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

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Andrew Tyrie MP, Chairman
Treasury Committee
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Our ref: Treasury Committee

Dear Mr Tyrie

Financial Services Consumer Panel
Competition and choice in the banking sector

I am delighted to accept the Committee's kind invitation to spend some additional time with Committee members on 18 November to answer questions on competition and choice in the banking sector, after the discussion with my two colleagues on the Financial Services Practitioner Panels on the future of regulation. I thought it might be helpful to write to you ahead of this latter discussion setting out the Panel's main thoughts in this area. The Panel will shortly be submitting evidence to the Independent Commission on Banking which the Committee might also find useful. Structural change could of course be a stimulus for greater competition and we will be able to assess this once the Commission's options for change are published in the spring of 2011. I will arrange for the Panel's Secretariat to send a copy of our evidence to the Clerk to the Committee, once it has been submitted.

Competition in the banking sector

While we do not regard competition as a panacea, we believe that there are barriers to entry into the retail banking sector and to competition within it that must be removed if consumers are to have a real choice of banking services. The current concentration of business in the large banking groups, together with common ownership of financial firms, severely limits the options for consumers to effect real change. The position is particularly acute in Scotland, where the retail banking sector is dominated by just two banks. When consumers are in a position to exercise effective choice the pressure will be on banks to improve customer service and introduce fairly priced products that meet consumer needs. This is a fundamental issue in banking. It is an example of a market with ostensibly competing businesses where competition is ineffectual in achieving good consumer outcomes and where regulation has been ineffective in delivering good value for consumers.

'Too big to fail'

If the market is to be opened to more new entrants there needs to be resolution of the implicit Government subsidy of banks that are "too big to fail". This distorts competition by weakening the ability of small or new entrants to become real challengers and destroys the functioning of an effective market.

The issue of regional monopolies in both Scotland and Northern Ireland warrants specific attention.

Competition and real choice

Competition and choice are not the same thing, although effective competition can lead to greater choice for consumers – but it must be a *real* choice. In retail banking this means a wider selection of products and services, rather than essentially the same product sold a number of times under different brands. The chances of customers having this real choice would be greatly enhanced if there were more banks or banking service providers in the market, creating an environment where new or innovative products can be developed.

It is difficult for consumers to "vote with their feet" when they are dissatisfied with the service provided by their bank when the process is, or at least is perceived to be, problematic and when there is no really different alternative. We have heard lack of account switching described as a result of consumer apathy. We do not think this is necessarily true. Rather it is often a recognition that another bank has nothing new to offer. Consumer Focus published research[1] on 9 October which showed that only 7% of customers moved their current account during the last two years, compared with 31% who switched energy supplier, 26% who switched telecom provider and 22% who switched home insurance. The Panel wants to see consumers in a position to shop around for banking services which meet their needs and have something alternative to offer.

So-called "free banking"

The pricing of banking services, including the erroneously named "free banking" model, is another barrier to competition. There is a perception that so-called free banking has become a basic customer and market expectation and this has the potential to restrict the development of different models by fledgling market participants. In other retail sectors, where effective competition prevails, consumers benefit from lower costs and genuinely innovative products designed to meet their needs. So-called "free banking" makes it hard for new entrants to offer fee-based current accounts even though this might provide many customers with better value for money overall. In this respect the lack of transparency about interest forgone on current accounts, and the difficulty of establishing the total cost of a current account work against customers making a rational decision about which bank to use for their main current account.

Payment services or transactional accounts

Consumers need access to and have confidence in, a resilient transactional payment service in order to buy basic utilities such as water and electricity supplies – as well as other consumer goods - at the best price. For example, direct debit is the cheapest way to pay utility bills. In the future, the trend towards electronic payment

[1] "Stick or twist: an analysis of consumer behaviour in the personal account market" at consumerfocus.org.uk

systems away from cash and cheques means that everyone will need a transactional account. There has to be clarity about the cost of the provision of such a service, which currently tends to be hidden in the overall cost of other banking facilities, or masked by the label of “free banking”.

In many respects this aspect of banking service is a utility but the access to customer information which it provides gives the bank holding this information a competitive advantage which works against effective competition in the market for financial services and raises the barriers for new entrants.

Regulation and competition in banking

It is not possible to consider competition in banking without taking into account the impact of regulation. For example, lack of transparency over product costs and charges in the market, where the growth in packaged accounts can only serve to blur the real cost of products still further, together with the legislative constraints in the Financial Services and Markets Act on the regulator’s ability to publish information which it collects in carrying out its duties – such as data on customer complaints – does limit consumers’ ability to exercise market freedom and so help to drive down prices. A legislative presumption in favour of transparency in the regulation of retail banking, including the contentious question of complaints data, could do a lot to support effective competition.

In our response to HM Treasury’s paper on a new approach to regulation we called for, among other things, a clearer remit and stronger powers for the new Consumer Protection & Markets Authority to protect and uphold the interests of consumers. In certain circumstances this would include promoting effective competition that delivers clear consumer benefits. Such powers will be needed to deliver real regulatory change in the retail banking sector that will encourage effective competition.

Yours sincerely

Adam Phillips
Chair
Financial Services Consumer Panel