

# Personal current accounts and banking services to small and medium- sized enterprises

Decision on  
market investigation reference

6 November 2014

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## Contents

Page

Summary .....	
1. Introduction and background .....	5
Historic reviews into the sector .....	5
The market studies .....	7
SME banking .....	8
PCAs .....	9
Provisional decision .....	11
The consultation on the provisional decision .....	12
2. Issues raised during the consultation on the provisional decision .....	13
Overall summary of responses received .....	14
The reference test.....	15
The necessity of defining what a well-functioning market would look like.....	16
The effect of developments in the sector.....	17
The relevance of concentration .....	19
The continued importance of a branch network as a barrier to entry.....	20
Linkages between products (particularly for SMEs).....	22
Cross-subsidisation .....	24
Switching .....	24
Customer outcomes – satisfaction.....	26
Customer outcomes – innovation .....	27
Transparency.....	28
Restrictions on the provision of banking services.....	29
The exercise of the CMA’s discretion to make a market investigation reference .....	29
The appropriateness of any structural solution .....	29
Undertakings in lieu proposals.....	30
The conduct of a market investigation .....	31
The scope of the terms of reference .....	32
SME banking .....	32
PCAs .....	36
3. The CMA’s final decision regarding an MIR.....	37
The reference test.....	37
SME banking .....	37
PCAs .....	39
Discretion to make an MIR.....	40
First criterion: scale of the suspected problem .....	41
Conclusion on the first criterion: scale of the suspected problem.....	51
Second criterion: availability of appropriate remedies through an MIR.....	51
Third criterion: the availability of undertakings in lieu of a reference .....	56
Conclusion on the third criterion: the availability of undertakings in lieu .....	60
Fourth criterion: alternative powers .....	60
Conclusion on MIR.....	61
4. Scope of the MIR .....	63

## Annexes

A: Terms of reference

## Summary

- On 18 July 2014 the CMA published two market studies about personal current accounts (PCAs) and banking services to small and medium-sized enterprises (SMEs). These market studies, while recognising that there had been various improvements in the retail banking sector in recent years, gave the CMA reasonable grounds to suspect that there are a number of features in both segments which prevented, restricted or distorted competition, including, in summary, that:
  - persistent levels of concentration and relatively stable market shares (and for SME banking, a market structure characterised by close linkages both between PCAs and BCAs, and between BCAs and general purpose business loans)
  - continuing high barriers to entry and expansion into the markets
  - demand-side issues, such as levels of customer shopping around and switching remain low
  - there is limited transparency, and difficulties for customers in making comparisons between banks, particularly for overdraft charges on PCAs which are very complex

Perhaps as a result, very limited market share gains have been made in recent years by those banks with the highest reported levels of customer satisfaction – not what would normally be expected in well-functioning competitive markets.

- On the basis of these findings, the CMA proposed to make a market investigation reference (MIR) in relation to both PCAs and SME banking. We then consulted on this provisional decision, giving respondents until 17 September 2014 to make representations.
- During that consultation the CMA received representations from interested parties across the PCA and SME banking sectors, and more widely.
- Most of these respondents were supportive of the CMA's proposed decision to make an MIR. In particular:
  - Various respondents agreed with the CMA's analysis regarding the existence of areas of potential competition concern, with several of them noting that these features were long-standing and led to poorer outcomes for customers and the wider UK economy. Which?, for example, submitted that it did not consider the sector to be 'functioning in the way we would expect of effective competitive markets', leading to 'poorer outcomes for consumers'.
  - Some smaller banks also agreed that a full, objective investigation of the sector was required to investigate and address competition concerns and propose solutions if necessary. Santander, for example, suggested that such an investigation was a 'critical opportunity' to address long-standing concerns and TSB said that 'the CMA is uniquely placed to conduct a thorough, objective analysis'.

- Most respondents considered that the undertakings offered by the largest banks as an alternative to an MIR being made, while welcome, would not be sufficient to address concerns in the sector.
- A small number of respondents, including the four largest UK banks, expressed reservations about the appropriateness of an MIR, including on the grounds that:
  - the CMA had not taken sufficient account of the overall impact of various developments under way
  - the CMA had not made the case for structural remedies; and that, in the case of SME banking, it was disappointing that the CMA had concluded that the undertakings in lieu offered by the banks (which did not extend to structural remedies) would not be sufficient to remedy the competition concerns it identified
  - the CMA had placed too much weight on switching figures and had not established a linkage between concentration and adverse market outcomes
  - the CMA had understated levels of customer satisfaction with their banks

However, the CMA considers that it had had regard to these considerations in reaching its provisional decision and that little or no substantial new analysis, argument or evidence has emerged from the consultation to lead the CMA to reach a different conclusion now (save as regards issues raised by certain large banks relating to the scope of the terms of reference – see below).

- After giving careful consideration to the various consultation responses, the CMA's overall analysis of the features in the sector remains unchanged, and the CMA remains of the view that it has reasonable grounds to suspect that these features prevent, restrict or distort competition in the UK, and, given these features, that an MIR is the most appropriate way of proceeding.
- The CMA therefore confirms its provisional decision of 18 July 2014 (save as regards the terms of reference) and now makes an MIR in relation to PCAs and to aspects of SME banking. The terms of reference for the MIR, included in Annex A to this decision, reflect changes made in the light of consultation responses.
- A Market Reference Group of independent CMA members will now conduct a full market investigation. Further details about the investigation will be published on the CMA's website.

## 1. Introduction and background

- 1.1 This document sets out the reasoning behind the CMA's decision to refer certain retail banking services to SMEs<sup>1</sup> and the provision of PCAs for a market investigation, confirming its provisional decision of 18 July 2014 (save as regards the terms of reference). The document is structured as follows:
- **Chapter 1** sets out the background to the CMA's decision to make an MIR
  - **Chapter 2** discusses the issues raised during the consultation on the provisional decision to make an MIR (the provisional decision)
  - **Chapter 3** presents the CMA's assessment of whether the legal test for making an MIR is met and discusses the CMA's assessment as to whether it would be appropriate to exercise its discretion to make an MIR
  - **Chapter 4** considers the terms of reference for the MIR
- 1.2 In this chapter we introduce and set out the background to the CMA's decision to make an MIR. In doing so we consider:
- the historic background of reviews into this sector<sup>2</sup>
  - the two market studies which were published on 18 July 2014: the market study on banking services to SMEs (the SME study) and the market study update on PCAs (the PCA update) (together the market studies)<sup>3</sup>
  - the CMA's provisional decision on making an MIR, published alongside the market studies<sup>4</sup>

### *Historic reviews into the sector*

- 1.3 The UK retail banking sector has been the subject of detailed scrutiny by the UK competition authorities and by other bodies in recent years. These have included:
- Sir Donald Cruickshank's review of retail banking, published in 2000

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<sup>1</sup> We consider an SME to be a business that, in respect of a given financial year applying to it, has annual sales revenues (exclusive of VAT and other turnover-related taxes) not exceeding £25 million a year.

<sup>2</sup> Throughout this document, where we refer to the sector, we are referring to both the supply of certain SME banking services and PCAs.

<sup>3</sup> These studies can be found [here](#).

<sup>4</sup> The provisional decision can be found [here](#).

- the Competition Commission's (CC's) investigation into the supply of SME banking services, published in 2002
- previous Office of Fair Trading (OFT) market reviews regarding SME banking (published in 2007) and regarding PCAs (including a market study published in 2008 and a review published in 2013)
- the Independent Commission on Banking, chaired by Sir John Vickers, whose final report (the Vickers report) was published in 2011
- the Parliamentary Commission on Banking Standards (the PCBS), whose report was published in June 2013

1.4 These reviews reported significant concerns about the effectiveness of competition in the sector, including:

- the persistence of high levels of concentration and relatively stable market shares
- barriers to entry and expansion
- a weak customer response, with customers not being able readily to access, assess and act on information they would need to ensure that they get the best possible deal

1.5 Both the Vickers report and the PCBS recommended that consideration should be given to making an MIR by 2015, if not before, unless there had been sufficient changes in the state of competition in the sector.<sup>5</sup> The Vickers report further concluded that, on the basis of the evidence that it had considered:

- There were features of the PCA market which prevented, restricted or distorted competition. These included market concentration, high barriers to entry, low levels of transparency and high switching costs.
- There were features of the Business Current Account (BCA) market which prevented, restricted or distorted competition, and these features were similar to those in the PCA market in nature, and were present to a similar, and in some cases greater, extent in the BCA market.<sup>6</sup>

These assessments and recommendations, while forming a part of the background to the decision, are, of course, not binding on the CMA. The CMA's

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<sup>5</sup> See [Vickers final report](#), paragraph 8.93, and [PCBS \(2013\)](#), paragraphs 65–68.

<sup>6</sup> See [Vickers final report](#), paragraphs 8.90 & 8.91.

decision is based on the analysis undertaken in the market studies and the subsequent consultation on the provisional decision.

### ***The market studies***

- 1.6 The CMA announced on 11 March 2014 that we would complete a short programme of work into aspects of retail banking, consisting of:
- completion of the SME study, launched by the OFT and undertaken jointly with the Financial Conduct Authority (FCA)
  - the PCA update, which was to be a short market study update, updating the market review conducted by the OFT in 2013 (referred to above). This was launched on 4 April 2014.
- 1.7 The CMA's decision to bring together work in relation to PCAs and SME banking reflected its belief that there were similar competition issues in both segments of retail banking, in particular:
- the way that PCA and SME customers consume banking services, including levels of customer engagement with banking providers
  - how the dynamics of competition seemed to operate
  - the same banks being prominent in both markets
- 1.8 Following a process of engagement with parties across the sector and careful analysis of the evidence received from multiple sources, the SME study and the PCA update reports were published on 18 July 2014. On the same date, the CMA sought views on its provisional decision to make an MIR.
- 1.9 Both reports noted that there had been important developments and initiatives to improve competition in the sector in recent years. These included initiatives to facilitate new entry, to make switching between accounts easier and also to improve transparency.
- 1.10 However, despite these important developments, and evidence of some new and prospective entry, the market study reports identified a number of features of these segments of retail banking which the CMA suspected prevent, restrict or distort competition in connection with the provision of retail banking services to SMEs and the provision of PCAs. Table 1 below sets out some of the key facts from the market studies, with an update in relation to more recent switching statistics.



TABLE 1 Key facts from the market studies

Personal current accounts (CMA market study update)	SME banking (Joint CMA and FCA market study)
<ul style="list-style-type: none"> <li>• The four largest providers account for over 77% of the market (of active accounts) in the UK</li> <li>• Some evidence that the larger PCA providers offer poorer service (as measured by customer satisfaction) than smaller providers, although we did not find evidence that the larger PCA providers charge higher prices</li> <li>• Satisfaction levels with four largest banks are less than 60%, yet their market shares have remained stable</li> <li>• Barriers to entry and expansion remain, including the need for an extensive network of local branches to be an effective scale competitor; there is evidence that convenient location is the most popular reason for choosing a bank when switching PCA</li> <li>• Notable recent entrants include Metro Bank, Tesco Bank and TSB (as a result of the current divestment by Lloyds Bank). Their combined market share is around 5%, of which TSB represents 4.2%</li> <li>• Annual switching levels remain low – only around 3% of PCA customers switch bank each year – and customer engagement remains limited more generally</li> <li>• The new current account switching service (CASS) seems to be working technically – there has been a 22% increase in switching in its first year, although this is from a low base.</li> </ul>	<ul style="list-style-type: none"> <li>• The four largest providers account for over 85% of BCAs and 90% of business loans</li> <li>• Satisfaction levels of SMEs with the four largest banks for BCAs are around 60%. Just 13% trust their bank to act in their best interests and only 25% feel supported by their bank</li> <li>• Barriers to entry and expansion remain significant, including the need for a network of local branches. Almost 70% of SMEs consider that having a local branch is still important</li> <li>• There has only been one entrant into full service SME banking – Metro Bank – in recent years</li> <li>• Annual switching levels remain low – only 4% of SMEs switch bank each year – and customer engagement remains limited more generally</li> <li>• Fewer than 30% of SMEs shop around regularly for BCAs and loan products.</li> </ul>
<p><b>In both segments we observed that the providers with the highest levels of customer satisfaction are not winning market share, while the banks with lower levels of customer satisfaction are barely losing market share. This is not what we would expect in a well-functioning, dynamic and competitive market.</b></p>	

## SME banking

1.11 In relation to SME banking, we suspected that there are a number of features which gave rise to competition concerns. These are:

- **Persistent levels of concentration and relatively stable market shares** among providers of both BCAs and general purpose business loans (see the SME study, Chapter 4, including a description of the particular causes of concern on this issue)
- **A market structure characterised by close linkages both between PCAs and BCAs, and between BCAs and general purpose business loans**, limiting the scope and speed for newer or smaller providers to expand and develop their business models (see the SME study, Chapter 4)
- **Continuing high barriers to entry and expansion in the supply of BCAs and general purpose business loans to SMEs**, particularly the inability of smaller or newer providers to develop their businesses outside of niche, specialist areas (see the SME study, Chapter 5). Such barriers include:

- the difficulties faced by new or smaller banks to acquire sufficient numbers of profitable customers to establish a credible SME banking business, partly in consequence of low levels of shopping around and switching by SME customers
- the continuing need (despite a very significant increase in online and mobile banking) for an extensive local branch network to acquire new customers and to distribute products effectively
- limited access to key inputs by smaller or newer banks, particularly some evidence of concerns about access to payment systems at commercially attractive rates (an issue which, we noted, is being considered by the Payment Systems Regulator (PSR)), and access to information on the creditworthiness of SMEs
- regulatory barriers arising from the methodology used to assess capital requirements imposed on banks
- **Demand-side issues**, with SMEs not easily able to access, assess and act on information to ensure that they get the best deal, manifested in low levels of shopping around and switching activity. This particularly reflects limitations in transparency and the comparability of information on the offers of different providers and SME customers' 'inertia' (ie reluctance to shop around between banks and to switch banks) (see the SME study, Chapters 6 to 8). Survey evidence of SME customers suggests that the reluctance to shop around or switch at least partly reflects a widespread belief that better alternatives are not available and that there are significant frictions in the switching process.

## PCAs

1.12 In relation to PCAs, we suspected that there are a number of features which gave rise to competition concerns. These are:

- **Persistent levels of concentration and relatively stable market shares** among providers (see the PCA update, Chapter 2)
- **Continuing high barriers to entry and expansion**, in particular (see the PCA update, Chapter 2):
  - the continued importance of an extensive branch network to distribute products effectively, despite increases in the use of online and mobile banking

- recent or potential entrants say that customer inertia is one of the most important difficulties they face when trying to expand in the PCA market, due to the relatively low levels of switching and shopping around referred to below
  - limited access to key inputs by smaller or newer banks, particularly some evidence of concerns about access to payment systems at commercially attractive rates (an issue which, as we noted, is also being considered by the PSR)
  - the capital requirements issue, referred to above for SMEs, applies also to PCAs (and indeed mortgages, personal loans and credit cards)
- **Demand-side issues**, including relatively low levels of switching and shopping around, which may be regarded as symptomatic of a ‘sticky’ market and create little incentives for providers to compete. Despite the launch of the CASS (which we discuss below), annual switching rates remain very limited, something that is exacerbated by difficulties faced by PCA customers in comparing costs and benefits between different providers’ PCAs. Survey evidence of PCA customers suggests that the reluctance to shop around or switch is largely based on a widespread belief that better alternatives are not available. (See the PCA update, Chapter 4.)
  - **Lack of transparency in charging structures**, especially for overdrafts which are complex and increasingly varied, making it very difficult for customers to choose the best value account for their needs (see the PCA update, Chapter 3)
- 1.13 We thought it also possible that, particularly for PCAs, there is a degree of cross-subsidy, which may be distortive of competition. Indeed, the ‘free-if-in credit’ model often involves cross-subsidy by other revenue streams for PCAs such as overdraft charges. In addition, we were told by some banks that PCAs as a whole were loss making, which could suggest the existence of a cross-subsidy from other retail banking products.

*Interrelationship between the features*

- 1.14 Moreover, we found that, in both segments, there appears to be a mutually reinforcing pattern of demand-side problems (including customer inertia, problems in understanding the complex pricing structures and a perceived lack of differentiation between banks) and supply-side problems (resulting from market concentration and high barriers to entry and expansion). These issues seem to combine, and contribute to one another, in a complex pattern,

ultimately resulting in a sector where competition is less effective than would otherwise be the case.

### ***Provisional decision***

- 1.15 Alongside the market study reports, the CMA also published its provisional decision in which it proposed to make an MIR.
- 1.16 An MIR is a decision of the CMA Board to make a reference to the Chair of the CMA for the constitution of a group<sup>7</sup> to conduct a market investigation (a Market Reference Group). Under section 131 of the Enterprise Act 2002 an MIR can be made only if the CMA has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK (in this document we call this the ‘reference test’).
- 1.17 Drawing on the findings and analysis set out in the market studies, and summarised above, the CMA provisionally concluded that the reference test was met in relation to the provision of retail banking services to SMEs and the provision of PCAs – both in relation to each segment separately and (reflecting our provisional conclusion that many of the features are common to both segments and that the products are closely related) in relation to the two segments together.
- 1.18 Once the CMA has provisionally concluded that the reference test is met, the CMA then has a discretion as to whether to make an MIR. There are four particular criteria which the CMA considers to guide the exercise of its discretion, as set out in our guidance: scale of the suspected problem; availability of appropriate remedies through an MIR; the availability of ‘undertakings in lieu’ of an MIR (we carefully considered ‘in principle’ proposals made by the four largest banks in relation to SME banking before making the provisional decision); and whether it would be more appropriate to use alternative powers available to the CMA or others to address the features identified.<sup>8</sup> In the provisional decision we set out our assessment against these criteria, and provisionally concluded that we should exercise our discretion to make an MIR for the reasons given in Chapter 4 of the provisional decision.

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<sup>7</sup> By virtue of [paragraph 36 of Schedule 4 to the Enterprise and Regulatory Reform Act 2013](#). The group of independent ‘members’ of the CMA are drawn from the panel which has been constituted under statute for this purpose.

<sup>8</sup> The CMA has adopted OFT Guidance *Market investigation references: Guidance about the making of references under Part 9 of the Enterprise Act (OFT511)*. See Chapter 2.

### ***The consultation on the provisional decision***

- 1.19 The CMA invited comments on the provisional decision through a full public consultation, which began on 18 July 2014 and concluded on 17 September 2014. In the consultation document setting out the provisional decision, we stressed the importance of the consultation process in assisting the CMA's decision-making process, and encouraged all interested parties to engage with it.<sup>9</sup>
- 1.20 In the following chapter, we summarise the key points made in response to the consultation process and set out our response to these.

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<sup>9</sup> We also highlighted a number of particular questions for respondents to consider during the consultation in paragraph 1.8 of the provisional decision.

## 2. Issues raised during the consultation on the provisional decision

2.1 During the consultation the CMA received over 120 responses from a range of interested parties, including:

- all four of the largest UK banks (Barclays, HSBC, Lloyds Banking Group (LBG) and Royal Bank of Scotland Group (RBSG))
- smaller and new entrant providers of banking services – Clydesdale Bank/Yorkshire Bank, Metro Bank, Paragon Bank, Santander, Tesco Bank, TSB, Virgin Money and Yorkshire Building Society
- consumer bodies and campaign groups – Which?, the Consumer Council for Northern Ireland (CCNI), Citizens Advice Scotland, the Financial Services Consumer Panel and Positive Money
- SME representative groups – the Federation of Small Businesses (FSB), the British Chambers of Commerce (BCC), the Institute of Directors (IoD), the Forum of Private Business (FPB), the EEF and the National Pawnbrokers Association (NPA)<sup>10</sup>
- regulators – the FCA and the Payment Systems Regulator (PSR)
- comparison websites – Moneyfacts and Money Saving Expert
- individual consumers and SMEs; the majority of these responses were complaints about the refusal of banks to offer PCAs to expatriates or the withdrawal of existing PCAs from expatriates. We made each of these respondents aware of the proposed EU Payment Accounts Directive, which covers some of these concerns.<sup>11</sup> Apart from that specific issue, none raised any new points of substance.<sup>12</sup>

2.2 We are today publishing these and other consultation responses on our website, excluding any confidential material provided in those responses.<sup>13</sup>

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<sup>10</sup> The CMA also received oral feedback from the CBI on the outcomes of certain consultations it had with members regarding competition in banking services.

<sup>11</sup> We understand that following the CMA making respondents aware of the Payment Accounts Directive, there has been correspondence between the European Commission and at least one of the complainants on this issue.

<sup>12</sup> During the consultation, the CMA also met Professor Russel Griggs, the Independent Reviewer of lending appeals for SMEs, and attended a roundtable hosted by Scottish Financial Enterprise. It also engaged with officials in each of the devolved nations in the UK.

<sup>13</sup> In doing so, the CMA has had regard to Part 9 of the Enterprise Act 2002. The consultation responses received in relation to the withdrawal of banking services to expatriates have not been published as these relate to issues distinct from those specifically considered in relation to the MIR.

The CMA thanks all of those individuals and parties which have responded to the public consultation for their assistance.

2.3 We have carefully considered the consultation responses received and in this chapter we provide an overall summary of them, before considering and responding to the main issues that they raise.<sup>14</sup>

### ***Overall summary of responses received***

2.4 Overall, the large majority of respondents agreed with the provisional decision and the CMA's analysis of the competition concerns, both in relation to PCAs and SMEs. In particular, smaller and new entrant banks were mostly in favour of an MIR (including Metro, Santander, Tesco, TSB, Virgin Money and Yorkshire Building Society).<sup>15</sup> For example:

- TSB said that 'the CMA is uniquely placed to conduct a thorough, objective analysis and to facilitate a robust evidence-based dialogue between all market participants'<sup>16</sup>
- Santander commented that 'the CMA's decision to carry out a single in-depth investigation of the PCA and SME markets [is] a critical opportunity for the industry to work with regulators to address long standing concerns about competition'<sup>17</sup>

2.5 Moreover, the large majority of consumer and SME representative bodies were strongly in favour of an MIR, including Which?, CCNI, FSB, FPB, EEF and BCC.<sup>18</sup> For example, Which? commented in its response to the consultation: 'We agree with the CMA's interim assessment that this market does not "appear to be functioning in the way we would expect of effective competitive markets" and that this leads to "poorer outcomes for consumers" and to the wider economy.'<sup>19</sup>

2.6 The FCA (which undertook the SME banking market study jointly with the CMA) welcomed the provisional decision to make an MIR in relation to SME banking. In relation to PCAs, the FCA welcomed the CMA's efforts to identify

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<sup>14</sup> In our analysis below, we provide references to relevant party submissions as appropriate. In doing so, we highlight the responses which prominently make the point we reference in the text by way of example. In some instances other parties will have made a similar or related submission.

<sup>15</sup> Tesco considered the provisional decision to be 'correct' in relation to PCAs, but was neutral in relation to SMEs. The CMA also notes that Aldermore, while it did not respond to the consultation, has [publicly welcomed an MIR in relation to SME lending \(and made no comment in relation to PCAs\)](#).

<sup>16</sup> TSB cover letter to response, p1.

<sup>17</sup> Santander cover letter to response, p1.

<sup>18</sup> The CBI also considered an MIR as an 'opportunity to address the question of competition once and for all', but did not submit a formal consultation response. See the [CBI's statement regarding an MIR](#).

<sup>19</sup> Which? cover letter to response, p1.

and address continued competition concerns in this market. The PSR did not express a view on the question of an MIR but said that it would work closely with the CMA should an MIR go ahead, noting the importance of avoiding duplication, providing clarity and minimising the risk of regulatory arbitrage.

- 2.7 The majority of personal customers, SMEs and other parties that responded to the question agreed that the markets in question were not working as well as they should and that an MIR was justified.
- 2.8 A minority of respondents were critical of the analysis underlying the provisional decision to make an MIR, and some of these explicitly opposed an MIR. These included:
- the four largest UK banks, which raised concerns about various aspects of the CMA's analysis (discussed below)
  - the IoD, which was not in favour of an MIR (in relation to SME banking) at the present time, on the basis that the banking sector had been the subject of numerous regulatory interventions in recent years and should be allowed time to rebuild, and that new challenger banks and new forms of finance were emerging as alternatives to traditional bank lending
- 2.9 Finally, some respondents were neutral on the question of an MIR (particularly Clydesdale/Yorkshire Bank).
- 2.10 While each of these categories of response provided arguments, no new significant issues were raised, and little or no new analysis, argument or evidence was provided which the CMA considered would necessitate further detailed 'Phase 1' work, with the exception of the points raised by certain banks relating to the CMA's proposed terms of reference (which are discussed below and in Chapter 4).
- 2.11 In the next section, we consider in more detail points made by respondents which were critical of the CMA's analysis or provisional conclusions, in relation to: the reference test; the CMA's exercise of discretion; and the terms of reference. We also set out our responses on those issues.

### ***The reference test***

- 2.12 A number of consultation responses commented on the CMA's provisional analysis regarding the reference test, in particular:
- the necessity of defining what a 'well-functioning market' would look like



- the effect of developments in the sector (also relevant to the exercise of the CMA’s discretion as to whether to make an MIR)
- the relevance of concentration
- the continued importance of a branch network as a barrier to entry
- linkages between products (particularly for SMEs)
- cross-subsidisation
- switching
- customer outcomes, including satisfaction and innovation
- transparency
- restrictions on the provision of banking services

2.13 We consider each of these in turn below.

*The necessity of defining what a well-functioning market would look like*

2.14 LBG submitted that the CMA had referred to its view that the SME and PCA sectors were not ‘well-functioning’, but without providing a clear benchmark of what a well-functioning market would look like. It considered that it was important that the CMA took a realistic approach in identifying such a benchmark to avoid specifying features that might be theoretically desirable but might not be feasible, or which might have unintended consequences that harmed customers and competition.<sup>20</sup>

2.15 The CMA notes that we did provide a description, in both the market studies, of the characteristics of a well-functioning banking sector,<sup>21</sup> and considered these various characteristics in its market study analysis.

2.16 Moreover, we did consider other sectors to provide at least some form of benchmark against which to assess how competitive this sector is. We concluded, however, that we do not see the same dynamic that we had observed in those other sectors.<sup>22</sup> More generally, we also note the comments of the

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<sup>20</sup> LBG cover letter to response, p1.

<sup>21</sup> SME study, paragraph 2.29, and PCA update, paragraph 4 of the summary.

<sup>22</sup> See, for example, Figure 4.8 of the PCA update and Figure 8.3 of the SME study. As we note in the market studies, we recognise the limitations of comparisons of this kind, but consider that they continue to have some value.

European Commission in relation to the merger of Orange/T-Mobile,<sup>23</sup> in which the Commission, in the context of the UK retail mobile telephony market, appears to have treated similar factors to those we have identified as an indicator of whether or not a market is sufficiently competitive:

Compared to other European mobile markets, in the UK there is a significant level of switching between different mobile service providers, and there is pricing and service innovation. These factors point to the fact that the UK retail mobile market is very competitive.

From our market studies, we do not see the same characteristics in relation to PCAs or SME banking.

- 2.17 Furthermore, the CMA also considers that what it has observed in this sector is an indication, more fundamentally, that this sector does not operate in a manner which would be expected in a well-functioning competitive market. In particular, our finding that those providers which exhibit the highest levels of satisfaction do not appear to be gaining significant market share – and, conversely, that those with relatively low levels of customer satisfaction have not significantly lost market share as a result – provides a highly relevant indicator that competition may not be functioning as effectively as it could be.

#### *The effect of developments in the sector*

- 2.18 Several of the largest UK banks<sup>24</sup> have submitted that the CMA should have given more weight in its assessment to the combined future impact of key structural, regulatory and technological changes that are already taking place and, as appropriate, give them sufficient time to take full effect.
- 2.19 The CMA, however, notes that it considered each of the relevant material changes in detail in its market studies, such as the following:
- **Divestments by LBG and by RBSG:** The CMA notes that it took full account of these divestments in both market studies and set out reasons in the market studies for its view that the divestments, while positive for competition, are not likely to have a significant impact.<sup>25</sup> We have received

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<sup>23</sup> [European Commission merger decision, Case M.5650 T-Mobile/Orange](#), European Commission, 1 March 2010, paragraphs 45–53.

<sup>24</sup> LBG response, Annex 1, paragraph 1.1; HSBC response, paragraphs 1–3; RBSG response, pp3–5; Barclays response, paragraphs 2.1–2.4.

<sup>25</sup> PCA update, paragraphs 2.16–2.25; and SME study, paragraphs 4.32–4.34.

no evidence during the consultation to suggest that view is incorrect (see Chapter 3 for our final Phase 1 assessment on that issue).

- **Evidence of new entry:** LBG expressed concern that the CMA had dismissed the future effect of new entrants, without fully understanding their growth strategies, and called for a more ‘forward looking’ assessment.<sup>26</sup> The CMA notes that it engaged, in detail, with a wide range of new and prospective entrants<sup>27</sup> during the market studies so as to understand their strategies and approach, and their current and likely prospective effect. It was only after this detailed consideration that the CMA concluded, for the purposes of its Phase 1 assessment, that they were unlikely to have a significant impact.<sup>28</sup> Indeed, the CMA continues to note that many new entrants focus on specific niches or on the same customer segment, limiting their ability to exert a significant constraint on the broader sector, even in aggregate (see Chapter 3 for our final Phase 1 assessment on that issue).<sup>29</sup>
- **Alternative business models:** Certain parties referred to the prospective impact of alternative providers of banking services such as PayPal, Google, Amazon and Tungsten. However, while welcoming additional market participants with different business models, the CMA notes that their entry remains focused on particular product lines (and, moreover, they do not currently appear in the UK to be seeking to create the same level of functionality as BCAs and PCAs), limiting the extent of the competitive constraint they can exercise.<sup>30</sup>
- **Regulatory developments:** Certain of the largest banks referred to ongoing market and regulatory developments to improve competition, particularly CASS and government initiatives to promote competition in SME lending.<sup>31</sup> The CMA considered each of these initiatives in detail in

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<sup>26</sup> LBG response, Annex 1, paragraph 3.2 d ii.

<sup>27</sup> Including those who are seeking to, or are considering, authorisation.

<sup>28</sup> We note that reference was also made during the consultation to Virgin Money and Nationwide as potential entrants in relation to SME banking. We note, in that regard, Virgin’s consultation response in which it indicates that it has no plans to enter the SME banking sector in the near future (Virgin cover letter to response, p1). Nationwide has made [public references](#) to the effect that it will develop a range of SME banking services in ‘coming years’, but has yet to do so. This suggests that in the short to medium term, it would be unsafe to assume that there will be such entry or, if there is, that it would have a significant effect.

<sup>29</sup> The CMA has considered HSBC’s submission regarding evidence of recent increases in market share by Santander, such that Santander is claimed to have a 14% share of the BCA market (HSBC response, paragraph 34a). The CMA notes, however, that Santander itself submitted its market share (of the wider SME sector) to be only 6% in 2014 (Santander response, paragraph 3.4); Santander also noted the various challenges it had encountered in growing its market share in its response to the consultation, noting that the ‘UK is a market defined in general by the lack of such organic dynamism in market shares’ (Santander response, part 3).

<sup>30</sup> The impact of PayPal was, in any event, specifically considered in the SME study, paragraph 5.19.

<sup>31</sup> LBG covering letter to the response, p3; Annex 2, paragraphs 2.3 & 2.4; HSBC response, paragraphs 1c, 1e & 1f; RBSG response, pp2–5; Barclays response, paragraphs 2.3 & 3.11.

the market studies. While the CMA recognises that these are positive developments, we continue to consider that each of them remain limited in effect. For example, the most recently publicised switching statistics under CASS show an increase in switching of some 22% over the first year of its operation,<sup>32</sup> with the result that switching rates continue to remain low, at around 3% for PCAs, even when other forms of switching are also considered. We continue to consider that this does not substantially change market dynamics (see Chapter 3 for our final Phase 1 assessment on that issue).

- 2.20 LBG has spoken of the need to consider the impact of the various developments occurring in the sector cumulatively. The CMA recognises the importance of considering the aggregate effect of developments. However, given the limited effect of the developments on the sector both separately and in aggregate, we have concluded that the reference test is met even when they are all taken into account.
- 2.21 More generally, the CMA also notes that this sector has been subject to continual change (regulatory or market-driven) over the past decade, but the competition concerns identified in the PCA and SME studies still persist. Indeed, in May 2013 the OFT decided not to refer the PCA segment for a market investigation, despite significant competition concerns, because of important developments expected in the segment 'in the coming months'. The PCA update shows that we believe those developments have either failed to materialise in the relevant time period or have failed to have the significant effect on competition that had been hoped for by the OFT. We see no basis for further deferring an MIR on the basis that change is incomplete.

#### *The relevance of concentration*

- 2.22 During the consultation, the following points were made:
- (a) levels of concentration in the market are not materially different from that observed in 2009, and concentration is therefore not increasing significantly;<sup>33</sup> and
  - (b) the CMA, in its analysis, did not find any clear link between concentration and customer outcomes.<sup>34</sup>

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<sup>32</sup> See ['First full-year results published for new Current Account Switch Service'](#).

<sup>33</sup> LBG response, Annex 2, paragraph 3.2.

<sup>34</sup> LBG response, Annex 1, paragraph 3.2; and Annex 2, paragraph 3.3 and HSBC response, paragraph 26c.

- 2.23 With respect to (a) – on levels of concentration– the CMA agrees that these are not materially different from the position in 2009. Indeed, we consider that this supports our overall concern, identified in our market studies, that high concentration and persistent market shares, particularly when combined with other factors such as barriers to entry and low levels of customer switching and shopping around, give reasonable grounds to suspect that competition is not working effectively.
- 2.24 With respect to (b), the CMA notes that much of its analysis was framed around the concept that concentration gave rise to competition concerns when combined with factors such as stable market shares, barriers to entry and low levels of customer switching and shopping around (as we mention above). However, the CMA did also set out the causes of concern in relation to concentration as a distinct issue in both the SME and PCA market studies.<sup>35</sup> As part of the market studies, we then conducted a preliminary assessment as to whether there may be a linkage between bank size and customer outcomes, of a type which could be indicative of concentration specifically giving rise to competition concerns.<sup>36</sup> In both segments, but particularly in relation to PCAs, we observed that larger banks tend to attract lower levels of customer satisfaction than smaller banks, which may support the existence of such concerns.
- 2.25 Moreover, the particular issue of concentration, and its impact, may well be an area which the Market Reference Group conducting the market investigation (the Group) would wish to obtain further information about and to analyse further, consistent with its more detailed investigatory role.

*The continued importance of a branch network as a barrier to entry*

- 2.26 It was also submitted by some respondents that the CMA has overstated the importance of a branch network to SME and PCA customers and, consequently, the necessity to have a branch network to be an effective scale competitor. In particular, the following arguments were put to us:
- first, there is no compelling evidence that an extensive branch network is needed for expansion into retail banking, as indicated by the example of First Direct<sup>37</sup>

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<sup>35</sup> PCA update, Chapter 2, and SME study, Chapter 4.

<sup>36</sup> See the SME study, Chapter 9, and the PCA update, Chapter 6.

<sup>37</sup> HSBC response, paragraph 27.

- second, technological innovation is providing customers with an alternative means to interact with their bank<sup>38</sup>
- third, many of the larger providers are contracting their branch networks<sup>39</sup>
- fourth, banks can rely on alternative models to establishing a physical presence (eg within other retail environments, such as supermarkets like Asda or the Post Office)<sup>40</sup>

2.27 The CMA notes these arguments, but we consider that each was addressed in detail during the market studies and taken into account in the findings.

2.28 On the first and second points, the consistent evidence continues to demonstrate that, notwithstanding technological developments, local branches remain important to customers – both personal and SMEs – and therefore to existing providers and many potential new entrants. This evidence includes:

- consistent customer survey evidence demonstrating the importance of branches, as presented in the market studies,<sup>41</sup> and subsequently augmented by TSB research<sup>42</sup>
- the submissions of various smaller banks which consider branch banking as commercially important. Indeed, Santander has submitted that having a national branch infrastructure and regional presence is important to organic growth.<sup>43</sup> TSB noted that branches remain vitally important for the provision of effective competition.<sup>44</sup>
- RBSG, in response to the consultation, said that it ‘accepts the CMA’s conclusion that branch networks are still important for some models of distribution for SME banking and PCA products’.<sup>45</sup> Outside of the consultation, we note that LBG’s strategy continues to emphasise that ‘branches will continue to play an important role in [its] multi-channel approach’.<sup>46</sup>

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<sup>38</sup> LBG response, Annex 1, paragraphs 6.5 & 6.6 and Annex 2, paragraph 3.8d; HSBC response, paragraph 20; RBSG response, p6; Barclays response, paragraphs 4.3–4.5.

<sup>39</sup> RBSG response, p6; Barclays response, paragraph 4.8.

<sup>40</sup> LBG response, Annex 2, paragraph 3.8d; Barclays response, paragraph 4.6.

<sup>41</sup> SME study, paragraphs 5.62–5.68, and PCA update, paragraphs 2.55–2.56.

<sup>42</sup> ‘[Why branches matter in a digital age](#)’. We also note that the FSB referred to the importance of branch banking in its response to the provisional decision (in paragraph 7.3(a)).

<sup>43</sup> Santander response, paragraph 3.2.

<sup>44</sup> TSB response, p1. We note that TSB is looking to increase its branch network by opening up to 30 new branches, as indicated in ‘[Why branches matter in a digital age](#)’, p10.

<sup>45</sup> RBSG response, p6.

<sup>46</sup> See [www.lloydsbankinggroup.com/our-group/group-overview/our-strategy/](http://www.lloydsbankinggroup.com/our-group/group-overview/our-strategy/).

- 2.29 On the third point, we note, as we did in the market studies, that, despite bank closure programmes, all of the four largest banks intend to maintain a large branch network to service personal customers and SMEs.<sup>47</sup>
- 2.30 On the fourth point, we have noted arguments regarding alternatives to traditional branches, such as usage of the Post Office or regional centres for SME banking. We have considered these and set out in the SME study the limitations of such mechanisms,<sup>48</sup> and note that other alternatives such as Barclays' initiative to trial branches in certain Asda stores is at too early a stage, and currently at too small a scale, to indicate that this will have an appreciable effect.<sup>49</sup> In any event, as discussed in the PCA update, there is as yet no example of a bank reaching a significant scale without a network of branches.<sup>50</sup>
- 2.31 The CMA's analysis at Phase 1, following consideration of responses to the consultation, continues to be that a local branch network remains likely to be necessary for any large-scale presence in retail banking.

*Linkages between products (particularly for SMEs)*

- 2.32 The largest banks raised a number of points about the CMA's analysis of the so-called 'gateway' effect, including the linkages between PCAs and BCAs, and BCAs and other products.
- 2.33 HSBC noted that, for SMEs, the BCA/PCA link is not evidence that new customers do not shop around. Indeed, according to HSBC, the fact that 18 months' free banking is offered to start-ups suggests that people do not automatically go to their PCA provider.<sup>51</sup> LBG remarked upon the value customers place on the continuity of the relationship with their bank, which is relevant to assessing the linkages between products. It also noted that providers with narrower product ranges have been successful in expanding their business, suggesting that a bank's ability to offer other services has a limited impact on its ability to compete.<sup>52</sup> RBSG, on a similar theme, also noted that Handelsbanken achieved 5% share of BCAs from only a limited PCA starting point.<sup>53</sup> Barclays also contended in its response that a high

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<sup>47</sup> In this regard, we have noted the announcement by LBG in October 2014 of its plans to close a net total of 150 branches in the UK. However, this represents only around 7% of its total branch network. It will continue to have a considerable branch network of around 2,000 branches even following the announced branch closures.

<sup>48</sup> SME study paragraphs 5.69–5.77.

<sup>49</sup> Tesco has a dense national presence for its own banking product, which is equivalent to having a branch network.

<sup>50</sup> PCA update, paragraph 2.57.

<sup>51</sup> HSBC response, paragraphs 44 & 45.

<sup>52</sup> LBG response, Annex 1, part 5.

<sup>53</sup> RBSG response, p6.

correlation of ownership of BCAs and other SME products does not indicate that BCA providers are ‘acting in an exploitative or anticompetitive manner’.<sup>54</sup>

- 2.34 With respect to HSBC’s argument, the CMA notes that, although it is clearly correct that not all SMEs go to their PCA provider when selecting a BCA provider, nevertheless over 50% at the largest UK banks do so. This in turn provides the incumbent PCA provider with a material ‘first port of call’ advantage over other suppliers, which is likely to reduce an incumbent’s incentives to compete intensely for new SME customers. The fact that some introductory incentives are offered by banks is not inconsistent with this position. More generally in response to LBG, the CMA is not concluding that there is no competition, but rather that competition is diminished or distorted. As regards the example of Handelsbanken, our analysis is that Handelsbanken’s market share of BCAs remains less than 1%, which we consider is consistent with our findings in the market studies regarding the relevance of linkages and the significance of the ‘gateway’ effect.<sup>55</sup>
- 2.35 With respect to Barclays’ submission that the CMA should be careful to avoid any assumption that, because there is a correlation of ownership of BCAs and other SME products, BCA providers are ‘acting in an exploitative or anti-competitive manner’, the CMA makes no such allegation and recognises that many customers may prefer the convenience of banking with one provider. Our concern, however, is that this dynamic may ultimately provide the largest providers with a ‘first port of call’ advantage. SMEs then are likely to take other products from that provider, particularly various types of lending products. As a result, unless a bank already provides a new-to-market SME with the SME owner’s PCA, it is less likely to win that SME’s initial business and then to be able to cross-sell to it a wider range of products over time. This limits the growth potential of stand-alone business bank providers or banks lacking a strong presence in PCAs. Moreover, as we mention earlier, this ‘first port of call’ advantage more generally limits the intensity of competition by providing the incumbent bank with an advantage over providers of competing products who do not have such an advantage.

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<sup>54</sup> Barclays response, paragraphs 6.7–6.9 (including Barclays’ comments with respect to the CMA’s comments before the Treasury Select Committee regarding the linkages between personal and SME products).

<sup>55</sup> SME study, paragraph 5.10.



### *Cross-subsidisation*

- 2.36 LBG commented that it did not agree that PCAs as a whole were loss-making or cross-subsidised with other banking products.<sup>56</sup>
- 2.37 The CMA did not state that this was universally the case, and in fact only stated that the evidence seemed to ‘suggest that there might be a degree of cross-subsidy’,<sup>57</sup> based on the evidence of published research and the evidence provided by a PCA provider. We note that the same respondent submitted that ‘it is very difficult to allocate these common costs referring to, eg, payments infrastructure, branches, ATMs, IT systems, staffing, customer support and marketing to conduct a meaningful profitability analysis’. This complex issue, alongside the more general issue as to the nature and extent of potential cross-subsidies arising from the free-if-in-credit model, would be a matter for the Group to consider if it chose to do so.

### *Switching*

- 2.38 The CMA also received various responses regarding the analysis of switching rates and customer engagement as set out in the market study reports. In particular:
- (a) Two banks have argued that the CMA placed undue weight on switching rates, which they considered understated the actual level of customer engagement. In particular, they considered that the CMA did not give sufficient weight to the impact of multi-banking, negotiation and ‘churn’ (the number of new accounts opened divided by the ‘stock’ of accounts).<sup>58</sup>
  - (b) More than one bank argued that the CMA did not set out what level of switching was ‘enough’.<sup>59</sup>
- 2.39 With regard to (a) – the suggestion that the CMA placed undue weight on switching rates – the CMA recognises, as we did in the market studies,<sup>60</sup> that switching is only one relevant measure of customer engagement. It is for that reason the CMA explicitly considered churn, multi-banking and (in the case of SMEs) negotiation as part of its competition analysis. However, we concluded that each of these factors appeared to have only a limited impact.<sup>61</sup>

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<sup>56</sup> LBG response, Annex 2, paragraph 3.8d.

<sup>57</sup> PCA update, paragraph 2.67.

<sup>58</sup> LBG response, Annex 2, paragraph 2.6; Barclays response, paragraphs 5.11–5.17.

<sup>59</sup> Barclays response, paragraph 5.5.

<sup>60</sup> SME study, paragraph 8.65, and PCA update, paragraph 4.26.

<sup>61</sup> SME study, paragraphs 8.87–8.89, and PCA update, paragraph 4.56.

- 2.40 As regards multi-banking, for PCAs we recognised that the extent to which multi-banking imposes a competitive constraint is unclear, primarily because the reasons consumers choose to open an additional PCA and, most importantly, how they make that decision are unclear.<sup>62</sup> Moreover, for SME banking, we noted that the incidence of multi-banking remains limited and confined to certain banking services.<sup>63</sup>
- 2.41 As regards churn, particularly in SME banking where parties argued that churn was particularly relevant to the competition assessment, we are concerned that churn will not always ‘discipline’ banks to the same extent as switching.<sup>64</sup> In particular, there remain good reasons to doubt, as outlined above, the intensity of competition for new customers given the high proportion of SMEs that go to their owner’s PCA provider when seeking a BCA.
- 2.42 Moreover, the CMA considers that simply summing the proportion of customers engaging in churn, multi-banking and negotiation together, as Barclays suggested we do,<sup>65</sup> would overstate the level of customer engagement with their banking provider. In addition to likely concerns about double counting of customers, the CMA does not consider, given the limitations on each of these factors as stated in the market studies, that this would be an appropriate indicator of the proportion of customers exercising effective customer choice.
- 2.43 With regard to (b) – the point about enough levels of switching – the CMA notes that comparisons were made with other sectors in its market studies.<sup>66</sup> Moreover, it is particularly striking that switching rates in relation to both PCAs and BCAs are low even though there is evidence of price and quality dispersion.<sup>67</sup> This seems to indicate that most customers face obstacles to switching – whether believed or actual – and they do not benefit from the competition that exists. In turn, this dampens further competition; low levels of switching entail relatively weak incentives on providers to develop better offers. It is therefore reasonable to suspect that the current low switching rates are symptomatic of a poor interactive dynamic between the supply and demand sides in this sector.
- 2.44 Moreover, and as we mention above, in addition to switching, shopping around and (for SMEs) negotiating with an existing provider are also important ways for customers to act in a manner which drives effective competition

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<sup>62</sup> PCA update, paragraphs 4.45 & 4.46.

<sup>63</sup> SME study, paragraph 8.72.

<sup>64</sup> SME study, paragraphs 8.84 & 8.85.

<sup>65</sup> Barclays response, paragraph 5.14.

<sup>66</sup> SME study, Figure 8.3, and PCA update, Figure 4.8.

<sup>67</sup> SME study, Figure 7.1, and PCA update, paragraph 4.76.

between providers. The combination of these three responses will give an indication of the negotiating power of customers. It is therefore not feasible to set out an optimal level of switching, without taking account of the relative strengths of other constraints.

### *Customer outcomes – satisfaction*

- 2.45 Various banks submitted that the CMA took a selective or partial view of the customer satisfaction evidence it relied on in the market studies.<sup>68</sup>
- 2.46 The CMA does not accept that submission. While the CMA recognises that different surveys will come to different results, taking account of the questions used and methodology employed, the CMA's satisfaction conclusions were based on the totality of the evidence we had received:
- We took into account a range of survey evidence, including various customer surveys which suggested that there was room for improvement at the largest banks and surveys showing relatively higher satisfaction levels.<sup>69</sup> We said that the evidence was, at times, 'mixed' for SMEs with some evidence of improvement for PCAs.<sup>70</sup>
  - We also took account of qualitative evidence from representative organisations, and from the SME focus group research as part of the SME study, which raised concerns about service levels.<sup>71</sup>
  - We cited complaints evidence in relation to PCAs,<sup>72</sup> supplemented by evidence from the FCA which indicates an increase in complaints about PCAs.<sup>73</sup>
- 2.47 In no instance, therefore, has the CMA based its findings on any single piece of evidence. Instead, its conclusions represented a rounded and reasonable assessment of the available evidence.
- 2.48 An important consideration was the inverse correlation we observed between customer satisfaction levels and success in both segments (but particularly for PCAs), on several measures – which, as we noted in our provisional decision, is not what one would expect to see in a well-functioning, competitive sector.

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<sup>68</sup> LBG covering letter to the response, p3; LBG response, Annex 1, paragraph 6.3, and Annex 2, paragraph 4.1; HSBC response, paragraphs 15, 18, 19, 36 & 37; Barclays response, paragraph 7.6.

<sup>69</sup> PCA update, paragraphs 6.17–6.31; and SME study, paragraphs 9.41–9.64.

<sup>70</sup> SME study, paragraph 9.66; and PCA update, paragraph 6.31.

<sup>71</sup> SME study, paragraph 9.6.

<sup>72</sup> PCA update, paragraphs 6.20–6.26.

<sup>73</sup> [Latest aggregate complaints data](#).

Two of the larger banks have, in their consultation responses, expressed concerns that the CMA disregarded measures (especially for PCAs) that contradicted its conclusion that there was an inverse correlation between customer satisfaction and market share.<sup>74</sup> The CMA does not consider this to be correct. Its conclusions were based (for PCAs) on Which? survey evidence and FCA complaints data and (for SMEs) on Charterhouse survey evidence and Business Banking insight scores in relation to smaller SMEs – all of which demonstrated such an inverse correlation.<sup>75</sup> Following the publication of the provisional decision, we have seen that this inverse correlation has been demonstrated again for PCAs; Which?'s research published in August 2014 confirmed that several of the biggest banks have relatively poor customer satisfaction levels for their PCAs.<sup>76</sup> We therefore continue to consider that our concerns with respect to an inverse correlation remain.

- 2.49 In relation to SME banking specifically, LBG and Barclays both made a specific submission regarding the Charterhouse survey, where they considered that the CMA should not have dismissed the 'good' rating in that survey.<sup>77</sup> The CMA recognises that this is a question of interpretation. However, we continue to consider that, on a five-point scale, a rating of three (or 'good' as it is described in the Charterhouse survey) is not likely to indicate that banks are fully satisfying their SME customers. Moreover, we note that the Charterhouse survey demonstrates that there was an overall net promoter score of –8% (ie a negative score), meaning that more SMEs would **not** be willing to recommend their bank than would be willing to do so. We consider that such a finding is consistent with our concerns that banks are not effectively fulfilling the needs of their SME customers.

### *Customer outcomes – innovation*

- 2.50 Various banks also submitted that the CMA had taken insufficient account of innovations in the sector, most particularly in relation to PCAs, and that the CMA had also failed to provide a forward-looking assessment.<sup>78</sup>
- 2.51 The CMA does not agree with this assessment. In the PCA update, we noted relevant technological and product innovation and recognised that there were some signs of emerging competition between providers. On the other hand, we also noted the limited innovation in service standards, with the little there is

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<sup>74</sup> LBG response, Annex 2, paragraph 4.1; HSBC response, paragraph 16.

<sup>75</sup> PCA update, paragraphs 6.21–6.27; and SME study, paragraphs 9.54–9.56.

<sup>76</sup> 'Best banks for customer satisfaction'.

<sup>77</sup> LBG covering letter to the response, p4; Barclays response, paragraph 7.4

<sup>78</sup> LBG response, Annex 1, paragraphs 6.5 & 6.6; HSBC response, paragraph 34; Barclays response, paragraph 2.2.

coming mainly from the newer, smaller PCA providers. Significantly, we noted that these innovations have not led to significant increases in market share.<sup>79</sup>

### *Transparency*

2.52 Various banks also commented that the CMA had failed to recognise the improvements in transparency in recent years:

- In relation to PCAs, in particular, various banks considered that the CMA had placed insufficient weight on the simplification of tariffs which had taken place over the last few years.<sup>80</sup> One bank also considered that the CMA did not provide evidence that customers were confused about current overdraft pricing.<sup>81</sup>
- In relation to BCAs, one major bank commented that the CMA did not take sufficient account of attempts to simplify the pricing of BCAs, promote transparency and increase the comparability of BCA products.<sup>82</sup>

2.53 Turning to PCAs first, the CMA notes that we explicitly considered the moves by various providers to alter tariffs during the market study. In particular, in the PCA update,<sup>83</sup> the CMA noted that many PCA providers have introduced, or are in the process of introducing, new charging structures which, they say, should be easier for consumers to understand. However, we concluded, and we remain of the view, that, while individually these charging structures might be easier to understand for customers, the proliferation of different charging models in the segment could make comparison between PCAs even more difficult than in previous years.

2.54 This is consistent with further evidence received during the consultation. In particular, the CMA notes that the FCA, in its response to the consultation, referred to consumer research which found that it was not clear that competition in PCAs was effective at providing consumers with good-value overdrafts, partially because unarranged overdraft charges have historically been very high, complex and opaque.<sup>84</sup>

2.55 In relation to BCAs, such moves to enhance transparency were taken account of in the SME market study report, in which we concluded that improvements

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<sup>79</sup> PCA update, paragraphs 6.4–6.16. The CMA also considered the impact of innovation in SME banking in paragraphs 9.39 & 9.40 of the SME study.

<sup>80</sup> For example, HSBC response, paragraph 1(b); Barclays response, paragraph 2.4

<sup>81</sup> HSBC response, paragraph 24.

<sup>82</sup> LBG response, Annex 1, paragraph 2.13.

<sup>83</sup> Paragraph 3.9.

<sup>84</sup> FCA response to the consultation, p4.

still do not typically allow for easy comparison across different providers to assess the cost of different BCAs.<sup>85</sup>

### *Restrictions on the provision of banking services*

2.56 The NPA raised concerns about the trend it had observed for banks to withdraw current accounts from pawnbrokers, thereby reducing an alternative credit option for SMEs.<sup>86</sup> In the SME study we explicitly considered concerns about the restriction of banking services to alternative providers, but concluded that we had not received evidence that the banks are strategically acting in a manner to prevent the emergence of alternative finance providers of credit to SMEs.<sup>87</sup>

### ***The exercise of the CMA's discretion to make a market investigation reference***

2.57 A number of consultation responses also commented on the CMA's discretion to make an MIR. In particular, parties commented on the appropriateness of structural solutions and the undertakings in lieu proposed by four largest UK banks, as well as the conduct of the MIR. We consider each of these in turn below.

### *The appropriateness of any structural solution*

2.58 The CMA, as part of its consultation, asked for views on whether alterations to the structure of the sector, in addition to (or in place of) remedies focused on increasing customer engagement, would be a potential solution to any competition concerns.

2.59 Some of the large banks suggested that, even if an MIR was made, structural remedies would be neither appropriate nor proportionate. However, various other respondents submitted that, in their view, no remedies should be ruled out until the market investigation had progressed.

2.60 While we recognise the significant costs associated with structural remedies, as set out in the provisional decision, the CMA continues to consider that it is important for all remedy options to remain open, and that without a market investigation it is premature to rule them out. As we noted in the provisional decision,<sup>88</sup> various sources, including the European Commission and the Vickers report, have in recent years identified structural concerns in this

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<sup>85</sup> SME study, paragraphs 7.21–7.24.

<sup>86</sup> NPA response, pp2 & 5.

<sup>87</sup> SME study, paragraph 5.163.

<sup>88</sup> Provisional decision, paragraph 13, fn 15, and paragraphs 4.49 & 4.50.

sector. It may be expected that the Group which will conduct the market investigation will carefully consider this issue in the event that it finds that there is an adverse effect on competition.

- 2.61 Separately, a specific point has been made during the consultation, regarding the undesirability of possible structural remedies in the light of the structural reforms by the banks to implement government proposals regarding the implementation of a ring-fence-based resolution regime.<sup>89</sup> We will remain in contact with the Prudential Regulation Authority (PRA) regarding the time-tables for the ring-fencing reforms. At this stage we see no grounds to believe that ring-fencing would or should preclude any structural remedies, or that a market investigation would or should preclude implementation of ring-fencing.

#### *Undertakings in lieu proposals*

- 2.62 In response to the CMA's invitation for parties to provide comments on the 'in principle' proposals for UILs in relation to SME banking which had been submitted to us by the four largest banks, we noted the views of many respondents which welcomed the UIL proposals. However, we also noted that most respondents which provided submissions on this issue concluded that the proposed UILs were insufficient to address the fundamental and long-standing concerns regarding the SME banking sector (and they do not address the PCA sector at all). We therefore continue to consider, while welcoming the initiative of the largest banks, that the UILs are not appropriate in the circumstances of this case.
- 2.63 The four banks that had made these proposals, following their consideration of the provisional decision, did not seek to develop them or make substantial arguments for them.<sup>90</sup> Moreover, no other party during the consultation specifically indicated that they would also be willing to agree to these UILs.<sup>91</sup>
- 2.64 As we have said, we see no reason for the banks to refrain from initiatives (such as those set out in the UIL proposals) to improve comparability, make account opening easier and increase transparency. The fact that we did not consider the UIL proposals sufficient ground not to make a market investigation reference should not preclude the banks, whether individually or (within the bounds of competition law) collectively, from making progress in these areas. We would hope that they would not regard the market

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<sup>89</sup> For example, HSBC response, paragraph 4.

<sup>90</sup> For example, LBG response, Annex 1, paragraph 7.1; HSBC response, paragraph 40.

<sup>91</sup> See, for example, Santander's view on the UILs, which did not indicate a willingness to sign up to them: 'We are supportive of the proposals put forward by the big four banks but do not consider these alone could substantially improve competition in the SME banking market' (Santander response, paragraph 5.6).

investigation as a reason to delay measures to enhance competition and improve consumer choice.

### ***The conduct of a market investigation***

- 2.65 During the consultation process, the CMA has noted the submissions of many respondents that any market investigation should be independent, should be proportionate and should seek to avoid duplication with the work of other regulators, most notably the PSR and the FCA.
- 2.66 The Group which will conduct the market investigation is independent of the CMA Board which was responsible for taking the decision to make an MIR. It will undertake an independent, expert investigation, and will be fully able to come to its own conclusions. Indeed, this independence is a core element of the market investigation regime under the Enterprise Act 2002 and is important to help ensure that the outcomes of the market investigation are seen as authoritative and credible.
- 2.67 The Group will naturally be conscious of the need for its investigative process to be proportionate.
- 2.68 We agree with the submissions of the FCA and PSR and some other respondents that any market investigation should avoid duplicating the work of other regulators and that the Group should coordinate its work with them as far as appropriate. In particular, our market studies identified access to payment systems as a potentially significant barrier to entry and expansion. We are aware that the new PSR is currently examining this area and developing policy proposals to address concerns similar to those which we considered in our market studies; we understand that the PSR intends to issue a consultation paper on these later this year. We also note that HM Treasury is currently consulting on those payment systems which it proposes to designate as payment systems which the PSR will oversee.<sup>92</sup> It may be expected that the Group will be aware of the work of the FCA, the PSR and HM Treasury in these areas and that the Group will take this into account as appropriate, conscious of the need, so far as possible, to minimise duplication and to avoid imposing unnecessary burdens on the businesses concerned.

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<sup>92</sup> [‘Designation of payment systems for regulation by the Payment Systems Regulator’](#).



## ***The scope of the terms of reference***

2.69 During the consultation, several of the largest banks made specific submissions regarding the draft terms of reference, published as part of the provisional decision.

### *SME banking*

2.70 In relation to the scope of the SME banking terms of reference, HSBC, Barclays and LBG submitted that the terms of reference for any MIR should be limited to the focal products of the SME study – ie liquidity management services<sup>93</sup> and general purpose business loans. LBG, however, noted that, notwithstanding its submission on limiting the scope of the terms of reference to the focal products, it considered that it was important that any MIR consider the wide range of lending products available to SMEs, which it considered exerted a strong and increasing competitive constraint on general purpose business loans and overdrafts.<sup>94</sup>

2.71 Conversely, the FCA submitted that it agreed with the CMA's proposed scope of the terms of reference in respect of SME banking. Given the close linkages between BCAs and the various other forms of finance available to SMEs, the FCA considered that unduly narrow terms of reference in respect of SME banking would be inappropriate.<sup>95</sup> Several other respondents also highlighted the linkages between the focal products and other products, noting their relevance to the competition analysis, most notably the FSB.<sup>96</sup>

2.72 The CMA has carefully considered respondents' submissions on this issue.

2.73 The SME banking market study considered in particular detail the focal products,<sup>97</sup> but the market study was not limited to those products. Indeed, in the initial scoping document for the market study (the Scoping Document), the OFT indicated that it would consider alternative lending products to general purpose business loans, both considering the extent that they exercised a competitive constraint on the focal products and any factors which impacted on the effectiveness of that constraint. Moreover, the OFT also emphasised that a particular factor in the focus on BCAs during the market study was their

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<sup>93</sup> While HSBC's and LBG's response to the consultation referred to liquidity management services, which include short-term business deposit accounts, Barclays' response referred only to BCAs and overdrafts.

<sup>94</sup> LBG response, Annex 3, p27.

<sup>95</sup> FCA response, p11.

<sup>96</sup> FSB response, paragraph 3.5.

<sup>97</sup> With respect to business deposit accounts, the CMA has considered short-term deposit accounts (see, for example, SME study, fn 26) and also longer-term deposit accounts (see, for example, SME study, Table 4.3, and Annex D, paragraph 2).

importance as ‘a so-called “gateway” product for banks to provide customers with a range of services’.<sup>98</sup>

2.74 The CMA’s analysis during the SME study therefore took account of non-focal products including alternative lending products and business deposit accounts generally. For example:

- The CMA concluded in the summary of the SME study that:

In particular, we have found that most SMEs (especially the smaller SMEs) choose, initially at least, to obtain a BCA from their PCA provider, providing the largest providers with a ‘first port of call’ advantage. *They then are likely to take other products from that provider, particularly lending products.* A provider is, therefore, less likely to capture new-to-market SMEs, *and then to be able to cross-sell to them a range of products*, if it does not currently provide their PCA. This limits the growth potential of stand-alone business bank providers or banks lacking a strong presence in the PCA. [Emphasis added.]

- The CMA then explicitly considered the ‘importance of gateways’ in Chapter 4 of the SME banking market study (among other parts), noting that one such gateway was that between BCAs and ‘other products’. It then went on to provide evidence as to the significance of that gateway effect in relation to overdrafts, deposit accounts, company credit cards, commercial mortgages, invoice finance and, to a lesser extent, asset finance (as shown in paragraph 4.41 and Table 4.3).
- The CMA, in its discussion of customer behaviour, also noted the preference of many SMEs to approach their BCA provider when seeking to obtain finance at various points in the analysis and their overall preference to ‘use a single bank which is likely to meet all of their relevant needs’.<sup>99</sup> This forms a relevant element as to our explanations of customer behaviour, particularly explaining elements of customer inertia, such as the limited incidence of multi-banking<sup>100</sup> and the unwillingness to approach intermediaries when looking to obtain finance.<sup>101</sup>

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<sup>98</sup> Although in the Scoping Document the CMA indicated that it did not expect to consider long-term deposit accounts, the evidence indicated that the ‘gateway’ effect did not only apply to short-term deposits. The CMA therefore considered long-term deposits during the SME study (as indicated by Annex D of the SME study, and the reference to ‘term or notice BDAs’).

<sup>99</sup> SME study, paragraph 5.147.

<sup>100</sup> SME study, paragraph 8.70.

<sup>101</sup> SME study, paragraph 8.20.

- The CMA considered deposit accounts specifically in Annex D to the SME banking market study, concluding that the ‘gateway effect’: ‘provides the main banking provider with a strong “first port of call advantage” over other providers, consequently limited the intensity of competition for those products [deposit accounts]’.

2.75 The CMA therefore considers that the analysis presented in the market study demonstrates that the CMA had considered a wider range of products, including non-focal products, and the linkages between various products, and fully reflected them in its competition analysis. Indeed, the fact that several of the banks and other interested parties explicitly referred to and critiqued this analysis in their responses to the provisional decision is consistent with that view. Consequently, taking account of the consultation responses and the analysis in the SME study, the CMA continues to consider it to be appropriate to specify the linkages between BCAs and other products as a feature which it has reasonable grounds to suspect restricts, prevents or distorts competition (see Chapter 3). In coming to this conclusion, the CMA has specifically considered the representations relating to linkages between products, provided by those parties which considered the terms of reference too broadly defined.

2.76 Moreover, and more generally, the CMA considers that it remains inappropriate, following a market study, unduly to limit the terms of reference, given that the specific intention of the market investigation regime is that detailed investigation takes place following an MIR. The content of references should therefore give the Group the scope to carry out such a detailed investigation. This position is consistent with the CMA’s MIR guidance in which we state:

The content of references gives the [Market Reference Group] scope to identify markets affected which differ from those that were considered by the [CMA Board] when making the reference, and to identify features giving rise to adverse effects on competition of which the [CMA] was not aware.<sup>102</sup>

2.77 However, we note that the OFT explicitly indicated in the Scoping Document that it did not propose to focus on non-lending products during the SME study and note that these products were then not considered in any detail during the SME study.<sup>103</sup> We therefore consider that, in the circumstances of this case, it is appropriate to exclude from the terms of reference other non-lending products, apart from BCAs and Business Deposit Accounts, such as:

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<sup>102</sup> OFT511, paragraph 3.13.

<sup>103</sup> OFT, *Update on proposed scope for SME banking market study*, OFT1507, paragraph 2.7. SME study, paragraph 2.35.

- insurance products
- merchant acquiring products
- hedging products<sup>104</sup>
- foreign exchange products

2.78 If any interested parties consider that there are competition concerns in relation to any of those products, they should identify them to the Group. If the Group considers that any such concerns are sufficient to justify extending the terms of reference to include these products, it would be able to request a variation of the terms of reference.<sup>105</sup>

2.79 Moreover, the CMA has also decided to make a small change to the terms of reference to clarify that the focus of the terms of reference is on banking services to SMEs, rather than any other service; this involves simply replacing the words 'in respect of small and medium-sized enterprises, the provision of services' by the words 'in respect of small and medium-sized enterprises, the provision of banking services'.

2.80 In addition, LBG made a further submission that the terms of reference should exclude from the definition of SMEs corporate entities with turnovers not exceeding £25 million that are part of corporate groups with a turnover of over £25 million, on the basis that these customers were likely to have similar characteristics to larger corporate customers.<sup>106</sup> We accept this. We note that an SME is defined as a 'business' in the terms of reference and so, to clarify the position, the CMA has decided that the terms of reference should state explicitly that a 'business' for this purpose shall have the same meaning as an 'undertaking' under competition law, which entails that the relevant entity is normally an entire corporate group, rather than a company within a larger corporate group.<sup>107</sup>

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<sup>104</sup> The CMA notes the [action being taken by the FCA in relation to the selling of interest rate hedging products to SMEs](#). However, this relates to concerns about failings in the way that certain banks sold these products which are best addressed by the FCA, rather than competition concerns of a type to be addressed during a market investigation.

<sup>105</sup> Any variation in the terms of reference would be made under section 135 of the Enterprise Act 2002. If the CMA Board was minded to make a variation in the terms of reference in a way which it considers is likely to have a substantial impact on the interests of any person, it would consult that person or persons pursuant to section 169 of the Enterprise Act 2002.

<sup>106</sup> LBG response, Annex 3, p27.

<sup>107</sup> A discussion on the definition of an 'undertaking' for the purposes of the Competition Act 1998 can be found in the OFT publication [Agreements and Concerted Practices](#), paragraphs 2.5 & 2.6.

## PCAs

- 2.81 The CMA has also received some representations in relation to the terms of reference for the PCA sector. Barclays submitted that private banking customers should be excluded from the scope of any MIR given their levels of sophistication.<sup>108</sup> LBG commented that ‘basic bank accounts’ and packaged accounts should be explicitly included in any investigation into PCAs.<sup>109</sup>
- 2.82 Private banking was within the scope of the market study and we have received no evidence that the level of sophistication or otherwise of private banking customers is a material factor in the competition analysis, and none was provided by Barclays in support of its submission. We therefore do not consider it appropriate to exclude these customers from the terms of reference. However, the Group may wish to take this submission into account when conducting its analysis.
- 2.83 In relation to LBG’s submission on basic bank accounts and packaged accounts, we consider that the definition of PCAs includes these types of accounts and accordingly that there is no need to add them to the terms of reference.
- 2.84 In addition, Metro<sup>110</sup> and Paragon<sup>111</sup> commented that PCAs could not be assessed in isolation from other products, especially savings accounts, although they did not explicitly make representations for the terms of reference to be broadened to include these products and we do not consider it appropriate to change the terms of reference in this regard.

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<sup>108</sup> Barclays response, paragraph 3.5.

<sup>109</sup> LBG response, Annex 3.

<sup>110</sup> Metro, pp3–4.

<sup>111</sup> Paragon, p6.

### 3. The CMA's final decision regarding an MIR

3.1 In order to make an MIR, the CMA must determine both:

- that the reference test is met, and
- that it would be appropriate to exercise its discretion to make an MIR

3.2 In this chapter, we set out our assessment in relation to these issues. This assessment takes account of the consultation responses received during the consultation. However, consistent with our analysis of consultation responses set out in Chapter 2, this assessment remains largely unchanged from the position set out in the provisional decision, reflecting the lack of significant new evidence received during the consultation.

#### *The reference test*

3.3 The reference test is contained in section 131(1) of the Enterprise Act 2002 and gives the CMA the discretion to refer a market if it has 'reasonable grounds to suspect that a feature or a combination of features of a market in the United Kingdom for goods and services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or part thereof'.

3.4 In this section, we set out our assessment in relation to the reference test. In doing so, we consider first whether the reference test is met in relation to each of the segments we have considered, before considering the sector generally.

#### *SME banking*

3.5 In relation to SME banking, as set out in the SME study, we consider that there are a number of features of this sector which we suspect give rise to competition concerns. These are:

- **Persistent levels of concentration and relatively stable market shares** among providers of both liquidity management services and general purpose business loans (see the SME study, Chapter 4, including a description of the particular causes of concern on this issue).
- **A market structure characterised by close linkages both between PCAs and BCAs, and between BCAs and general purpose business loans.** In response to respondents who suggested that we limit the terms of reference as regards SME banking just to BCAs and general purpose business loans, we would note that the SME study also found such linkages between BCAs and deposit accounts and other forms of finance

offered to SMEs. **All of these linkages limit the scope and speed for newer or smaller providers to expand and develop their business models** (see the SME study, Chapter 4).

- **Continuing high barriers to entry and expansion in the supply of BCAs and general purpose business loans to SMEs**, particularly the inability of smaller or newer providers to develop their businesses outside of niche, specialist areas (see the SME study, Chapter 5). Such barriers include:
  - the difficulties faced by new or smaller banks to acquire sufficient numbers of profitable customers to establish a credible SME banking business, partly in consequence of low levels of shopping around and switching by SME customers as referred to below
  - the continuing need (despite a very significant increase in online and mobile banking) for an extensive local branch network to acquire new customers and distribute products effectively
  - limited access to key inputs by smaller or newer banks, particularly some evidence of concerns about access to payment systems at commercially attractive rates (also being considered by the PSR), and to information on the creditworthiness of SMEs
  - regulatory barriers arising from the methodology used to assess capital requirements imposed on banks
- **Demand-side issues**, with SMEs not easily able to access, assess and act on information to ensure that they get the best deal, manifested in low levels of shopping around and switching activity (4% annually for BCA customers despite the introduction of CASS). This particularly reflects limitations in transparency and the comparability of information on the offers of different providers and SME customers' 'inertia' (i.e. reluctance to shop around between banks and to switch banks) (see the SME study, Chapters 6 to 8). Survey evidence of SME customers suggests that the reluctance to shop around or switch at least partly reflects a widespread belief that better alternatives are not available and that there are significant frictions in the switching process.

3.6 The CMA considers that these features, alone or in combination, meet the reference test. In particular, we consider that this sector is characterised by a mutually reinforcing pattern of demand-side problems (including customer inertia, problems in understanding the complex pricing structures and a perceived lack of differentiation between banks) and supply-side problems (resulting from market concentration and high barriers to entry and

expansion). These issues seem to combine, and contribute to one another, in a complex pattern (see Chapter 10 of the SME study).

- 3.7 The SME study (see for example, Chapter 9 of the SME study) has identified that these features may apply differently between the largest and smallest SMEs, such that competitive dynamics between these groups may well vary. In particular, we have seen more evidence of greater competition between providers for larger SMEs. Nevertheless, we continue to have reasonable grounds to suspect that competition is prevented, restricted or distorted across the SME sector. This is particularly the case in respect of concentration and aspects of demand-side issues (with, for example, some evidence of impediments to switching arising from the deeper relationship between larger SMEs and their bank).

### *PCAs*

- 3.8 In relation to PCAs, as also set out in the market study update published on 18 July 2014, we consider that there are a number of features of this sector which we suspect give rise to competition concerns. These are:
- **Persistent levels of concentration and relatively stable market shares** among providers (see Chapter 2 of the PCA update).
  - **Continuing high barriers to entry and expansion**, in particular (see Chapter 2 of the PCA update):
    - the continued importance of a branch network to distribute products effectively, despite the recent increase in the use of online and mobile banking
    - recent or potential entrants propose that customer inertia is one of the most important difficulties they face when trying to expand in the PCA market, due to relatively low levels of switching and shopping around referred to below
    - limited access to key inputs by smaller or newer banks, particularly some evidence of concerns about access to payment systems at commercially attractive rates (also being considered by the PSR)
    - the capital requirements issue referred to above for SMEs applies also to PCAs (and indeed mortgages, personal loans and credit cards)
  - **Demand-side issues**, including relatively low levels of switching and shopping around, which may be regarded as symptomatic of a 'sticky' market with relatively little incentive for providers to compete. Despite the



launch of CASS, switching rates remain at around 3% annually for PCA customers, and this is exacerbated by difficulties faced by PCA customers in comparing costs and benefits between different providers' PCAs. Survey evidence of PCA customers suggests that the reluctance to shop around or switch is largely based on a widespread belief that better alternatives are not available (see the PCA update, Chapter 4).

- **Lack of transparency in charging structures**, especially for overdrafts which are complex and increasingly varied, making it very difficult for customers to choose the best value PCA for their needs (see the PCA update, Chapter 3).

3.9 The CMA considers that these features, alone or in combination, meet the reference test. In particular, we consider that, in common with SME banking, the PCA sector is characterised by a mutually reinforcing pattern of demand-side problems (including customer inertia, difficulty in understanding the pricing structures and a perceived lack of differentiation between banks) and supply-side problems (resulting from market concentration and high barriers to entry). These issues seem to combine, and contribute to one another, in a complex pattern (see the PCA update, Chapter 6).

### ***Discretion to make an MIR***

3.10 Once the CMA has concluded that the reference test is met, there are four particular criteria which it normally considers when deciding whether to exercise its discretion as to whether or not to make an MIR. These are:

- scale of the suspected problem and whether a reference would be an appropriate response
- availability of appropriate remedies
- whether UILs would address concerns
- alternative powers available to the CMA or to sectoral regulators

3.11 In considering these factors, the CMA recognises that a market investigation leads to significant costs, both to the CMA itself (and the public purse) and to the parties involved. We understand the point made to us by a number of banks, and also raised by some of the other respondents to the consultation, that there would be considerable time (including management time), energy and cost expended in the event of an MIR, which could otherwise be expended by the parties perhaps on competitive commercial action, including innovation. We have of course carefully considered in the application of the discretionary criteria the need for any market investigation to be proportionate

and to ‘add value’ over and above what might be achieved using alternative approaches.

- 3.12 In the remainder of this chapter, the CMA considers each of the four discretionary criteria in turn, highlighting any differences by reference to their application to each of SME banking and PCAs.

*First criterion: scale of the suspected problem*

- 3.13 In determining the scale of the suspected problem, the CMA’s guidance identifies three factors of particular significance:

- the size of the market
- the proportion of the market affected by the features
- the persistence of those features<sup>112</sup>

*Size of the market*

- 3.14 The available evidence, including the responses to the consultation, demonstrates the size and importance of these markets, both to customers and the economy more generally.

- 3.15 Each aspect of the retail banking sector under consideration constitutes a substantial sector of the UK economy. For instance:

- PCA revenues are £8.1 billion annually
- BCA revenues from SMEs are well over £2.5 billion annually
- the value of outstanding term loans to SMEs in Great Britain is some £90 billion<sup>113</sup>

- 3.16 Moreover, the workings of the retail banking sector have a very substantial effect on consumers, businesses and the economy as a whole:

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<sup>112</sup> [OFT 511](#) sets out three factors relevant to determining the scale of the suspected problem; however, the CMA may take other relevant factors into consideration as appropriate.

<sup>113</sup> Information on the relevant sources for the market size figures can be found in the separate market study reports.

- The sector affects nearly all households in the country as holders of PCAs. In 2013, there were approximately 80 million PCAs, of which 65 million were active.
- The sector affects most of the 4.5 million SMEs in the UK. According to the FSB, nearly 60% of the UK private sector workforce is employed by SMEs.<sup>114</sup>
- Retail banking is part of the essential infrastructure of the UK economy, facilitating personal and SME transactions and the flexibility, adaptability and viability of SMEs.

3.17 Given the size and importance of this sector, we consider that even small restrictions on competition would be likely to have a significant overall effect and that even small improvements in competition could therefore generate substantial benefits to SMEs and consumers.

*The proportion of the market giving rise to the features*

3.18 The available evidence demonstrates that the features of concern are widespread in nature and relate to fundamental aspects of the operation of the sector that have been described here, including on both the demand side and the supply side.

3.19 We therefore consider that a large proportion of these segments gives rise to the features of competition concern.

*Persistence of the features*

3.20 In relation to both SME banking and PCAs, the available evidence demonstrates that the features we identify are long-standing in nature (with each being specifically considered by various inquiries over many years – see Chapter 1) and, in our assessment, likely to persist.

3.21 However, notwithstanding these concerns, during the market studies and during the consultation on the provisional decision, the CMA has carefully considered a number of recent initiatives and developments across retail banking which may, potentially, diminish the features of concern identified in paragraphs 3.5 and 3.8 above. The main recent initiatives and ongoing developments can be categorised as follows:

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<sup>114</sup> See the FSB [press release](#), 28 May 2014.

- initiatives or developments which might directly reduce concentration
- initiatives or developments to reduce barriers to entry and expansion
- initiatives or developments to facilitate switching
- initiatives or developments to enhance transparency and comparability

3.22 Each of these categories of initiatives or developments, and their impact on the persistence of the feature to which it most appropriately relates, are considered below, taking account of the consultation responses.

*Persistence: initiatives or developments which might directly reduce concentration*

3.23 The most significant, direct, structural changes which are intended to reduce concentration arise from the ongoing or proposed divestments of:

- TSB from LBG (Project Verde)
- Williams & Glyn from RBSG (Project Rainbow)

3.24 These divestments were required under EU state aid rules and are intended to facilitate the entry of new competitors or the reinforcement of a smaller existing competitor in UK retail banking.<sup>115</sup>

3.25 As we set out in each of the relevant sections of the market study reports (see the SME study, Chapter 4, and the PCA update, Chapter 2), the CMA notes that, although concentration levels will be reduced once each of these divestments is completed, the segments will still remain concentrated, particularly those in Scotland.<sup>116</sup> In addition, the OFT's advice to the Chancellor of the Exchequer in September 2013 on the then proposed divestments concluded that 'our market share analysis indicates that the divestments will only have a limited impact on overall structure in PCAs and SME banking'.<sup>117</sup>

3.26 Moreover, these divestments are still some time away. In the case of Project Verde, TSB remains 50% owned by LBG, and we understand that it is consolidated in LBG's accounts;<sup>118</sup> LBG is not required to sell its remaining 50% stake in TSB until 31 December 2015. In the case of Project Rainbow,

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<sup>115</sup> See ['State aid: Commission approves restructuring plan of Lloyds Banking Group'](#) and ['State aid: Commission approves impaired asset relief measure and restructuring plan of Royal Bank of Scotland'](#).

<sup>116</sup> The Northern Ireland markets remain unaffected by the divestments and therefore remain highly concentrated for SME banking and concentrated for PCAs after Project Verde and Project Rainbow.

<sup>117</sup> See [letter to the Chancellor of the Exchequer](#), 11 September 2013.

<sup>118</sup> *Financial Times*, 26 September 2014.

the process for completion of that divestment has been delayed for several years, following the European Commission's decision of 9 April 2014, and is now not required to be completed before the end of 2017.<sup>119</sup> We have considered the effect of these divestments and remain of the view that, even after fully implemented, they will only have a limited effect on concentration in the future.

3.27 In addition to these proposed divestments, new entrants have emerged which could have an effect on concentration levels in the future:

- Metro Bank has entered and expanded in both the SME banking and PCA segments, albeit so far on a relatively small scale, with a current network of 28 branches and plans to expand significantly (but not to the scale of the larger banks in the medium term).
- Tesco Bank launched its PCA in June 2014. The account pays interest on credit balances and is linked to the Tesco Clubcard. Tesco plans to use its stores to raise awareness of the product; however, the account is sold online. Customers can carry out certain transactions (such as cash deposits) at the customer desks of Tesco's largest 300 stores, but the account is designed to be accessed primarily online.
- Virgin Money has announced that it is developing a range of current accounts and has launched its Essential Current Account, initially available at Virgin Money Stores in Scotland and Northern Ireland only.
- The Post Office has conducted a pilot scheme in the East of England operating three PCAs in partnership with the Bank of Ireland in around 100 branches (although account servicing is available nationwide). The Post Office announced plans to expand this trial to 239 branches across the UK.<sup>120</sup>
- It was announced in the spring of this year that there is an intention to launch a new bank (Atom Bank), which would provide SME banking services and PCAs through an online-based offer. We understand that the intention is to launch in the first half of 2015.

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<sup>119</sup> In April 2014, the European Commission allowed RBSG to delay the disposal of Williams & Glyn from December 2013 (for an unspecified time, understood to be several years). [European Commission press release IP/14/410, State aid: Commission approves amendments to restructuring plan of Royal Bank of Scotland](#), 9 April 2014.

<sup>120</sup> 'Number of Post Office branches offering current accounts to double', *The Guardian*, 1 July 2014.

- 3.28 The CMA also notes that, in relation to SME banking, Aldermore, Shawbrook and Handelsbanken continue to expand in relation to specific customer groups or product lines. However, this is fairly small scale: the largest of these three providers, Handelsbanken, accounts for less than 1% of SME main banking relationships.<sup>121</sup>
- 3.29 The developments identified above are certainly positive and promising. Furthermore, there are some encouraging signs in relation to PCAs, in particular that CASS has been introduced and is reported to be working well from a technical perspective, new products have been launched and there is also new entry. Nonetheless, we remain concerned that entry and expansion is on a small scale and focused on servicing particular customer groups for SMEs, and that although entry into PCAs is inducing some innovation by the larger banks, the scale of such entry is open to question. Many entrant banks maintained that PCAs were a particularly complex product to develop and that they expected only relatively slow growth after launch.
- 3.30 The CMA therefore considers that, while there have been some potentially important developments, mainly in relation to PCAs, they do not seem likely to alleviate the persistence of the concentration and relatively stable market shares in these sectors.

*Persistence: initiatives or developments to reduce barriers to entry and expansion*<sup>122</sup>

- 3.31 The CMA has also considered a number of specific developments and initiatives in relation to barriers to entry and expansion, to assess whether the features identified above are likely to persist. A brief summary of our initial assessment, considered further in the market studies, is as follows:
- **Access to branch services (PCAs and SME banking):** As set out in the PCA update, Chapter 2, and the SME study, Chapter 5, and in Chapter 2 above, the CMA considers that a wide network of local branches continues to be important for a provider to compete effectively in the sector as a full service provider. We recognise the rapid continued growth and usage of direct means for customers to access banking services through online or mobile channels, and the declining usage of bank branches for transactions. However, the evidence we have seen suggests that most SMEs and PCA customers still place considerable value on having a local branch for their bank. The strategies of most banks in maintaining or

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<sup>121</sup> See the SME study, Chapter 5.

<sup>122</sup> While we have found that customer inertia is a barrier to entry, we consider this issue in relation to developments or initiatives to facilitate switching and transparency rather than in this section.

developing extensive branch networks (even in the case of larger banks with branch closure programmes) seems to us consistent with this. Indeed, we note that TSB has announced that it intends to open additional branches, indicating the continued relevance of branches at least to some challenger banks.<sup>123</sup> We therefore consider that this barrier to entry is likely to persist.

- **Regulatory barriers (PCAs and SME banking):** As identified in the PCA update, Chapter 5, and the SME study, Chapter 5, the CMA has received generally favourable feedback on the effect of recent amendments to the regulatory authorisation scheme, such that we have good grounds to believe that this concern has been materially reduced. Indeed, during the consultation, Paragon, which had recently been authorised, commented in its consultation response that it could attest to the fact that the authorisation process was no longer the barrier it once was. In relation to SME lending, however, concerns still arise in relation to the impact of certain aspects of capital requirements, notwithstanding recent changes made by the PRA. We consider that these are likely to persist.
- **Access to payment systems (PCAs and SME banking):** As identified in the PCA update, Chapter 2, and the SME study, Chapter 5, the CMA has heard widespread concerns from newer or smaller banks about the actual or believed ease and cost of access to payment systems, particularly Faster Payments. These relate both to the costs of obtaining direct and indirect access, and to the service offered to those accessing the payments system through indirect access. While the evidence on this issue is currently insufficient to conclude that smaller or new banks are in fact disadvantaged, the extent and frequency of concerns about the lack of competition in indirect access to payment systems indicates at least that there is an issue to be investigated. The PSR, which will become fully operational in relation to the regulation of payment systems in April 2015, is currently examining access to payment systems.<sup>124</sup> We do not know at this point how the PSR will address these concerns. However, we note the PSR's wide-ranging powers to address concerns in relation to payment systems. As we note in Chapter 2, we envisage that the Group in the market investigation will take account of the PSR's work on this (and HM Treasury's work on designating payment systems to be overseen by the PSR), including its soon to be published consultation document on its future work, to address any concerns regarding duplication in this area.

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<sup>123</sup> See [summary of the number of bank branches closed by some banks and opened by others](#).

<sup>124</sup> See [call for inputs document](#).

- **Information asymmetries on customer creditworthiness (SME banking):** While a lack of information on creditworthiness of potential applicants for SME lending products appears to restrict the ability of newer or smaller banks to compete effectively with established providers (see the SME study, Chapter 5), the government has introduced legislation to Parliament to facilitate wider access to such information. Should the legislation be enacted and then implemented, the CMA considers that these proposals are likely to address concerns arising in relation to this issue.

3.32 The CMA therefore considers that, while there have been some potentially important developments, they do not seem likely overall to prevent the persistence of high barriers to entry and expansion, including the continuing need for an extensive branch network to be a scale competitor in the sector.

*Persistence: initiatives or developments to reduce barriers to switching*

3.33 The most potentially significant initiative in relation to this issue has been the introduction of CASS, launched in September 2013, following the recommendations of the Vickers report. Since we published our provisional decision, the Payments Council announced that there were 1.2 million switches using the new service in its first full year of operation – a 22% increase over the equivalent period the previous year. Nevertheless, switching levels continue to be low, with around 3% of PCA customers and 4% of BCA customers switching across both segments per year (including switches not made through CASS), a rate which is considerably lower than a number of other sectors we have considered.<sup>125</sup>

3.34 Moreover, there are specific concerns when the figures are considered in more detail:

- The number of customers switching between Lloyds and TSB PCAs up to June 2014 was greater than the increase in switchers recorded by CASS. This is likely to be a one-off occurrence, reflecting the wish of certain Lloyds and TSB customers not to be customers of the bank allotted to them in the LBG/TSB demerger, and suggests that the level of switching, excluding the effect of the demerger, may be lower in subsequent years.

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<sup>125</sup> In other sectors, annual switching rates are typically 10–15% in energy, around 10% in mobile telephony, around 30–35% in car insurance, but less than 5% in digital television. The question of the significance of other measures such as ‘churn’ rates is considered in the summary of the CMA market study update on PCAs, July 2014.



- In relation to BCAs, CASS is available for SMEs with a turnover of up to €2 million. Out of a total of over 3.5 million BCAs held by SMEs, under 20,000 SMEs switched using CASS in its first year.

3.35 Although CASS has apparently made the switching of BCAs and PCAs an easier process, it has not led to significantly greater levels of switching.

3.36 The CMA therefore considers that switching rates have been persistently low, weakening incentives to compete, and that the emergence of CASS, although clearly a welcome development, does not appear to be sufficient to change this fundamentally.

*Persistence: initiatives or developments to enhance transparency and comparability*

3.37 The CMA's analysis has also covered a wide range of initiatives that have been undertaken to improve transparency and comparability of the prices and services offered by a number of banks.

3.38 In relation to PCAs, these include:

- OFT recommendations to roll out transparency initiatives such as providing annual summaries and enhanced monthly statements and illustrative charging scenarios on unauthorised overdraft charges
- OFT recommendation to enhance the PCA price comparison website on the Money Advice Service website to enable more accurate and detailed comparisons across PCAs
- providing simplified overdraft terminology
- following the government's Consumer Credit and Personal Insolvency Review,<sup>126</sup> the option for customers to receive text alerts if their balance falls below a certain limit

3.39 The CMA's analysis of these transparency initiatives designed to help consumers understand and control their usage of their own PCAs is included in the PCA update, Chapter 3.

3.40 Although these initiatives have now been implemented, in some cases this is more than two years after the initial target date. Initial evidence provided by the FCA as part of the MIR consultation suggests that some initiatives, for

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<sup>126</sup> BIS, HMT, [Consumer Credit and Personal insolvency Review](#), November 2011.

instance mobile banking, may have resulted in positive changes in consumer behaviour in relation to overdraft charges<sup>127</sup> (however, others like annual summaries have been found by the FCA to make no economic impact for most consumers<sup>128</sup>).

- 3.41 For many consumers, there is still confusion and a lack of understanding about overdrafts. This is primarily because overdraft charging scenarios are complex and difficult to understand. Indeed, the variety of new charging structures may well have increased complexity. As a result, we remain of the view that there is still a significant problem with consumers' ability to understand the costs they incur from their own PCAs.
- 3.42 We have also found a lack of transparency with charging structures, a point re-emphasised during the consultation. Overdrafts remain very complex both for authorised and unauthorised charges and they have become more complex. There are a multitude of charges including monthly fees, daily fees, interest and item charges and this makes it very difficult for consumers to compare the cost of PCAs across providers. This in turn reduces the possibilities of shopping around and weakens competitive constraints. It can also mean that consumers can end up paying relatively high costs for small additional loans.
- 3.43 Moreover, overdraft revenues overall have fallen by just 3% over the last couple of years, despite bigger falls in wholesale funding, perhaps indicating that the pricing of overdraft lending is not particularly responsive to changes in funding rates. We are concerned that banks are unlikely to have the incentive to compete on overdraft charges.
- 3.44 The CMA is also aware of two other transparency-related developments regarding PCAs. These developments and our assessment of them are below:
- As part of the MiData initiative (see the PCA update, Chapter 3, and the SME study, Chapter 7), a number of banks<sup>129</sup> have agreed to provide customers with detailed account data which they can upload to comparison websites to achieve 'bespoke' comparison information in relation to PCAs. In June 2014 the government announced that it had secured agreement on the industry standard format for PCAs and that account providers

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<sup>127</sup> The introduction of mobile banking decreased average overdraft charges by 12–28% depending on the consumer subgroup considered.

<sup>128</sup> We note the FCA's finding that annual statements may have had an important impact on consumers holding packaged bank accounts. See the FCA's response, p9.

<sup>129</sup> The banks committed to MiData are as follows: Barclays, HSBC, LBG, Nationwide, RBSG and Santander. See '[Government to make it easier to check that you've got the right bank deal](#)'.

would make it available to their customers by the end of March 2015. The downloads will include a year's worth of PCA transactions in a single file that can be read by online tools. The government noted that comparison tool providers were already looking to create online tools that used the information. As envisaged, we consider that this should be a positive step forward and will allow consumers to compare accounts meaningfully based on their likely account usage. Nonetheless, the precise usage and effect of such a tool is uncertain, and as such, we have not attempted to predict its likely effectiveness. Moreover, the consultation responses provided no new evidence to alleviate our concerns that existing price comparison websites do not have the capability to enable consumers to accurately choose the right account for their needs.

- The recently adopted EU legislation on payments and banking (the Payment Accounts Directive) is designed to enhance transparency and facilitate the creation of comparison tools for PCAs (see the PCA update, Chapter 5). The FCA is working with HM Treasury to implement this legislation. Although the CMA considers the Payment Accounts Directive as a positive development, it does not, in general terms, go materially further than existing or planned regulatory developments in the UK. It will nevertheless require some further standardisation both of terminology and of the format in which information is provided. It will also require the UK to implement rules on the provision of basic bank accounts and account switching.

3.45 There have been fewer initiatives regarding transparency and comparability of information for SMEs. It remains the case that there are no effective price comparison tools (we consider proposals from the banks in relation to this issue below). However, as we set out in the SME study, Chapter 7, and as we mention in Chapter 2, the CMA welcomes Business Banking Insight, a service comparison website promoted by the FSB and the BCC, which enables SMEs to compare their existing bank's service offering with that available from other providers. However, this initiative is very recent, with roll-out only taking place on 28 May 2014. It is not possible at this stage to conclude on its effectiveness, particularly the extent to which it is used by customers to drive competition between providers, although we understand that they are looking at ways to improve the service further.

3.46 In relation to transparency initiatives in both segments, the CMA considers that, despite certain positive developments, it is not possible to say with any degree of certainty that they are likely to alleviate the persistence of our concerns in relation to this issue.

### *Conclusion on persistence of the features*

- 3.47 The CMA recognises that there have been a number of significant regulatory initiatives and other developments seeking to improve competition in retail banking. We consider that some of these changes – such as in relation to payment systems (assuming that the new PSR is able to remedy any problem that does exist), authorisation of new banks and information asymmetries – are likely to have the result that the features for which the CMA currently has concerns will not persist into the future. However, in relation to the other features identified above – particularly concentration levels and stable market shares, continuing high barriers to entry and expansion, low levels of customer switching and shopping around, and lack of transparency – the CMA considers that these concerns are likely to persist for the foreseeable future notwithstanding the individual and aggregate effect of the various initiatives we explored above.
- 3.48 As we note in Chapter 2 more generally, in these sectors significant change has often been said to be imminent without in practice materialising.<sup>130</sup> Given the available evidence, we consider that recent and forthcoming developments are not likely to cause significant change to the sector.

### *Conclusion on the first criterion: scale of the suspected problem*

- 3.49 For the reasons set out above, the CMA has decided that the scale of the problem identified is sufficient to merit an MIR.

### *Second criterion: availability of appropriate remedies through an MIR*

- 3.50 The availability of remedies and the prospective value of a market investigation is part of the CMA's assessment when considering whether to make an MIR. However, it is not for Phase 1 market studies to determine which remedies would or would not be appropriate for the CMA to consider in a 'Phase 2' market investigation, following the detailed analysis that is properly undertaken at Phase 2. Rather, it is sufficient that the CMA believes that there is a reasonable chance of appropriate remedies being available through an MIR by virtue of the CMA's wide-ranging powers to accept undertakings or impose an Order. We assess that question in the following paragraphs.

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<sup>130</sup> In the context of assessing the argument that the Internet had removed the need for an extensive branch network as a barrier to entry, the Vickers report of September 2011 had noted: 'It is worth noting that in 2001, internet and telephone banking were already being pointed to as offering the potential for new entrants to put competitive pressure on incumbents' (see [Vickers final report](#), fn 34, p176).

3.51 As a result of the CMA's efforts in this Phase 1 work to consider the kind of solutions that a market investigation might produce, the CMA has had regard to the availability of the following two categories of remedies:

- behavioural/regulatory remedies
- structural remedies

*Behavioural/regulatory remedies*

3.52 If the CMA were to find one or more adverse effects on competition following an investigation,<sup>131</sup> it is plausible that there are a number of incremental behavioural and regulatory measures, some supported in consultation responses, that it could apply and that might address some of the features above. A non-exhaustive list of potential remedies as regards PCAs could, for example, include:

- Enhancing the provision of information to customers through improvements to the statements they receive. Examples would be the provision of more standardised information, and the introduction of an agreed, consistent, industry-wide time period for the issuing of annual statements to PCA customers. These might enhance transparency and engagement, and so assist customers' decision-making.
- Requiring banks to make charges and other provisions more transparent and more easily available on their websites, in order to make it easier for customers to understand what individual bank accounts are offering and compare with other accounts.
- Requiring banks who do not already do so to send their customers text alerts to warn them if they are about to go into overdraft. This may assist customers to control their usage of their account so that they only use overdrafts when it is the best way of meeting their needs.
- Requiring banks to offer their customers the option to opt out from overdrafts at no cost in all fee-free accounts.
- Prohibiting certain charges that are particularly complex for customers to assess.
- Improving redress mechanisms for complainants.

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<sup>131</sup> [Section 138 of the EA02](#).

- 3.53 Similarly, with respect to SME banking, certain behavioural and regulatory measures might address our concerns. A non-exhaustive list of potential remedies could, for example, include:
- enhanced information to SMEs setting out BCA costs and usage, to improve the ease with which customers can compare different providers
  - introduction of comparison and choice tools, to enable SMEs more readily to perceive differentiation between the offers of various banks
  - requiring particular steps to be taken when an SME is sold an SME banking product (for example, a requirement for specific advice), with the aim of ensuring that they are in a position to take a fully informed decision
- 3.54 Other options, applicable to both SMEs and PCAs, could include compulsory access schemes, such as the requirement for incumbent banks to provide competitors (especially new entrants and smaller providers) with access to their branch network or other assets, such as payment systems, or intervening more directly in the conduct of parties, including the charges that they may levy for the products or the services that they must provide (including, for example, overdrafts).<sup>132</sup>
- 3.55 The assessment and design of any behavioural and regulatory remedies would, of course, be the subject of very detailed consideration by the Group in order to facilitate their effectiveness. This is particularly important in the case of detailed behavioural remedies in complex markets, such as those set out above, where the detailed provisions of any such remedy are critical. Indeed, we consider that the Phase 2 remedies process, in itself, if one or more adverse effects on competition are found, may be valuable to determine the extent to which effective remedies are likely to be available and, if so, to ensure that remedies are designed in an appropriate manner to facilitate their effectiveness.

#### *Structural remedies*

- 3.56 Structural remedies are generally one-off measures that seek to increase competition by altering the competitive structure of the market. They might be used to change the market structure by lowering barriers to entry and expansion. These remedies can often be costly and affect the property rights of the parties subject to them, and so they are not imposed lightly.

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<sup>132</sup> This is, of course, similar to the transitional undertakings imposed following the CC market investigation into SME banking in 2002.

3.57 The divestment of assets is one possible structural remedy that might be imposed following a market investigation. Examples of divestment required to address competition concerns in the market include the European Commission's decisions under the EU state aid rules to require divestments by LBG and by RBSG 'as an appropriate means of increasing competition on the concentrated UK retail banking market',<sup>133</sup> and the recommendation in the Vickers report that the LBG divestment be substantially enhanced.<sup>134</sup> However, this is not the only structural remedy available or the default position where there are structural concerns. Structural remedies might take various forms; for instance, the structural remedies considered (but not adopted) by the CC in 2002 in relation to SME banking included:

- divestment of branches
- divestment of SME businesses without property
- divestment of SME businesses, with branches

In addition, there could in principle be structural remedies to address vertical integration issues (such as banks' interests in payment systems).

3.58 In the context of this sector, the CMA is aware of various sources which have identified structural concerns in this sector, and have advocated structural solutions to address the long-standing competition concerns identified. Furthermore, the CMA is aware that such measures have already been mandated to improve competition, particularly in the case of the European Commission's requirements for divestments by LBG and RBSG, referred to above.<sup>135</sup>

3.59 The CMA has also heard concerns about the very significant costs which would be likely to arise from any forced divestments. In particular, various parties have highlighted the direct costs associated with the divestments of:

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<sup>133</sup> European Commission decision, *State aid Case N 428/2009 – United Kingdom: Restructuring of Lloyds Banking Group*, 18 November 2009, paragraphs 179–188, especially paragraph 188. See also European Commission decision, *State aid case N 422/2009 and N 621/2009 – United Kingdom: Restructuring of Royal Bank of Scotland*, paragraph 244.

<sup>134</sup> *Vickers final report*, paragraph 8.13.

<sup>135</sup> For example, as we mention above, the European Commission's decisions under the EU state aid rules to require divestments by LBG and by RBSG 'as an appropriate means of increasing competition on the concentrated UK retail banking market', and the recommendation in the Vickers report that the LBG divestment be substantially enhanced.

- TSB by LBG, which we understand were of the order of £1.4 billion to date.<sup>136</sup> Indeed, the IT costs alone associated with that divestment were of the order of £[redacted]<sup>137</sup>
- Williams & Glyn by RBSG, which we have been informed were of the order of £[redacted] to date.<sup>138</sup> Of that, some £300 million was required to establish the IT systems for Williams & Glyn<sup>139</sup>

3.60 In addition, we are aware of the costs to customers in terms of being forced to switch provider. Moreover, we are aware that there may be significant indirect costs associated with the management time and focus devoted to the implementation of such divestments. Finally, it is by no means certain, given the challenges associated with the divestiture of TSB,<sup>140</sup> that there would be a willing buyer for a business with an extensive network of branches.

3.61 The CMA has taken account of these issues in its consideration of this criterion, particularly including those arguments raised on this matter during the consultation and referred to in Chapter 2. We note, as we describe above, that structural remedies do not necessarily involve divestments of the nature and scale of those required for LBG and RBSG, but also that such divestments can be required and have been required.

3.62 We also note that the features we have identified appear to us to be potentially serious in nature and long-standing, and may require interventions either to address the market structure or consumer behaviour or both. As we discuss in Chapter 2, we therefore remain of the view that we cannot rule out the possibility that structural remedies may be necessary, or at the very least be carefully considered by the Group at 'Phase 2'.

#### *Other relevant factors*

3.63 Moreover, there remain identifiable factors that we have reasonable grounds to suspect prevent, restrict or distort competition, and that it appears possible to ameliorate as we set out in the provisional decision, paragraph 4.55.

3.64 Finally, the CMA, consistently with a number of the consultation responses, also considers that a market investigation is likely to be of value. For a number of years, and particularly since the financial crisis, this sector has

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<sup>136</sup> See [Lloyds Interim Management Statement, Q3, 2013](#).

<sup>137</sup> LBG submission to the CMA.

<sup>138</sup> Meeting with RBSG.

<sup>139</sup> See ['RBS to spend £300m on Williams & Glyn's IT system'](#).

<sup>140</sup> For example, the failed sale of the Verde branches to the Co-operative Group, which was recently the subject of detailed investigation by the Treasury Select Committee.



been the subject of detailed scrutiny and, most frequently, negative public comment, about the implications of the current market structure and dynamics for competition and for customers. The CMA considers that there is merit in a thorough, independent and expert analysis of competition in the sector, building on the previous work of the OFT and others.

*Conclusion on the second criterion: availability of appropriate remedies through an MIR*

- 3.65 For the reasons set out above, the CMA has decided that appropriate remedies are likely to be available and that an MIR report is likely to be of value.

*Third criterion: the availability of undertakings in lieu of a reference*

- 3.66 The CMA has the power under section 154 of the EA02 to accept UILs of making an MIR. Before doing so, the CMA is obliged to 'have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned and any detrimental effects on customers so far as resulting from the adverse effect on competition'.<sup>141</sup> As the CMA's guidance notes, such UILs are 'unlikely to be common'. The guidance also refers to the significant practical difficulties associated with negotiating UILs with several parties, where the adverse effects have not been comprehensively analysed.<sup>142</sup>
- 3.67 During the course of the SME study, as we mentioned above, a number of banks argued strongly that UILs would be an effective, less costly outcome, if competition concerns were identified. It was also suggested that such UILs would be likely to be capable of quicker implementation than remedies made as a result of an MIR.
- 3.68 The CMA welcomed the submissions from the four largest UK retail banks and has carefully considered them. As mentioned above, we appreciate that an MIR would not be cost free, either for parties or for the CMA. We therefore gave careful consideration before the provisional decision as to whether we could be confident that UILs would provide as comprehensive a solution as is reasonable and practicable, consistent with our statutory obligations.

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<sup>141</sup> [Section 154\(3\) of the EA02](#).

<sup>142</sup> [OFT 511](#), paragraph 2.21.

3.69 The UIL proposals, offered in the context of SME banking only, consisted essentially of three elements, all of which are purely behavioural and designed to enhance customer engagement with their banking provider:

- A website enabling SMEs to compare the price and service offerings of BCAs from different providers. In relation to business loans, the website would primarily act as a 'portal', including a link to loan providers' websites, rather than including an actual comparison of indicative loan prices.
- Standardised and simplified account-opening procedures.
- The development of BCA annual summaries and other activities to stimulate SME engagement (eg promotion of CASS to SMEs).

Further specific detail on these UILs were set out in Annex A to the provisional decision dated 18 July 2014.

3.70 After careful consideration, the CMA, when reaching its provisional decision, decided not to take forward these proposals, principally on the grounds that there were concerns about their appropriateness, effectiveness and deliverability.

3.71 During the consultation, as we mention in Chapter 2, while various respondents welcomed the UIL proposals, most considered that they were insufficient to address the fundamental and long-standing concerns regarding the SME banking sector, and that an MIR was instead necessary. In addition, the largest banks, while regretting the CMA's position, have not come forward with further ideas to develop their proposals. On this basis, the CMA, after further examination of this issue, does not consider it appropriate to change its provisional position regarding the UIL proposals.

3.72 Our final assessment of the UIL proposals is therefore substantially unchanged from the provisional decision, and is set out below.

#### *Appropriateness*

3.73 Although the CMA has conducted a considered analysis of the operation of the SME banking sector, the analysis it has conducted is only of the depth that can reasonably and viably be conducted in a Phase 1 analysis. The CMA considers that an MIR is merited, at least in part, in order to gain a deeper understanding of the effectiveness of competition in the sector and the issues affecting it. These include the causes of behavioural concerns manifested in the low levels of shopping around and switching, and an assessment of the significance of concentration, barriers to entry and market structure on the provision of banking services to SMEs. The interactions between market

structure and customer behaviour are complex. While they have been considered during the market study (see the SME study, Chapter 4), these interactions have not been the subject of the detailed analysis that would inevitably follow an MIR.

- 3.74 As might be expected in a Phase 1 market study, the CMA has not yet assessed comprehensively the nature and extent of any adverse effect on competition, and so cannot at this stage be reasonably confident that any remedies offered would constitute as comprehensive a solution to the adverse effect on competition as is reasonable and practicable. It is possible that the competition concerns are driven primarily by behavioural and demand-side issues, as various parties submitted during the SME study and the consultation, such that a market investigation could result in remedies not significantly different in their general nature from what is proposed in the UILs. It also remains a possibility that, following a Phase 2 market investigation, some of the concerns would be more appropriately remedied by structural measures rather than, or in addition to, behavioural remedies (see earlier discussion on the possible remedies). To date, no structural remedies have been proposed by any of the banks; indeed, a number of the banks have insisted both during the market studies and during the consultation that no structural remedies are necessary or appropriate.

#### *Effectiveness*

- 3.75 In order to design appropriate undertakings which the CMA could be confident could provide as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned, the CMA would need to be persuaded of their likely effectiveness. The CMA considers that robust evidence and appropriate testing are likely to be essential before it is possible to engage in detailed design of any remedies.
- 3.76 This is particularly relevant in the case of behavioural remedies in complex markets, such as the SME banking segment, where the relative success of the remedies is largely dependent on the effectiveness of their detailed design, and particularly the impact that they have on customer behaviour, which is an inherently challenging process. This is likely to require detailed evidence as to the likely impact of particular measures on actual customer behaviour.
- 3.77 None of the banks has provided sufficient evidence, both before the provisional decision and during the consultation period, to persuade us of the likely effectiveness of their proposals in respect of UILs. In particular, none has been able to highlight any circumstances in which similar remedies in any

other comparable sectors have had a significant beneficial impact on addressing similar concerns to those which we set out above.

- 3.78 As we note above, in contrast to a process designed to obtain UILs, the CMA during a market investigation has inherited a well-developed remedies process which is specifically designed to test the effectiveness and proportionality of various potential remedies, including detailed external consultation. Furthermore, the CMA may, following a market investigation, use its order-making powers, which is more likely to be conducive to achieving effective remedies (as well as feasible remedies – see the next section) than the complex negotiations with multiple parties all with different interests which would be required to reach agreement on UILs at Phase 1.<sup>143</sup>

### *Feasibility*

- 3.79 Moreover, the CMA notes that, in the light of the market study conclusions, which relate to the whole of the UK, at a minimum a UIL package would need to apply to all the large banks throughout each of the geographic markets we identified in the SME banking market study. This would mean that UILs would be likely to need to be offered by at least eight banks. While the four largest UK retail banks have approached the CMA with a proposal, this does not include the agreement of any of the main banks in Northern Ireland (albeit Ulster Bank, as a subsidiary of the RBSG, was willing to agree to them in principle) or of other banks in Great Britain. The CMA, based on the extensive remedy-making experience of both the CC and the OFT, and as suggested by the MIR guidance,<sup>144</sup> does not currently consider that it is likely to be feasible to obtain agreement from so many organisations on an effective package of what may well be a complex and wide-ranging set of undertakings, in a highly complex sector. Indeed, the CMA notes that the maximum number of parties which have previously been included in UILs was three, and that was in considerably less complex fields.<sup>145</sup> An Order following ‘Phase 2’, on the other hand, could have wide coverage, both of the largest retail banks and other relevant market participants (including any which emerge in the future, but do not currently exist).
- 3.80 In any event, we note that the banks proposing UILs also said that the CMA should accept UILs because the banks do not want to delay progress on making worthwhile improvements to the operation of the sector. We welcome their willingness to move quickly in this area, and note that it is obviously open

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<sup>143</sup> See [Guidelines for market investigations, CC3](#), Part 4.

<sup>144</sup> [OFT511](#), paragraph 2.21.

<sup>145</sup> [Extended Warranties UIL \(2012\)](#) and [Postal Franking Machines \(2005\)](#). Both of these can be found on the [Register of Orders and Undertakings](#).

to them to take appropriate action outside the context of UILs should they choose to do so.

*Conclusion on the third criterion: the availability of undertakings in lieu*

3.81 For the reasons set out above, the CMA has decided that it cannot be confident that UILs could provide as comprehensive a solution as is reasonable and practicable.

*Fourth criterion: alternative powers*

3.82 Finally, the CMA has considered whether alternative powers are likely to be available to the CMA or others to address the features which it has identified in Chapter 3. We begin by considering the CMA's powers in relation to the competition law prohibitions on anticompetitive agreements or abuse of a dominant position,<sup>146</sup> before considering the powers available to other regulators, most particularly the FCA, PSR and PRA.

*Other competition powers of the CMA*

3.83 The CMA has not found evidence of any agreement or conduct that may involve an infringement of the competition law prohibitions. Instead the features of concern we have identified are broader than the issue of firm conduct, which those prohibitions are intended to address, and relate to the overall functioning of the sector.

*Other sectoral regulators*

3.84 The CMA worked with the FCA and the PRA as we developed our analysis in the market studies. The SME banking market study was produced jointly with the FCA. The CMA also received valuable insights from the FCA relevant to the PCA sector. However, unlike the SME banking market study, which was a formal collaboration, the PCA update was a CMA output reflecting the fact that it was intended as an update of the market review published in January 2013 by the CMA's predecessor body, the OFT. More recently, we have received responses to the consultation on the provisional decision from the PSR and FCA, and have continued to engage with the PRA on discrete issues.

3.85 Earlier in this chapter we specifically considered whether various initiatives currently being undertaken by those regulators, as well as by government departments, would be sufficient to ensure that the features of concern would

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<sup>146</sup> The Chapter I and Chapter II prohibitions contained in [sections 2](#) and [18](#), respectively, of the Competition Act 1998 and their counterparts in EU law, Articles 101 and 102 of the [Treaty on the Functioning of the EU](#).

no longer persist. As noted there, we have found that, in some instances, these regulators have addressed or are likely to address our concerns, such that the use of these alternative powers would be appropriate.

- 3.86 However, despite these initiatives, the concerns we identified in our market studies, particularly that there are long-standing and interlinked aspects of competition concern on both the demand and supply sides, are precisely the types of concerns which the market investigation regime was established to investigate and, where necessary, remedy. Indeed, the CMA considers that a joined-up approach to the features, rather than focusing on individual aspects, would have significant benefits.
- 3.87 Many of the regulators' initiatives have not yet completed. In any event, we envisage that the market investigation will take account of their work as it develops.
- 3.88 Moreover, we do not consider that the initiatives being undertaken by the relevant regulators, which we expect to be very important and valuable, are likely, in and of themselves, to address the features identified above comprehensively.

*Conclusion on the fourth criterion: alternative powers*

- 3.89 For the reasons set out above, the CMA has decided that alternative powers are likely to be less appropriate than an MIR.

**Conclusion on MIR**

- 3.90 The CMA's findings on market outcomes, particularly in relation to service and satisfaction (see the SME study, Chapter 9, and the PCA update, Chapter 6), are consistent with our analysis of features giving rise to competition concerns and suggest that SME and PCA customers appear to be suffering poorer outcomes than they would in a well-functioning competitive sector. As discussed in Chapter 2, no evidence or arguments have been presented by the respondents to the consultation to give the CMA grounds to change this analysis. This analysis is, however, based on a Phase 1 assessment and does not represent a finding that there is an adverse effect on competition arising from the features above.
- 3.91 The CMA's view is that there are reasonable grounds to suspect that features of both the SME banking and PCA sectors restrict or distort competition and that the reference test is therefore met.

- 3.92 In addition, the CMA concludes that it is appropriate to exercise its discretion to make an MIR.
- 3.93 There are important similarities in the competition issues found in the SME banking and PCA sectors, such as:
- many of the features identified are common to both markets
  - the products are closely related – indeed, the majority of SME owners obtain their BCA from their PCA provider
  - the same banks are prominent in both markets
- 3.94 We have not received any particular representations regarding separating the two sectors in the event of a market investigation. The CMA has therefore decided to refer the two sectors for a single in-depth Phase 2 market investigation.

## 4. Scope of the MIR

- 4.1 In the light of the foregoing, the CMA has decided to make an ‘ordinary’<sup>147</sup> MIR, within the meaning of section 131(6) of the EA02, in respect of the provision of retail banking services to SMEs and the provision of PCAs.
- 4.2 The CMA is required, in the terms of reference, to set out a description of the goods or services to which the feature or combination of features concerned relates. As stated in the guidance on the making of MIRs, the CMA is not, however, obliged to provide a precise definition of the market or markets to which its MIR relates. This reflects the fact that no market definition exercise is typically conducted during a Phase 1 assessment.<sup>148</sup> The draft terms of reference were set out, for consultation, in Annex B to the provisional decision dated 18 July 2014 and the CMA indicated that it would welcome respondents’ comments on that draft. These comments, and our response to them, are discussed in Chapter 2.
- 4.3 Following careful consideration of the responses to the consultation, and as set out in Chapter 2, the CMA has made certain alterations to the terms of reference consulted on. The final version of the terms of reference are set out at Annex A to this decision.
- 4.4 In relation to SME banking, the CMA has excluded certain products which, in the early stages of the market study, the OFT had explicitly said that it did not propose to consider and which were not considered during the market study. The CMA expects that the Group will publish the issues statement before the end of the year, which will set out the expected areas of focus for the MIR. Parties will have a full opportunity to provide representations on this issue at that stage.
- 4.5 Also in relation to SME banking, the definition of ‘small and medium-sized enterprise’ is clarified by reference to the definition of ‘undertaking’ in the Competition Act 1998.
- 4.6 In relation to PCAs, the terms of reference now clarify that one of the exclusions refers to current account mortgages.

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<sup>147</sup> To distinguish this reference from a ‘cross-market’ reference.

<sup>148</sup> [OFT 511](#), paragraph 2.28.



## Terms of reference

The Competition and Markets Authority (CMA) in the exercise of its power under sections 131 and 133 of the Enterprise Act 2002 hereby makes an ordinary reference to the Chair of the CMA for the constitution of a group under Schedule 4 to the Enterprise and Regulatory Reform Act 2013 for an investigation of the supply of retail banking services to personal current account customers and to small and medium-sized enterprises.

The CMA has reasonable grounds to suspect that a feature or a combination of features of the market for the supply of those services in the United Kingdom prevents, restricts or distorts competition.

For the purposes of this reference:

- ‘retail banking services’ means:
  - in respect of personal current account customers, provision of an account marketed to individuals rather than businesses, which provides the facility to hold deposits, to receive and make payments by cheque and/or debit card, to use automated teller machine facilities and to make regular payments by direct debit and/or standing order but does not include:
    - an account in which money is held on deposit in a currency other than the official currency of the United Kingdom or
    - an account in which credit funds are held and offset against mortgage debt or a loan (other than an overdraft facility), ie a current account mortgage
  - in respect of small and medium-sized enterprises, the provision of banking services, which includes, but is not limited to, the provision of business current accounts, overdrafts, general purpose business loans and deposit accounts, but which excludes the provision of other non-lending products such as insurance, merchant acquiring, hedging and foreign exchange
- ‘small and medium-sized enterprise’ means a business that, in respect of a given financial year applying to it, has annual sales revenues (exclusive of VAT and other turnover-related taxes) not exceeding £25 million. For this purpose a ‘business’ shall have the same meaning as an ‘undertaking’ under the Competition Act 1998.