded that the losers were most likely those with high balances not earning interest; people who used overdrafts; and those who did not shop around.

The provisional findings have not shed any light on the distribution of costs and benefits arising from FIIC, because banks can't (or won't) estimate the profitability of their individual product lines. It is impossible to gauge whether the current account market is competitive without knowing the true cost and profitability of bank accounts and related products, and we believe the CMA should go to greater lengths to examine these. Furthermore, if the CMA examines only the aggregate profits of banks' retail operations then it should exclude misconduct costs from the analysis. There is evidence that, excluding misconduct costs, retail banking profits are at a record high.[1]

Overdraft fees and charges have become more complex and difficult to compare over the past few years, as banks have moved away from charging interest to charging daily fees, monthly fees, interest or some combination of these. Unarranged overdrafts may also have paid and unpaid item charges alongside other charges. This makes it more difficult for consumers to understand which account offers them best value, especially if they anticipate using an overdraft. Often, the answer as to which account is best for them will be "it depends" – it will depend on how often, how much and for how long they use their overdraft. There is evidence that many consumers underestimate their usage of overdrafts and may be over-optimistic about their ability to avoid them in the future. In these circumstances greater transparency alone is unlikely to have the desired effect.

Unarranged overdraft fees can be seen as a type of discontinuous pricing strategy, used to exploit financial difficulty and small errors from consumers with charges that far exceed marginal cost. In some circumstances the cost of an overdraft can exceed the cost of a payday loan, which the FCA has capped at 0.8% interest per day. This difference in cost between payday loans and unarranged overdrafts, when banks face very low customer acquisition costs for their unarranged overdrafts, merits closer examination by the CMA. Unarranged overdrafts should also be lower risk as banks possess a significant amount of information about their customers' financial circumstances.



The possibility to cross-subsidise current accounts from other product lines, such as mortgages, may also have an impact on competition in the current account market by acting as a barrier to new entrants. The Panel urges the CMA to put the spotlight on the true cost of 'free' banking, and the impact on competition, when it publishes its final report in 2016.

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[1] See TSB Prospectus, page 58 https://www.barclaysstockbrokers.co.uk/SiteCollectionDocuments/tsb-prospectus.pdf

We are disappointed that the majority of the remedies being proposed focus on the demand side; that is, consumers are required to take action to achieve the desired effect. These types of demand-side remedy have had only limited effectiveness in other markets, such as energy and home credit[2]. We believe there should be more pressure on firms to change their behaviour, be more transparent and treat their customers fairly. A market judged solely on levels of switching does not incentivise firms to reward loyalty; instead, as has happened in the past, banks may only offer improved interest rates or services to new customers.

The CMA should also undertake more research into the quality of consumers' switching decisions in the current account market. This should include examination of whether the switching decision has resulted in the consumer switching to a better value product.

Regardless of what remedies it eventually pursues, the CMA should learn from the previous experience of leaving the implementation details of the remedies to industry groups and trade associations dominated by the largest banks. There are a number of examples where this approach has led to delays, only partial consideration of the options, and the lack of independent cost-benefit analysis. For example, industry 'ownership' of the 2009 remedy[3] requiring summaries of costs resulted in these only being provided once a year and excluded foregone interest; the transparency remedies took over 5 years to roll out across the market; and the annual summaries "as designed by banks, had no effect on consumer behaviour when considering whether they incurred overdraft charges, altered balance levels or switched to other current account providers"[4]. The CMA should establish an independent and transparent governance process to monitor and implement any remedies and should consider how the FCA and PSR should assess the effectiveness of those remedies once implemented.

The Panel is currently conducting some qualitative retail and SME consumer research exploring what banks' customers expect and want from a bank with a "fair" culture. It is possible that this research will throw some light on those elements of a PCA or BCA deemed most important, and how retail consumers and SMEs might 'measure' their bank and the service they receive. We would be happy to share this research with the CMA when it is published in early 2016.

The Panel takes a close interest in the treatment of smaller SMEs in relation to financial services as part of its wider consumer remit. Bank business loans account for 70% of funding for SMEs in the UK. Overall bank lending to micro and small businesses (MSMEs) declined by a quarter from the financial crisis to the end of 2013. Over the same period, lending margins increased, from 2.5% to 4%. Despite the government's "Funding for Lending" scheme being re-focused towards encouraging lending to MSMEs, lending contracted by £0.5 billion per quarter in 2014. While some of this decline was due to decreased demand, there is also evidence the banks withdrew from what they saw as riskier lending: in 2011–2012, 23% of MSMEs had a loan application rejected and 19% were refused an overdraft. Over the period 2005–2007, rejection rates were 6% for loans and 8% for overdrafts. Lack of access to finance can be a particular problem for microbusinesses due to information asymmetries and the additional cost of providing small loans[5]. But it is also the case that banks have been withdrawing from funding businesses of all sizes as they seek profit elsewhere, particularly from derivative and

[2] http://webarchive.nationalarchives.gov.uk/20140402141250/http:/www.competition-commission.org.uk/assets/competitioncommission/docs/2013/remedies/130228_home_credit_evaluation.pdf
[3] OFT (2009), Personal current accounts in the UK – a follow-up report
[4] FCA (2015), Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour
[5] Extract from: Lewis, S., and D. Lindley. 2015. Financial Inclusion, Financial Education, and Financial Regulation in the United Kingdom. ADBI Working Paper 544

related transactions and individual mortgage lending. John Kay estimates that lending to the real economy amounts to only around 3% of UK banks' assets[6].

The reduced availability of bank funding to MSMEs has the potential to stifle economic growth as the alternative sources of funding are either difficult to get (for example, most types of asset finance) or not provided in sufficient quantities (for example, peer to peer lending).

The smallest MSMEs fall between two stools in that they are seen as both riskier and less profitable than individual customers or larger SMEs. As the CMA has identified, this has led to low availability of funding, failure to provide the right type of products, and very little product innovation in the MSME market.

In light of the above, it is hard to see how increased customer engagement alone will lead to the greater competition, product innovation, increased product choice and value that this important part of the UK banking market requires.

We would encourage the CMA not only to review the operation of the 2002 and 2008 SME banking undertakings put in place by the Competition Commission as it has already indicated that it will do, but also to consider measures, and especially supply side measures, to improve:

- access to finance for MSMEs;
- the availability of banking products tailored to the needs of MSMEs; and
- the treatment of MSME customers by banks in terms of pricing, terms and conditions, and forbearance.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel

[6] Other People's Money: The Real Business of Finance. John Kay and JA Kay. 22 Sep 2015

Comments on proposed remedies where the Panel has specific comments:

Measures to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers

As discussed above, the Panel believes these remedies are unlikely to be effective until the main issues around cross-subsidisation and complex charging structures are addressed.

Tesco Bank has carried out some interesting work into the difficulty for consumers in comparing current accounts[7]. It has focused on the key issues for industry to address, including helping consumers to determine the value of their current account.

Remedy 1 – Prompt customers to review their PCA or BCA provider at times when they may have a higher propensity to consider a change

This is unlikely to have a significant effect. The trigger is only part of the switching journey – consumers also need the motivation to act and the ability to make a decision and to execute. To maximise the chances, the messages would have to be strong, specific to that individual, and repeated at regular points. They would also have to include the specific steps that consumers could take to switch account.

Remedy 2 – Increase public awareness of the potential savings or rewards that could be obtained by changing one's current account provider and of the benefits of using the Current Account Switch Service to do so in terms of security and convenience

There is very little evidence presented that raising awareness of CASS would have a significant impact on switching. The initial advertising campaign for CASS should be evaluated before considering further promotion of the service.

Remedy 3 – Facilitate price comparisons between providers by making customer specific transaction data more easily available and usable, including by PCWs

We are unaware of any evidence that consumers would use customer specific transaction data. BIS first announced the "potentially limitless" possibilities of the MiData initiative in April 2011, but MiData is still not widely used four years on. For PCWs to better facilitate price comparisons, they need to be truly independent with no commercial relationships, and it should be possible to compare products on a single page without advertisements. We support the introduction of an open Application Programming Interfaces (API) standard and for all banks required to implement this standard as soon as possible. We are concerned that the "Open Banking Working Group" is dominated by industry representatives. The increasing use of reward current accounts means that the API standard will need to cover the detail of consumers' expenditure.

Remedy 4 – A PCW for SMEs

There are already commercial comparison sites for BCAs, such as GoCompare. However, the CMA has identified the very significant barriers to MSMEs switching, and it is unlikely that more comparison websites would of themselves make a difference. What is needed is more innovative products and services, tailored to MSME needs.

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[7] http://library.the-group.net/tesco_bank/client_upload/file/Tesco_Bank_TNS_White_Paper.pdf

Remedy 5 – Enable consumers and SMEs to make comparisons between current account providers on the basis of their service quality

The Panel has published research[8] and a position paper[9] on 'Consumers as co-regulators'. We looked at why people don't switch away from firms that visibly behave badly, and asked how it would be possible to harness the power of the consumer to help it. Our research found that consumers would find it helpful to have information about firms' behaviour and service quality. We would like to see a score for firm behaviour that gave people an insight into firm culture. A rating for firms could be based on, for example, penalties and redress paid out by firms, quality of service indicators, and customer feedback.

Remedy 7 – Make it easier for prospective PCA customers to find out, before initiating the switching process, whether the overdraft facilities they were seeking would be available to them from another provider

We support this remedy. Consumers do not benefit from a switching service where all account activity is moved to a new account, leaving an overdraft with the previous account provider.

Remedy 8 – Require payments into the old account to be redirected to the new one for a longer period than at present

We support this remedy. However, it may be better in the long-run for Account Number Portability (ANP), or a system which performs the same function, to be introduced. This should be informed by a full cost-benefit analysis and detailed technical study carried out by the PSR.

Remedy 9 – Require banks to retain and provide ex-customers, on demand, with details of their BCA and PCA transactions over the five years prior to their account closure

This may give some consumers confidence to switch, but should of course be aligned with UK and EU data protection requirements.

Remedy 10 – Require Bacs to transfer continuous payment authorities on debit cards when switching through CASS

The Panel does not support the use of CPAs as a replacement for direct debits or other payment methods. CPAs are not clearly listed on banks' systems, or on mobile or internet banking applications. It may be beneficial for Bacs to advise consumers of any existing CPAs, enhancing their ability to control the payments, but we would not support a remedy to transfer CPAs without measures to improve the transparency and protections associated with them.

Remedy 12 – Changes to CASS governance

We support reforms to the governance of CASS to remove it from the control of the industry. It should either be governed by an independent board or brought within the oversight of the Payment Services Regulator.

Remedy 13 – Data sharing with credit reference agencies

[8] https://www.fs-cp.org.uk/sites/default/files/consumers-coregulators-research-2015.pdf
[9] https://www.fs-cp.org.uk/sites/default/files/consumers_as_co-regulators_final.pdf

As before, we would expect any proposals to be aligned with UK and EU data protection requirements.

Remedies the CMA is minded not to consider further

Measures to control outcomes for example a remedy which would impose a price control on unarranged overdraft charges or which would create an obligation to offer minimum interest rates

The Panel has repeatedly made the point that the FCA's definition of high-cost short-term credit (HCSTC) is too narrow. "Mainstream" sources of credit are currently far more likely to lead to over-indebtedness than payday loans are. We believe there should be consistency in treatment between different forms of HCSTC; if one form is to be capped then so should others. At the very least, it is disappointing that the CMA has not considered whether there are any lessons from the FCA's price cap that could be applied to unarranged overdrafts.

It is also disappointing that the CMA has not considered restoring the ability of regulators to assess charges for fairness – the position which existed before the OFT lost the bank charges test case in the Supreme Court. Regulators would then be able to study whether the level of these contingent charges reflected the costs incurred by the banks when consumers use an unarranged overdraft.