Competition & Markets Authority

Personal current accounts

Market study update

18 July 2014

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Summary

Overview

1. The market for personal current accounts (PCAs) in the UK is significant, not only in terms of value but also because PCAs are virtually essential to modern life. Almost everyone has a current account and they are used daily. It is estimated that there are some 65 million active PCAs generating revenues of £8.1 billion for providers in 2013.

2. PCAs provide important services for UK consumers, including:

   - allowing payments such as wages and benefits to be received
   - allowing payments to be made to others (both spontaneous like debit card payments and planned, such as standing orders and direct debits)
   - holding balances for consumers
   - offering a line of credit through overdrafts

3. Effective competition between PCA providers is essential for ensuring that consumers enjoy increased choice, innovation and value in PCA offerings. In the context of its work programme on retail banking, the Competition and Markets Authority (CMA) has assessed the extent to which the factors which the Office of Fair Trading (OFT) considered in its 2013 report[1] to be restrictive of competition have now changed and the extent to which long-standing concerns about this market have now been addressed.

4. In taking forward this market study update, we have been informed by a view as to what a well-functioning sector would look like. In our view, such a well-functioning sector would exhibit the following characteristics:

   - **The banking sector is customer-focused.** Providers' products are well suited to their customers' needs and are provided in a way that makes it easy for customers to make well-informed decisions about how and when they are used.
   - **Consumers are sufficiently engaged with their banking services to drive competition.** Banks equip their customers to make better decisions about which products they use, and how they use them.

[1] OFT, Review of the personal current account market, January 2013.

- **Competition between banks (and from non-banks) is driving providers to operate more efficiently and to innovate.**

- **Consumers have a broad choice of provider.** The sector is relatively less concentrated than it has been historically, and newer and smaller banks and/or new technology provide scope for increased competition from outside the traditional banking model.

- **Barriers to entry and expansion are lower**. Credible new players are able to join the market and have reasonable prospects for attracting the scale of customer base needed to achieve the economies of scale required to operate effectively.

5. We have, however, found this to be a market which is still not functioning as one would expect of an effective, competitive market:

   - There have been some improvements to competition in recent years – including some new market entry, improvements in the regime for authorising banks, mobile banking which allows account holders more control of their accounts (eg through text alerts when they are close to going into overdraft), and the introduction in September 2013 of the new seven-day current account switching service (CASS).

   - However, it remains the case that:

     — Despite customer satisfaction levels below 60% for the four largest banks, there is relatively little customer shopping around or switching, leaving market shares relatively stable.

     — PCA providers with higher satisfaction levels have not been able to gain significant market share.

     — This seems to reflect continuing high barriers to entry and expansion, including the continuing need for an extensive branch network to be a scale competitor in the sector (despite increased usage of online and mobile banking, and reduced usage of branches, it appears that customers continue to value having local branches) and apparent difficulties for smaller PCA providers in gaining access to key inputs such as payment systems; the low levels of switching are themselves a barrier to expansion.

     — A consequence is that the PCA sector remains concentrated across the UK, and particularly so in Scotland and Wales, with some evidence of this itself leading to poor outcomes as the larger PCA providers seem to offer poorer service (as measured by complaints and customer satisfaction levels); there is also some resultant harm in the small and medium-sized enterprise (SME) banking sector, given that more than half of SMEs take their business current accounts from their PCA provider (see SME report, Chapter 3).

- The changes which the OFT in May 2013 had envisaged in the following months as 'potentially [having] a significant impact on the effectiveness of competition in the PCA market'[2] in some cases have been delayed and in other cases have failed to have the effects hoped for:

  — The disposal by Lloyds Banking Group (LBG) (of TSB) commenced in June 2014 and is due to be completed by the end of 2015, while the disposal by The Royal Bank of Scotland Group (RBS) (of Williams & Glyn (W&G)) has been deferred until 2016/17.

  — Despite the introduction of CASS, levels of switching and shopping around remain relatively low, and there has been no transformative increase.

Background

6. Concerns have long been expressed about the state of competition in PCAs and the impact this has on consumers and on the economy overall. The CMA's predecessor bodies, the OFT and the Competition Commission (CC), have examined the PCA sector a number of times over the years.[3] A number of other public bodies have also looked at the sector including the Parliamentary Commission on Banking Standards (2013),[4] the Financial Services Authority (FSA) and the Bank of England (2013),[5] the Independent Commission on Banking ('Vickers report') (2011),[6] and indeed right back to the Cruickshank report in 2000.[7]

7. To varying degrees these reports identified competition concerns in the PCA market (similar concerns have also been expressed in relation to SME

[2] OFT decision not to make a market investigation reference to the Competition Commission of the market for personal current accounts in the UK, 14 May 2013.
[3] OFT, PCA Banking Market Study Project Page, 2008; OFT press release, Personal Current Accounts Review 2013, 25 January 2013; CC, Northern Ireland Banks Review of Order, 28 February 2011; CC press release, Supply of banking services to SMES, 14 March 2002.
[4] Parliamentary Commission on Banking Standards, project page, July 2013.
[5] FSA and the Bank of England, A review of requirements for firms entering into or expanding in the banking sector, March 2013.
[6] Vickers (ICB), Final Report, September 2011.
[7] Don Cruickshank, Competition in UK Banking, March 2000.

banking which is the subject of a parallel but separate CMA market study report) including:[8]

- The persistence of high levels of concentration and relatively stable market shares.
- The existence of significant barriers to entry (and expansion).
- A 'sticky' market, with customer inertia indicated by low rates of switching and limited shopping around. This relatively weak demand side means that customers are not able to readily access, assess and act on information they would need to ensure that they get the best possible deal.
- Limited customer knowledge and awareness of the products, reflecting limited availability of information and tariff complexity (especially as to overdraft charges).
- Poor customer outcomes, including in respect of service and prices particularly for overdrafts, and some evidence of customer dissatisfaction.

8. In 2011 the Vickers report recommended that a market investigation reference (MIR) should be considered by 2015 if the retail banking sector had not sufficiently changed before then. A similar recommendation was made by the Parliamentary Commission on Banking Standards in its 2013 report.[9]

9. The most recent OFT examination of the PCA market was published in January 2013,[10] carried out to understand the changes that had taken place in the market over previous years, including those that had resulted from initiatives that the OFT had agreed with PCA providers. The conclusion from that review was that, while there had been some improvements to the customer experience – including the usage of, and charges for, overdrafts – long-standing competition concerns remained in the PCA market: concentration remained high, new entry was infrequent and switching rates were low.[11]

10. Nevertheless, the OFT decided in May 2013 that, because of three significant developments happening or expected in the following months which 'could potentially have a significant impact on the effectiveness of competition in the PCA market', it would not make a MIR at that time but that it would revisit this

[8] CMA press release, The Competition and Markets Authority (CMA) today announced a short programme of work on banking, 11 March 2014.
[9] Parliamentary Commission on banking standards, Changing banking for good, June 2013.
[10] OFT, Review of the personal current account market, January 2013.
[11] ibid, January 2013, paragraph 1.4.

decision during or before 2015.[12] These expected significant developments were:

(a) the divestments by LBG and RBS;[13]

(b) the introduction of CASS; and

(c) completion of the roll-out of transparency initiatives previously agreed with the OFT.

11. In fact, the LBG divestment (of TSB) is taking place over the period June 2014 to December 2015, and the RBS divestment (of W&G) has been postponed and is now expected to take place in 2016/17. The effects of the CASS and of the roll-out of the transparency initiatives are considered, respectively, in paragraphs 30 to 33 and 26 to 29.

12. This report provides an update on the extent to which these developments have affected competition in the PCA market, and whether significant concerns still exist.

The market study update

13. The CMA announced on 11 March 2014[14] that the findings of the OFT's 2013 report would be updated to:

- assess the effectiveness of the three initiatives the OFT identified as having the potential to increase competition
- enable the CMA to form a view on whether long-standing competition concerns have been removed and whether the PCA market should be the subject of an MIR

14. In addition to examining the developments referred to in paragraph 1.9 above, we have also taken into account other recent developments, including:

- the forthcoming operational launch of the Payment Systems Regulator (PSR)

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[12] OFT, OFT decision not to make a market investigation reference to the Competition Commission of the market for personal current accounts in the UK, 14 May 2013, paragraphs 20 & 43.
[13] Please note the OFT further provided advice to the Chancellor of the Exchequer in September 2013 on the effects of competition from the LBG and RBS divestments.
[14] CMA, press release, The Competition and Markets Authority (CMA) today announced a short programme of work on banking, 11 March 2014.

- the establishment of the Financial Conduct Authority (FCA) with competition powers which will come into force in April 2015

- changes to the authorisation regime for new entrants

- new market developments including the launch by Tesco Bank of a PCA offering from June 2014

15. This market study update builds on the 2013 OFT report in the context of the CMA's consideration of whether to make an MIR decision (see the consultation document being published today).[15] During the market study update we have analysed data received from information requests and submissions, reviewed a number of surveys and engaged with interested parties from across the UK, including PCA providers, potential entrants to the market, consumer groups, government bodies and other interested parties. The wide range of views obtained and the evidence considered have helped ensure that our conclusions take into account the wide variety of perspectives about competition in the PCA market.

Key findings

16. There have been some improvements since the 2013 OFT report, but the PCA market is still characterised by continuing barriers to entry and expansion, relatively high levels of concentration and relatively stable market shares, low levels of switching (despite the introduction of CASS) and lack of transparency, especially in regard to charging structures. This is a market where despite customer satisfaction levels below 60% for the four largest PCA providers, there is little switching and market shares are stable. Moreover, the PCA providers with the highest satisfaction levels have not been able to gain significant market share, which is not what one would expect in a well-functioning competitive market.

[15] www.gov.uk/government/consultations/personal-current-accounts-and-banking-services-to-smes.

Key facts:

- The PCA market remains relatively concentrated, with the top 4 banks representing 77.2%[16] of the market in December 2013.
- Market shares have been very stable over time, aside from the effect of mergers and acquisitions, which suggests that growth and expansion are difficult in this market.
- The divestment by LBG of its 'TSB' banking activities is under way and is due to be completed by December 2015. The likely effect of this is that concentration will reduce somewhat; TSB currently has a market share of 4.2%.
- The divestment by RBS of its W&G banking activities has been deferred and now not required to be completed until the end of 2017. In any event W&G accounts for around 2% of the market.
- There has been some new entry to the market including Metro Bank, and now Tesco Bank and the soon-to-be-divested TSB. These are unlikely to increase their market share to a point where concentration will be reduced significantly.
- In terms of harms resulting from this level of concentration, there is some evidence that the larger PCA providers offer poorer service (as measured by customer satisfaction) but we have not found evidence that it leads to the larger PCA providers charging higher prices.

17. The UK PCA market is concentrated as a whole, and in Scotland and Wales is highly concentrated. Since 2011, there has been very little movement in market shares and although there have been small changes these are very gradual and, at the current rate, unlikely to reduce overall levels of concentration significantly.

18. The LBG divestment of TSB is under way with an Initial Public Offering (IPO) of the first tranche of LBG's shareholding in June 2014 and complete divestment expected by December 2015. The new bank appears willing to differentiate itself from its competitors and grow its share of the market. However, TSB has a relatively small size and it is unclear whether the divestment will, in and by itself, bring a significant competitive constraint on existing PCA providers.

[16] This figure is calculated on the number of 'active' accounts. An active account is one which is defined as defined accounts which have had at least one customer-initiated transaction within the last three months, ie not a dormant account.

19. W&G is currently projected to have over one million active customers,[17] representing a market share within the PCA market of around 2%.[18] At this stage we do not consider that the W&G divestment, while positive for competition, and which in any event is not currently required to be completed before 2017, will have a significant impact on the PCA market.

20. There has been another notable entry to the market with Tesco Bank launching a PCA on 10 June 2014. There are plans for entry into the PCA market by Virgin Money and a new online-only bank called Atom, but it seems that entry by the Post Office, on any big scale, is far from certain. In any event, these are relatively small-scale entrants as providers of PCAs; they may well have a positive impact on competition in the market in the longer term but that is as yet uncertain given the barriers to entry and expansion described in this report.

21. We also examined whether high levels of concentration result in poor outcomes, through larger PCA providers offering poorer levels of service or charging higher prices compared with smaller PCA providers. In terms of service, we have found some evidence to suggest that larger providers have lower satisfaction scores and attract more complaints. In terms of price, however, although there is some evidence that larger PCA providers pay lower interest on credit balances, there is no clear evidence that overall they are earning higher revenues per customer.[19] A similar outcome may be found in the SME sector perhaps because more than half of SMEs take their business current accounts from their PCA provider (see SME report, Chapter 3).

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[17] The figure includes SME as well as PCA customers: www.rbs.com/news/2013/09/return-of-williams-glyns-moves-closer.html.
[18] BBA, Promoting competition in the UK banking industry, June 2014 report, p20, Figure 2, BBA calculations.
[19] Please see Chapter 2 for more details.

Key facts

- The authorisation process for new banks is now simpler, and capital requirements for small banks have been reduced.
- IT costs for new entrants have been reduced recently with new IT off-the shelf solutions, especially for providers willing to outsource the development of their IT platform and/or to accept relatively standardised solutions.
- Difficulties over access to payment systems may be a barrier to entry, although the introduction of the PSR may reduce concerns.
- Local bank branches remain valued by customers, despite the recent huge increase in online and mobile app banking and the decrease in the volumes of branch usage. This suggests that an extensive branch network is still required to compete on any significant scale in this market. This constrains the option of entry and expansion without a branch network.
- Levels of switching and shopping around are low, making it difficult for banks to enter and expand.
- Possible cross-subsidisation in the PCA market which may be distortive of competition.

22. Banks which accept deposits need to comply with capital and liquidity legal requirements. The OFT and the Vickers report identified a number of ways in which small banks or new entrants might face higher capital requirements compared with large incumbents, and explained how this could act as a barrier to entry. The FCA and the Prudential Regulation Authority (PRA) introduced a number of changes to the prudential regulation of new banks in April 2013, which has reduced the capital requirement at authorisation and gives new banks a three- to five-year period before they need to match the requirements faced by their larger competitors, thus reducing this barrier to entry.

23. There is evidence that an extensive branch network is still required to be an effective national competitor. Convenient location of a branch remains the most popular reason for choosing a new provider when switching current accounts.[20] While there is significant evidence of consumers increasingly embracing Internet and mobile banking, it seems doubtful that large-scale entry is possible without branch networks. Recent entrants to the market offer

[20] GfK Financial Research Survey (FRS), December 2013. All switching main current account in last 12 months, 1,715 adults (aged 16+) interviewed.

either branches (Metro and TSB) or some form of physical access to banking services (even Tesco's online offering includes physical banking facilities at over 300 of its larger supermarkets where customers can make deposits and withdraw cash).

24. PCA providers require access to several payment systems (such as BACS and CHAPS). Access can be gained through direct membership of the schemes, or indirectly, by entering into an agency agreement with a direct member. In the course of our review we received representations from several small banks indicating that access to payment systems remained difficult and costly with little transparency around charges and instances of poor service by the agency banks. We note that the new PSR will have wide-ranging regulatory powers to address such issues. In particular, we note the focus of the PSR on access issues in the call for inputs.[21]

25. It is also possible that there might be a degree of cross-subsidy in the PCA market, 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 also told that PCAs as a whole were loss-making. If this were the case, this could suggest the existence of a cross-subsidy from other retail banking products.

[21] See call for inputs www.fca.org.uk/your-fca/documents/payment-systems-regulation-call-for-inputs.

Transparency

Key facts

- Transparency initiatives previously agreed with the OFT have been rolled out and this has improved consumers' ability to understand the costs of their PCAs in the last couple of years.
- Charging structures are still complex and have become even more difficult to compare since the OFT 2013 report.
- There has been a rapid increase in the take-up of mobile banking and text alerts which increase consumers' control of their accounts and reduce the risks of going into overdraft when they have alternative sources of funds to meet their cash shortfall. However, there has been little progress with allowing consumers to 'opt out' of unarranged overdraft charges.
- At least some tariffs are likely to serve PCA customers poorly. Unarranged overdraft charges for instance can be very high. Moreover, recent changes in overdraft charge tariffs to address concerns about complexity seem to have had the effect of introducing a variety of different and complex charging structures which are very difficult to compare.
- Overall, it remains the case that there is very little evidence of shopping around on overdraft features and charges.
- There has been positive progress with the MiData project in relation to current accounts and this has the potential to address our concerns about the difficulties faced by consumers when comparing accounts. However, MiData is not likely to provide a solution to consumers not being able to compare the costs of PCAs until the latter part of 2015 and therefore the extent of its impact on competition conditions in the PCA market will not be known for some considerable time.

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26. The transparency initiatives recommended in the OFT's 2009 report[22] to help consumers understand and control their own PCAs have now been rolled out, although in some cases more than two years after the initial target date. There is limited evidence that these have led to some positive changes in consumer behaviour but for many consumers there is still confusion and a lack of understanding about overdrafts. This is primarily because overdraft charging structures are complex and difficult to understand. Indeed, the variety of new charging structures may well have made comparison of costs across providers more difficult. As a result, we consider that there is still a significant problem with consumers' ability to understand the costs they incur from their PCAs.

[22] OFT, Personal Current Accounts – a follow-up report, October 2009.

27. Mobile banking apps and text alerts are being increasingly rolled out to consumers. There is some evidence that those tools can provide consumers with the ability to control the costs of their PCAs, potentially leading to fewer charging events. But it is disappointing to note that many consumers still do not have the option to ‘opt out’ of unarranged overdrafts on many different types of accounts. It is conceivable that many customers will actually prefer to keep the option of incurring an unarranged overdraft when they have insufficient funds in their account to meet a payment, but they should have the choice to opt out of this feature without being charged. As a result, we consider that although progress has been made, there is still room for PCA providers to improve on the levels of control consumers can exert over their PCAs.

28. There is a lack of transparency with charging structures. Overdrafts remain very complex both for arranged and unarranged charges and they have become more complex since the 2013 OFT report. 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 ability to successfully shop around, a finding confirmed by recent FCA research on overdrafts. We are therefore concerned that banks are unlikely to have the incentive to compete on overdraft charges.

29. This lack of incentive to compete on overdraft charges may have led to a smaller reduction in overdraft charges than we might otherwise have expected. Overdraft revenues overall have fallen by just 3% over the last couple of years, despite significant falls in wholesale funding, indicating that the pricing of overdraft lending is not particularly responsive to changes in funding rates.

Key facts

- CASS was introduced on 16 September 2013 allowing consumers to complete a switch from one PCA to another within seven days.
- Switching levels reportedly increased by 14% in the period October 2013 to March 2014, compared with the same period last year, although much of this may be related to the Lloyds/TSB demerger and thus more reflective of particular events than a long-term change in the market. In the period January to June 2014 there has been a slight increase in switching levels to 16%.
- The CASS system has made the process of switching quicker and easier. Awareness appears to be relatively high: 99% of all switches through CASS are completed within the seven-working-day timescale, and consumer awareness of CASS was reported at 67% in March 2014.
- Some banks have said that the introduction of CASS has led to the launch of new PCA propositions and increased competition.
- But despite this, the switching rate remains very low, at around 3%.

30. The introduction of CASS has effectively mitigated the costs and risks involved with the switching process for consumers. It is now quicker, simpler and relatively risk free to switch. There is also significant customer awareness of the service. However, it has not led to a transformative change in the switching rate. There was a 14% increase in switching rates in the first six months of the service compared with the same period in the previous year, and in the six-month period to the end of June 2014, there was a 16% increase, but despite this, the overall rate of switching including non-CASS switching forms (for example, manual and gradual switching rates) remains at around 3% which is low, especially compared with switching rates in other markets.[23] There is evidence that much of the 14% increase in switching levels in the first six months represented customers cross-switching between Lloyds and TSB following the separation of the brands.

31. A number of PCA providers have argued that the pure ‘switching’ figures conceal significantly higher levels of churn and multi-banking. However, according to data received from providers, the CMA estimates the overall churn rate (ie the ratio of account openings to the stock of existing accounts) at around 7%, which is still relatively low.

[23] For example, annual switching rates are typically 10 to 15% in energy, around 10% in mobile telephony, and around 30 to 35% in car insurance.

32. There is some evidence that, where switching does occur, this is having a competitive impact on the market with PCA providers innovating and differentiating products (such as the Club Lloyds interest paying account being introduced following the introduction of Santander's 1-2-3 account).

33. However, it remains the case that there is a reluctance to shop around with survey evidence showing a clear majority of PCA holders asserting to the proposition 'I cannot be bothered to switch [PCAs] as I do not believe I would get better service/value for money elsewhere'.[24]

Conclusion

34. The CMA has found that there have been some improvements in the market since the OFT's 2013 report. CASS has been introduced and is reported to be working well, new products have been launched and there is also new entry. Additionally, the FCA's current and planned work and the availability of concurrent competition powers from April 2015 may well help improve competition over the medium term. However, the market is still concentrated and is likely to remain so as new entrants are relatively small, and given barriers to entry and expansion, are unlikely to grow market share rapidly to the extent that the structure of the market will alter radically. It is also not certain that the FCA's work will offer comprehensive and timely solutions to all the concerns we have identified.

35. Some barriers to entry have been reduced, but there remain significant concerns over entry and expansion: specifically we do not believe that the increase of online and mobile app banking has removed the need for an extensive branch network in order to compete at scale effectively. Customers seem reluctant to shop around because they do not believe that better alternatives are available and possibly also given the complexity of overdraft charges. There is much greater ability to switch but despite this and new products, switching rates remain low and CASS has not had the transformative effect that the OFT had hoped for. This remains a market where PCA providers with lower satisfaction levels are generally able to retain market share, while those with high satisfaction levels are limited in their ability to grow market share significantly. This is not what one would expect from a well-functioning competitive market.

36. Our analysis is that the features above (high levels of concentration, barriers to entry and expansion, low switching and lack of transparency) are closely

[24] Tesco, Customer Insights PCA Research, April 2014.

interrelated and mutually reinforce one another, resulting in competition being more limited than it would otherwise be. In particular:

(a) Low switching rates weaken competitive constraints by reducing provider incentives to compete as providers see less benefit in charging lower prices to attract scarce new customers. It also creates significant barriers for other parties to enter the sector, by significantly reducing the number of profitable customers available to more competitive providers, making it difficult for them to grow and develop their business.

(b) Customers' belief that there is limited differentiation between providers, and the complexity in PCA charging structures result in low switching.

37. It is also likely that the pricing models used by PCA providers generate significant cross-subsidies between different categories of consumers. PCAs using the 'free if in credit' model do not charge fixed fees. Instead they drive a significant proportion of their income from overdraft charges, and therefore it is likely that consumers who use their overdrafts regularly cross-subsidise those who do not, which could, in itself, be distortive of competition.

38. As a result of these findings, the CMA has assessed whether it would be appropriate to make an MIR, based on the statutory test in section 131 of the Enterprise Act 2002, as well as the criteria for the CMA deciding whether to exercise its discretion to make an MIR. The CMA has provisionally decided, subject to a public consultation, that it should make an MIR of the market for the retail supply of banking services to PCA customers and to SMEs, for the reasons set out in the accompanying consultation document and invites comments on that provisional decision by 17 September 2014.

1. The update of the personal current accounts review

Introduction

1.1 The market for PCAs in the UK is significant, not only in terms of value but also because PCAs are virtually essential to modern life. Almost everyone has a current account and they are used daily. We estimate there are approximately 80 million accounts in the UK, 65 million of which are active,[25] and these generated revenues of £8.1 billion for providers in 2013.

1.2 Concerns have long been expressed about the competitiveness of this market and the impact this has on the economy and consumers. The CMA's predecessor bodies, the OFT and the CC, have examined the PCA sector over the years.[26] A number of other public bodies have also looked at the sector including the Parliamentary Commission on Banking Standards (2013),[27] the FSA and the Bank of England (2013),[28] the Independent Commission on Banking ('the Vickers report' 2011),[29] and indeed right back to the Cruickshank report in 2000.[30]

1.3 To varying degrees these reports identified competition concerns in the PCA market (similar concerns have also been expressed in relation to SME banking which is the subject of a parallel but separate CMA market study report) including:[31]

(a) The persistence of high levels of concentration and relatively stable market shares.

(b) The existence of significant barriers to entry (and expansion).

(c) A 'sticky' market, with customer inertia indicated by low rates of switching and limited shopping around. This relatively weak demand side means customers are not able to readily access, assess and act on information they would need to ensure that they get the best possible deal. The limited customer knowledge and awareness of the products, reflects at

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[25] Active accounts are defined as accounts which have had at least one customer initiated transaction within the last three months, ie not a dormant account.
[26] OFT, PCA Banking Market Study Project Page, 2008; OFT press release, Personal Current Accounts Review 2013, 25 January 2013; CC, Northern Ireland Banks Review of Order, 28 February 2011; CC press release, Supply of banking services to SMES, 14 March 2002.
[27] Parliamentary Commission on Banking Standards, project page, July 2013.
[28]FSA and the Bank of England, A review of requirements for firms entering into of expanding in the banking sector, March 2013.
[29] Vickers (ICB), Final Report, September 2011.
[30] Don Cruickshank, Competition in UK Banking, March 2000.
[31] CMA press release, The Competition and Markets Authority (CMA) today announced a short programme of work on banking, 11 March 2014.

least to some extent the observed tariff complexity (especially as to overdraft charges).

(d) Poor customer outcomes, including in respect of service and prices particularly for overdrafts, and some evidence of customer dissatisfaction.

1.4 The most recent OFT examination of the PCA market was published in January 2013.[32] It was a market review carried out to understand the changes that had taken place in the market over previous years, including those that had resulted from initiatives the OFT had agreed with PCA providers in 2009. The conclusion from that review was that, while there had been some improvements to the customer experience – including the usage of, and charges for, overdrafts – long-standing competition concerns remained in the PCA market: concentration remained high, new entry was infrequent and switching rates were low. While there had been improvements around unarranged overdrafts and transparency of charges, charging structures were still complex and comparisons between products remain challenging. Similarly, despite some reduction in error rates, consumers still lacked confidence in the switching process. Together, these problems result in a market in which a lack of dynamism from providers combines with consumer inertia to deliver suboptimal outcomes for consumers and the economy.[33]

1.5 Nevertheless, the OFT decided in May 2013 that because of three significant developments happening or expected in the following months which 'could potentially have a significant impact on the effectiveness of competition in the PCA market', it would not make an MIR at that time but that it would revisit this decision during or before 2015.[34] These were:

(a) the divestments by LBG and RBS;[35]

(b) the introduction of CASS; and

(c) the completion of the roll-out of planned transparency initiatives.

1.6 In 2011 the Vickers report recommended that an MIR should be considered by 2015 if the retail banking sector had not changed sufficiently before then. A

[32] OFT, Review of the personal current account market, January 2013.
[33] OFT, OFT decision not to make a market investigation reference to the Competition Commission of the market for personal current accounts in the UK, 14 May 2013, paragraphs 20 & 43.
[34] ibid, paragraphs 20 & 43.
[35] Please note that the OFT further provided advice to the Chancellor of the Exchequer in September 2013 on the effects of competition from the LBG and RBS divestments.

similar recommendation was made by the Parliamentary Commission on Banking Standards in its report of 2013.[36]

1.7 In this context, the CMA announced on 11 March 2014 that the findings of the OFT's 2013 report would be updated, and that this would be carried out in parallel to the completion by the CMA and the FCA of the study into banking for the SME sector which the OFT and the FCA had launched in the summer of 2013.[37]

Objectives and scope of this update

1.8 The objectives of the study are to:

(a) update the findings from the OFT's 2013 review of the PCA market;

(b) assess the effectiveness of a number of current and forthcoming initiatives identified as having the potential to increase competition; and

(c) enable the CMA to form a view on whether this market should be the subject of an MIR.

1.9 This update has considered ongoing and planned steps taken to improve competition in the market. These steps include the effect of CASS, the current divestments by LBG and the proposed divestment of RBS of parts of their retail banking businesses, the roll-out of transparency initiatives, the establishment of the PSR and the forthcoming acquisition by the FCA of competition law powers. This update considers the extent to which these steps have led to, or are likely to lead to, sufficient improvements in competition in the industry to alleviate concerns about competition in the PCA market.

1.10 In more detail, this update looks at the various features that were identified as contributing to competition concerns in the 2013 review, and whether there have been any significant changes in these features since then, in order to enable the CMA to form a view of whether this market should be subject to a MIR. We analyse:

(a) Whether the structure of the market has changed significantly, in particular the extent to which the market is concentrated and variations in

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[36] Parliamentary Commission on banking standards, Changing banking for good, June 2013.
The Commission recommends that the Competition and Markets Authority immediately commence a market study of the retail and SME banking sector, with a full public consultation on the extent of competition and its impact on consumers. We make this recommendation to ensure that the market study is completed on a timetable consistent with making a market investigation reference, should it so decide, before the end of 2015.

[37] CMA press release, The Competition and Markets Authority (CMA) today announced a short programme of work on banking, 11 March 2014.

market shares; the extent to which there are still significant barriers to new firms entering the market for PCAs, or existing firms expanding in the market; and the extent to which the current and proposed divestments are likely to lead to improvements in competition. These issues are discussed in Chapter 2 of the report.

(b) Whether the transparency of charges levied on customers of PCAs has increased, in particular whether consumers are better able to understand and control the costs of their own PCA, compare the costs of alternative PCAs and as a consequence choose the most appropriate one for their needs. These issues are discussed in Chapter 3 of the report.

(c) Whether consumers are able to switch easily between providers of PCAs, in particular whether consumers are aware of the tools available to them to switch; whether they have confidence in using the process; and whether the rate of switching is sufficient to act as a competitive constraint on providers (having regard also to multi-banking and overall churn). These issues are discussed in Chapter 4 of the report.

(d) Whether recent or forthcoming regulatory and legislative changes have, or are likely to have an effect on competition in the short to medium term, in particular whether the new PSR is likely to have an effect on competition, and whether the forthcoming EU Directives on Payments Accounts and Payment Services are likely to have a major impact. These issues are discussed in Chapter 5 of the report.

(e) What the outcomes for consumers are in terms of innovation, customer satisfaction and overdrafts. These issues are discussed in Chapter 6 of the report.

1.11 This update presents the CMA's views on competitive conditions in the PCA market. A separate document sets out the reasons for the CMA's resultant provisional decision to make an MIR of the retail supply of banking services to PCA holders and to SMEs, for an in depth market investigation by an independent group of CMA panel members. That provisional decision is subject to public consultation.[38]

1.12 In carrying out the update we have reviewed the PCA market and engaged with a wide range of interested parties. The main elements of the CMA's approach included:

[38] www.gov.uk/government/consultations/personal-current-accounts-and-banking-services-to-smes.

(a) a general invitation to submit evidence when the update was formally launched in April;

(b) an in-depth analysis of key data requested from PCA providers, complemented by meetings on strategic issues;

(c) review of a number of PCA providers' websites, covering the information and materials available as well as considering a number of price comparison sites; and

(d) discussions with a large number of stakeholders, including established players, new entrants and potential entrants, the PSR, government departments, industry associations and consumer representative groups.

1.13 We have also had valuable discussions with the FCA in the course of this study and received valuable insights from the FCA relevant to the PCA sector. However, unlike the SME banking market study which has been a formal collaboration with the FCA since it was first scoped in September 2013, this report is solely a CMA output reflecting the fact that it is intended as an update of the market review published in January 2013 by one of the CMA's predecessor bodies, the OFT.

1.14 We thank all those who have contributed with information and with submissions and arguments.

2. Market structure and barriers to entry

Introduction

2.1 PCAs are an important part of the retail banking sector and an essential service for UK consumers. As set out in the introduction, there have been long-standing concerns about the structure of the PCA banking sector, particularly the persistence of relatively high levels of concentration and the existence of high barriers to entry and expansion. This chapter presents our analysis of the current position with respect to market structure and barriers to entry and expansion, and how these have changed since the OFT's 2013 report. We also discuss the link between PCAs and other retail banking products.

2.2 In more detail we discuss:

(a) market structure – concentration (paragraphs 2.3 to 2.32); and

(b) market structure – barriers to entry and expansion (paragraphs 2.33 to 2.75).

Findings from the 2013 report

The OFT's 2013 report provided an overview of the PCA market and identified several potential issues with the structure of the market. The main findings were the following:

- **Market structure.** The market became more concentrated in 2008 as the financial crisis led to a number of mergers and acquisitions in the industry. Lloyds acquired HBOS, even though the OFT's investigation of the anticipated merger found that there was a realistic prospect that it would lead to a substantial lessening of competition. Santander acquired Alliance & Leicester together with the deposits and branch network of Bradford & Bingley following its nationalisation. After the crisis the collective and individual shares of the four largest providers remained relatively high and static, which exacerbated concerns regarding the effectiveness of competition in the market. However, the planned divestment by LBG and by RBS of parts of their retail businesses, as required by the European Commission under EU state aid rules, was considered to be a potential new source of competition in the market, and in September 2013 the OFT provided advice to the Chancellor of the Exchequer on the likely effect on competition of these proposed divestments.
- **Barriers to entry and expansion.** Potential entrants and small providers continued to face barriers to entry and expansion in the PCA market. This was due to a number of factors including regulatory issues, IT costs, customer inertia, and customers' preferences for PCA providers with large branch networks and established brands. While there had been two new entrants in the period preceding the review, Metro Bank and M&S Bank (a joint venture between Marks & Spencer and HSBC), neither was at that point in a position to provide a significant challenge to the established providers.

Market structure – concentration

2.3 There are approximately 80 million accounts in the UK, 65 million of which are used regularly. PCAs generated about £8.1 billion in revenues for providers in 2013, equivalent to £125 per account. At the moment, 20 banking groups provide PCAs in the UK market and 9 of them have more than one million active accounts on their books.[39]

2.4 Market structure and measures of concentration are often useful indicators of the intensity of competition in a market, particularly when products or services are not highly differentiated.

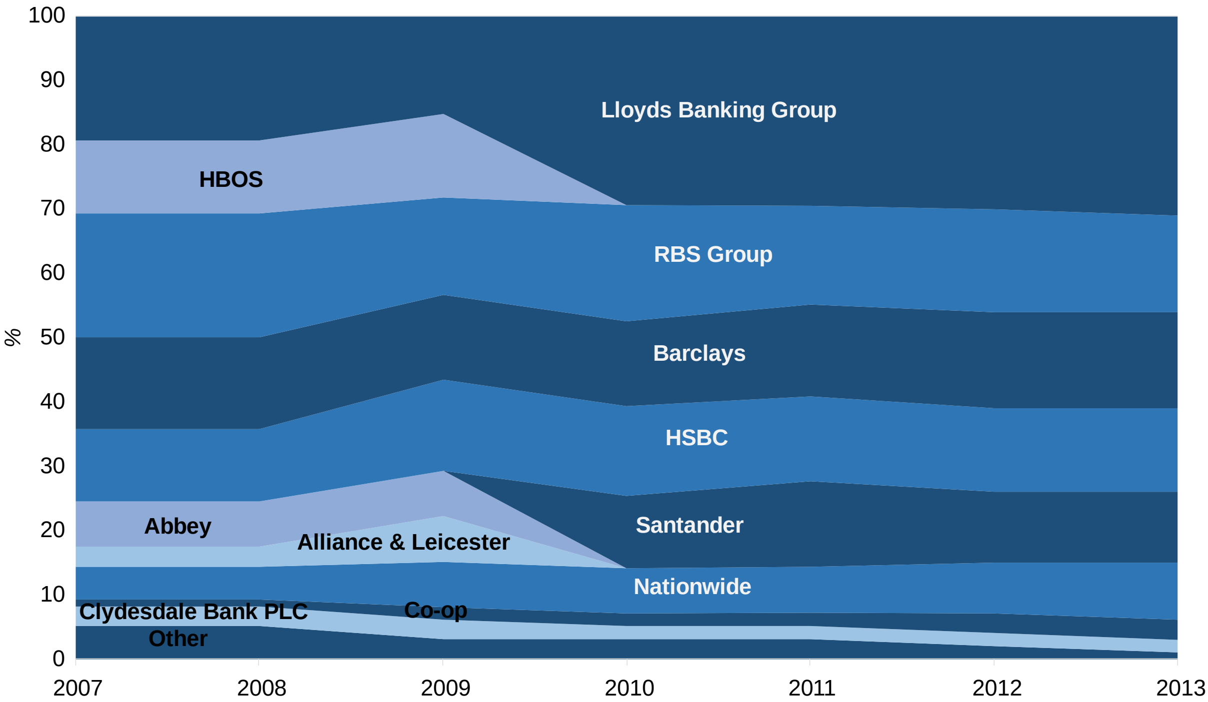
[39] CMA Information requests.

Market shares

2.5 Figure 2.1 below provides a long-term perspective on market shares in PCAs since 2007. These estimates are based on data collected by the research agency Mintel through an annual survey of about 2,000 customers. It shows that concentration increased sharply in 2009 as the financial crisis led to a number of mergers and acquisitions in the sector. Since then movements in market shares have been limited.

FIGURE 2.1

Market shares based on annual customer survey (2007 to 2013) by volume, UK

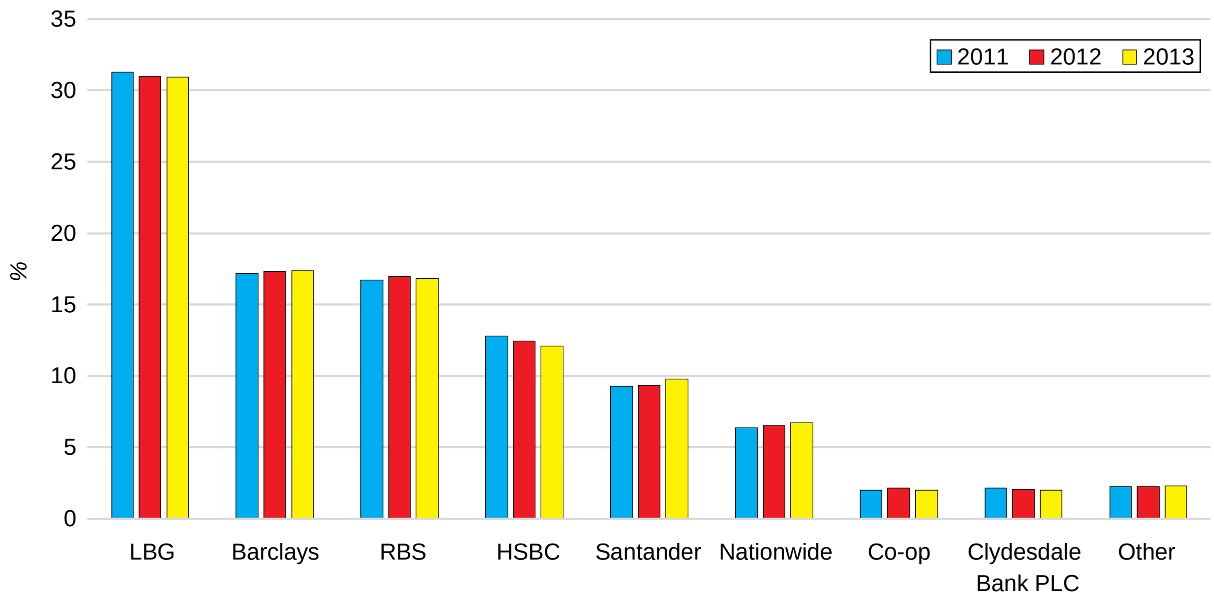


Source: Mintel retail banking overviews, 2007–2013.

2.6 Figure 2.2 below provides more detail on movements in market shares over the past three years (the effect of the LBG divestment is considered in the next subsection). These estimates are based on information provided by the PCA providers in this review, and more specifically on the number of active accounts on their books. Since 2011, Santander and Nationwide increased their market shares by 0.5 percentage points and 0.3 percentage points, respectively, while HSBC and LBG saw their market shares reduced by 0.7 percentage points and 0.3 percentage points, respectively. The Herfindhal-Hirschman Index (HHI), which measures the overall level of concentration, dropped very slightly, from 1,853 in 2011 to 1,838 in 2013 based on active accounts.[40]

FIGURE 2.2

Market shares based on number of active accounts, UK



Source: Response to the CMA's information requests to PCA providers – 2014.
Note: PCA providers aggregated in the 'other' category include Ulster Bank, Danske Bank, Metro Bank, AIB, Bank of Ireland, Citi Bank, Norwich and Peterborough BS, Secure Trust Bank, Coventry, Harrods Bank, and The Post Office.

2.7 Of the smallest PCA providers (aggregated in the 'other' category in the chart), only Metro Bank has increased its share in recent years. It currently has less than 1% of active accounts.

2.8 PCA market shares have traditionally been calculated based on the total number of accounts or the number of 'active' accounts (we have defined these as accounts which have had at least one customer-initiated transaction within the last three months, ie not a dormant account).

2.9 Some PCA providers told us that this is simplistic – accounts are used in different ways as customers are not homogeneous. They have suggested that any measurement of shares should consider this, for instance by looking at 'funded accounts' (or primary accounts), which are accounts that receive

[40] The Herfindhal-Hirschman Index (HHI) is a measure of market concentration that takes account of the differences in the sizes of market participants, as well as their number. The HHI is calculated by adding together the squared values of the percentage market shares of all firms in the market. The CMA is likely to regard any market with an HHI in excess of 2,000 as highly concentrated, and any market with an HHI in excess of 1,000 as concentrated – see Competition Commission, *Guidelines for market investigations: Their role, procedures, assessment and remedies*, April 2013 (this guidance was originally published by the CC and was later adopted by the CMA board).

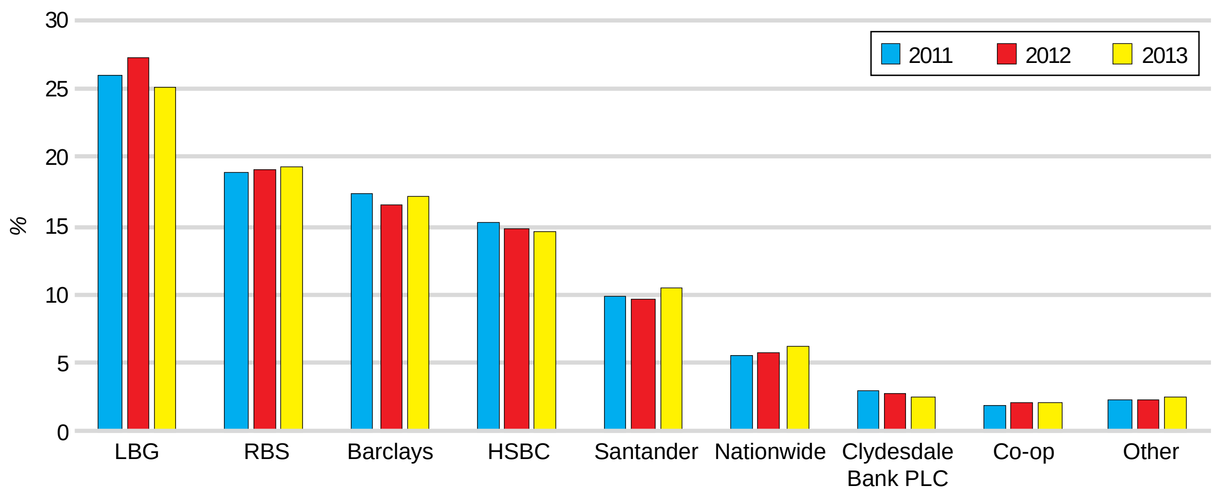
significant monthly payments from a source external to the bank, such as a monthly wage (ie it is not a transfer of funds from one bank account to another, such as from a single account to a joint account). There is no single definition of the lowest value of 'funding' but one workable definition is accounts that receive at least £500 per month. Some PCA providers have suggested that looking at this measure gives a different picture of concentration among PCAs.

2.10 We agree that the value of an account for a consumer and a provider will depend on how intensively it is used (along a number of dimensions). For this reason it is worth using various approaches to measuring concentration. We measured market shares based on the number of accounts with more than £500 in monthly credits ('funded accounts' – see Figure 2.3 below). We used this criterion as a proxy to identify PCAs used as primary accounts and to consider whether competitive dynamics were different in that segment.

2.11 This segment of the market appears slightly less concentrated and movements in market shares are slightly more pronounced: between 2011 and 2013 Santander and Nationwide increased their market shares by approximately 0.8 percentage points and 0.6 percentage points, respectively, while HSBC and LBG saw their market shares reduced by 0.7 percentage points and 1.0 percentage points; and the HHI based on funded accounts fell from 1,710 to 1,668. Nevertheless, the HHI based on number of funded accounts still indicates a concentrated market.

FIGURE 2.3

Market shares by number of 'funded accounts', UK



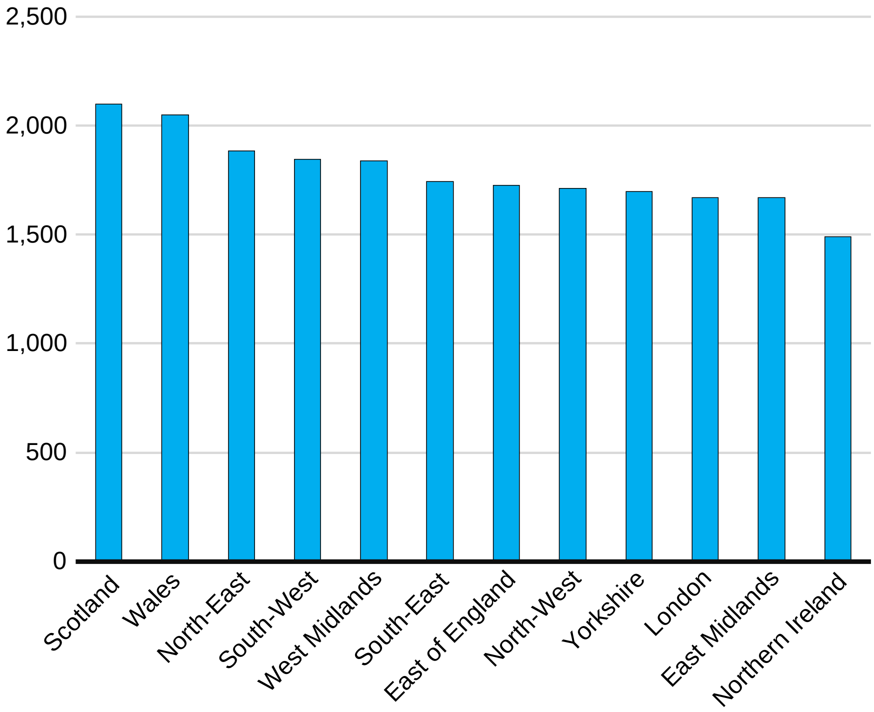
Source: Response to the CMA's information requests to PCA providers – 2014.

2.12 We also considered whether concentration varied for different areas in the UK. Figure 2.4 below shows that concentration is higher in Scotland and

Wales (where the HHI is above 2000, which is traditionally considered as indicative of a highly concentrated market) but lower in Northern Ireland. There is little variation in overall concentration levels among the regions of England.

FIGURE 2.4

HHIs by region (2013)



Source: Response to the CMA's information requests to PCA providers – 2014.
Note: These estimates of HHI assume that TSB is a separate entity (ie they are an estimate of concentration post-divestment).

2.13 Overall, there has been very little movement in market shares although there is evidence that mid-size PCA providers have grown slightly at the expense of some of the larger PCA providers. However, the changes are very gradual, and at the current rate they would not reduce the level of concentration back to its pre-crisis level in the foreseeable future.

Impact of mandated divestments

2.14 Both LBG and RBS have been required under EU state aid rules to divest parts of their retail banking businesses as a condition for the recapitalisation they received during the financial crisis.[41] This was seen by the European Commission as needed to address 'the distortion of competition created by

[41] See State aid No. N 428/2009 – United Kingdom Restructuring of Lloyds Banking Group (for LBG), paragraph 188; and, and State aid No N 422/2009 and N 621/2009 – United Kingdom Restructuring of Royal Bank of Scotland (for RBS), paragraph 244.

the aid and … an appropriate means of increasing competition on the concentrated UK banking market'. The parts to be divested by LBG (under the codename Project Verde) are branded 'TSB' and the parts to be divested by RBS are branded 'Williams & Glyn' (under the codename Project Rainbow).

2.15 In its 2013 report, the OFT noted that the planned divestments were both substantial in size and could represent a source of competitive threat in the market. In September 2013 the OFT provided advice to the Chancellor of the Exchequer on the impact of these divestments on competition and recommended a number of enhancements to the LBG divestment plans to strengthen the impact on competition. For the purpose of this market study we reviewed the OFT's advice and considered it in the light of more recent market developments.

LBG divestment of TSB

2.16 TSB, which is being divested by LBG, is a banking business with 632 branches and a focus on personal customers. In its September 2013 advice to the Chancellor, the OFT stated that the divestment would have only a limited impact on concentration. However, the OFT also noted that changes in concentration alone could not be the sole basis for analysing the effect of the divestment on competition. This is because small PCA providers can, in certain circumstances, compete effectively through differentiation and innovation as their incentives are not aligned with those of their larger competitors.

2.17 The OFT's advice to the Chancellor identified several factors as important in determining whether a bank could act as an effective competitor: sufficient national and regional scale, an ability to offer a breadth of products, a base in PCAs from which to grow into other products, a strong brand and reputation, an ability to generate profit, an ability to innovate, and strong management and staff. The OFT reviewed the divestment package proposed by LBG against these criteria and concluded that although TSB had the potential to provide a competitive constraint in the retail banking market, its relatively small size meant that it was unlikely to alter other PCA providers' incentive to compete significantly. Moreover the divestment was unlikely to reduce LBG's size to such an extent that its incentive to compete would be significantly altered.

2.18 The OFT identified three areas of concern with regard to TSB's ability to compete:

(a) the business and IT service agreements with LBG, which could impair TSB's ability to compete independently;

(b) TSB's financial position and profitability, which could dampen its ability to grow and compete; and

(c) TSB's initial market share, which falls below the range which has previously been observed for effective competitors.

2.19 Shortly after the OFT gave its advice in September 2013, LBG launched TSB as a separate, stand-alone business. LBG also made two amendments to the terms of TSB's separation to mitigate the first two of the OFT's concerns: it accepted the appointment of a Skilled Person to monitor the operation of ongoing systems relationships; and it included high-margin mortgages in the business to enhance the profitability of TSB in the short term.

2.20 On 20 June 2014, LBG sold approximately 38% of the shares in TSB by way of an IPO. LBG is required to sell its remaining stake before 31 December 2015.

2.21 The direct impact of TSB's divestment on market concentration will be relatively modest. TSB reports a market share of 4.2% in the UK PCA market,[42] and we estimate that the divestment will reduce the HHI in PCAs from 1,838 to 1,632 nationally, based on active accounts. However, TSB will have a 15% market share in Scotland where concentration is currently highest (the HHI in Scotland will fall from 3058 to 2099). We also note that TSB has made some efforts to differentiate itself from its competitors, both through its branding and its product features. For example, it has launched an advertising campaign to increase brand awareness, and a new current account which offers a 5% credit interest rate on balances up to £2,000. This is the highest interest rate on credit balances among mass-market standard accounts, and the Money Advice Service shows this account as one of the most competitive PCA for customers who do not use overdrafts. TSB has announced that one of its strategic priorities will be to grow its market share of the PCA market so that it exceeds its market share of branches in the UK (approximately 6% as at 31 August 2013).[43] In its prospectus, TSB states that it believes that despite the relative maturity of the PCA market, the introduction of the current account switch guarantee scheme may present opportunities to acquire new PCAs going forward.[44]

2.22 In summary, we note that TSB appears willing to differentiate itself from its competitors and grow its share of the market. However, TSB has a relatively

[42] This is based on CACI data for active accounts, excluding basic accounts.
[43] TSB price range prospectus, June 2014.
[44] TSB, Price Range Prospectus, 9 June 2014, p89.

small size and it is unclear at this stage what its overall impact on competition will be.

RBS proposed divestment of Williams & Glyn

2.23 RBS is planning to meet its commitment by divesting a share of its business under the W&G brand. W&G has 314 branches and has been developed with a focus on the SME market. In its advice to the Chancellor, the OFT concluded that the entity was not sufficient in size or scale to compete effectively in the PCA market on a national scale.

2.24 Since the OFT produced its advice, RBS has agreed a £600 million pre-IPO investment in W&G with a consortium of investors led by Corsair Capital and Centerbridge partners. However, RBS was unable to meet the 31 December 2013 deadline for the divestment and the UK Government had to submit an amended restructuring plan to the European Commission for approval. The European Commission approved the amended plan on 9 April 2014. RBS must now divest the W&G business by IPO, whole business sale or tendering procedure for its entire interest. In the expected event of divestment by IPO, RBS must carry out this IPO before 31 December 2016 and complete the disposal of its entire interest in the W&G business by 31 December 2017.[45]

2.25 W&G will have over one million active customers,[46] representing a market share within the PCA market of around 2%.[47] At this stage we do not consider that the W&G divestment, which in any event will not be completed before 2017, will have a significant impact on the PCA market.[48]

Concentration levels – theory of harm

2.26 In 2011 the Vickers report reviewed a number of academic studies indicating a positive relationship between concentration and poor customer outcomes in various retail banking markets. However, the economic mechanisms driving this relationship are not known precisely, and it is unclear how, or, indeed, whether it applies to the PCA market in the UK. As part of this update we have sought to explore the impact of concentration in more detail.

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[45] RBS press Article, RBS announces an agreement with HMT to provide for the future retirement of the Dividend Access Share and revised State aid terms, 9 April 2014.
[46] The figure includes SME as well as PCA customers: www.rbs.com/news/2013/09/return-of-williams-glyns-moves-closer.html.
[47] BBA, Promoting competition in the UK banking industry, June 2014 report, p20, Figure 2, BBA calculations.
[48] We note that the BBA report, Promoting competition in the UK banking industry, estimates an HHI post-divestment of both TSB and W&G of around 1,450 (p4). Based on information provided to us by PCA providers the CMA considers the HHI will be 1,583 based on active accounts and not 1,450 as reported by the BBA.

2.27 Also, concentration levels may not only be an indicator of competition problems, but under certain circumstances, concentration can also be a source of competition problems. We recognise that there is no clear and simple relationship between concentration levels and competition (and, in turn, better outcomes for customers). However, there is a tendency, all else being equal, for more concentrated markets to be less competitive. This tendency is stronger when such markets are also characterised by significant barriers to entry and consumers who are inactive in terms of shopping around for the best offer (concerns which we explore in later chapters of this report).

2.28 One possible theory of harm linking concentration and poor outcomes for consumers is that large PCA providers might have a tendency to charge higher prices or offer poorer service compared with smaller PCA providers when faced with customer inertia and a lack of ability to price discriminate between different categories of customers.[49] If a bank has a relatively high market share, and therefore a relatively large existing customer base – and in conditions, where, as appears to be the case in the PCA market: *(a)* customers are relatively 'sticky', and *(b)* it is difficult to discriminate in price or service offering between sticky and non-sticky customers – that bank with the relatively high market share has an incentive to exploit its existing customers by setting prices high or failing to invest in improved service, whereas PCA providers with smaller market shares without a large base of sticky customers have a greater incentive to price low or offer improved service standards in order to attract new customers and potential switchers (since they have 'less to lose' by pricing low or investing in better service).[50]

2.29 To explore this hypothesis, we undertook a preliminary assessment of the relationship between size and value for customers. We used various metrics to approximate value to customers:

(a) **Size and revenue per account**. We first approximated the pricing of PCAs by calculating the ratio between PCA revenues and the number of accounts for standard accounts (the yield per account). In principle, higher

[49] In this case we use the term 'price' as a shortcut for the range of financial and non-financial characteristics that determine the value of PCAs to consumers. An increase in the 'price' of PCAs could mean, alternatively or in combination: an increase in overdraft charges, an increase in the interest rate on debit balance, a reduction in the interest rate on credit balance, and/or a reduction in quality (eg shorter opening hours for branches, reduced functionality of electronic platforms, etc).

[50] In the interim Vickers report it was noted: 'For a small bank, setting a low price to attract switchers is more worthwhile than for larger banks since small banks can gain a greater proportion of their total customers by offering good deals. In addition, smaller banks lose less money on their existing customers by offering good deals as the existing customers are a smaller proportion of the existing and new customers together.' Such a finding is consistent with Abbey National's submission to the CC, during the course of its investigation into the proposed merger between Lloyds TSB and Abbey National in 2001, in which it stated that: in markets 'with switching costs, firms with lower market share tended to grow (or "sow") their share by competing aggressively and through price, while those with high market share tended to exploit (or "harvest") theirs by preserving or increasing margins on the existing customer base', paragraph 5.113 on p146.

charges or lower credit interest should be reflected in higher revenues per account. We considered this relationship both for total PCA revenues and for overdraft revenues only. The ratio between total PCA revenues and customer numbers offers a better overview of the ‘all-in’ profitability of PCAs, but because providers use different approaches to calculate net credit interest (NCI) some of the differences observed might be due to differences in transfer pricing methodologies rather than actual differences in pricing.[51] The ratio between overdraft revenues and customer numbers is less affected by transfer pricing (since net income interest is a smaller share of the numerator), but it only represents one dimension of PCA pricing. For this reason it is important to consider both measures of revenues. This exploratory analysis did not indicate any clear relationship between size and pricing. On average, larger PCA providers had slightly higher overdraft revenues per account compared with smaller PCA providers, but they did not appear to have higher total revenues overall.

(b) **Size and credit interest rates**. The interest paid on credit balances (or the lack thereof) is an important aspect of PCA providers’ pricing policies for PCAs. For the theory of harm to hold, we would expect the larger PCA providers to pay lower interest rates. In principle this should be reflected in banks’ revenues, but there have been several changes in credit interest policies recently which would not have been reflected fully in 2013 revenues. We note that at present, a number of PCA providers offer interest rates above 1% on credit balances for standard accounts, including: TSB (Classic Plus account), Lloyds (Club Lloyds account), Santander (1-2-3 account), Nationwide (Flexdirect account), and Clydesdale (Current Account Plus).[52] With the notable exception of Lloyds, most of these PCA providers are mid-sized or small PCA providers.

(c) **Size and cost of unarranged overdraft**. To obtain an overview of the cost of unarranged overdrafts we collected information on the charging scenarios[53] published by the different suppliers and we averaged the cost of scenarios 3 and 4, which are representative of a regular usage patterns for overdraft users.[54] Figure 2.5 below suggests that while there is

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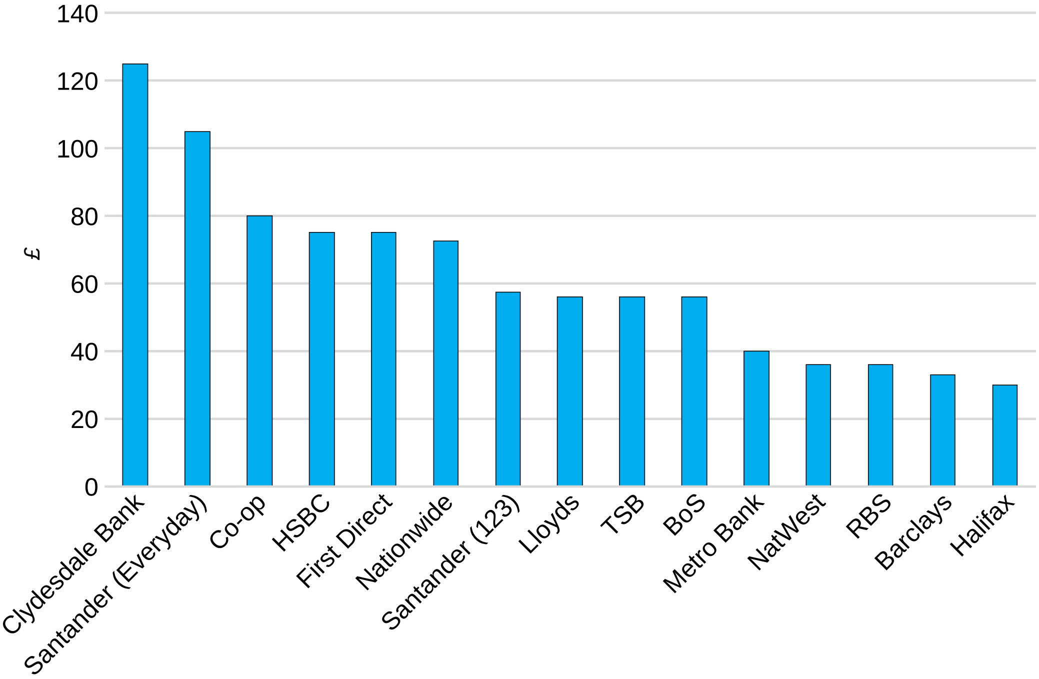
[51] NCI is the difference between the interest paid on deposits and the interest paid on these funds by the treasury functions of the banks. This concept is explored in more detail in the Annex to this report on PCA revenues.
[52] Halifax also pays a ‘reward’ of £5 per month to users of its Rewards account.
[53] For an explanation of charging scenarios, see paragraph 3.49.
[54] Scenario 3 is described as: ‘a payment from your account takes you into your unarranged overdraft and you make another payment from the account while you are overdrawn. You use your overdraft for two days in a row during the month. Scenario 4 is ‘A payment from your account takes you into your unarranged overdraft, and you make nine more payments from the account while you are overdrawn. You use your unarranged overdraft for 10 days in a row during the month’.

significant price dispersion in the market there is no obvious relationship between the size of the providers and the level of charges they apply.

FIGURE 2.5

Monthly cost of an unarranged overdraft (average between scenarios 3 and 4 – main PCA providers operating in the GB market)*



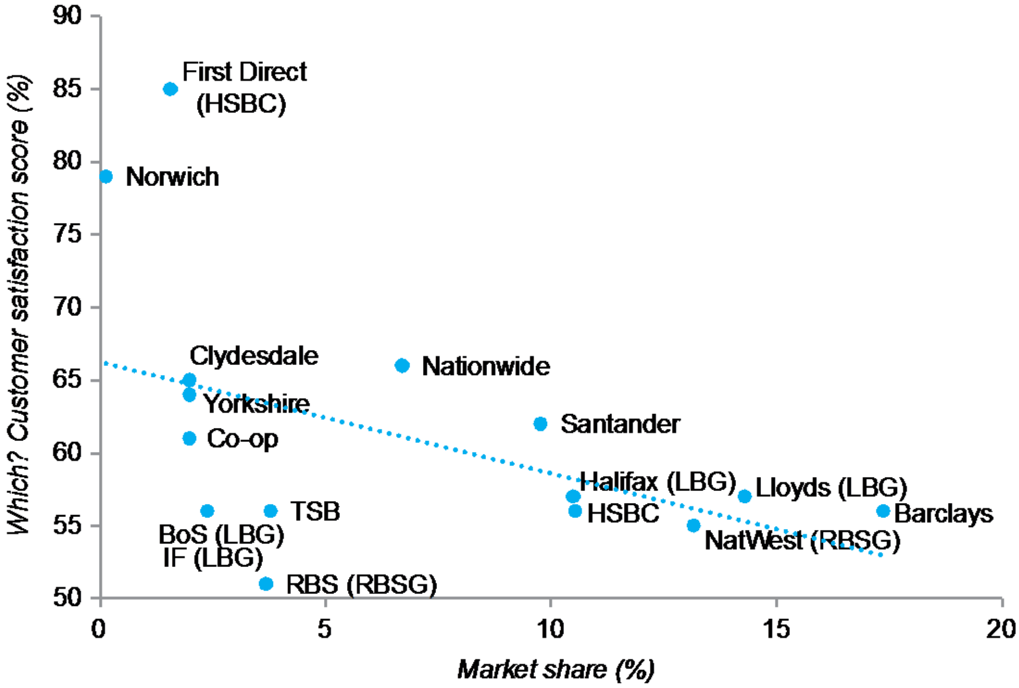
Source: Response to the CMA's information requests to PCA providers – 2014.
*These figures are based on the information provided to the CMA during its investigation. Clydesdale has informed the CMA that from 1 June 2014, it has reduced its Returned Item Fee from £35 to £15.

(d) **Size and customer satisfaction**. We conducted a similar exercise considering the relationship between size and customer satisfaction. We approximated customer satisfaction with two metrics: the number of complaints per 10,000 accounts, and the customer satisfaction scoring given to different brands by *Which?* Figure 2.6A below suggests that the brands with the larger customer bases tend to have lower satisfaction scoring. We also note that there is some dispersion within banking groups: for example, First Direct has much higher satisfaction levels than HSBC, even though both brands belong to the same group. Figure 2.6B suggests that there is a clearer relationship between size and the number of complaints per account.

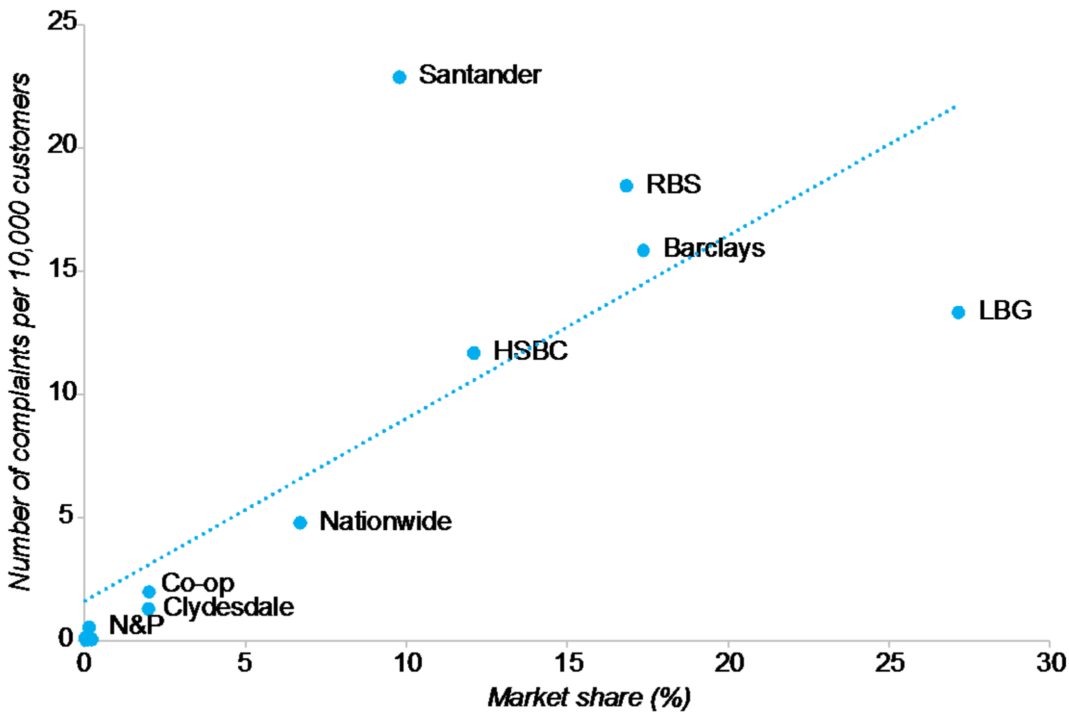
FIGURE 2.6

Relationship between size and customer satisfaction

A. *Which?* customer satisfaction score and size



B. Complaints per account and size



Source: Market shares calculated by the CMA, Which? satisfaction ratings and FCA complaints data.
Note: The trend lines are provided for indicative purposes and do not indicate statistical significance.

2.30 In summary, this preliminary analysis provided mixed evidence on the link between the size of providers and value for their customers.

(a) In terms of service, there is some evidence that larger providers have lower customer satisfaction scores and attract more complaints.

(b) In terms of price, although there is some evidence that larger providers pay lower interest on credit balances, we have not seen evidence that overall they are earning higher revenues per customer.

2.31 It is plausible that, in the PCA market, service is likely to be a more significant dimension of competition than price – given that most PCAs are free of charge when in credit, that overdraft charges are complex and hard to compare, and that interest payments to those in credit are uncommon and, where they do exist, generally quite low. This seems to be substantiated by evidence on consumers' reasons for switching (see Chapter 4).

2.32 There is also some resultant harm in the SME banking sector, given that more than half of SMEs take their business current accounts from their PCA provider (see SME report, Chapter 3).

Market structure – barriers to entry and expansion

2.33 In 2010, the OFT examined barriers to entry in retail banking to inform the Vickers report.[55] This analysis identified several key issues related to the regulatory framework, the ability of small providers to access essential inputs, and the ability of small providers to attract customers and reach scale. To decide whether these factors still apply, in this market structure, the CMA reviewed market developments and spoke with recent and potential entrants to the PCA market. Table 2.1 summarises our conclusions and the remainder of this chapter provides more details on our assessment.

TABLE 2.1 **Summary of barriers to entry**

Barriers identified in previous reviews	*Updated assessment*
FCA authorisation process	Mitigated following the FCA/PRA's 2013 review
Capital requirements for small PCA providers	Mitigated following the FCA/PRA's 2013 review
IT costs	Partly mitigated through innovation in IT market
Access to payment systems	Still a barrier, but could be addressed through PSR intervention
Need for extensive branch network	Still a barrier, although it might diminish over the longer term
Limited shopping around	Still a barrier
Cross-subsidies from other activities	Some evidence

Source: CMA.

[55] OFT, Review of barriers to entry, expansion and exit in retail banking, November 2010.

FCA authorisation process

2.34 PCA providers require authorisation to take deposits and offer overdrafts. In 2010, the OFT found that applicants faced difficulties and uncertainties arising from this process, and that this had the effect of delaying entry and making it harder to raise capital. In March 2013, the FSA and the Bank of England published a review of the authorisation process and of the prudential and conduct requirements that apply to new entrant PCA providers. The review stated that the FSA's successor bodies, the PRA and the FCA, would implement changes along two dimensions: reforms to the authorisation process and a major shift in the approach to the prudential regulation of banking start-ups.

2.35 The review introduced several changes to make the authorisation process quicker and more cost-effective.[56] The process is now structured around two options:

(a) 'Option A' is designed for firms that have the development backing, capital, and infrastructure needed to set up the bank quickly. Examples would include banks currently operating in other jurisdictions, or firms operating in non-financial markets but able to utilise their existing systems and financial resources to provide financial products. This option includes a higher level of up-front support to firms at the pre-application stage compared with the previous model. The objective is to enable applicants to submit higher-quality materials at the application stage, which in turn should enable the PRA and the FCA to work together to complete the assessment and make a decision within six months (the process previously took 11 months on average).

(b) 'Option B' (or the 'mobilisation' option) is designed for firms which require the certainty of an authorisation before committing to major capital outlays or infrastructure investments. This new process contains clear stages that allow the applicants to complete their full build-out and secure investment with the certainty of authorisation.

2.36 In summary, the new process should be quicker for firms which already have the required resources at the application stage, and less risky for applicants who do not have these resources at the onset.

2.37 The changes came into effect in April 2013. In July 2014, the FCA and the PRA published an update on the implementation of these measures and their

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[56] FSA and the Bank of England, A review of requirements for firms entering into of expanding in the banking sector, March 2013.

impact on barriers to entry.[57] In this update the authorities note a number of positive developments, including:

(a) Engagement in pre-application – the regulator held 47 pre-application meetings with over 25 potential applicants in the 12 months to 31 March 2014 (whereas 48 meetings were held in the 36 months between 2010 and 2012).[58] Positive comments have been received from potential applicants about the regulators' willingness to engage during pre-application, the usefulness of the discussions and the access to specialists.

(b) Take-up and interest in the mobilisation option – in the 12 months to 31 March 2014 three of the five entities authorised as banks used the mobilisation option, and a number of firms in the pre-application stage have also shown an interest.

(c) Improvements to the application pack and information requirements – a comprehensive review of the application pack and supporting notes has resulted in one stand-alone pack and a single document of supporting notes aimed at delivering clarity and efficiencies to both the prospective entrant firm and the regulators.

2.38 A potential entrant currently going through the authorisation process confirmed that the process is now easier to navigate, and we did not receive any representation suggesting that this still represented a barrier to entry. Overall we have seen no evidence to suggest that these requirements are disproportionate or pose excessive barriers to entry or expansion in the banking market.

Capital requirements

2.39 Banks which accept deposits also need to comply with capital and liquidity requirements. The OFT and the Vickers report identified a number of ways in which small banks or new entrants might face higher capital requirements compared with large incumbents: they might be required to hold extra capital to compensate for concentration in a particular market or to reflect the greater uncertainty surrounding their business plan; the risk weights of their assets might be higher due to using a standardised rather than advanced approach

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[57] FCA and PRA, A review of requirements for firms entering or expanding in the banking sector: one year on, July 2014.
[58] These firms have a range of different business models from wholesale banking, to FCA-regulated Payment Services firms who are looking to enter the banking market and offer deposits and lending to their current client base (including small SMEs) to others who are proposing to offer a mixture of SME or mortgage lending, funded by retail and SME deposits.

to risk-weighing; and they might be penalised for less experienced management or lack of a track record.

2.40 To address these issues the PRA introduced a number of changes to the prudential regulation of new banks:

(a) Removal of additional requirements (known as ‘add-ons’ and ‘scalars’) previously applied to new banks to reflect the greater uncertainty surrounding their business plan.

(b) A more flexible approach to setting the Capital Planning Buffer (CPB) for new entrant banks that were assessed as resolvable with no systemic impact.

(c) A commitment to addressing underestimation of risk that can result from applying the Internal Ratings Based (IRB) approach to certain types of exposures.

(d) A more flexible approach to implementing the fourth Capital Requirements Directive (CRD IV), where new banks will initially only need to meet a common equity tier 1 capital ratio of 4.5% of risk-weighted assets while major existing banks will need to achieve a 9.5% ratio.

2.41 The July 2014 update clarified some detailed elements of this new approach and outlined the progress in implementing these changes. New entrants that meet the definition of a Small Specialist Bank (SSB) are now initially required to hold an absolute minimum amount of capital equal to €1 million or £1 million (whichever is higher) plus a CPB, rather than the previous minimum level of €5 million plus a CPB.[59] The new entrant banks that were assessed as resolvable with no systemic impact have benefited from the more flexible approach to setting the CPB. The PRA also expects to consult on its revised approach to Pillar 2 capital requirements under CRD IV later this year.

2.42 However, we note the recently published report by the British Banking Association (BBA) which said that despite a reduction in the initial capital a new bank has to have, challenger banks are still disadvantaged vis-à-vis the established banks.[60]

[59] To be considered an SSB, banks have to carry out one or more of the following activities: providing basic banking services which could include current and savings accounts; lending to SMEs; and residential mortgage lending. Banks are still expected to be fully resolvable and to meet both regulators’ Threshold Conditions at all times.
[60] BBA, Promoting competition in the UK banking industry, June 2014.

IT costs

2.43 In 2010, the OFT found that while potential entrants had a number of options for establishing IT systems, most of these involved a substantial fixed cost that was unlikely to be recoverable in the event of market exit. In the early years of establishing a presence, these costs had to be spread over relatively few customers, which increased the risk of entry.

2.44 We spoke to three IT providers who had been involved in creating the IT platforms for recent entrants and/or were currently developing such platforms for potential entrants (Temenos, Fiserv, and Tusmor). They told us that the IT costs of entering the PCA market had fallen over recent years as the market had developed several platforms that could be used by potential entrants, either as standardised solutions (as a ‘bank in a box’) or with specific add-ons to accommodate the need of particular providers. IT providers now tended to charge a relatively low fixed fee at the onset, and then a variable maintenance fee per account (we understand this ranges from £15 to £60 per account per year depending on the provider and the number of customers). This approach might have the effect of reducing the fixed costs involved in the development of the IT infrastructure, which might, in turn, reduce the risk of entry and expansion.

2.45 We also received some feedback on this issue from recent and potential entrants in the market. One potential entrant told us that the market had developed more flexible solutions for dealing with the IT needs of new entrants and that they were using an IT provider to develop their IT solution at a reasonable cost. In contrast, another bank which had considered entry in the PCA market told us that developing the infrastructure needed to provide PCAs remained a complex and lengthy process that could cost between £20 million and £50 million. Another potential entrant told us that it had to develop its own proprietary solution to retain the ability to propose customised products and that the cost amounted to about £30 million.

2.46 One large bank told us that modern IT systems offered a competitive advantage, rather than a barrier to entry, for new entrants as they provided state-of-the-art functionality with scalable solutions obviating the need for up-front investment, whereas established PCA providers were constrained by legacy IT systems.

2.47 We concluded that IT costs for new entrants had been reduced recently, especially for providers willing to outsource the development of their IT platform and/or to accept relatively standardised solutions.

Access to payment systems

2.48 A new entrant wishing to offer a PCA requires access to several payment systems such as BACS (for direct debits and credits), Faster Payments services (for fast transfers), the Cheque and Credit Clearing Company and LINK (for clearing cash machine withdrawals). Such a new entrant can access payment systems either directly, by becoming a direct member of the schemes, or indirectly, by entering into an agency agreement with a direct member.

2.49 To become direct members of payment systems, providers are required to meet certain criteria. These typically include maintaining a credit rating above a certain level, holding a settlement account at the Bank of England, meeting the technical and operational requirements set by the operator of the payment system, and being willing to fund part of the system. In practice, for many systems direct access is an expensive option that is only accessible to large PCA providers with the sufficient scale.

2.50 To become an indirect member of a payment system a provider will need an agency agreement with a direct member. The access terms and charges are negotiated bilaterally between the indirect member and the agency bank. In 2013, the OFT found that indirect participants had limited choice and bargaining power in seeking access through direct members, and that this could make it difficult for small providers to compete on an equivalent basis with larger banks.[61] In the course of our review we received representations from several small banks indicating that access to payment systems remained difficult and costly with little transparency around charges and instances of poor service.

2.51 In response to this and various other concerns with UK payment systems, the Financial Services (Banking Reform) Act 2013 required the FCA to establish a PSR. The PSR was established as a subsidiary of the FCA on 1 April 2014, and will be fully operational in the regulation of payment systems in April 2015. One of the PSR's statutory objectives is to promote competition, both in the market for payment services and in the market for services provided by payment systems. The PSR will have concurrent competition law powers with the CMA – including the power to conduct market studies and make MIRs to the CMA[62] – as well as five other specific regulatory powers. These are: *(a)* giving directions to payment system participants; *(b)* imposing requirements on operators regarding system rules; *(c)* the power to require the granting of

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[61] OFT, UK payment systems – how regulation of UK payment systems could enhance competition and innovation, July 2013.
[62] These powers are to be commenced on 1 April 2015.

access to payment systems; *(d)* the power to vary agreements relating to payment systems; and *(e)* the power to require disposals of interests in payment systems. In March 2014, the FCA launched a call for inputs to help the PSR to develop the PSR's regulatory approach and identify early priorities for action. The PSR is considering issues of access (among other things) and is expected to develop that work further.

2.52 Based on the evidence collected by the OFT in previous reviews and the representations we received in this market study we cannot discard the possibility that the terms of access to payment systems for small banks may represent a barrier to entry in PCAs. We note that the PSR has wide-ranging regulatory powers to address such issues, and that the PSR is already examining access to payment systems. It is currently devising its regulatory approach, such that it is not possible to say at this point how it may address these concerns in relation to payment systems. In particular, we note the focus of the PSR on access issues in its call for inputs, and so there is scope for this barrier to be reduced or removed over time.

Extensive branch networks

2.53 In 2013, the OFT found that the vast majority of PCA customers continued to use branches to access their PCA[63] and that they still expected PCA providers to offer this service. This means that potential entrants face a choice between incurring a substantial fixed cost to build a large network of branches or focusing on particular segments of the market that require a less substantial investment (for example, large cities or customers who do not require a branch). The former approach makes entry more risky as it involves significant sunk costs: even though premises can be rented, investment in skilled staff and systems would be significant and would take time. The latter approach is less risky but it makes entry less effective as a source of competitive pressure on the wider market.

2.54 There is no doubt that technological innovation, specifically the recent upsurge in online and mobile app banking, is reducing the usage of bank branches. Online banking is now used by 85% of customers according to Mintel[64] and supported 534 million transactions in 2013 according to data provided by the eight largest PCA providers (up by 64% since 2011). Mobile banking is now used by 37% of customers[65] and supported 113 million transactions in 2013 according to data provided by the eight largest PCA

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[63] OFT, Review of the personal current account market, January 2013.
[64] Mintel, Packaged and Current Accounts – UK, July 2013, p67. Consumer survey of nationally representative sample of 1,959 Internet users aged 16+ with a current account.
[65] Mintel, Packaged and Current Accounts – UK, July 2013, p67.

providers (up from 2 million in 2011). As a result, there is some evidence that customer footfall has fallen,[66] and almost all PCA providers have closed branches and/or announced future closures. The information provided by PCA providers in the course of this review indicates that the total number of branches dropped from 8,656 in 2012 to 8,190 in 2014, a reduction of 5%.

2.55 But it does not, contrary to submissions made by some major PCA providers in the course of this update, follow that it is no longer necessary to have an extensive branch network in order to be an effective competitor and achieve scale. Indeed, although 25% of UK customers say that they would consider using a pure digital branch,[67] the evidence suggests that most customers are not willing to use PCA providers without branch networks.

(a) According to Mintel,[68] despite the growth of online and mobile banking 47% of customers still use counter services at least once a month, and 92% use counter services at least once a year (see Figure 2.7).

(b) According to a survey by GfK, the convenience of branch location near to work or home is the most common reason given by customers for choosing a new bank.[69]

(c) TSB told us that approximately 80% of new account opening was still done in-branch, and several other PCA providers told us that branches remained an important sales channel for PCAs as well as other financial products.

(d) A survey by YouGov for the BBA found that 58% of respondents said having a local branch was important.[70]

2.56 What is clear is that large providers still maintain large networks of branches. One bank, for example, despite closing a significant number of branches and planning further closures, still plans to maintain a large network at least as far as 2020. Large providers also continue to invest in branches: Lloyds invested a significant amount of money in 442 branches between 2011 and 2013, and Barclays has announced an agreement with ASDA to open branches into supermarkets.

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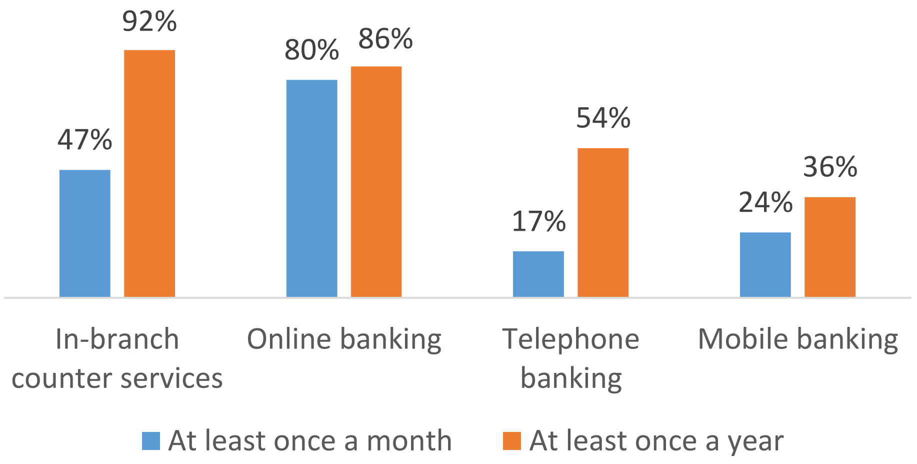
[66] However, a survey by Accenture based on interviews with over 3,600 UK current account holders, shows contrasting evidence on customers' attitude to retail banking channels. For example, the survey points to a rise in customers using branches: according to the survey, the number of customers going into a branch at least once a month has risen from 45% in 2012 to 52% this year, with the most pronounced increase among customers aged 18 to 24. Accenture press release, UK Consumers Open to Pure Digital Banks.
[67] Accenture press release, UK Consumers Open to Pure Digital Banks.
[68] ibid, p67.
[69] GfK press release, Customers have little reason to switch current account providers, 16 September 2013.
[70] BBA, Promoting competition in the UK banking industry, June 2014, p26.

2.57 Branches are also important for smaller players. TSB has recently announced the opening of 70 new branches[71] and Metro Bank, which entered the market in 2010, did so with a branch strategy and emphasises the quality of services provided in its branches as one its key selling points. Virgin Money, which is looking to enter the PCA market in the future, is opening new 'lounges' to foster relationships with its customers. Tesco Bank, which entered the PCA market on 10 June 2014, does not have any branches, but plans to use its groceries stores to raise awareness of the new products and its PCA customers will be able to access basic banking services (eg making deposits into their PCA) at customer desks in a network of its 300 large stores. We appreciate that there are examples of PCA providers offering PCAs without branches (First Direct, Citi, Cardone Bank, and potentially the proposed new Atom Bank), but these are relatively small players and there is as yet no example of a bank reaching a significant scale without a network of branches, and in the case of First Direct, customers can use HSBC branches.

FIGURE 2.7

Proportion of PCA customers using different access channels (2013)



Source: Mintel, Packaged and Current Accounts – UK, July 2013, p67.

2.58 Industry commentators appear to have different opinions on the future of branches, but few predict a total collapse in the number of branches. For example, Deutsche Bank AG expects that most PCA providers will change the design of their branches rather than their numbers.[72] According to this research, branches will become cheaper to fit out, easier to move, and primarily designed around the need to provide advice to customers.

[71] Press article, *This is Money*, 28 May 2014. Available at: www.thisismoney.co.uk/money/markets/article-2640750/TSB-reveals-ambitious-plans-High-Street-giants.html.
[72] Deutsche Bank AG, The Future of Banking, 8 September 2013.

2.59 It appears that an extensive network of branches remains a condition for competing effectively in the PCA market on a large scale. This makes entry and expansion more difficult for providers without an extensive branch network.

Customer behaviour

2.60 Most recent or potential entrants continue to argue that customer inertia is one of the most important difficulties they have to face when trying to expand in the PCA market. We discuss this factor in more detail in Chapter 4 of this report.

2.61 The increase in multi-banking (ie customers holding more than one PCA) might also have some relevance for barriers to entry and expansion. However, as noted in Chapter 4, paragraph 4.46 we have little information on the motivations for multi-banking, and the impact on barriers to entry and expansion is not straightforward. Customers who routinely engage with multiple providers might be more willing to move their banking to new providers in response to changes in charges and quality. On the other hand, it might be more difficult for new entrants to attract valuable customers if customers open secondary account to ‘cherry pick’ certain services with attractive charges (eg transactions abroad or overdrafts) without moving their main banking activity. This might be one reason why most new products require minimum levels of funding.

Recent and planned entry

2.62 We also reviewed cases of recent or planned entry to understand how PCA providers could overcome the existing barriers to entry and the extent to which they might create new competitive constraints on the PCA providers.

(a) **Metro Bank** entered the market in 2010 with four branches located in London. It currently has 26 branches in and around London and a market share of less than 1% of the market. It is planning to grow to 200 branches by 2020 (primarily in the South-East). Metro Bank emphasises the quality of its customer service and the accessibility of its branches rather than its product specifications.

(b) **Tesco Bank** launched its PCA on 10 June 2014. The PCA pays interest on credit balance and is linked to the Tesco Clubcard. Tesco plans to use its stores to raise awareness of the product but the PCA 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 PCA is designed to be accessed primarily online.

(c) **Virgin Money** has announced that it is developing a range of PCAs but the details of the offering have not been made public yet.

(d) **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. Following the trial, the Post Office is now set to increase the number of branches offering PCAs and by the end of September it expects that the number of branches in the scheme will rise to 239.[73] Initially a PCA must be opened in a participating branch but after that it can be run online or through any Post Office.

(e) **The proposed Atom Bank** is a project run by Anthony Thomson, founder and former chairman of Metro Bank, and Mark Mullen, who was previously CEO of First Direct. Atom Bank will have no branches and its PCAs will only be accessible online. The bank is expected to launch in the first half of 2015.

2.63 These examples show that entry in the PCA market is possible. However, the scale of such entry is open to question, and all these PCA providers maintained that PCAs were a particularly complex product to develop.

Entry in payment services

2.64 We also note that PCA providers may be facing increased competition in the provision of payment services from firms from outside the banking sector. Some companies such as PayPal are developing payment services that may allow customers essentially to 'bypass' their PCA providers for certain transactions. At the moment most of these transactions are settled through the customers' debit or credit cards, which means that the PCA providers still receive interchange income and data from these transactions. However, in the future a greater share of these transactions might be settled through automated payments from the customers' PCAs. This potentially represents three threats for PCA providers: they may lose the interchange income associated with the transactions; they might get less data on their customers' purchasing behaviour (which providers may otherwise use to assess the customers' creditworthiness and their need for other products); and their relationship with their customers might become weaker. At the moment these alternative payment services are focused on e-commerce but it is conceivable that competition will also develop in other segments of the payments market (eg in-store payments).

[73] 'Number of Post Office branches offering current accounts to double', *The Guardian*, 1 July 2014.

2.65 We recognise that this development represents a challenge to PCA providers in the area of payment services, and there are some indications that some PCA providers have already started to respond by developing their own innovation in payment solutions (eg PayM, contactless cards, offers, and rewards, etc). However, it is not clear that this is strengthening competition in the broader PCA market. None of these new payment services provides an effective substitute for a PCA. For example, customers still require a PCA to get their wages or benefits paid in, or to access an overdraft. On the one hand, new entry in PCAs might become more likely as payment services providers might find it easier to provide PCAs once they have created a base in payment services. On the other hand, new entry might become less likely if PCAs become less attractive for providers as they provide fewer opportunities to build relationships with customers and collect data on their purchasing behaviour.

Cross-subsidies

2.66 As set out in the introduction, we have not undertaken a profitability analysis of PCAs as part of this update but during the course of our work we have heard views that PCAs are cross-subsidised with other retail banking products. A report by Credit Suisse has reviewed the profitability of UK retail banks both at aggregate level and between products[74] and found that mortgages and credit cards are the most profitable products, while current accounts (personal and business) are loss-making. We have also heard from one PCA provider that PCAs are loss-making for them.

2.67 This seems to suggest that there might be a degree of cross-subsidy between activities within retail PCA providers which, if true, could itself be distortive of competition. It might also represent a barrier to entry and expansion.

2.68 It is also likely that the pricing model used by PCA providers generates significant cross-subsidies between different categories of customers. PCA providers incur fixed costs to provide PCAs, but under the ‘free if in credit’ model PCA providers do not charge a monthly fee for using PCAs. Instead, they derive the majority of their revenues from NCI and overdraft charges. This pricing model is unlikely to be perfectly cost-reflective, and it might result in cross-subsidies between different categories of customers. For example, customers who use their overdrafts regularly and customers who keep large balances on non-interest-bearing accounts may subsidise other categories of customers which could, in itself, be distortive of competition.

[74] Credit Suisse, UK retail banking – determining ‘true profitability’, May 2013.

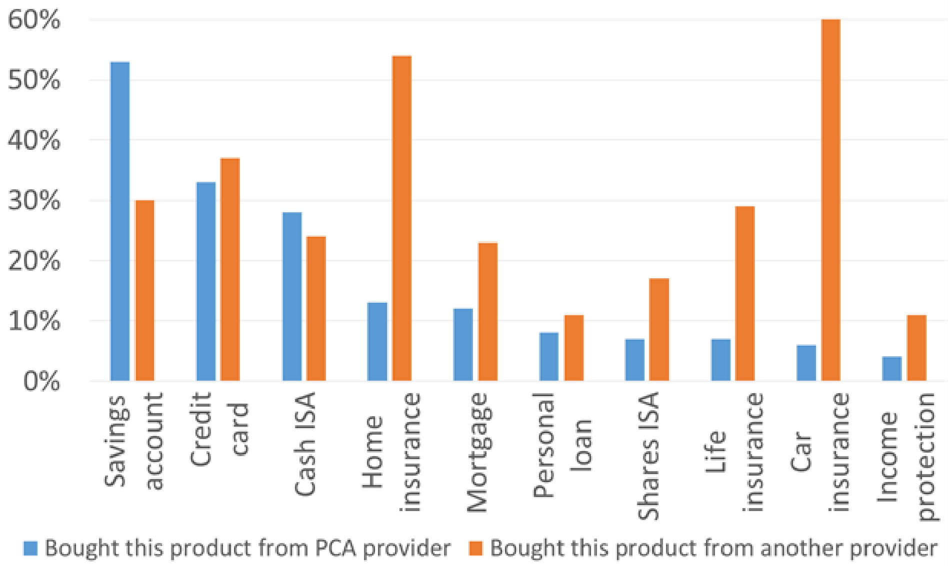
PCAs as gateway products

2.69 We also researched the extent to which providers were using PCAs to cross-sell other products. For example, the SME banking market study report has found linkages between PCAs and business current accounts (BCAs) with, for example, more than half of SMEs obtaining their BCA from their current PCA provider. This limits those providers' incentives to compete intensively for new BCA customers.[75]

2.70 Data from Mintel shows that cross-selling seems particularly effective for cash savings, cash ISAs, and credit cards, whereas there appears to be more shopping around for other products (see Figure 2.8). The FCA's market study into cash savings provided more evidence on the importance of customers' relationship with their PCA provider in driving their choice of savings account.[76] Based on a GfK survey of 60,000 savers, the FCA found that 57% of savings accounts opened in 2013 were opened with the customer's PCA provider. The FCA also found that customers were more likely to shop around for products which typically hold higher balances, such as fixed-term bonds and cash ISAs.

FIGURE 2.8

Cross-selling for different types of products (2013)



Source: Mintel, Consumers and Retail Banking – UK, October 2013. The survey fieldwork was carried out in June 2013 and involved questioning a nationally representative sample of 1,959 Internet users aged 16+ with a current account.

[75] CMA SME report, Chapter 3.
[76] FCA, Cash savings market study: interim report, July 2014.

2.71 In general most PCA providers recognise that PCAs provide valuable opportunities for follow-on sales. TSB states in its prospectus that PCA customers are considered to be very valuable by PCA providers as they have historically been likely to hold other products (such as mortgages, savings and loans) with the bank providing their PCA.[77] Another bank contemplating entry in the PCA market told us that offering PCAs was essential to be perceived as a ‘full-service bank’, However, PCA providers also pointed out that cross-sales were not guaranteed and that most customers had relationships with a number of financial services providers besides their PCA provider. One bank also stressed that PCAs remained a profitable product in its own right, and that they were not selling PCAs at a loss to capture the value of follow-on sales.

2.72 The FCA argued in its market study into cash savings that the most important driver behind cross-selling of savings accounts was likely to be convenience, as it is typically easier to manage several retail banking products through a single branch or online banking facility than across different providers. More generally, a number of PCA providers told us that PCAs enabled cross-selling because they created a sustained relationship with customers and because they provided PCA providers with data on customers’ financial needs and creditworthiness that could be used to target certain products at them.

2.73 There is some evidence that cross-selling is becoming slightly less effective: according to Mintel the average number of products bought from the main PCA provider has fallen from 1.9 to 1.7 since 2011. Mintel also reports that a growing number of PCA customers appear to have moved their savings away from their main bank over the last two years, possibly driven by low interest rates.

2.74 Cross-selling can have both positive and negative effects on competition in PCAs. On the one hand, customers might be more reluctant to switch to an alternative PCA provider if they hold multiple products with their current provider and they want to keep ‘everything under one roof’. On the other hand, it is conceivable that PCA providers may compete harder to offer PCAs because of the value of follow-on sales.

2.75 These other retail banking markets are much less concentrated than the PCA market (see Figure 2.9). This suggests that even if PCA providers use PCAs to cross-sell other products, this does not preclude entry by other providers into other retail banking markets.

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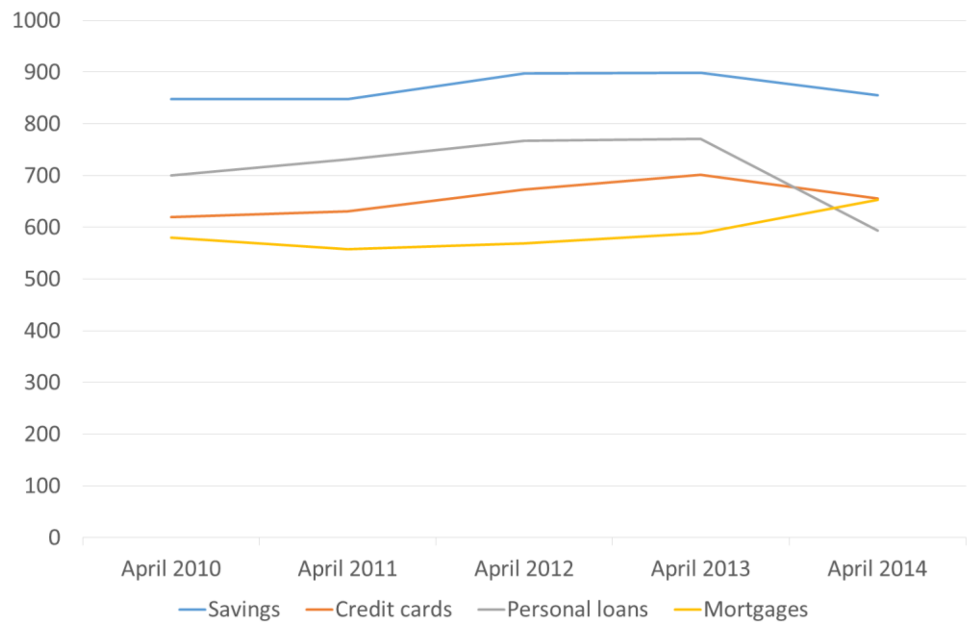
[77] TSB, Price range prospectus, 9 June 2014, p59.

FIGURE 2.9

HHI for other retail banking markets



Source: GfK Financial Research Survey.

Conclusion

2.76 We have examined how market conditions have changed in terms of market structure barriers to entry and sources of PCA revenues since the OFT 2013 report (please note these are discussed in detail in Annex A). Our key findings are:

(a) **Market structure – concentration**. The PCA market remains concentrated, although there are indications that mid-size PCA providers such as Santander and Nationwide are slowly growing at the expense of some of the larger providers. The LBG divestment of TSB will further reduce concentration and TSB appears to be willing and able to differentiate itself from other providers. Moreover, other smaller PCA providers appear willing to grow their market shares. These are gradual changes, however, and concentration is unlikely to reduce to its pre-crisis level in the near future. That said, the effect of concentration on market customer outcomes is not straightforward: larger PCA providers seem to attract higher levels of dissatisfaction than smaller PCA providers, but there is no obvious relationship between size and pricing.

(b) **Market structure – barriers to entry and expansion**. Some of the barriers identified by the OFT in previous reviews have been reduced through regulatory intervention: the authorisation process for new banks is

now faster and easier to navigate, and the relative disadvantage of small banks in terms of capital requirements has been reduced. We have heard some evidence that access to payment systems is difficult and costly for certain small providers, and this feature of the market will be reviewed by the new PSR. A network of branches remains necessary to achieve a significant scale in the market despite the growing use of online and mobile banking for transactions. Limited shopping around, as evidenced by low switching rates, discussed in more detail in Chapter 4, makes expansion difficult for small providers and recent entrants. Overall, barriers to entry have been somewhat reduced, but barriers to expansion for new, successful and innovative entrants remain high.

(c) **Cross-selling**. PCA providers are still using PCAs to market other products, but the effectiveness of cross-selling has slightly diminished (especially for savings products).

2.77 In summary, there are some indications that new providers can more easily enter the market now and mid-size PCA providers are able to grow at the expense of some of the larger PCA providers. But barriers to expansion for new, successful and innovative entrants remain high. Overall, the market remains concentrated and changes in market shares are very gradual despite significant differences in prices and quality between providers. The PCA providers with the higher satisfaction scores are not easily gaining market share and it is those with the most complaints per account who retain the highest market shares. This is not what we would expect in a well-functioning market.

2.78 We are not able to conclude at this stage whether concentration is, in and of itself, a cause of consumer harm, but we remain concerned that concentration – alongside stable market shares as continuing barriers to entry and expansion – continues to indicate that competition in the PCA market is weak.

3. Transparency and comparability

Introduction

3.1 A competitive market relies on consumers being able to choose the best account for their needs. This drives the competitive process by ensuring that competitive providers who can meet customers' needs at lower costs benefit from increased custom. However, for this process to work effectively, consumers need to understand their own needs, the services provided to them by PCA providers, the cost of these services, and how these costs compare with products offered by other providers.

3.2 It is therefore important for consumers to be able to understand and predict the cost of their own PCA, and to be able to control their usage so that they only use overdrafts when it is the best way of meeting their needs. It is also important that consumers are able to compare the costs of PCAs across the market, so that each consumer can choose the PCA that is best for their needs.

3.3 The vast majority of PCAs are still 'free if in credit', which means that PCA providers do not charge any regular, or per-transaction charges, for using the accounts. Instead, customers pay for their PCAs primarily through the interest foregone on their credit balances and the overdraft charges paid when their PCA is in debit.[78] These costs are typically more complex to grasp for customers than, for example, a monthly fee. It is therefore critical that the 'free if in credit' model is accompanied with sufficient transparency about the cost of different features of the PCAs.

3.4 This chapter examines changes since the OFT's 2013 report in the transparency of cost information and the ability of consumers to use that information to control their PCAs. It then looks at the extent to which there has been an improvement in the clarity of information available to consumers to enable them to compare the PCA offerings of different providers. It further examines transparency in relation to service levels and updates the work on the interest foregone trial undertaken since the 2013 OFT report.

3.5 In more detail, this chapter discusses:

(a) consumers' ability to understand the costs and benefits of their own PCA (paragraphs 3.7 to 3.16);

[78] Annex A to this report provides more detail on the relative important of different sources of revenues.

(b) consumers' ability to control their PCAs including mobile banking, text alerts and opt-outs from unarranged overdraft facilities (paragraphs 3.7 to 3.30);

(c) consumers' ability to compare costs across the market, including initiatives such as the Money Advice Service (MAS), charging scenarios and the MiData project (paragraphs 3.31 to 3.59);

(d) transparency of other competitive features (paragraphs 3.60 to 3.62); and

(e) update on 'interest foregone' trial (paragraphs 3.63 to 3.65).

3.6 Overall, we have found some improvements, but there is increasing complexity in overdraft charges and, as yet, a limited ability to compare overdraft charges. The MiData project being undertaken by Government is a positive step but will take some time to bear fruit.

Findings from the 2013 report

The OFT's 2013 report examined improvements in the transparency of pricing information available to consumers, and in consumers' resulting ability to control the costs of their PCAs. It found that PCA providers had begun rolling out the initiatives that had been agreed with the OFT in 2009 to improve both the transparency of PCA pricing and the control that consumers have over that pricing but that progress had been slow. In particular it found:

- Enhanced monthly information on statements and annual summaries: the roll-out of the enhanced monthly information on statements had taken place across the board, but its impact was mixed. The vast majority of providers had completed the roll-out of annual summaries but implementation had been slow.
- Illustrative charging scenarios: some improvements with the provision and location of charging scenarios in PCA providers' websites, but the usage of these scenarios was still not high.
- Price comparison: the report recommended that the Money Advice Service should enhance its PCA price comparison website to enable more accurate and detailed comparisons across PCAs and providers based on a consumer's own specific needs.
- Interest foregone: the OFT considered that there may be benefits from providing consumers with information on interest foregone but there was a lack of consensus on the issue. The OFT committed to working with the industry to trial the provision of information to customers on interest foregone. Three providers agreed, in principle, to participate in a trial.
- Simplified overdraft terminology: In the light of concerns over the transparency and comparability of overdraft fees, a number of the largest PCA providers agreed to introduce standardised wording by September 2013. The OFT considered that this could increase clarity for consumers and make it easier for them to compare costs across different PCA providers' products.
- Control: PCA providers had made progress in helping consumers control when they use unarranged overdraft facilities and the charges they incur, for example, using mobile technology and balance alerts. However, awareness of text message alert services was low and opt-outs from unarranged overdraft facilities were not offered across the board.

Consumers' ability to understand the costs and benefits of their own PCA

3.7 The OFT expressed concern in 2013 that the transparency initiatives agreed with the major PCA providers in 2009[79] had not all been fully implemented. These have now been virtually rolled out in their entirety, but we note it has

[79] OFT, Personal Current Accounts – a follow-up report, October 2009.

taken over a year since the OFT 2013 report, and five years since they were initially agreed, for this roll-out to be completed. This may be a symptom of a lack of priority or even reluctance on the part of some PCA providers to address transparency of costs. For instance, in relation to annual summaries, we have been told that 2.4 million Halifax customers (part of LBG) were not sent an annual summary in 2013, as a result of a system error. Some Halifax consumers will only receive their first annual summary in 2014. PCA providers have made significant progress in making annual summaries available in electronic and paper form throughout the year, although these are still not universally available.

3.8 The CMA has also found 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. Some PCA providers have introduced overdraft costs which are based on daily or weekly charges (ie £1 per day) which they suggest would be easier for consumers to relate to than debit interest charges. Some PCA providers have also removed certain categories of charges (such as unpaid item fees) entirely.

3.9 The CMA has not at this stage taken a view as to whether any particular model of charges is best for consumers. Although some of the new charging structures, considered individually, might be easier to understand for customers, the proliferation of different charging models in the market could make comparison between PCAs even more difficult than in previous years.

3.10 FCA research published in April 2014 also found that, despite the introduction of transparency initiatives, the terms set by PCA providers can be so complex and opaque that 'even the most astute consumer could struggle to understand what they are paying for'.[80] A consumer survey commissioned by the FCA as part of that work found that there is widespread confusion and a lack of understanding about overdrafts, for example, people thinking that overdrafts are simple or free.[81]

3.11 This concern is supported by other survey evidence. Mintel,[82] for example, found that 82% of consumers thought that PCA providers should be more open about their charges. This figure rose to 89% of consumers for those who described themselves in the financial position of 'struggling/in trouble' or as 'I'm much worse off' when compared to [the same] time [a year earlier]. It therefore still appears that, despite numerous initiatives to improve

[80] FCA press release, FCA research shows many consumers paying too much for overdrafts, 10 April 2014.
[81] FCA, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014, pA19.
[82] Mintel, Consumers and Retail Banking, October 2013, p85.

transparency, the large majority of consumers think that not enough has been done to make charges clear.

3.12 The CMA has received a number of direct examples of the lack of clarity about charges. The Scottish Association of Citizens Advice Bureaux told us of a consumer who: 'thought she was being charged £1.00 a day overdraft charges, however she was also charged an additional £50.00 a month on top of the £1.00 daily charge. Client claims that she was never told about this £50.00 charge'.[83]

3.13 Citizens Advice Bureaux have also reported that 'Consumers often report that overdraft charges are expensive, unclear and can get out of control.' Indeed the CC's research into payday lending found that some consumers actively chose payday lending over bank overdrafts because they believed them to be cheaper and easier to understand.[84]

The effects of the transparency initiatives

3.14 Responses to our information request indicate that some PCA providers consider that transparency initiatives have led to improvements in the way that consumers understand the costs of their PCAs. One bank stated that 'overdraft income and fees have fallen because of new tools and improvements in transparency have changed customer behaviour, as well'. Some PCA providers went further and suggested that initiatives to improve transparency have reduced average total overdraft charges incurred by customers. One bank predicted a significant reduction in overdraft fee income going forward as a result of implementing transparency initiatives.

3.15 Our analysis shows that there has been progress with the roll-out of the initiatives, and they are all virtually completed with one or two exceptions. Some charging structures have also been simplified or are in the process of being simplified.

3.16 It appears that such targeted initiatives to increase transparency can have a positive effect and help consumers manage their PCAs more efficiently, and we consider that more could be done in this to ensure consumers understand the costs of their PCAs.

[83] Submission to the CMA from the Scottish Association of Citizens Advice Bureaux.
[84] CC working paper 'Competition between payday lenders and other credit providers'.

Consumers' ability to control their PCAs

3.17 Although transparency of PCA costs allows consumers to understand and predict charges, that by itself is not enough to allow consumers to control the costs that they incur. To address this, a number of innovations were introduced by Government following the 2011 Consumer Credit and Insolvency Review to help consumers control their PCAs.[85] These included:

- providing customers with text or email alerts of charges incurred, or of low balances which could lead to charges being incurred if no remedial action was taken by the consumer
- increasing customers' awareness of 'grace periods' (a short period of time during which consumers can fund PCAs to take them out of unarranged overdraft, without incurring unarranged overdraft charges)
- introducing a small 'buffer zone' (a value of money which, while over the arranged overdraft limit (and is therefore unarranged overdraft) does not incur unarranged overdraft charges)

3.18 The 2013 OFT review found that mobile technology along with balance alerts meant it was easier for consumers to manage their PCA and avoid incurring charges. However, awareness of text message alert services was low. Furthermore, opt-outs from unarranged overdraft facilities were not offered across the board – providers typically offered opt-outs on a limited range of PCAs which often attract a monthly fee.[86] We have looked at developments across these three areas to assess developments in these three areas.

Mobile app banking

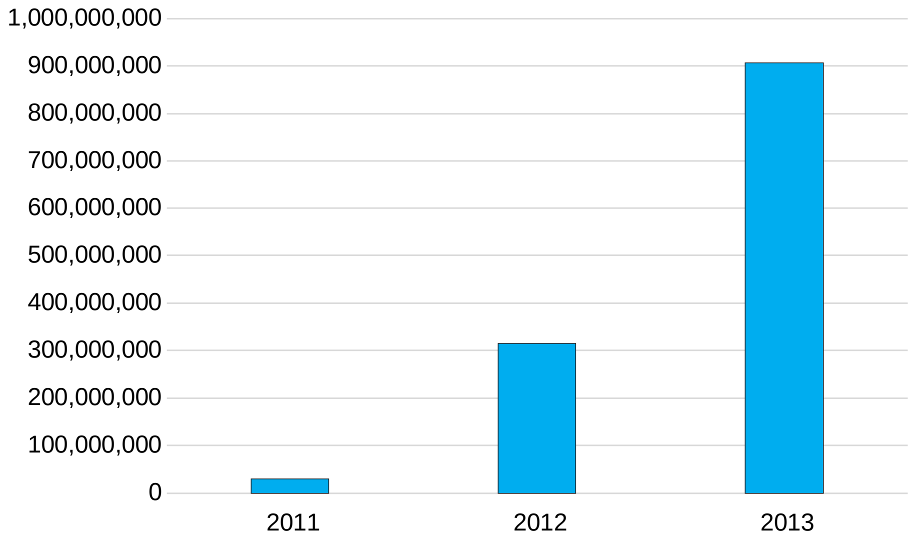
3.19 Mobile app banking allows consumers to make payments and to manage their PCAs using mobile devices such as tablets and mobile phones. The 2013 OFT report expressed concerns about the low levels of awareness of this service. However, the usage of mobile banking has increased dramatically since then, with the total number of bank log-ins via mobile devices as well as the number of transactions increasing rapidly.

3.20 Figure 3.1 highlights that in a little over two years total mobile banking log-ins have increased from just under 30 million per year in 2011 to over 900 million in 2013.

[85] BIS, HMT, Consumer Credit and Personal insolvency Review, November 2011.
[86] OFT, Review of the personal current account market, January 2013, paragraph 1.4.

FIGURE 3.1

Total number of mobile banking log-ins



Source: CMA analysis of the top 8 PCA providers' responses to information request.

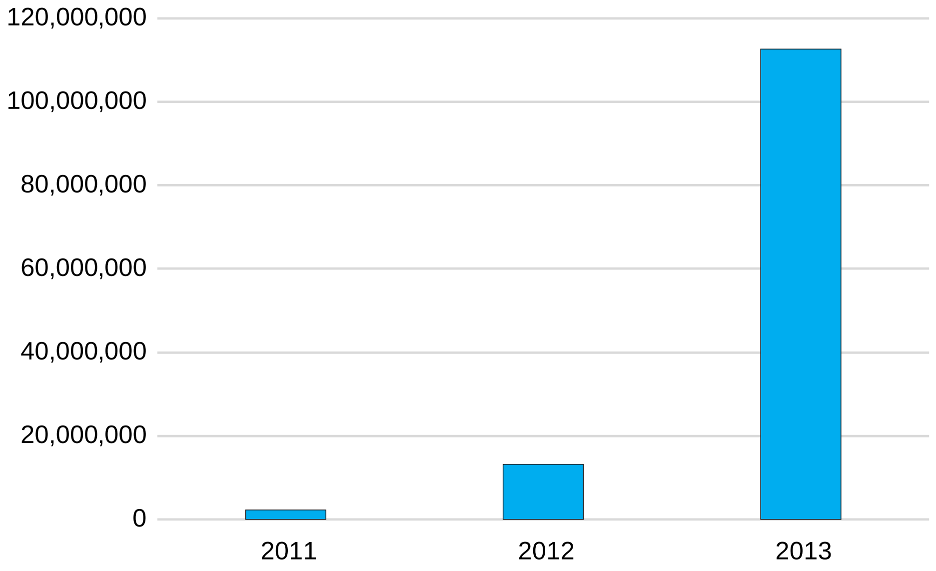
3.21 Parties we have spoken to have all referred to the increased usage of mobile banking. For example, HSBC told us in its submission that the development of mobile banking apps had radically improved the access to, and availability of, information about PCAs via a medium which consumers were inclined to engage in. LBG told us how mobile banking had grown and given customers greater control and understanding of their PCA and its costs and RBS said that it had seen an increase of one-third in the number of mobile banking users in one year. This evidence is further confirmed by research conducted by the BBA which shows that the number of customers using banking apps per week has doubled between 2012 and 2013, from approximately 9.1 million to 18.6 million.[87]

3.22 The number of transactions using mobile banking has also increased significantly, indicating a higher degree of engagement by consumers with this medium.

[87] BBA, Banking on the move: The next revolution has begun, April 2014.

FIGURE 3.2

Total number of mobile banking transactions



Source: CMA analysis of the top 8 PCA providers' responses to information request.

3.23 There is some evidence that the increased consumer control that mobile banking brings results in lower costs faced by PCA customers. One major bank, for example, told us that, following installation of its mobile app, regular overdraft users enjoyed a 25% fall in overdraft charges they incurred. Research by Deustche Bank also indicates that mobile banking apps can help the consumer avoid the costs of overdrafts and unplanned overdraft usage.[88]

Text alerts

3.24 In terms of text alerts, the 2013 OFT report expressed concerns about the low awareness of text alerts, a measure introduced following the Government's Consumer Credit and Personal Insolvency Review.[89]

3.25 Text alerts are now becoming more common. We have found that all major PCA providers and a number of smaller providers now offer some form of text alert service, such as weekly balance statements, alerts when balance reaches a certain level or when overdraft limit is approaching and alerts when transactions are made over a certain size. For example, Marks and Spencer Bank provides text alerts to all customers with an overdraft limit, and who have provided their mobile telephone number, when they reach 1, 50, 80 or 100% of their arranged overdraft facility. In 2013, 302 million text alerts were

[88] Digital banking customers are 50% less likely to go overdrawn – Deutsche Bank – Markets Research, Industry Retail Bank Strategy, September 2013, Figure 60.
[89] BIS, Consumer Credit and Personal Insolvency Review – Formal response on consumer credit, November 2011.

sent by LBG, and another bank indicated that 40% of its customers took action when an alert was sent and, as result, 250,000 potential fee events were avoided. In addition, some of the main PCA providers are now moving to auto-enrolling consumers on to the text alert service, ensuring that even consumers who have not taken the active step of applying for this service will also benefit.

Opt-outs from unarranged overdraft facilities

3.26 The OFT's 2013 report suggested that 'PCA providers do more to make opt-out of unarranged overdraft facilities available without charge on a wide proportion of PCAs that they offer'.[90] The 2013 review noted that there had been limited progress in this area with the majority of PCA providers who offer an opt-out doing so only on a select number of PCAs, which often require a monthly fee. The OFT considered it likely that many consumers who may otherwise have wanted an 'opt-out' PCA, may have decided not to take one because they calculated that the monthly fee would be in excess of what they would be charged in unarranged overdraft fees.

3.27 The CMA's information requests found that the majority of PCA providers still do not offer opt-outs across their whole range, and opt-outs largely remain limited to PCAs with a monthly fee. Table 3.1 below shows that there has been little progress in this area since 2013 when compared with the situation reported in the previous OFT PCA review.

TABLE 3.1 **Comparison between 2013 review and current situation with respect to major PCA providers offering opt-outs**

Bank	*Opt-out not offered*	*Offered with a fee on some PCAs*	*Offered without a fee on some PCAs*	*Offered without a fee on all PCAs*
Barclays				O X
Co-operative	O X			
HSBC		O X		
First Direct	O X			
Lloyds		O X		
NAB		O X		
Nationwide				O X
RBS/Natwest		O	X	
Santander	O	X		
TSB		X		

Source: CMA information request response from PCA providers.

*The stand-alone TSB business was not part of the 2013 OFT review.
Note: X – 2014 position, O – 2013 position.

3.28 Some PCA providers have queried whether opt-outs are of value to customers. For example, HSBC commented that customers were concerned about the risk of missing important payments (such as monthly mortgage payments)

[90] OFT, Review of the personal current account market, January 2013, paragraph 5.26.

and customers therefore would favour having a facility (unarranged overdraft) that could cover these payments. In addition LBG said that customers valued PCA providers' discretion in making payments and therefore had not engaged with opt-out control features. However, because unarranged overdraft payments are made at the discretion of the bank, consumers do not have certainty that such payments will in fact be made, even if they have not 'opted out'.

3.29 There is still a low level of consumers choosing to opt out of unarranged overdraft charges (about 1% of those holding a PCA).[91] It is unclear as to whether this is because of the charges associated with some opt-outs or because consumers value the possibility that payments may be made (at a price) even if that payment would mean they would enter unarranged overdraft, or simply because opt-outs are insufficiently understood or known about by consumers.

3.30 We still consider that there may be value in allowing consumers greater access to opt-outs which are not charged for in order for them to have a greater control of their PCA and we are disappointed at the lack of progress in this area.

Consumers' ability to compare costs across the market

3.31 The ability to compare the costs and benefits of different PCA offerings is also an important factor to foster competition. During the course of this update, we examined the websites of PCA providers to determine how easy it is to compare the cost of PCAs across the market. We found that it was difficult to compare the costs of PCAs using information on providers' websites, and that this situation may in fact have worsened since 2013. This is because many PCA providers have introduced different charging structures that are not easily comparable with those used by other PCA providers. While these PCA providers have told us that the new charging structures are simpler for consumers to understand, it appears to have had the effect of making it more difficult for consumers to compare the costs of overdrafts across providers. We welcome simplification, however, it is important that this is done in a way which addresses the fundamental issue of giving consumers the capability to compare costs and benefits across PCAs, and with other credit products (eg credit cards).

3.32 It is also important to acknowledge that consumers may not choose the right PCA because their choices may be distorted by behavioural biases, such as

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[91] CMA information request.

underestimating their propensity to use overdrafts. The FCA found that many consumers, for instance, did not consider overdrafts as debt, and instead considered them to be an extension of their funds. These factors can also lead to consumers taking the wrong decision when it comes to choosing a PCA.[92] In addition, the way some PCA providers present overdraft facilities as available funds could be exacerbating these behavioural biases.

3.33 If a consumer cannot compare PCAs accurately that consumer is likely to decide on a PCA which may not be best suited to their individual needs. For example, research carried out by *Which?*[93] into switching behaviour found that the majority of consumers (79%) who switched PCAs reported finding it easy to compare between PCAs to identify the best value PCA for them, but that the actual process of comparison was very limited with consumers not making well-informed decisions. The research involved analysis of customers' behaviour when choosing a new PCA, with customers often choosing a PCA on the basis of one or two features rather than a comprehensive look at costs and benefits. As a result of taking these poor decisions, *Which?* concluded that 'some consumers, particularly overdraft and/or unauthorised overdraft users, risk switching to a worse product'.[94]

3.34 To illustrate further the complexity of comparing charges, Figure 3.3 sets out the different types of unarranged and arranged overdraft charges that can be incurred depending on the PCA.

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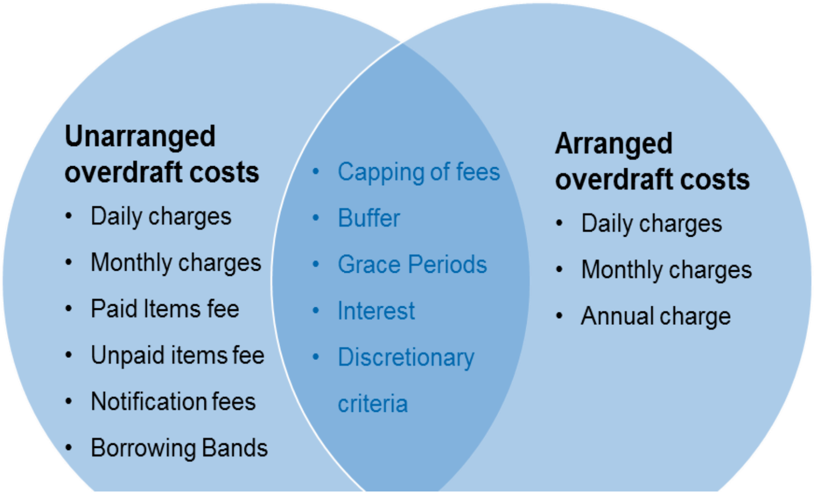
[92] FCA, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014, pA19.
[93] *Which?* Real consumers survey, April 2014. A mixed-methods approach was used: an online quantitative survey of 192 UK adults who had recently switched and a study of 18 consumers recording their switching journey via an online diary. Fieldwork conducted between the end of September and mid-December 2013.
[94] *Which?* Real consumers survey, April 2014.

FIGURE 3.3

Different types of unarranged and arranged overdraft charges



Source: Response to the CMA's information requests to PCA providers – 2014.

3.35 In terms of unarranged overdrafts these include:

- daily fees (charged for each day a consumer is in unarranged overdraft, subject to certain criteria)
- monthly charges (a one-off fee charged for each month at which an unarranged overdraft is entered into, subject to certain criteria)
- unpaid item charges (charged for each item that is returned unpaid by the PCA provider)
- paid item charges (charged for each item that is paid by the PCA provider that leaves the consumer in, or extends the unarranged overdraft)
- interest (charged on daily balances)
- notification fees (charged for notifying the consumer of a charge)

3.36 Moreover, the way that such charges are applied differs between PCA providers:

- some PCA providers cap the number of charges that can be applied to a consumer in any one charging period
- some PCA providers have a buffer in place that allows consumers to go into an overdraft for a very small amount, usually around £10, without charging any unarranged overdraft fees

- some PCA providers have a grace period that allows consumers to even out their balance until a certain time of the day after having gone into unarranged overdraft

- some PCA providers' charges differ depending on the amount the consumer is in unarranged overdraft (sometimes referred to as 'borrowing bands')

- some PCA providers have discretionary policies that are not made public, but can be applied to consumers who have incurred charges under certain circumstances (bereavement, ill-health, etc)

3.37 In addition, arranged overdraft fees can also take a number of different forms:

- daily fees (charged for each day a consumer is in arranged overdraft, subject to certain criteria)

- monthly charges (a one-off fee charged for each month at which an unarranged overdraft is entered into, subject to certain criteria)

- an annual charge (a one-off fee charged if the account enters arranged overdraft in the year)

- interest (charged on daily balances)

3.38 This mix of monthly fees, daily fees, item charges and interest is very complex and makes comparisons across providers difficult. Where it is difficult for consumers to understand and compare costs we might expect to see a failure of consumers to shop around on those features. This lack of understanding caused by the complexity of overdraft charging may contribute to the FCA's finding that:

> There was virtually no evidence of shopping around or making comparisons between overdraft facilities … There was little evidence that the overdraft facility within such accounts was used to compare across accounts, although some consumers did point out that the overdraft simply came as part of the packaged account.[95]

3.39 Customers play a central role in providing a competitive constraint on providers through that willingness to search for (and implicitly, to threaten to switch to) another provider, which offers them a better deal. The level of shopping around can provide an important indication of the extent to which

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[95] FCA, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014, pA19.

consumers are, in practice, creating such a constraint. This lack of shopping around on the costs to consumers of overdraft facilities is therefore likely to limit the incentives on PCA providers to compete on this measure. For example, during our information-gathering exercise, one bank gave us research which it carried out to inform its decision to introduce a new overdraft charging structure. The research suggested that the reasons behind developing the new structure were to reduce the number of consumer complaints and to reduce regulatory risk. By contrast, the charging structures of competitors were not referred to as one of the reasons behind the new charging structure. This is consistent with the bank not feeling compelled to compete on overdraft fees (albeit they will typically try to limit customer dissatisfaction created by high fees which is an important competitive variable).

3.40 A couple of tools have been developed to assist consumers in choosing a PCA, including the MAS and charging scenarios included on PCA providers' websites. In addition, the 2013 report also noted the development of the MiData project, a project between Government and business to give consumers increased access to their personal data in a portable, electronic form. The following sections assess the effectiveness of these tools and what progress and improvements have been made since the 2013 OFT report.

Money Advice Service

3.41 The MAS describes itself as 'a free and impartial service, set up by the Government to help people make the most of their money.[96] The MAS website allows consumers to compare the key costs of PCAs. In 2013 the OFT recommended that MAS enhance the usability of this tool. In the intervening period MAS has applied an algorithm to the comparison tool that PCAs for total costs of ownership of PCAs depending on personal user profile such as overdraft usage and average balance. This allows the user to enter their personal profile into the comparison tool and the algorithm will then apply the monthly shape of the income profile/overdraft usage to the charging data of the PCA providers. As a result, the MAS tool for comparing PCAs has the capability to be useful for consumers in comparing PCAs.

3.42 The MAS tool generates indicative costs for the consumer, based on assumptions about how the consumer will likely use the PCA and what sort of charges will be applied. The reason MAS has chosen to produce a tool with indicative costs is that producing one with 100% accuracy would be very complex for the user. Given that there is little standardisation across the banking sector with regard to charges, particularly overdraft charges, it would

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[96] www.moneyadviceservice.org.uk.

be hugely complex and resource intensive for MAS to produce a fully accurate tool.

3.43 MAS has chosen to make the tool as simple to use as possible to engage users – but the trade-off is that the customer will get a list of indicative costs based on assumptions about their usage, rather than a fully comprehensive list based on exactly what the consumer will do and what charges this behaviour may incur.

3.44 For unarranged overdraft charges MAS applies many different assumptions due to the complexity of charging structures. For instance, it assumes that PCA providers process two paid item charges per month. This assumption is used to generate an indicative cost scenario based on a given amount of unarranged overdraft usage. As all PCAs are subject to the same assumption, this provides a level playing field across the PCAs.

3.45 The tool provides indicative costs for the first year of running the account – this is because of the complexity of modelling different costs beyond the first year (when special offer may expire). In addition, only monetary features are considered although the website does allow filtering based on features such as access requirements (such as via high street branches, phone banking, online banking and mobile banking).

3.46 In addition, MAS relies on an intermediary to provide it with the latest information from PCA providers about new products and features. We understand from MAS that this new information is turned around in hours or in some in cases, days. MAS has chosen to use an intermediary, which also provides information to other PCA comparison tools in the market, in order to offer a tool that is efficient and value for money.

3.47 So, although the MAS PCA tool is useful for consumers in that it has the capacity to give a helpful indication of the cost and benefits of a PCA, it can only provide a limited assessment given the complexity and lack of standardisation of the charging arrangements and modelling. This is especially true when overdrafts are considered and MAS has decided to make a standard assumption about overdraft usage across all PCAs it compares.

3.48 Usage of the tool is also low. In the first quarter of 2014 (January to March) it received 11,500 hits, which is a very small percentage of the overall number of the 65 million active PCAs in the UK. It is also not immediately accessible on the MAS website and needs some navigation on the part of the user before the tool can be accessed.

'Charging scenarios'

3.49 In 2009, the OFT and the major PCA providers agreed that PCA providers would publish information showing how much would be charged in a series of six scenarios of consumers going into unarranged overdraft. Some scenarios were typical of consumer behaviour whilst others were examples of more extreme cases.[97] As part of this update, we asked PCA providers to discuss their usefulness. The majority of those who responded to this question affirmed the value of having such charging scenarios. For instance, one PCA provider thought that the scenarios enabled consumers to compare the costs of PCAs across different providers and made the point that 'there is no other way in which such a comparison can be made and, as such we believe that these scenarios remain of value to our customers (and the customers of other PCA providers)'.[98]

3.50 However, four main drawbacks have been identified. The first is that even the charging scenarios do not give a full picture of how charges can be applied because of their complexity. The FCA, for example, has reported that there is a lack of clarity about the way charges are levied (for example, some providers refund charges the first time they are incurred).[99]

3.51 The second is that relatively few consumers use these scenarios to choose between PCAs and the total number of views does not appear to have significantly increased since the 2013 report when the OFT said that there were 1.4 million unique views of the charging scenarios in 2011. Our current research indicates that this figure has not increased, and remains steady at around 1.4 million unique views per year, which is just 16% of the total number of active PCA that incurred an unarranged overdraft charge throughout 2013 assuming that every unique view represents a PCA holder. It should be noted that a number of these unique views could be the same consumer revisiting pages, so it is not possible to equate the number of unique views to the total number of consumers using charging scenarios. Even taking into

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[97] For more detail on charging scenarios please see the OFT's 2009 Personal Current Accounts report, paragraphs 4.45-4.49 (OFT, Personal Current Accounts – a follow-up report, October 2009). The scenarios are:
Scenario 1. We refuse a payment from your account because there is not enough money in your account.
Scenario 2. A payment from your account takes you into an unarranged overdraft by less than £10. You are overdrawn for one day during the month.
Scenario 3. A payment from your account takes you into an unarranged overdraft and you make another payment from the account while you are overdrawn. You are overdrawn for two days in a row during the month
Scenario 4. A payment from your account takes you into an unarranged overdraft, and you make nine more payments from the account while you are overdrawn. You are overdrawn for 10 days in a row during the month.
Scenario 5. A payment from your account takes you into an unarranged overdraft. You are overdrawn for one day. However, on three more occasions during the month, a payment takes you into an unarranged overdraft. On each of these occasions you are overdrawn for three days in a row.
Scenario 6. A payment from your account takes you into an unarranged overdraft. You are overdrawn for 21 days in a row during the month and you make 12 more payments from the account while you are overdrawn.
[98] Response to CMA's information requests to PCA providers
[99] FCA, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014.

consideration that not all PCA holders will access information online, the use of charging scenarios is clearly limited and will have a limited effect on most consumers' ability to compare products.

3.52 The third is that these scenarios only relate to the cost of unarranged overdrafts. They do not allow consumers to compare the costs of arranged overdrafts. As discussed in paragraph 3.38, it is clear that arranged overdraft costs are increasingly important to consumers who use overdrafts, and increasingly difficult for consumers to compare.

3.53 Finally, charging scenarios are located together with terms and conditions. We found that for some PCA providers it takes up to seven clicks from the home page for PCAs to land in the webpage which featured the charging scenarios and the terms and conditions. It is likely that consumers are less able to find charging scenarios, and therefore, less likely to use them, if they are not prominent on a website.

3.54 It is possible that those consumers who look at charging scenarios may find them useful to compare the potential costs of PCAs. We have not assessed this within the context of this update but, in any event, the limited number of views indicates their impact in resolving concerns regarding transparency and comparability of costs is likely to be limited.

MiData

3.55 MiData is a programme of work undertaken by the Government to help consumers access, use and control their personal data[100] held by private sector companies. The aim is to 'drive improvements in consumer value and choice by promoting competition and reducing problems with information, searching, and switching costs'. In respect of PCAs, the Treasury and the Department for Business, Innovation and Skills announced in March 2014 that they had secured agreement from six PCA providers[101] to give customers their account data in a simple, standardised format that can be used in online comparison sites for the first time. Moneysavingexpert.com also announced that it would work with the major PCA providers with a view to potentially developing a comparison tool for consumers to check whether they are getting the best deal for them on the PCA.

3.56 On 24 June 2014 the Government announced that the industry standard format for PCA MiData had been agreed, and that PCA providers would make

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[100] Personal data includes financial (purchases, credit cards, debit cards, charges), retail (purchases, loyalty cards), utilities (energy consumption and cost) and telecoms (charges).
[101] LBG, RBS, HSBC, Barclays, Santander and Nationwide.

it available to their customers by end of March 2015. The downloads will include a year's worth of current account transactions in a single file that can be read by online tools and the information will be appropriately anonymised to help protect consumers. The Government noted that comparison tool providers are already looking to create online tools that use the information.[102]

3.57 The Government believes MiData will benefit consumers in the following ways:[103]

- Helping consumers to see which PCA might best for them. The Government considers that at present it is too difficult for people to compare the deal they get with PCAs because the cost and benefits of these products are highly dependent on how individuals use them.

- Improving competition in the PCA market, which will in turn support better outcomes for consumers – greater transparency in current accounts, where it is easier for consumers to identify the best deals, will help competition market forces operate more efficiently.

- While the information will be stripped of any details that link it to the individual directly, to make it safer to use, it will include what shops a consumer's money has been spent with, as well as how much has been spent. The Government considers that this opens up many possibilities, for example, if a customer always shops at a particular supermarket, the comparison site will be able to see this and might highlight a PCA offered by that supermarket, as the offer of reward or loyalty points might be a good option for that customer.

3.58 We have received comments from participants in our study supporting MiData, although some concerns were expressed by one bank about whether its current format would deliver the functionality and data that third party providers needed to develop the tools that customers wanted and would use. However, the agreement announced on 24 June 2014 may have removed these concerns.

3.59 In addition, while we understand that the Government is working with price comparison tool providers, it is unclear how consumers will interact with the data and how effective the price comparison sites will be and that is likely to remain the case for some time. As a result, the CMA considers that MiData is

[102] HM Treasury press release, 'Online current account comparison moves a step closer'.
[103] HM Treasury press release, 'Competition in banking for consumers'.

a positive step in the right direction but the extent of its impact on competition conditions in the PCA market will not be known for some considerable time.

Transparency of other competitive features

3.60 In addition to comparability of costs, other features are also important for a well-functioning market. In the PCA market these include benefits provided by the PCA and levels of service. As is the case with costs, it is not always easy for consumers to compare benefits.

3.61 In terms of financial benefits, price comparison websites can be of use in comparing PCAs on narrow factors such as which PCA pays the most interest or offers the largest joining bonus. But in terms of the consumers' overall pricing benefit, it is still very difficult for a consumer to compare across different types of financial benefit, especially as these products offer ongoing services. It should also be remembered that a consumer may spend time in credit and in overdraft, meaning that comparisons have to be made across rates, charges, interest rates and other features across both credit and debit.

3.62 It is also difficult to compare service and quality levels. There are a number of companies such as *Which?*, Defaqto and Uswitch which provide information to consumers on the quality of a product or satisfaction with providers. Whilst useful, these tools have their limitations and they do not really allow a full comparison between different PCA propositions and their suitability to particular individuals.

Update on 'interest foregone' trial

3.63 While consumers typically understand that charges are a cost, it is much less well understood that a 'cost' in their PCA is the amount of 'interest foregone'. This is the difference between what a consumer earns in credit interest from their PCA and what they could earn holding the same money in a savings account or a PCA with a higher interest rate. It is the opportunity cost of holding credit balances in a PCA. In the OFT's 2013 report it was announced that the OFT would work with the industry to trial the provision of information to customers on interest foregone. Three providers agreed, in principle, to participate in the trial. In the event, only two providers participated.

3.64 The results of the very limited trials carried out by these PCA providers do not demonstrate significant consumer interest in interest foregone. This may be, as one of the PCA providers indicated, because of the current low interest rate environment, which results in relatively little incentive for consumers to move balances from a PCA to a savings account.

3.65 Tesco Bank, which entered the PCA market and launched a new PCA in June 2014, has committed to showing its PCA customers on an annual basis what their money could have earned if they had moved non-credit earning deposits to a Tesco Bank savings account, an initiative that the CMA welcomes. It may also be the case that, as PCAs that provide credit interest become more common, consumers might become more aware of the cost of holding money in non-interest bearing accounts. We will look to see how this develops.

Conclusion

3.66 The OFT's 2013 report found that improvements were still required with the transparency of PCAs, in respect of both consumers' ability to understand and control the costs they incur from their own PCAs, and their ability to compare the costs they would incur from any other PCAs.

3.67 There is some evidence that initiatives which have been introduced through government and by individual PCA providers such as mobile app banking and text alerts will lead to better and more timely information about the costs and benefits of consumers' PCAs. The overall picture, however, is that the costs and benefits of PCAs are difficult to understand and compare for consumers.

3.68 In particular, we do not consider that sufficient progress has been made by PCA providers to enable consumers to understand better the costs they incur from their own PCA or to more easily compare such costs between different providers' PCAs. We welcome steps taken to simplify charging structures, but we note these have introduced a further degree of complexity given the different ways in which charges are still made across the industry and that there is a wide variance in the cost of unarranged overdrafts.

3.69 It remains the case, therefore, that although recent transparency initiatives have helped matters, there is very little sign that consumers shop around on overdraft charges or features. This in turn weakens the incentives to shop around between providers and weakens competitive pressures in the market.

3.70 We recognise the potential that the MiData project could have in addressing our concerns about transparency and the ability of consumers to shop around effectively. MiData should provide customers with personal and detailed information which will allow them to compare PCAs in a way which is relevant to their circumstances. However, we note that it could take some time before it is able to be used by consumers to choose between PCAs.

4. Switching and shopping around

Introduction

4.1 As we describe in Chapter 3 markets are more likely to work well when consumers are engaged and they can and do access, assess and act on information to ensure they get the best possible deal, ie 'shopping around' between providers and switching providers when they are dissatisfied and/or there is a better alternative. This dynamic is the essence of competition and creates stronger incentives for providers to compete effectively against one another.

4.2 However, there can be a number of reasons why this dynamic does not function well, limiting the degree to which consumers can drive competition. In Chapter 3 we discussed the lack of transparency and difficulty in shopping around. A second factor is the ability to switch and the appetite to do so.

4.3 For PCA consumers to shop around, they must believe that it is possible to gain from switching, through obtaining either lower prices or a better quality service (or both). However, if there is a general belief on the part of consumers that there is little to differentiate PCA providers and therefore little to gain from switching, fewer PCA consumers will shop around, even if they might have benefited from switching. Consumers may also be dissuaded from shopping around if they consider it to be time-consuming or if they regard the process of switching as risky, complex or costly.

4.4 In general, the more shopping around and switching that takes place between providers, the stronger are providers' incentives to compete to retain and win customers. The CMA recognises that it is not necessary for many consumers to switch in order to drive competition among providers. If a sufficiently significant proportion of PCA consumers switch, this could be sufficient to act as a competitive constraint on the PCA providers and to protect those consumers that do not switch. Moreover, actual switching is only one way in which consumers can provide a competitive constraint on the behaviour of PCA providers, as the *threat* of switching can also provide a constraint.

4.5 This chapter looks at the introduction of CASS and considers the extent to which switching is likely to provide an effective constraint on PCA providers. In detail it looks at:

(a) CASS (paragraphs 4.6 to 4.25);

(b) switching activity (paragraphs 4.26 to 4.57); and

(c) factors involved in switching decisions (paragraphs 4.59 to 4.73).

Findings from the 2013 report

The OFT 2013 report looked at the effect of a number of initiatives which had been agreed as a result of previous interventions and tested them against a range of factors: switching levels, consumer awareness, problems with the switching process and confidence in the switching process. The findings were:

- **Impact on switching levels**. Despite a gradual increase, switching levels remained low. The rate at which current account holders switched their main account in a 12-month period increased from 2.3% in 2008 to 3.1% in 2012.

- **Consumer awareness**. The 2013 report monitored developments in levels of consumer awareness of the switching process. It found that there was evidence of consumers accessing switching information and using providers' automated switching processes. However, consumers' overall knowledge of the switching process had not significantly improved.

- **Problems with the switching process**. Problems with the switching service were still occurring at the time of the 2013 report, but the OFT found that they were often resolved by the provider.

- **Confidence in the switching process**. The OFT found that the initiatives had not succeeded in making a significant impact upon the general perception among consumers that the switching process was difficult and that problems will occur.

The 2013 report also referred to the imminent introduction of the current account switching service or CASS. This was one of the reasons the OFT decided not to make an MIR as it expected that CASS could represent a significant improvement to the switching process and therefore had the potential to increase consumers' willingness to switch accounts.

CASS

4.6 The Vickers report of 2011[104] recommended the establishment of a current account redirection service. Following acceptance of the Vickers's recommendations, CASS was launched by the Payments Council on 16 September 2013, with extensive input from the industry into the design and operation of the system (and at significant cost to the industry).

4.7 The aim of CASS was to 'increase competition, transparency and customer choice'.[105] In order to achieve this, CASS was designed to provide a consistent switching service across all participants.[106] It was designed to be

[104] Vickers (ICB), Final Report, September 2011.
[105] Payments Council submission to the CMA.
[106] There are 33 banks and building societies brands participating in CASS. Payments Council website, see list at www.paymentscouncil.org.uk/switch_service/who_is_participating/.

hassle-free for the consumer and remove problems associated with switching by automatically transferring payments orders to the new PCA and redirecting payments sent to the old PCA to the new PCA. The service takes seven days and is free for the consumer to use. The main changes between previous switching services and CASS are summarised in the table below.

TABLE 4.1 **Summary of changes between previous switching services and CASS**

Switching process pre-September 2013	*CASS*
The switching process varied from bank to bank.	CASS provides a consistent service for all customers of members.
Once the new account was open, the switching process could take between 18 and 30 working days.	Once the new account is open and the switch date chosen and agreed, the switching process takes seven working days.
Some PCA providers and building societies arranged for the Internet banking payee details held on the old online bank account to be transferred to the new online bank account.	All participating PCA providers and building societies will arrange for the Internet banking payee details held on the customer's old online bank account to be transferred to the new online bank account.
After the switch date, payments accidentally made to the old account were mostly rejected and not processed.	After the switch date, payments accidentally made to the old account are redirected to the new account for a period of 13 months.
After the switch date, a direct debit that a company tried to take from the old account would not be processed. This sometimes led to a situation where the service being paid for was withdrawn or a penalty fee charged.	After the switch date, a direct debit that a company tries to take from the old account will be redirected to the customer's new account for a period of 13 months, and the company will be notified that the account details have changed.
There was no guarantee in the event of something going wrong.	The Current Account Switch Guarantee means that consumers will receive a refund of any interest and charges incurred if anything goes wrong with the switch.

Source: Payments Council, Consumer Fact Sheet.

4.8 In the 2013 review, the OFT considered that CASS had the potential to address barriers to switching, in particular by reducing problems with switching and improving confidence in the switching process. The OFT also considered that awareness of CASS would increase if accompanied by publicity campaigns.

4.9 CASS is accompanied by a guarantee in the event that something goes wrong with the process. The Current Account Switch Guarantee (CASG)[107] is designed to improve consumer confidence in the switching process. Under the CASG the new provider guarantees to:

(a) provide the switching service free of charge;

(b) move all payments from the old account (going out and coming in) to the new account;

(c) transfer credit from old account to the new account;

[107] Payments Council website.

(d) arrange for payments made to the old account to be redirected to the new account for 13 months;

(e) contact the senders of payments to the old account to notify them of new account details;

(f) contact the consumer if there are any issues in making the switch before the switch date; and

(g) refund any interest (paid or lost) and charges made on either your old or new current accounts as a result of problems with the switch.

4.10 It is noted that the guarantee only applies where the old PCA is closed. Should the consumer elect to keep the old account open they are able to transfer their direct debits and standing orders through CASS, however, they do not benefit from the CASG or the 13-month redirection service. This is referred to as a partial switch (see paragraph 4.36(a)(ii))

4.11 CASS will be successful only if consumers are able to switch to the PCA provider of their choosing. Therefore CASS needs to have coverage of almost the entire market. There are 33 PCA providers participating in CASS[108] which between them cover almost 100% of the market in terms of active PCAs.

4.12 Some PCA providers have opted out of CASS because either they operate in a niche market, or have very low numbers of new-to-bank customers and do not intend/expect to increase their UK customer base or they have low numbers of customers generally which would not make participation in CASS economic. For example, a small PCA provider told us that its expected customer volumes from CASS would not be sufficient to warrant the cost of IT development which would be required to join CASS. This is supported by comments from a CASS participant who told us that it would take many years to recoup the cost of participating in CASS. In addition, one small PCA provider told us that it was unable to join CASS as its sponsoring bank did not build an IT solution for it.

Awareness

4.13 Awareness of CASS is important as consumers are not likely to consider switching if they are not aware there is a process they can use to switch PCA providers. Therefore if awareness levels are low the competitive constraint that switching or the possibility thereof imposes on PCA providers will be low.

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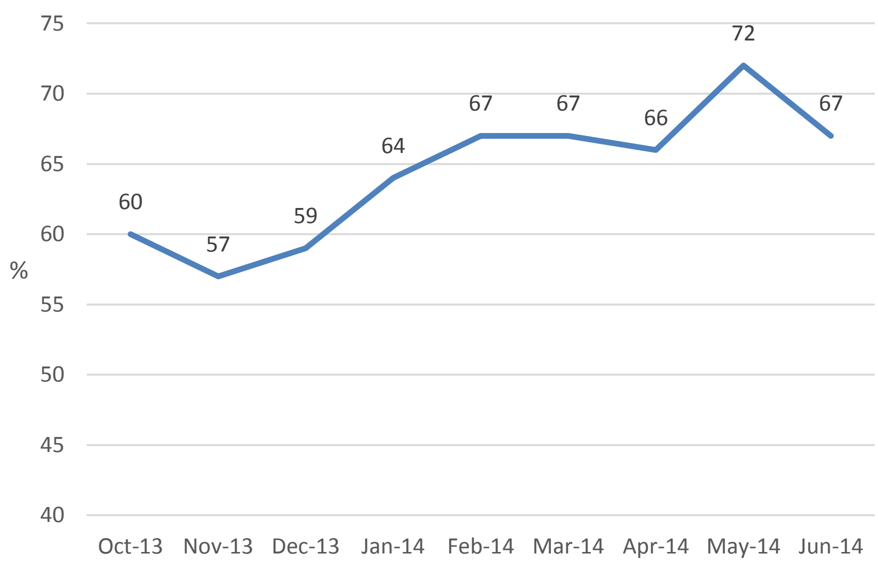
[108] Payments Council website, see list: www.paymentscouncil.org.uk/switch_service/who_is_participating/.

4.14 The 2013 OFT report found that there were indications that consumers were becoming more aware of the switching process following a number of initiatives that had been put in place as a result of previous OFT studies. For example, the number of consumers viewing switching information on providers' websites was increasing, although relatively slowly. It also found that 45% knew at least a little about switching, up from 41% in 2008.[109] The OFT considered that the introduction of the switching service and associated advertising by the Payments Council and providers would raise awareness.

4.15 Awareness of CASS is currently high and has increased since the launch of CASS. The Payments Council measures consumer awareness of CASS through an omnibus survey[110] question which asks 'Have you heard of the Current Account Switch Service?' In October 2013 awareness was reported to be 60%; in February and March 2014, following a number of marketing campaigns, awareness was 67% remaining at that level in June 2014.

FIGURE 4.1

Percentage of consumers who are aware of CASS



Source: Payments Council Dashboard, March and July 2014.

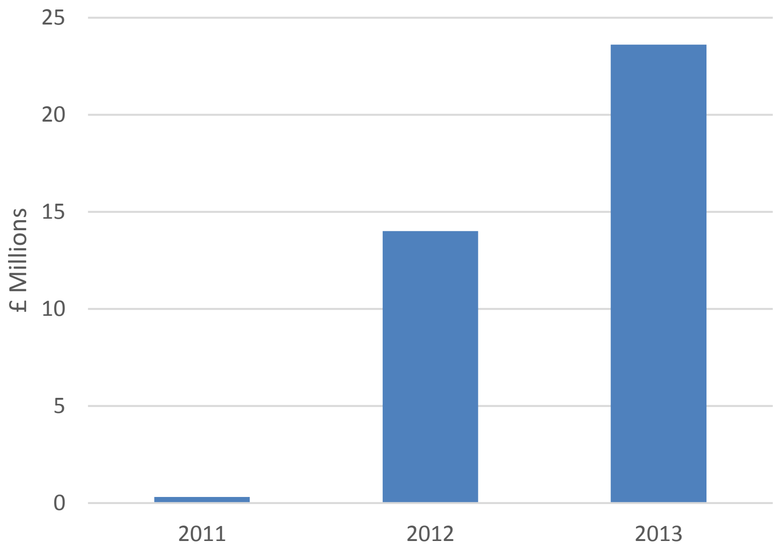
4.16 Marketing has been a key driver in increasing awareness of CASS. The Payments Council undertook an extensive promotional campaign and PCA providers have also extensively advertised their accounts (and have drawn

[109] OFT/IFF Consumer Survey, 2012. A telephone-based consumer survey of 1,752 PCA users. Fieldwork was conducted between 11 September and 9 October 2012 by IFF Research.
[110] Payments Council Dashboard, March and July 2014. This is an online monthly omnibus survey being undertaken with people aged 18 and over, using a sample size of 2,200 respondents across Great Britain and Northern Ireland.

attention to CASS). MINTEL reported that total current account ad spend on brand building for PCAs increased by almost two-fifths in the 12 months to February 2013.[111]

FIGURE 4.2

Advertising spend on brand building for PCAs



Source: Mintel, Packaged and current accounts – UK, July 2013, p61.

4.17 However, the centralised campaign from the Payments Council is now at an end and this could well mean that awareness of the switching service either stabilises or may even reduce. Nevertheless, the majority of PCA providers who are part of the CASS scheme include a reference to CASS in their advertising, and specific CASS and switching advertising campaigns have been run by a number of providers.

Confidence

4.18 Consumers need to be confident that the switching process will be quick, easy and without error. If consumers lack confidence in the process they will be less willing to switch and PCA providers will have less incentive to offer better products or deals to attract switchers.

4.19 Previous OFT reviews have found that consumers believed the switching process to be risky and complex. In 2013, 81% of consumers who reported that they had switched PCAs in the previous 12 months found the process very, or fairly easy, which was similar to the number in 2008. However, even if

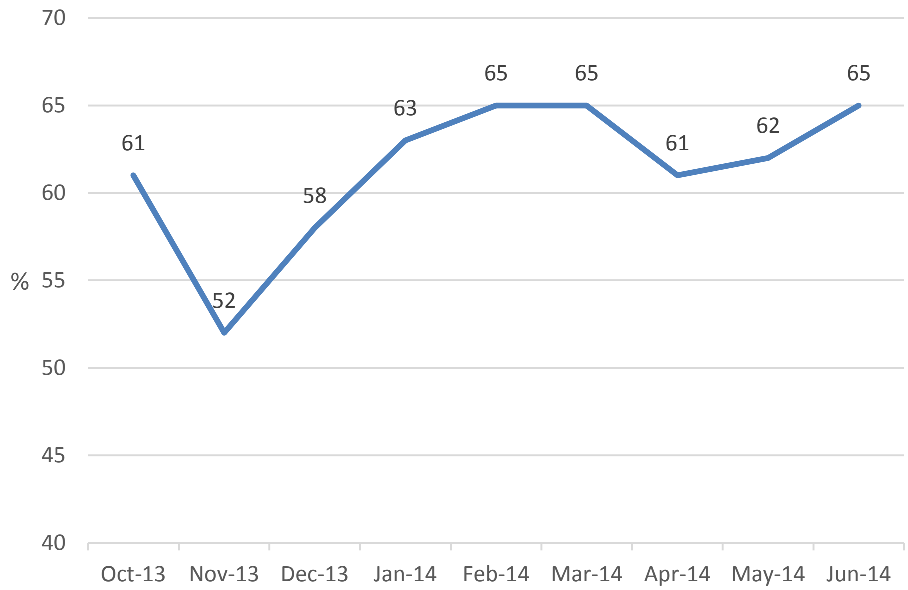
[111] Mintel, Packaged and current accounts – UK, July 2013, p61.

the switching process is easy, if consumers perceive it to be difficult or complex they are unlikely to switch. In 2013, the OFT found that 41% of consumers who had never switched were either not very, or not at all confident that the switching process would go smoothly. This was similar to the findings in 2008. The OFT considered that the introduction of CASS would reduce problems associated with switching and in turn raise confidence in switching.[112]

4.20 As CASS is the central system for switching to a new PCA, having confidence in CASS equates to having confidence in the switching process. Confidence in CASS appears to have increased slightly. The Payments Council measures consumer confidence through an omnibus survey question following an explanation of how the service works. In October 2013 confidence of the CASS was 61%; at the end of June 2014 confidence had risen to 65%.[113]

FIGURE 4.3

Percentage of consumers who expressed confidence in CASS



Source: Payments Council Dashboard, March and July 2014. The confidence rating was obtained by survey data. Following an explanation of what the service is and how it works, respondents were shown five statements and asked: 'How much do you agree or disagree?' in order to establish a composite confidence rating. Those statements are: I think it would be easy to switch banks, I think it would be quick to switch banks, I think there would be very little effort on my part, I think I would be in control of the process, and I think the process would be error free.

4.21 The evidence also suggests that consumers now consider it easy and quick to switch PCAs, but that there is still concern that there will be errors with the

[112] OFT/IFF Consumer Survey, 2012.
[113] Payments Council Dashboard, March and July 2014.

process. According to the Payments Council[114] in March 2014, 78% of consumers thought it would be easy to switch accounts and 75% thought it would be quick to switch accounts. However, only 37% thought the process would be free of errors. If consumers are concerned about errors in the process they will likely be less willing to switch. On the other hand, if the process is free from errors over time one would expect confidence to increase through word of mouth and information from third party websites. Problems with moving direct debits, standing orders and balances were previously identified as the most problematic to consumers and therefore the biggest barriers to switching.

4.22 Indeed, a large part of the rationale for CASS has been to introduce a service which is automated and quick, thus addressing previous problems and errors with the switching process.

4.23 We are aware that some errors still occur. PCA providers, for example, have reported problems with switching applications being rejected, however, the industry has been working on these issues to ensure that acceptance rates are rising. The main issue appears to be with matching up and validating data on IT systems which has led to applications being rejected. The Payments Council said that the PCA providers had been improving account opening processes which had led to a rise in acceptance rates from 70% to over 90% of customers and 99% of all switches that were accepted were completed within the seven working day timescale.[115]

4.24 The Payments Council has also undertaken other initiatives to reduce problems with payments. For example, since May 2014, under a voluntary code, PCA providers have put in place standard central processes and defined maximum timescales to help customers recover money sent to an incorrect account.

4.25 It is to be expected that a new system would experience some teething problems, but these should be resolved to the customer's satisfaction. Evidence from PCA providers and consumer bodies finds that the majority of consumers are satisfied with the switching process. For example, *Which?* reported that 83% of switchers are satisfied with the overall process of switching bank.[116]

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[114] Payments Council submission to the CMA.
[115] ibid.
[116] *Which?* Real consumers survey, April 2014.

Switching activity

4.26 There are many different ways of assessing and measuring switching activity in the PCA market. In this review we have considered the following different metrics.

(a) **Number of switches conducted through CASS**. This represents the 'core' of switching activity, where customers move all their banking activity from one provider to another through the automated service.

(b) **Non-CASS switching rates**. This includes partial or gradual switches, where customers open a new PCA and 'manually' move all or part of their banking to this new PCA over time.

(c) **Multi-banking**. Multi-banking is where a customer holds a number of different PCAs with different PCA providers. This includes the number of PCAs held by consumers and the number of consumers opening an additional PCA.

(d) '**Churn**'. This is the total number of new PCAs opened in a year over the total number of PCAs. This includes both CASS-operated and partial or gradual switches, but also new PCA opening by customers who are new to the banking market or who need an additional PCA.

(e) **Internal switching**. This is where a consumer switches to a new PCA with the same provider.

CASS-operated switches

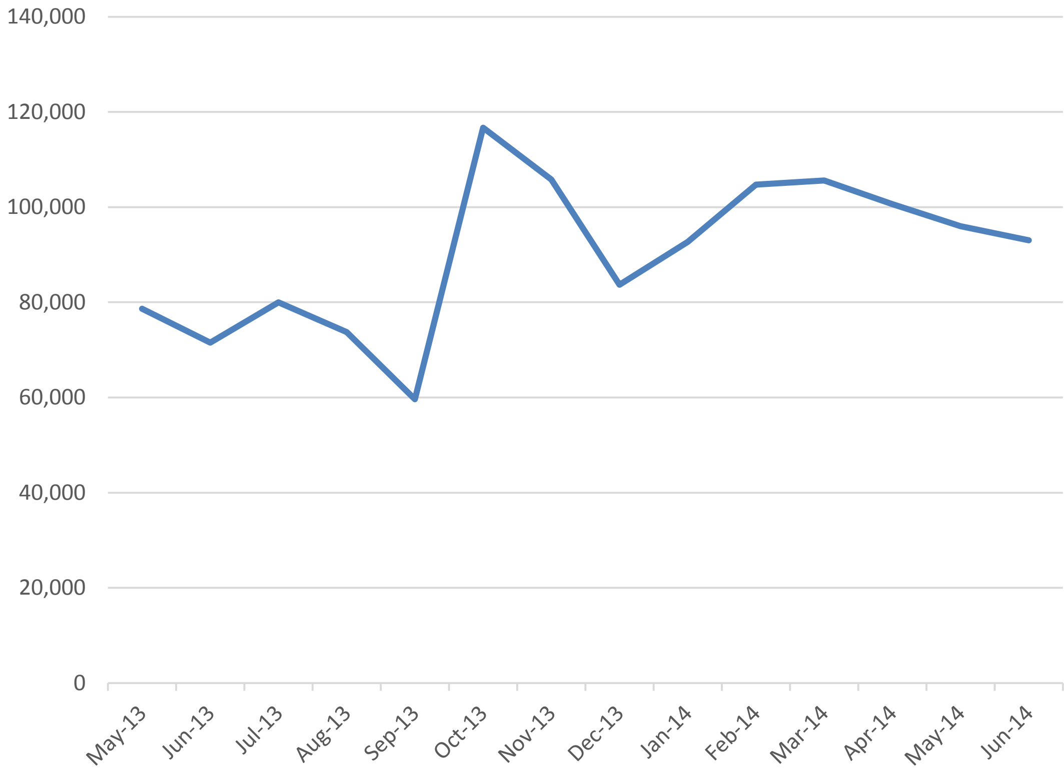
4.27 According to the data from the Payments Council, the number of PCA switches has increased but remains at a low level. Between October 2013 and March 2014, there were 609,300 switches, 89.8% of which were carried out using CASS, 9.3% were carried out using the CASS service but where the consumer elected to keep the old account open (referred to as a partial switch) and less than 1% through the old service, the Transfer of Direct Debits and Standing Orders (ToDDaSO).[117] The Payments Council reported a 14% increase (76,800 switches) in the number of switches in the first six months of the service (October 2013 to March 2014) compared with the same period in 2013.[118] On 16 July 2014 the Payments Council published switching data covering the first half of 2014. This showed that the overall switching rate has increased by 16% compared with the same period the previous year.

[117] Payments Council figures provided to the CMA on 11 June 2014.
[118] Payments Council Dashboard, March 2014.

4.28 The chart below shows the number of switches per month since May 2013.[119]

FIGURE 4.4

Switching levels May 2013 to June 2014



Source: Payments Council.

4.29 Despite the reported increase in switching levels, the overall rate of switching remains low. According to data from the Payments Council, and evidence gathered by the CMA on number of active accounts, the CMA estimates the switching level for CASS and ToDDaSO switches to be around 1.8% of all active accounts.[120]

4.30 It is worth noting that the introduction of CASS coincided with the separation of TSB from Lloyds, and a share of the switches reported in the first six months of the service are due to customers switching between the two brands. This was facilitated by a 'stay/go' process set up by Lloyds and TSB which allowed customers to change brands to suit their personal preference,

[119] Payments Council figures provided to the CMA on 26 June 2014. Payments Council Dashboard, March and July 2014.
[120] The switching rate is calculated by the number of switches between June 2013 and June 2014, divided by the number of active accounts at the end of 2013.
Previous OFT reports have calculated the switching rate using survey data which takes into account other types of switching, including gradual and manual switches. The comparable figure to the OFT's previous reports is in paragraph 4.37.

for example, customers could choose to change to the brand which had a branch closest to their home or work location. According to data from the Payments Council, between October 2013 and March 2014 a greater number of customers switched between Lloyds and TSB through CASS[121] than the 76,800 *increase* in switches reported. This out-of-the-ordinary event means that it is unclear what the switching levels may have been without the Lloyds/ TSB separation and indeed whether the observable 14% increase in switching in that period was in fact more due to this specific circumstance than greater confidence in the switching process.

4.31 It is also worth bearing in mind that a small share of these switches are between brands of the same group. For example, in the six months following the setup of CASS, around 5% of all CASS switches were between two PCA providers within the same group.[122] We do not consider switching between providers in the same group to be as strong a competitive constraint as switching between rivals. This is because the customer is not 'lost' to a competitor. Sales captured by another provider of the same combined group in response to a switch are internalised by the combined banking group. In addition, this intra-group switching also has the effect of overestimating the switching rates reported by CASS, as different brands within some banking groups are counted as separate entities.

4.32 A number of PCA providers have argued that using the switching levels reported by the Payments Council underestimates the 'true' level of switching in the market. They argue that these figures do not take account of significantly higher levels of churn (see below for discussion on churn levels), including new customers opening PCAs, PCAs being closed (eg on death), non-CASS switching and multi-banking in which customers hold several PCAs.

4.33 Additionally, other PCA providers have argued that measuring switching levels for active PCAs is not the best measure for assessing the competitive impact of switching. For example, one bank pointed out that if switching and churn rates were measured against 'funded accounts' rather than active accounts, the rates would be higher. As noted in Chapter 2, we define funded accounts as accounts with more than £500 of incoming payments per month (which for the purpose of this study was used to approximate primary

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[121] This only includes switches where the old account was closed in the process.
[122] Payments Council, CASS quarterly movement report, Q3 2013, Q1 2014. Data provided to the CMA on 29 May 2014.

accounts). This bank provided analysis of its books showing that the switching rate for ‘funded accounts’ was 2.6 vs 1.7% for all active accounts.[123]

4.34 We recognise that the switching rate is likely to be higher for funded accounts than for active accounts. This is consistent with the fact that most of the new products developed by providers over the past few years require minimum levels of funding, and with our observation that movements in market shares are slightly more pronounced in this segment (see Chapter 2). However, this does not necessarily imply that customer response is sufficient to constrain the behaviour of providers. The switching rates in this segment are only slightly higher than in the wider market, which indicates that even if switching for funded accounts was separated out from active accounts, a large share of the customer base remains ‘sticky’ and thus does little to drive competition.

Non-CASS switching rates

4.35 There are no reliable statistics for non-CASS switching as it is difficult to define the boundaries between a non-CASS switch, and consumers simply opening an additional PCA.

4.36 The Payments Council captures some types of switching but others are not centrally recorded:

(a) Types of switching captured by the Payments Council’s data include:

(i) Full switch (old PCA closed): consumers who use CASS when opening a new PCA to transfer direct debits, standing orders and payments. The old PCA is closed in this process and the consumer benefits from the guarantee and redirection service.

(ii) Partial switch: consumers use CASS to transfer direct debits, standing orders and payments when opening a new PCA but elect to keep the old PCA open.

(iii) ToDDaSO: consumers who switch using the old redirection service.[124]

(b) The types of switching not captured by the Payments Council’s data include:

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[123] The churn rate includes customers who switched to the bank using CASS and customers with no previous relationship with the bank who opened an account at the bank without using CASS.
[124] Please note that as there are a number of banks which are not signed up to CASS, ToDDaSO will continue for the foreseeable future.

(i) Manual switch: consumers who, without contacting their bank, manually change PCA provider by transferring standing orders, direct debits, etc themselves.

(ii) Gradual switch: consumers who open a new PCA keeping the other PCA open. The additional PCA is later converted into the primary PCA usually within a year, by the consumer transferring payments to the new PCA.

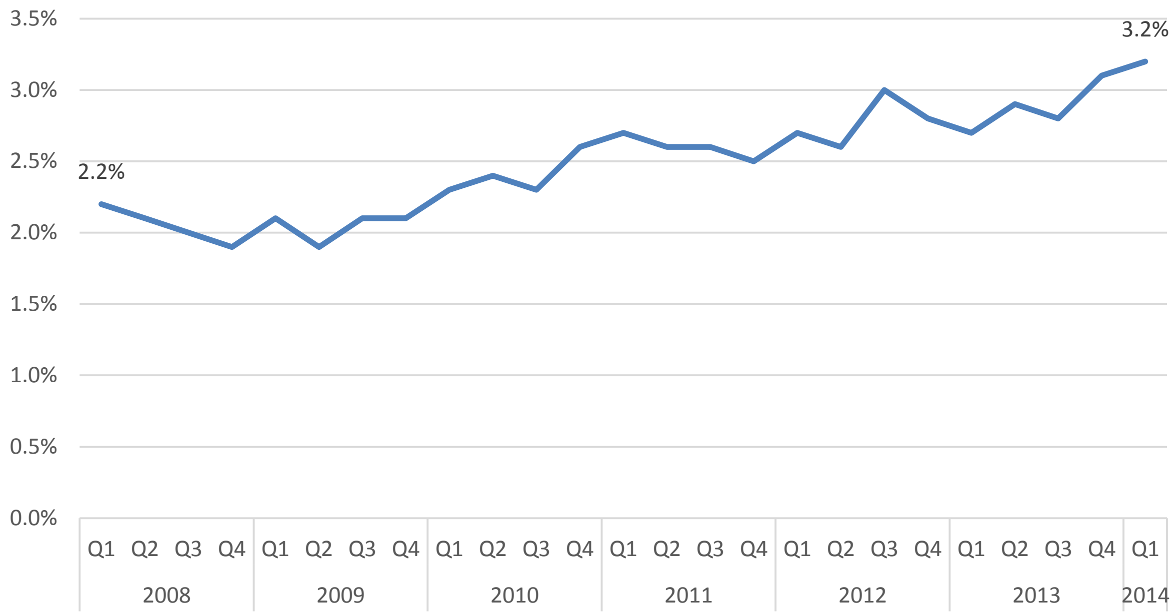
(iii) Try before you buy: consumers who open a new PCA and try it out before deciding to keep it and make it their primary PCA, with intent of returning to original PCA if the new one is no better.

4.37 We have received representations from a number of PCA providers stating that the levels of switching are significantly higher if manual or gradual switching are taken into account. According to data from GfK's Financial Research Survey,[125] the switching rate, taking into account all other types of switching (full CASS switches, ToDDaSO, manual and gradual switches), was 3.2% in the first quarter of 2014.

[125] The GfK survey asks consumers whether they have switched their main bank account. It does not distinguish between full CASS switches, ToDDaSO switches, gradual or manual switches. Therefore this survey should capture all types of switching.

FIGURE 4.5

Percentage of PCA holders that have switched in a 12-month period



Source: GfK Financial Research Survey (FRS), December 2013. All switching main current account in last 12 months, 1,715 adults (aged 16+) interviewed.

4.38 This is relatively consistent with other survey data:

(a) Survey data from TNS Global suggests the PCA switching rate was around 3% in April 2014.[126]

(b) A recent *Which?* survey found that only 3% of consumers had switched in the last year. 58% of consumers had never switched.[127]

4.39 The CMA agrees that there are different ways in which consumers can switch PCAs and that simply relying on figures of switching through CASS is likely to underestimate the true switching rate. However, even when these additional forms of switching are taken into account, the switching rate only increases the number of switchers from 1.8% to around 3%. This is an increase on the figure in the OFT market survey in 2008 where the level was 2.2%.

4.40 In addition, survey evidence shows that the majority of consumers have held their main PCA for a long period of time. According to surveys carried out by

[126] TNS Global, April 2014. Nationally representative sample of 94,596 consumers interviewed between July 2013 and March 2014. Interviews conducted face-to-face in-home twice weekly. Available at: www.tnsglobal.com/uk/press-release/current-account-switching-index-switching-activity-remains-steady-drift-big-four-banks.
[127] *Which?* Consumer satisfaction survey, March 2014. An online survey of 5,000 consumers carried out between 28 February and 16 March 2014.

Which?[128] and Uswitch,[129] nearly 60% of PCA holders have had their main PCA for over ten years.

Multi-banking

4.41 Some PCA providers have argued that many consumers, rather than switching, are increasingly opting to 'multi-bank' and that again, this should be taken into consideration when looking at competition in the market. Multi-banking is where a customer holds a number of PCAs with different PCA providers. It could impose a competitive constraint on providers if consumers are using multi-banking to shop around for the best deal. In addition, some of these consumers could be considered potential switchers if they are trying out a new PCA with a view to switch if they are happy with the new PCA.

4.42 Mintel[130] found that, in July 2013, 63% of UK consumers held one PCA, 28% held two and 7% held three or more. This is consistent with research from *Which?*[131] that found 62% of consumers have one PCA and 30% have two PCAs.

4.43 Some evidence suggests that the number of consumers choosing to multi-bank is increasing. According to data from the GfK Financial Research Survey, the percentage of consumers who have taken out a PCA in addition to their main PCA in the last 12 months has increased from 2.8% in 2008 to 4.0% in the first quarter of 2014.

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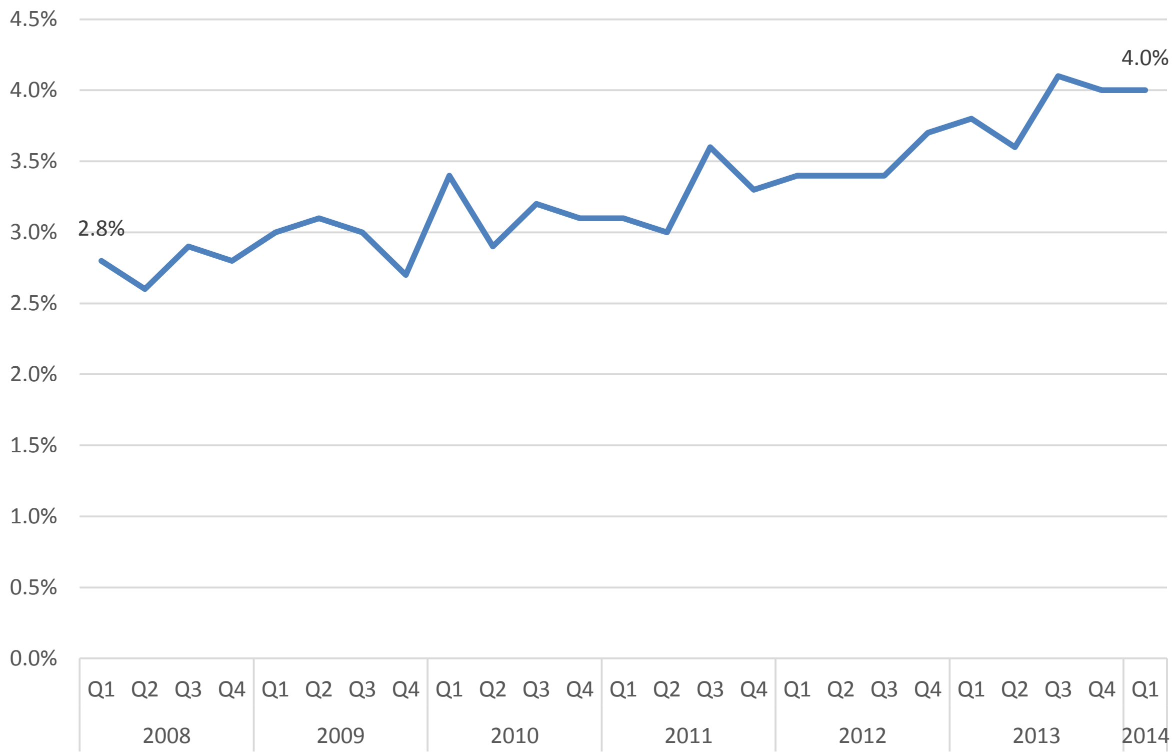
[128] *Which?* Consumer satisfaction survey, March 2014.
[129] USwitch/Opinium online survey carried out between 7 and 17 January 2014 among 10,629 current account holders. Available at: www.uswitch.com/media-centre/2014/07/tide-turns-as-three-quarters-of-consumers-now-trust-their-bank/.
[130] Mintel, Packaged and current accounts, July 2013.
[131] *Which?* Consumer satisfaction survey, March 2014.

FIGURE 4.6

Percentage of consumers who have taken out a PCA that is in addition to their main PCA in the last 12 months



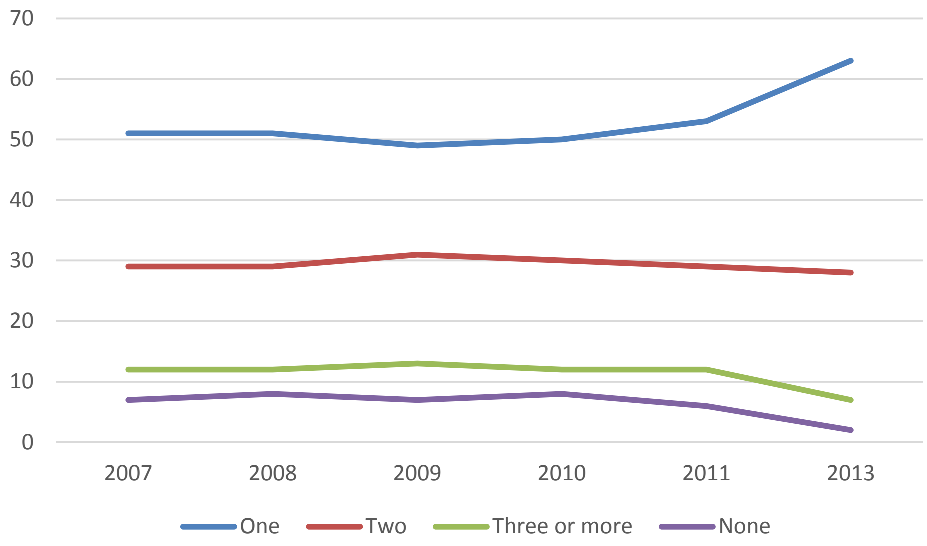
Source: GfK Financial Research Survey, quarterly data, about 5,000 respondents interviewed per month. Time period: Q1 2008 – Q1 2014.

4.44 Mintel's surveys,[132] however, paint a different picture and report that the percentage of consumers holding two or more PCAs remained broadly constant since 2006 until around 2011. After 2011 the percentage of consumers holding two or more PCAs declined and the number of consumers holding one PCA increased.

[132] Mintel, Packaged and current accounts, reports dated 2011, 2012, 2013. Based on surveys carried out since 2006.

FIGURE 4.7

Number of PCAs held by consumers since 2006



Source: Mintel, Packaged and current accounts, 2011, 2012, 2013.

4.45 The extent to which multi-banking imposes a competitive constraint on the market is unclear. PCA providers have argued that consumers are choosing to multi-bank to take advantage of product offerings including higher credit rates. Some of these consumers do not intend to make the additional PCA their main PCA and others are merely testing the PCA before they decide whether to switch. They have argued that this puts competitive pressure on PCA providers, on the one hand to retain customers who have the main PCA with them and on the other hand to convert new multi-bankers into main PCA holders.

4.46 However, the reasons consumers choose to open an additional PCA and, most importantly, how they make that decision are unclear. There is some evidence that multi-banking is more common in couple households, where both partners have their own PCA and a joint PCA for shared household expenses. Mintel found that 18% of consumers stated all of their PCAs are held jointly with someone else and 10% said they held both a joint and their own PCA. In addition, other groups such as sole traders are more likely to have an additional personal PCA for work purposes.[133]

4.47 To assess the extent to which multi-banking imposes a competitive constraint on the market it will be necessary to understand:

[133] Mintel, Packaged and current accounts, July 2013.

(a) The reasons customers hold several PCAs. Some customers may actively use different PCAs for different purposes such as to obtain credit interest, whereas, other customers might use different PCAs passively, for example because they were required to open a PCA when they purchased another financial service such as an ISA from the PCA provider.

(b) Whether customers hold their additional PCA with the same PCA provider as their main PCA or a different PCA provider. Where a consumer identifies a need for an additional PCA, for example, a joint PCA for household expenses, and opens it with their current provider this would not provide a competitive constraint on providers in the PCA market.

(c) Whether consumers shopped around for the best PCA for their needs.

4.48 The CMA recognises the relevance of multi-banking to an assessment of competition, in so far as it demonstrates that PCA holders could be using a number of PCA providers and choosing to use whichever of those providers is likely to offer them the best deal at any point in time. We also recognise that it is relevant in the context of overall switching levels. However, we do not have sufficient information to determine whether it would radically alter the assessment of switching rates.

Churn

4.49 A number of PCA providers have also argued that the CMA should take into account churn in the market when analysing competition in the market. Churn is the number of new PCAs as a proportion of the number of PCAs in the market.[134] It includes CASS-operated switches, other types of switches, new PCAs opened by customers who are new to the market, and new additional PCAs.

4.50 According to data received from PCA providers, the churn rate has remained at just over 7% for the past three years.[135] Significantly though, not all these PCA openings will reflect active choices by customers. Certain customers may open a second PCA with their current provider without shopping around. Certain PCA providers also require customers to open a PCA with them if they purchase another financial product (eg an ISA account).

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[134] We understand that there are different ways to calculate churn and that for the SME banking study, a number of banks indicated the churn rate to be: [(number of new accounts opened)+(number of accounts closed)] / 2 x (number of accounts at the beginning of calendar year).

[135] The figures were 7.55% in 2011, 7.29% in 2012, 7.30% in 2013. The figures using a similar calculation to the one used by banks in the SME market study: [(number of new accounts opened)+(number of accounts closed)] / 2 x (number of accounts at the end of year), would give the figures 7.03% in 2011, 6.54% in 2012, 6.35% in 2013.

Internal switching

4.51 PCA providers have also argued that the CMA should take into account customers who switch within a brand. This is where a consumer will switch to a different PCA with their current provider.[136]

4.52 Some PCA providers put forward the point that internal switching is evidence of consumers taking advantage of more competitive offers and PCA providers reacting to competition in the market to attempt to retain customers. Indeed a number of providers have given us evidence of specific marketing campaigns aimed at retaining current customers or new products developed to prevent customers leaving. For example, one bank told us that it had developed a new current account product as a response to the success of the Santander 1-2-3 account to prevent customers switching to Santander.

4.53 One PCA provider put forward the point that higher levels of internal switching represented consumer awareness and activity in the market. It provided evidence that internal switchers represented 5.9% of its active PCAs, whereas external switchers represented 1.7%. It is not clear that internal switches constrain providers as effectively as external switches do. It is possible that customers switch between products of the same group or brand without shopping around and comparing alternatives more widely. Indeed a number of PCA providers recommend that consumers switch to a different PCA within their product range.

4.54 The CMA accepts that PCA providers' efforts to retain customers by developing new products will be beneficial for existing customers, and to some extent internal switching could be evidence of rising consumer engagement with the market. However, the CMA is unclear as to the extent to which internal switching occurs, the reasons behind that switching, and therefore its overall competitive effect on the market. In any case, internal switching is not likely to impose a strong enough competitive impact on the market as the current PCA provider does not lose the relationship with the consumer.

Conclusion on switching levels

4.55 On balance, and despite the introduction of CASS, we do not consider the percentage of consumers wishing to carry out a full switch has increased significantly, especially when exceptional events, particularly the Lloyds/TSB divestment and the initial publicity around the introduction of CASS are taken into account. In other words, CASS so far has not proven to have had a

[136] This is different to the intra-group switching described above in paragraph 4.31. If a consumer switches within a group, they will switch PCA provider and may not be aware the new provider is part of a group of PCA providers. When a consumer switches internally, they will be aware they are staying with their current provider.

significant effect on switching rates. On the other hand, the available evidence shows that CASS has had a positive influence in the market by increasing awareness and confidence in the switching process.

4.56 While we accept that additional forms of switching, churn and multi-banking are part of the picture and should be considered, they do not appear to significantly increase competition in the market:

(a) When the additional forms of switching, ie manual and gradual switching, are taken into account the switching rate raises from 1.8% (based on the Payments Council data) to around 3% (which takes into account other types of switching). This is still a relatively low level compared with other financial markets (see below).

(b) The level of churn in the market is around 7%. This is still a low figure and a share of new PCA openings may not reflect active choices between alternatives by customers. For example, one PCA provider told us that a significant proportion of its new PCA openings came from existing customers (see paragraph 4.53).

(c) Although the PCA providers have argued that they need to compete to retain customers and convert multi-bankers into main PCA holders, there are many different reasons behind multi-banking and the competitive constraints exercised by them differ.

Comparison with levels of switching in other industries

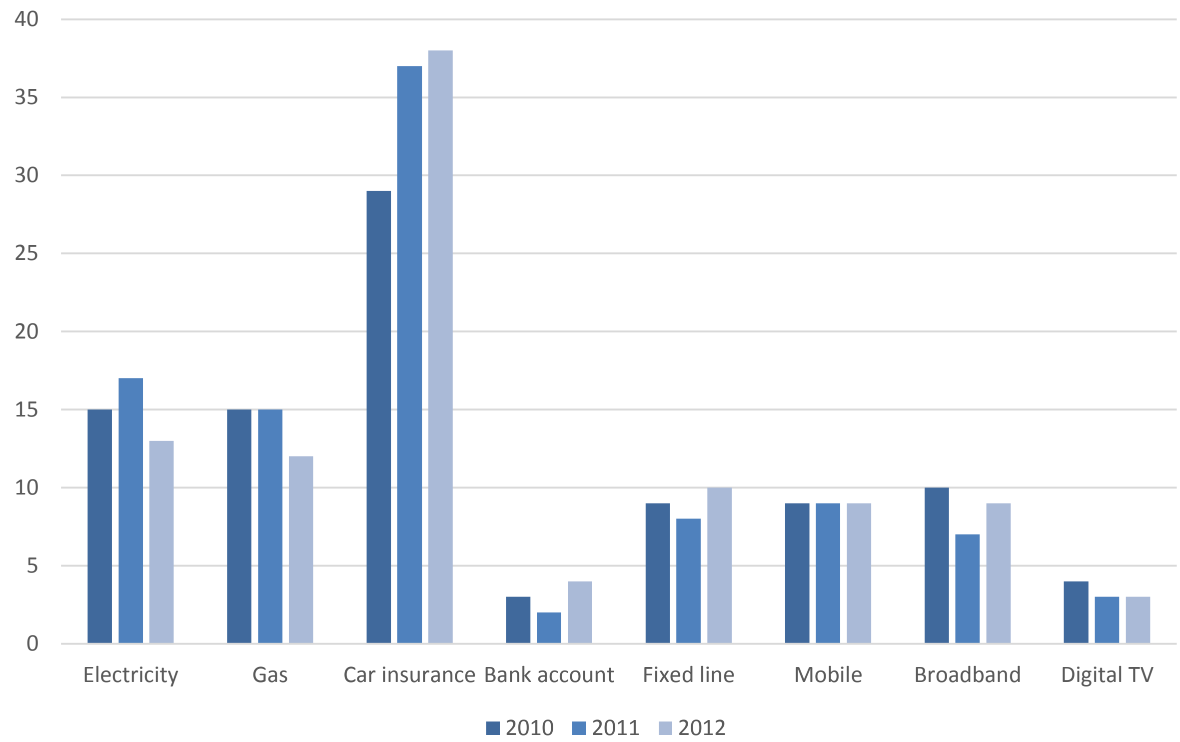
4.57 Switching rates in financial services are generally low, but switching is even lower for personal PCAs than is the case for other financial services such as credit cards and mortgages.[137]

4.58 Outside of financial services, levels of switching for PCAs are substantially lower than for other ongoing services such as energy, mobile phone contracts and car insurance. It is worth noting that these other industries have features which may make switching easier, for example, a break point in a contract.

[137] Vickers (ICB), Final Report, September 2011.

FIGURE 4.8

Comparison between levels of switching in the UK for other ongoing products, such as utilities and mobile phone providers



Source: Ofcom, Consumer Switching Report, August 2013. Ofcom decision-making survey carried out by Saville Rossiter-Base in July to August 2008, 2009 and 2010, June to July 2011, July to August 2012.

Factors involved in switching decisions

4.59 Consumers are likely to switch for one of two reasons: pull reasons or push reasons. A push reason may include dissatisfaction with the current provider, because it has made mistakes or has charged the customer for services that the customer objects to. A pull reason may include a competitor offering better interest rates, bonuses or rewards, or an innovative product. Without better products, or products which appeal to different consumers, it is unlikely that consumers will switch for 'pull' reasons.

4.60 The OFT consumer survey[138] carried out for the 2013 report found that push and pull reasons were more or less evenly split among consumers who had switched their PCAs. Those who had never switched, however, believed that they would be more incentivised by push factors such as receiving poor service/returns from their current PCA provider.

4.61 There is some evidence that consumers are primarily switching for ‘push’ reasons such as dissatisfaction with current bank and poor service. *Which?*[139] found that among the top cited reasons to switch were dissatisfaction with the current bank (37%) and poor customer service (27%). This is supported by TNS research which found that the number of switchers citing poor customer service as their incentive to switch has remained constant at just under a quarter of switchers in the last three quarters.[140]

4.62 However, ‘pull’ factors are also starting to emerge as reasons to switch. The same *Which?* survey found that having a branch for the new provider near to where the consumer lives (16%), having a PCA which offers a good rate of interest (14%) and obtaining a one-off financial incentive (11%) were also in the top 5 reasons to switch.

4.63 Interestingly, while consumers may be attracted to switch by financial incentives, they seem less concerned about charges, in particular overdraft charges. The TNS survey (see Figure 4.9 below) shows that charges were not cited as a reason for choosing a new bank (though they are a reason for leaving a bank). In the *Which?* survey only 5% mentioned switching for a better overdraft facility.[141] This may be an indication that the limited shopping around that consumers undertake is not driven by charges, possibly due to the complexity of comparing overdraft charges as discussed in the previous chapter.

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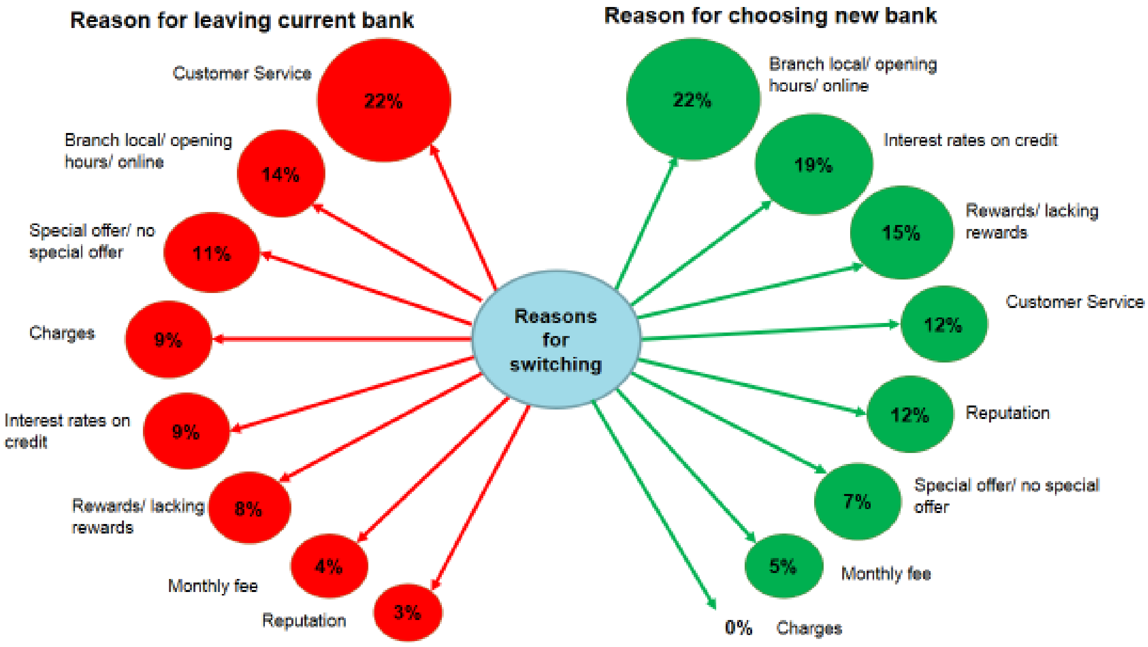
[138] OFT/IFF Consumer Survey, 2012.
[139] *Which?* Consumer satisfaction survey, March 2014.
[140] TNS Global, www.tnsglobal.com/uk/press-release/current-account-switching-index-switching-activity-remains-steady-drift-big-four-banks.
[141] *Which?* Consumer satisfaction survey, March 2014.

FIGURE 4.9

Reasons for switching



Source: TNS Global survey.

4.64 Many providers cite the rise of mobile and Internet banking as evidence that there is less of a need for a branch network, but the importance of a convenient branch location cannot be underestimated. As noted above, the separation between Lloyds and TSB caused a significant number of consumers to switch between these brands. TSB has also told us that the most commonly cited reason (around 50 to 60%) for this was branch location.[142] Research for Tesco[143] shows that 80% of consumers feel 'more comfortable' having a PCA with a high street bank.

4.65 Indeed, according to research by GfK, the convenience of a branch location near to work or home is the most common reason given by customers for choosing a new bank.[144] This is also consistent with the TNS Global research above and *Which?* research which found that the most cited reason (31% of consumers) to choose a bank is that it is easily accessible. While this is more important to the over 60s (37%) it is also important to the 18–34 age group (22%).

[142] TSB submission to the CMA.
[143] Tesco, Customer Insights PCA Research, April 2014.
[144] GfK press release, Customers have little reason to switch current account providers, 16 September 2013.

Factors preventing consumers from switching

4.66 Switching can be beneficial both for those consumers who use overdrafts, as there may be significant cost variation and for those who do not as they may benefit from higher interest rates or cashback offers. Despite these benefits, switching levels are low at around 3% as discussed earlier. This low level of switching and shopping around may be explained by consumers being satisfied with their PCA provider.

4.67 Indeed, one of the main reasons consumers do not switch appears to be that they are satisfied with their current provider. *Which?*,[145] for example, found that 67% of consumers said they did not switch as they were happy with their PCA. On the other hand, research for Tesco shows that 64% of PCA holders are not willing to switch because they 'do not believe I would get better service/value for money'.[146] This is also supported by research from *Which?* that found the fifth most popular reason (out of 18) not to switch was 'all PCA providers offer same service so no point'.[147] It would appear that even if consumers are unhappy with their provider, they do not switch as there may be a belief that there is nothing worth switching to.

4.68 Another reason consumers are unlikely to switch could be difficulty in comparing PCAs as discussed in Chapter 3. Research by *Which?*[148] found that 59% of consumers who switched either agreed, or were unsure, that there was a PCA on the market that better suited their needs. Increased transparency and ability to compare PCAs is likely to increase consumers' willingness to switch and therefore, switching rates.

Which providers are attracting switchers and why?

4.69 Latest research by TNS Global indicates that two of the three biggest net gainers from consumers switching PCAs as reported in its monthly survey are not the big four PCA providers. It shows that Santander, Halifax (part of LBG) and Nationwide are all making net gains while Lloyds, Barclays and NatWest (part of RBS) are making net losses.

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[145] *Which?* Consumer satisfaction survey, March 2014.
[146] Tesco, Customer Insights PCA Research, April 2014.
[147] *Which?* Consumer satisfaction survey, March 2014.
[148] *Which?* Real consumers survey, April 2014.

TABLE 4.2 **PCA providers who are making net gains and losses**

PCA provider	*Gain*	*Loss*	*Net*
			%
Santander	24	11	13
Halifax	19	12	7
Nationwide	9	4	5
Lloyds	11	12	–1
NatWest	13	15	–2
Barclays	8	11	–3
RBS	3	6	–3
Co-op	3	8	–5
HBSC	2	9	–7

Source: TNS Global survey, June 2014. TNS interviewed a nationally representative sample of 8,372 current account holders between 25 April and 16 May, of whom 240 were switchers. Interviews were conducted face-to-face in-home.

Note: This reflects the gainers and losers over the period 25 April and 16 May 2014, based on a survey carried out by TNS.

4.70 PCA providers have told us that the biggest net gainers are providers who have run specific advertising campaigns or provided financial incentives to switch. This appears to be backed up by the TNS Global and Uswitch survey evidence. Santander, Halifax and Nationwide have all run advertising campaigns highlighting financial incentives to encourage people to switch, for example, cash payments, a higher interest rate or cashback offers and have been voted the PCA providers to have the best rewards.[149]

4.71 Some PCA providers highlight innovations in the market, such as the introduction of new and differentiated PCA offerings with features including higher credit interest rates and cashback rewards, the increase in advertising and incentives to switch, for example, £100 offer to switch PCA provider as examples of how the market has become more competitive. This is supported by the Payments Council which reported that since 2011, when the introduction of CASS was first proposed, participating PCA providers have implemented 150 current PCA enhancements.[150]

4.72 While product development and advertising campaigns cannot be solely attributed to the introduction of CASS, there is some evidence that PCA providers are reacting to the introduction of CASS by running specific switching advertising campaigns and developing different products targeted at switchers. There is also evidence of an increase in advertising spending on PCAs (see paragraph 4.16).

4.73 In conclusion, it is clear that providers have developed new products over the past 12 months and that the customers who do switch are attracted by these offers. However, it is striking that the overall level of switching has not increased materially in response to this growing differentiation between

[149] USwitch survey 2014.
[150] Payments Council Submission.

products. This suggests that the market continues to be affected by significant customer inertia.

Conclusion

4.74 The 2013 OFT report cited the introduction of CASS as one of the reasons why it had decided not to make an MIR. We have examined the impact of the service and whether competitive conditions have changed as a result.

4.75 The evidence suggests that the introduction of CASS has been successful in raising awareness of the switching service, and has effectively reduced the time and risks involved with the switching process. It is now quicker, simpler and relatively risk free to switch.

4.76 However, CASS has not led to a transformative change in the switching rate. The 14% increase in switching in the first six months of the service is significant but still leaves switching at relatively low levels, especially compared with switching rates in other markets.[151] In any event, there is evidence that all of the increase in switching levels, reported since CASS was introduced, represents customers cross-switching between Lloyds and TSB following the separation of the brands.

4.77 A number of PCA providers have argued that the pure ‘switching’ figures conceal significantly higher levels of churn and multi-banking. However, ‘churn’ rates are still quite low at just 7% and the evidence of the impact of multi-banking on competition is unclear.

4.78 There is some evidence that where switching does occur it is having a competitive impact on the market, for example, consumers switching to PCAs with financial incentives and PCA providers innovating and differentiating products to attract different consumer groups of switchers.

4.79 There appears to be deeper problems ingrained in the market which are not addressed by CASS. Despite the introduction of an effective switching service, consumers’ willingness to switch does not appear to have increased materially so far. This may be due in part to lingering perceptions that there will be problems with the switching process but also reflects a belief that there are no better alternatives to their existing provider. The reluctance to switch is exacerbated by increasing complexity in the market, especially in relation to overdraft charges, which makes it difficult to compare PCAs and understand the different deals available.

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[151] For example, annual switching rates are typically 10 to 15% in energy, around 10% in mobile telephony, and around 30 to 35% in car insurance.

5. Changes to the regulatory landscape

Introduction

5.1 In examining the PCA market now the CMA has also considered likely developments which might have a significant effect on competition. This chapter considers recent and forthcoming legislative and regulatory measures and other initiatives which the OFT considered would have or were likely to have an effect on competition in the short to medium term and other relevant recent developments.

5.2 This chapter covers whether the following initiatives are likely to have a major impact on the UK market:

- *(a)* EU legislative initiatives. This includes the Payment Accounts Directive (PAD), the proposed amendment of the Payment Services Directive and the proposed Regulation on Interchange Fees.
- *(b)* Regulatory initiatives in the UK. This includes the introduction of concurrent competition powers for the FCA, future regulation by the new PSR, the PRA, and industry codes and self-regulation.

EU legislative initiatives

Payment Accounts Directive

5.3 In April 2014, the European Parliament adopted the proposal for a Directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features. This PAD is due to come into force this autumn and the majority of its provisions must be implemented by the UK within two years. It only applies to PCAs and accounts held by businesses or SMEs are outside its scope. It imposes obligations on payment account providers,[152] including PCA providers, in three areas, as set out below.

Transparency

5.4 PAD establishes that all payment service providers must provide consumers with a fee information document listing the most common services provided

[152] "Payment account" means an account held in the name of one or more customers which is used for the execution of payment transactions. The concept is wider than that of a bank account, as payment accounts can be offered by payment service providers other than banks. In practice, however, most payment accounts are provided by banks. Bank accounts that can only be used as deposit accounts (without the possibility to do payment transactions) are not considered as payment accounts'.
http://europa.eu/rapid/press-release_MEMO-14-300_fr.htm?locale=fr

and the fees charged for each of them before a PCA is opened.[153] Payment service providers must also provide consumers with an annual ‘statement of fees’ with information on fees and interest paid by the customer on the account, as well as any interest earned in the previous year.

5.5 These documents must be drafted using standardised terminology and standard formats and enable consumers to make comparisons between competing accounts easily. PAD also requires that there should be at least one independent comparison website in each member state collecting information on the fees charged by payment service providers.

Switching

5.6 Under PAD, payment service providers must transfer recurring payment orders (such as credit transfers or direct debits) established on a customer’s account to another account within 15 days[154] and do so free of charge. Payment service providers are also required to provide consumers with adequate information on their rights to switch bank accounts and the process involved.

Access

5.7 PAD entitles consumers to have access to a payment account with basic features irrespective of their personal financial situation or place of residence in the EU.[155] The essential services to be provided with basic accounts include withdrawals, bank transfers and a debit card but overdrafts or credit facilities are not permitted on such accounts. Consumers in the EU will be allowed to open a payment account with any payment service provider in the EU, even when they are not residents of the provider’s country.

Overview

5.8 The CMA considers that the introduction of the PAD is a positive development, although it does not materially go further than existing or planned regulatory developments in the UK. For instance, the OFT’s 2009 transparency initiatives have already led to annual summaries of cost information being introduced, and the CASS outperforms the requirements in the PAD.

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[153] Upon request, payment service providers must also supply a glossary of terms used in relation to payment accounts.
[154] 30 days if the switch is made between providers located in different EU countries.
[155] Member states must ensure that at least one payment service provider offers a payment account with basic features in their territory and they should inform the public about the availability of these payment accounts.

Proposed amendment of the Payment Services Directive

5.9 Proposed as a revision to Payments Services Directive (2007/64/EC), the latest package of reforms, known commonly as PSD2,[156] aims to increase competition in the electronic payments market by providing consumers with better choices between different types of payment services and service providers.

5.10 Under the proposed amendments all payment service providers will need to prove that they have certain security measures in place to ensure payments are secure and to protect consumers from fraud and other abuses.

5.11 The proposed amendments also enhance consumer rights in complaints and disputes. Consumers can demand unconditional refunds, even in the case of a disputed transaction. PCA providers are obliged to respond in writing to any complaint within 15 business days. Member states are also obliged to designate competent authorities to handle complaints made by payment service users and other interested parties, such as consumer associations.

5.12 The nature of PSD2, focusing on the security of payment services for consumers and updating the original Directive to take account of new innovations in the payments market, means that it is unlikely to have a significant effect on the dynamics of competition for the UK's PCA market.

Proposed Regulation on Interchange Fees

5.13 The European Commission has also proposed a Regulation on interchange fees,[157] which the European Parliament has been discussing. The European Commission believes that interchange fees restrict competition and unnecessarily increase retail prices, and the interchange fee Regulation addresses the European Commission's concerns about the impact of interchange fees charged on debit and credit card transactions.

5.14 The effect of the proposed interchange fee Regulation would be to introduce maximum levels of interchange fees for transactions. Some PCA providers have told us that the caps imposed by the proposed interchange fee regulation will impact their revenue streams. The exact effect of the caps on interchange fees for UK PCA providers is yet unclear. We consider that it is

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156 In addition to repealing the Payment Services Directive, the proposal also amends the Second Electronic Money Directive (2009/110/EC), the Capital Requirements Directive (2013/36/EU), and the Distance Marketing of Consumer Financial Services Directive (2002/65/EC).

157 Interchange fees are fees paid by banks to each other for each card payment. See 2013/0265 (COD) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0550:FIN:EN:PDF.

too early to conclude on the impact that these proposed measures might have on competitive dynamics in the PCA market.

Regulatory initiatives in the UK

5.15 The OFT 2013 report noted that there were a number of developments expected to have an effect on the PCA market in the following months. This included the creation of the FCA with a new competition mandate which might play a role in stimulating effective competition. The OFT noted that, while the FSA had not had a strong competition remit, the new FCA would have an operational objective of promoting effective competition in the interests of consumers in the markets for regulated financial services and that it would have an accompanying duty to discharge its general functions in a way which promotes competition in the interests of consumers. This stronger competition remit would mean that the FCA would take a different approach to regulation from that taken by the FSA, which is likely to provide further stimulus towards effective competition. This section looks at the establishment of the FCA, the possible impact of the new PSR, the PRA and moves towards self-regulation in some areas.

Financial Conduct Authority

5.16 Since the OFT's review of the PCA market in 2013, a significant development has been the launch of the FCA in April 2013.[158] The FCA has an operational objective to promote effective competition in the interests of consumers. It also has a duty to promote effective competition when using its general functions to advance its consumer protection and market integrity objectives. Together, the objective and the duty provide the FCA with a strong mandate to help the organisation achieve its strategic objective of making markets for financial services work well.

5.17 The FCA can use all of its current powers in pursuance of its competition mandate, including:

- making or changing rules through its rule-making powers
- taking action against firms the FCA regulates, such as changing the permissions the business currently operates under and/or adding a specific requirement

[158] The CMA has recently (1 July 2014) entered into a Memorandum of Understanding with the FCA setting out the framework for cooperation between the CMA and FCA in relation to competition issues, consumer protection and access to payment systems.

- conducting market studies

5.18 The FCA is expected to be granted concurrent competition powers with effect from April 2015. This will enable the FCA to make MIRs to the CMA. It currently has the power to conduct market studies but not to make an MIR. The grant of concurrent competition powers from April 2015 will also enable the FCA to take enforcement action under the Competition Act 1998 against anti-competitive agreements and abuse of dominance.

5.19 Since its inception the FCA has undertaken or is planning a programme of work examining competition in the retail banking sector. This includes:

- Working with the PRA to produce an update following the FSA/Bank of England's 2013 review of requirements for firms entering into or expanding in the banking sector. As discussed in Chapter 2 in respect of barriers to entry, this review stated that the FSA's successor bodies, the PRA and the FCA, would implement change along two dimensions: reforms to the authorisation process and a major shift in the approach to the prudential regulation of banking start-ups. The FCA/PRA July 2014 follow-up review suggests that these changes have been well-received. Since the original review of requirements for firms entering or expanding into the banking sector was published in 2013 there has been a marked increase in the number of firms in pre-application discussion with both the FCA and the PRA. In the 12 months to end March 2014 there have been pre-application discussions with over 25 potential applicants, which is a significant increase over previous years.

- The FCA launched a market study into cash savings in October 2013, the interim findings of which have now been published and the FCA has announced that it will launch a market study into credit cards by the end of the year.

- The FCA is continuing its work on overdrafts. The FCA has published the qualitative consumer research on overdrafts[159] that was carried out as part of its consumer credit work.

- The FCA has also been asked by the Chancellor of the Exchequer to review the effectiveness of the CASS in September 2014 and also to consider the costs and benefits of PCA number portability as a way of increasing competition in banking. PCA number portability may involve

[159] FCA, Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, 7 April 2014.

upgrades to payment systems networks but could potentially reduce any risks associated with switching PCAs.

5.20 The CMA considers that the FCA's current and planned work and the availability of concurrent competition powers from April 2015 may well be of substantial relevance for the assessment of competition and may help improve competition over the medium term. On the other hand, it is not certain that the FCA's work will offer comprehensive and timely solutions to all the concerns we have identified. In any case, many of the FCA's initiatives will not be complete by the time of the CMA's final MIR decision. In any event an MIR would monitor and take account of this work.

Payment Systems Regulator

5.21 In response to a number of concerns about UK payment systems, the PSR was established as a subsidiary of the FCA on 1 April 2014 with its own Managing Director and Board. It will become fully operational in relation to the regulation of payment systems in April 2015. Its current focus is on the preparation for operational launch in April 2015, when regulation will commence. This will include consulting on a day-one rule book and the fees regime. It may also begin more in-depth reviews into areas it thinks may warrant more fundamental change.

5.22 As noted earlier in Chapter 2 a new entrant wishing to offer a PCA requires access to several payment systems. Smaller PCA providers and new entrants have reported difficulties and excessive costs in obtaining access (directly or indirectly) to payment systems. The PSR's objectives will be to promote competition, innovation, and the interests of end-users through overseeing designated UK domestic payment systems. In doing so, it will have a wide range of significant legal powers, including:

- concurrent powers to make MIRs under Part 4 of the Enterprise Act 2002, with effect from 1 April 2014
- concurrent powers to apply the UK and EU prohibitions on anticompetitive agreements and abuse of dominance, with effect from April 2015.
- From April 2015, the regulatory power to:
  - — give directions to providers on required actions and standards
  - — impose a requirement regarding payment system rules
  - — require access to payment systems

- vary agreements relating to payment systems
- require disposal of an interest in a payment system operator

5.23 As noted in Chapter 2, based on the evidence collected by the OFT in previous reviews and the representations we received in this market study we cannot discard the possibility that the terms of access to payment systems for small PCA providers may represent a barrier to entry in PCAs. We note that the PSR has wide-ranging regulatory power to address such issues, and that the PSR is already examining access to payment systems.[160] It is currently devising its regulatory approach, such that it is not possible to say at this point how it may address these concerns. However, we note the PSR's wide-ranging powers to address concerns in relation to payment systems. In particular, we note the focus of the PSR on access issues in the call for inputs and so there is scope for this potential barrier to be reduced or removed over time.

Prudential Regulation Authority

5.24 The PRA, established in April 2013 along with the FCA, is the UK financial services regulator responsible for the prudential regulation of firms including PCA providers. In March 2014 the PRA was given a secondary competition objective to act, so far as is reasonably possible, in a way which facilitates effective competition in the markets it regulates.[161] When taking action that advances its other objectives or when creating and keeping under review its prudential rules and codes, the PRA is expected to act in a way which advances its competition objective. As noted above, 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 concerns regarding the authorisation process have been materially reduced.

5.25 The FCA and the PRA have been, and continue to be, engaged in significant work in making the authorisation of new banks easier and faster. The CMA considers that in so far as there are remaining barriers to entry from regulatory permissions, the PRA might address these. However, the timeline is uncertain and this is just part of the picture.

[160] See call for inputs http://www.fca.org.uk/your-fca/documents/payment-systems-regulation-call-for-inputs
[161] Under section 2H(1) of Financial Services and Markets Act 2000.

Industry codes and self-regulation

5.26 In addition to regulatory initiatives, there have been recent moves towards self-regulation in the wake of the banking crisis to improve standards and the reputation of the banking industry. A number of PCA providers[162] have agreed to set up a standards body for the banking industry called the Banking Standards Review Council. The Council will seek to improve the 'culture, competence and customer service' of PCA providers with a focus on improving standards for high street banking consumers.

5.27 Although it will not have statutory powers, the body intends to recommend standards of good practice that may include whistleblowing protocols, processes for handling small businesses in distress, dealing with conflicts of interest in the capital markets and managing high-frequency trading.

5.28 While we welcome initiatives that improve the health of the retail banking sector, we do not consider it likely that this body will have a major effect on competition in the PCA market, as its remit does not seem to encompass competition issues.

Conclusion

5.29 Our assessment of regulatory changes has shown that those at the EU level do not go further than existing initiatives in the UK and as a result they are unlikely to have an impact on competition. The possible exception may be in the area of interchange fees but we do not know yet what the effect will be on competition in PCAs, if any. In relation to regulatory initiatives in the UK, we welcome the positive steps made by the FCA, the PRA and the forthcoming PSR.

5.30 However, the interlinked concerns we have identified in this market study mean that we consider a focus on individual aspects may not address them comprehensively and holistically and a joined-up approach may be needed.

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[162] Barclays, HSBC, LBG, RBS, Standard Chartered, Santander UK and Nationwide Building Society. http://mediapoint.press.net/article.jsp?id=9897844 (subscription required).

6. Consumer outcomes

Introduction

6.1 A competitive market provides good outcomes for consumers with products that meet their needs, are competitively priced and offer the right levels of service. In Chapter 2 we examined how competition conditions have changed in terms of pricing of PCAs and concluded that the market remains concentrated and changes in market shares are very gradual despite significant differences in prices between providers. In this chapter we present evidence on other outcomes for consumers in the PCA market (innovation, customer satisfaction and overdraft charging structures) and whether these have changed since the 2013 OFT report, having regard as to whether outcomes from competition in the PCA market are those that we would expect in a well-functioning market.

Findings from the 2013 review

The 2013 OFT review of PCAs revisited issues first highlighted in the OFT's 2008 report regarding a lack of innovation and customer satisfaction levels. It also found that innovation in the PCA market was a result of government/regulatory initiatives rather than competition.

In regards to overdrafts, the report found that consumers were still paying a similar amount in overdraft charges. It also reported that charging structures remained complex, difficult to understand for consumers and therefore compare across products.

6.2 This chapter is set out as follows:

(a) Innovation. This looks at innovations in payment services such as PayM and new products and services launched by PCA providers (paragraphs 6.4 to 6.16).

(b) Customer satisfaction. This looks at the level of complaints and customer satisfaction levels across providers (paragraphs 6.17 to 6.31).

(c) Overdrafts. This looks at whether consumers are being served well by their overdrafts including the changes in overdraft charging (paragraphs 6.32 to 6.37).

6.3 In summary, there has been considerable technological innovation; however innovation on product types has been more limited and recent, and on innovation on service standards, this has been primarily from some of the newer, smaller, PCA providers. So far we have seen little impact on market shares. Moreover, customer satisfaction with the established PCA providers is also lower than with smaller and newer competitors, although the overall evidence on customer satisfaction is mixed. Yet, the market remains stable and PCA providers with the highest satisfaction scores do not appear able to gain market share. Finally, we are concerned that consumers are not being served well by their PCAs in relation to overdraft charges.

Innovation

6.4 Innovation is one of the signs of a competitive market. In PCAs this means firms competing strongly with one another to bring new PCA propositions to the market such as tools to allow consumers better control and understanding of their finances. It also means new products being developed which respond to consumer needs and different and improved levels of service.

6.5 In terms of technology and innovation, Chapter 3 discussed the rapid increase in the take up of mobile banking and the rise in the number of text alerts being sent by providers. Positive progress has been made in this area and consumers have now the tools at their disposal to better control their PCAs. The CMA recognises the significant technological innovation that has taken place over the last couple of years.

Technological innovations in payments

6.6 One aspect of the PCA market which has witnessed some degree of innovation in recent years is that of payment services. This includes PayM,[163] launched in April of this year and which allows users to make payments using a mobile phone number as opposed to the recipients' full details. Numerous PCA providers[164] participated in its launch and others will join the scheme in the coming months.[165] Barclays has also developed its own payment services tool called Pingit, a mobile app payments service which allows registered users to transfer money, via the Faster Payments system, to other registered users via a mobile phone number.

6.7 PCA providers are also putting resources into the area of contactless payments. The UK Card Association recently announced that contactless spending reached £100 million per month[166] and RBS has forecast 'that

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[163] Research based on a sample of 180,000 costumers.
[163] PayM is a way of sending money to another bank account using a mobile phone number which is linked to a bank account number. Full details of the programme can be found at: www.paym.co.uk/.
[164] Participating banks and building societies at launch of PayM: Bank of Scotland, Barclays, Cumberland Building Society, Dankse Bank, Halifax, HSBC, Lloyds Bank, Santander and TSB.
[165] Banks and building societies that have committed to joining PayM later in 2014: Clydesdale Bank, First Direct, Isle of Man Bank, Natwest, RBS, Ulster Bank and Yorkshire Bank. Nationwide has committed to joining PayM in 2015.
[166] www.bbc.co.uk/news/business-27202538.

contactless payments will reach 250 million by 2023 (in 2013 there were 14 million such transactions and 44 million are expected this year)'.[167] Some providers are also working on e-wallet digital propositions that will allow customers to complete purchases without using or entering their card details.

6.8 There is also an initiative by the Cheque and Credit Clearing Company that will involve image-based cheque clearance as opposed to the current paper-based system. This will allow for quicker cheque clearing and will be compatible with mobile technology.[168]

6.9 Many of these initiatives have been developed by PCA providers working together through the Payments Council, and therefore are not truly a factor of differentiation between PCA providers (Pingit is an exception). They might reflect nevertheless a degree of competition between PCA providers and non-bank players in the market for payment services, with some PCA providers offering these services to consumers more quickly than others.

6.10 Indeed, part of this innovation in the area of payments can be attributed to the technology companies looking to provide services that are traditionally associated with PCA providers. We discussed in Chapter 2 how companies such as PayPal and Google are starting to disrupt the traditional banking services and sources of revenue by offering transaction-type services previously associated with PCAs. For example, PayPal allows consumers to move money into a PayPal account which can then be used for online payments[169] and Google has launched Google Wallet,[170] which allows consumers securely to store their debit, credit and store cards online and then use to shop in stores, buy online and send money.

6.11 We note that this is an aspect of PCA provision where PCA providers appear to be responding to challenges from non-PCA providers but as discussed in Chapter 2, it is not clear that this is strengthening competition in the broader PCA market. At the moment, the products developed do not fulfil all of the functions of a current account (eg receiving salaries and benefit payments, etc). That is, they are no substitutes for a PCA.

New products and services

6.12 Various PCA providers have pointed to the introduction of new PCA product offerings to the market in very recent months, perhaps as a response to the introduction of CASS. In March 2014, LBG for example launched its new PCA

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[167] BBA – Banking on the move: The next revolution has begun.
[168] www.chequeandcredit.co.uk/cheque_and_credit_clearing/cheque_imaging/.
[169] PayPal: www.paypal.com/uk/webapps/mpp/home.
[170] Google Wallet: www.google.co.uk/wallet/#.

offering, Club Lloyds, and Santander has continued to grow its flagship 1-2-3 account. There has been a small increase in the number of PCAs offering credit interest as well as those offering rewards and cashbacks (for example, Santander, Halifax, Natwest and RBS and Tesco Bank which is offering Clubcard points). The Payments Council has also told us that there have been 150 product enhancements across PCA providers between 2011 and 2013, including improvements to customer services, and product or service innovation. Further, we are aware of PCA providers further reviewing their PCA offerings with a view to launching new products.

6.13 Some innovation is also taking place in terms of service standards but it is mainly the newer, smaller PCA providers that are offering this. Metro Bank offers the facility to replace instantly debit cards and for the customer to block and unblock a temporarily mislaid debit card. Metro Bank also seeks to differentiate itself in terms of service provision by having longer opening hours and opening at the weekend. Similarly TSB has positioned itself differently in the PCA market and launched with the slogan ‘welcome back to local banking’. TSB has also started to offer longer opening hours in a number of branches, which it tells us has led to a competitive response by other PCA providers in these areas. As noted above, however, these innovations have not led to significant increases in market share for the PCA providers that have introduced them, suggesting a relatively weak incentive to innovate on service standards.

Conclusion on competition in innovation

6.14 Competition through innovation should result in competitors seeking to gain an advantage over their rivals by providing better and more imaginative products and services to attract consumers and to keep existing customers. We welcome the positive technological innovations that have taken place over the last couple of years in the PCA market as well as the recent launch of new products and improvements in service, especially on the part of the smaller PCA providers.

6.15 However, we note that despite new products being offered and increased differentiation in PCA offering, consumers still consider PCA providers’ offerings to be largely undifferentiated. This appears to be supported by findings from a recent survey carried out on behalf of Tesco that said that 64% of consumers ‘cannot be bothered to switch as I don’t not believe that I would get better service/value for money from another bank’.

6.16 The 2013 OFT report highlighted that innovations in the PCA market such as text alerts had been a result of regulatory pressure rather than as a result of competition between PCA providers.[171] There are now some emerging signs that PCA providers are starting to differentiate themselves with the PCAs they offer. However, consumers do not appear to be reacting yet as evidenced by low switching rates and the perception that there are no significant benefits to switching.

Consumer satisfaction

6.17 The 2013 OFT report expressed concerns over customers' satisfaction with their PCA provider as well as the variation in upheld complaints between providers which, it said, may indicate an issue with competition. It also commented on the need for the banking sector to be more consumer focused.

6.18 We have looked at customer complaints and satisfaction as a proxy for outcomes in terms of service levels to consumers. Indeed, service levels are likely to be (or should be) important for PCA customers, given that many consumers do not pay for PCAs. Therefore, in a competitive market, one would expect firms to compete on the quality of service provided to the customer.

6.19 Consumers dissatisfied with a service received from their PCA provider can first complain to their PCA provider. Those complaints that are not dealt with within one business day are then reported to the FCA which publishes information on the number of complaints both on an industry-wide basis and for individual providers.[172] In the event that a consumer is not satisfied with the response from the PCA provider, they may take the complaint to the Financial Ombudsman Service (FOS).[173] The FOS will review the complaint and will then make a finding either in favour of the consumer or of the provider in relation to the complaint.

Complaints to the FCA

6.20 The number of complaints made to PCA providers which are not resolved within one business day and are therefore notified to the FCA is significant and stands at around 600,000 per year. We were unable to collect reliable statistics for the overall number of complaints about PCAs, including those that were resolved within one business day. We note that the number of complaints overall is on a downwards trend, however, this appears to have

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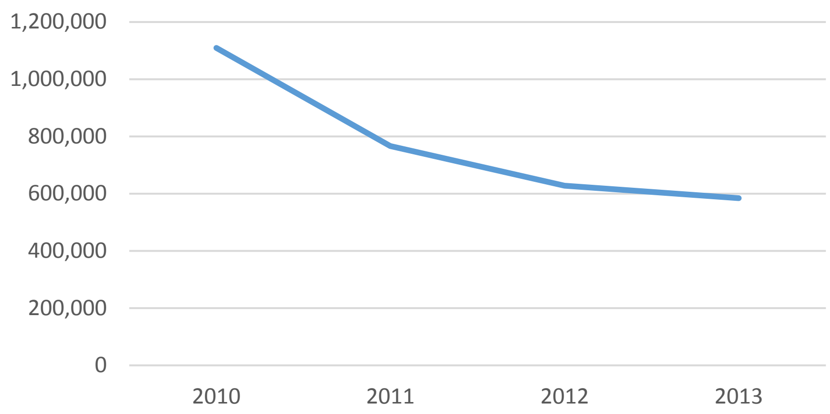
[171] OFT, Review of the personal current account market, January 2013, paragraph 5.14.
[172] See: www.fca.org.uk/firms/systems-reporting/complaints-data.
[173] See: www.financial-ombudsman.org.uk/.

been reversed in the last six months with the FCA reporting an 8% increase in the number of complaints.[174]

FIGURE 6.1

Number of complaints – PCAs



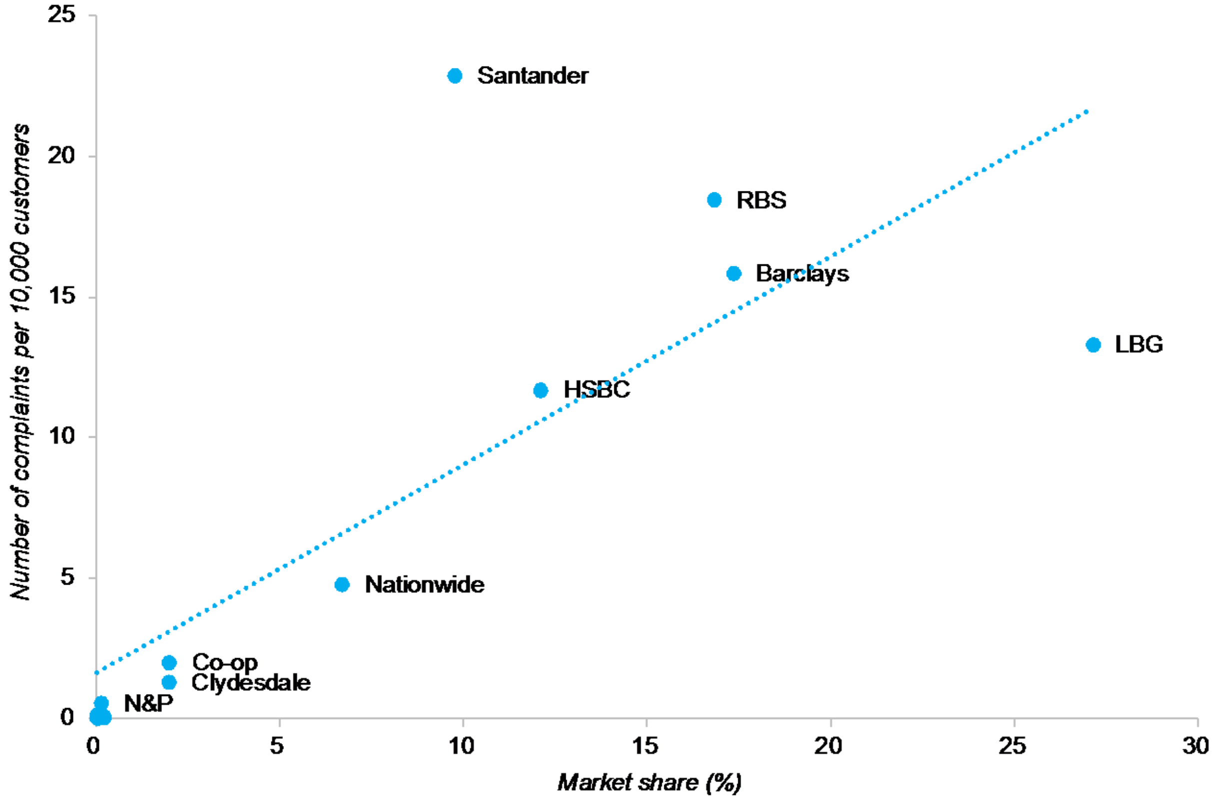
Source: FCA information based on PCA provider complaints data.

6.21 There is also some evidence that PCA providers with the most number of complaints per account are those with the highest market shares, as we discussed in Chapter 2. This would tend to suggest that those PCA providers are able to maintain high market shares despite delivering relatively low levels of service, which indicates that competition is not working well.

[174] See: www.fca.org.uk/firms/systems-reporting/complaints-data.

FIGURE 6.2

Complaints per account and size (based on complaints reported to the FCA)



Source: Market shares calculated by the CMA, and FCA complaints data.

6.22 In a well-functioning market, all else being equal, we would expect to see PCA providers with the highest proportion of complaints losing market share at the expense of those with the lowest proportion of complaints.

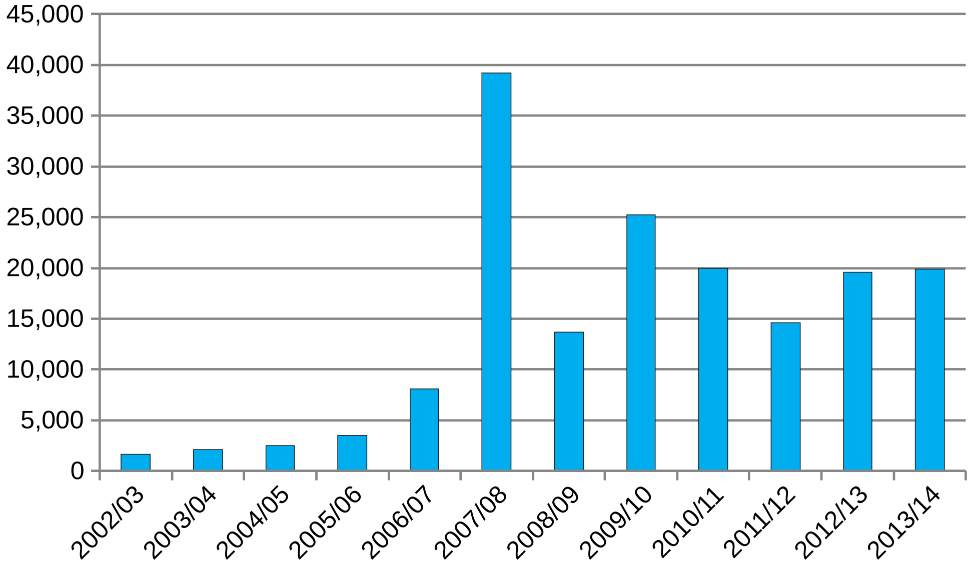
Complaints to the FOS

6.23 As explained in paragraph 6.19, complaints which are not resolved by PCA providers can be taken to the FOS for further review. We note that there has been an increase in the number of complaints that have not been resolved by the PCA provider and that have been reported to FOS since 2011/12 which now stand at 20,000 per year, and they seem to be stable, leaving aside the large spike in 2007/08 following a number of complaints about unarranged overdrafts and the publicity this received.[175] This stability suggests that PCA providers are not sufficiently under pressure from competition to improve quality of service and customer satisfaction.

[175] PCA market study 2013 report, paragraph 4.19.

FIGURE 6.3

Number of new cases received by the FOS relating to current accounts



Source: CMA analysis of data from FOS Annual Reviews.

6.24 One particular sub-product of PCAs, packaged accounts,[176] has attracted an increasing number of complaints. The FOS recently published its 2013/14[177] Annual Review which showed a significant rise in complaints about packaged accounts from 1,629 to 5,667, a rise of 248% in one year. Over the period 2011 to 2013, the number of packaged accounts fell from 10.5 million to 10 million which suggests that the number of complaints per account has risen significantly. Complaints included products being sold which did not meet consumers' needs or where the consumer had not been given enough information about the product. This view is further confirmed by Citizens Advice UK, which has previously noted that a customer can often be 'misled or otherwise mis-sold a packaged account which they can ill afford, or which offers benefits they cannot use or do not need'.[178] We note that the FCA is planning to conduct a review of packaged accounts in the second half of 2014/15.[179] The review by the FCA will look at how PCA providers have implemented the packaged account rules that were introduced in 2013[180] and how they are dealing with past complaints.

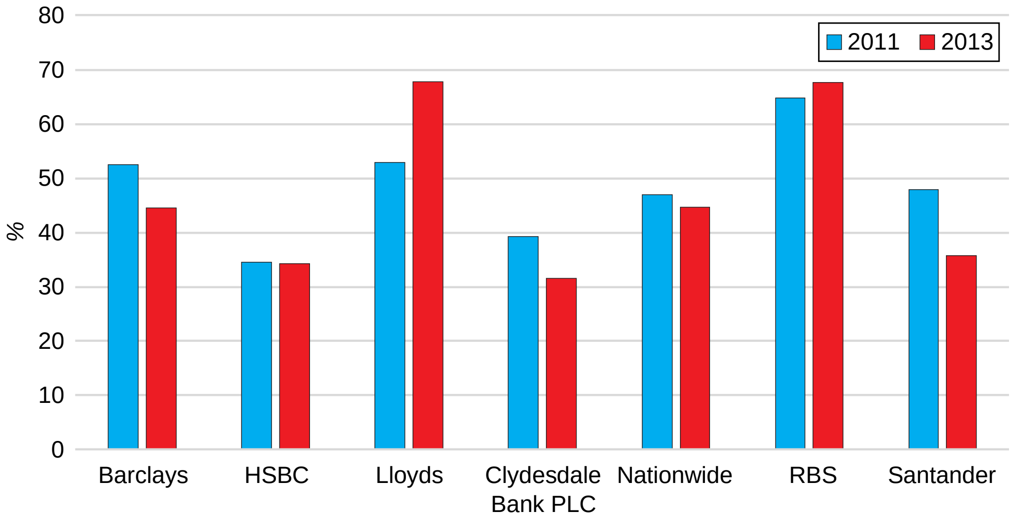
[176] A packaged account is a PCA with additional benefits such as travel insurance. Packaged accounts usually charge a monthly fee.
[177] FOS 2013/14 annual review.
[178] Citizens Advice response to EU commission consultation on bank accounts (June 2012), p3.
[179] FCA Business Plan 2014/15.
[180] The rules introduced on 31 March 2013 were designed to provide protection for consumers buying insurance as part of a packaged account as opposed to those buying it on a stand-alone basis. The rules required that firms should take reasonable steps to ensure that the product is appropriate for the customer, that the customer knows if they are eligible to claim and that they are provided with an annual insurance eligibility statement.

6.25 The 2013 OFT report recognised that it was difficult to interpret a normal level of complaints in relation to PCAs, but looked at the proportion of complaints that were upheld as a proxy to determine whether providers act in a way that could be justified. For the full year 2012/13 the uphold rate[181] for complaints handled by FOS was 33%, a slight increase on the 31% reported in 2011/12. This is also lower than uphold rates across all financial services FOS is responsible for, where the average uphold rate is 49%.

6.26 The FCA also reports on the resolution of complaints between the PCA provider and the consumer from data supplied by PCA providers. As shown in Figure 6.4 below the proportion of complaints upheld between the major PCA providers still varies from 30% to almost 70% and this gap has grown since it was reviewed in the previous OFT PCA review.[182]

FIGURE 6.4

Proportion of banking complaints upheld by providers, 2011 and 2013



Source: CMA analysis of FCA complaints data on banking.

Customer satisfaction scores

6.27 In addition to complaints we have also looked at customer satisfaction scores in the PCA market. *Which?* carries out research on satisfaction scores. The figures are set out below. Two aspects of this are noteworthy:

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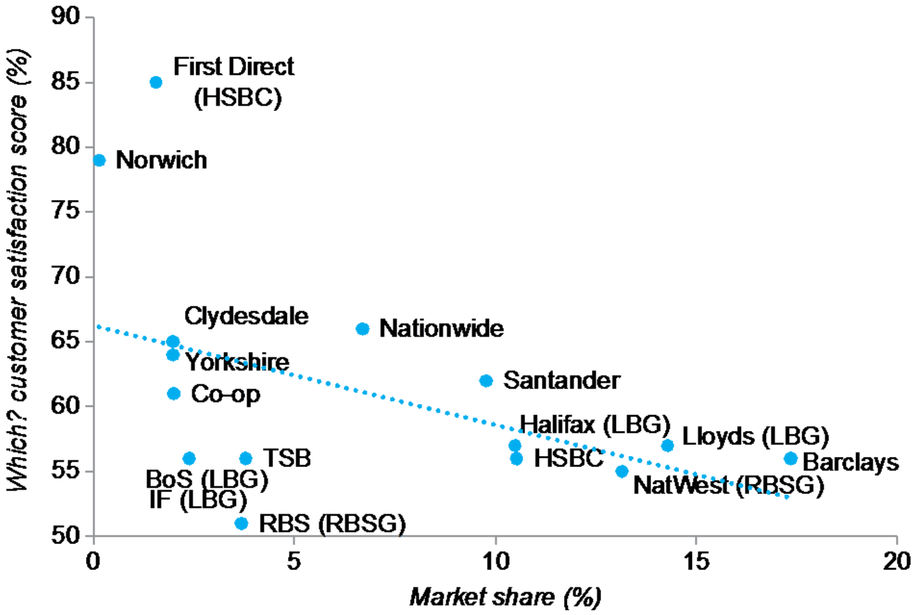
[181] If a complaint is upheld then it broadly means that the decision was in favour of the consumer. Either the provider was found to be wrong, or the provider was found to have not previously offered adequate redress to the consumer.
[182] In the 2013 OFT review it was noted that the variation in upheld complaints was from 35 to 60% (OFT PCA 2013 review, paragraph 4.22).

(a) First, all the four largest PCA providers have satisfaction ratings below 60%.

(b) Second, as a broad but noticeable trend, the higher the market share a provider has, the less satisfied the consumer is with the bank (the relationship between concentration and satisfaction is discussed in Chapter 2). This is consistent with the finding on complaints (see paragraph 6.21). It suggests a market in which PCA providers prosper despite poor customer service, and do not significantly lose market share through better customer service.

FIGURE 6.5

***Which?* customer satisfaction scores compared with market shares (GB)**



Source: Market shares calculated by the CMA, *Which?* satisfaction ratings.

6.28 A recent survey by USwitch[183] has found that smaller PCA providers have the highest satisfaction scores. The top three scoring PCA providers were First Direct, Nationwide and the Co-operative with the big four failing to make it into the top 3 positions on any of the measures scored by uSwitch.[184]

6.29 Some PCA providers have pointed to research undertaken by Mintel which shows that only 3% of PCA holders are unhappy with their existing bank.[185]

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183 USwitch/Opinium online survey carried out between 7 and 17 January 2014 among 10,629 current account holders.
184 USwitch survey 2014.
185 Mintel – Consumers and Retail Banking, October 2013, p74.

Barclays has also told us that Mintel reports 80% of Barclays PCA customers said they were happy with their existing provider.[186]

6.30 The evidence on customer satisfaction is mixed. Mintel records a low level of customer dissatisfaction, which may reflect either, a simple lack of awareness of what a more competitive and innovative market could offer, or genuine satisfaction with what providers offer, or both.

Conclusion on customer satisfaction

6.31 The number of complaints regarding PCAs is still substantial, and despite the overall downward trend, complaints appear to have increased in the past six months. It is too early to tell whether this is a blip or the beginning of a rise in consumer complaints. Satisfaction with the established PCA providers is also lower than with smaller and newer competitors, although the overall evidence on customer satisfaction is mixed. Yet, the market remains stable and PCA providers with the highest satisfaction scores do not appear able to gain market share. In a well-functioning market we would expect to see, all else being equal, providers with high satisfaction scores gaining market share at the expense of those with lower scores.

Overdrafts

6.32 The 2013 OFT report expressed concerns that charging structures for over-drafts remained complex, difficult to understand for consumers and therefore difficult to compare across products. As shown in Chapter 3, this is still the case.

6.33 In 2013 25.3 million customers used an overdraft, which represents 39% of all active PCAs.[187] Arranged and unarranged overdrafts generated £2.9 billion of revenues for providers in 2013.[188] This equates to an average of £115 per PCA that went into overdraft at least once during the year. Overdraft costs are even more significant for customers who use their overdraft facility regularly: in 2013, 1.8% of customers paid between £200 and £300 per year in overdraft charges (not including interest charges), and 3.0% paid more than £300 in overdraft charges in that year (again, not including interest charges).Moreover, we calculated the ratio between total overdraft revenues and debit balances as a high-level proxy for the 'all-in cost' of borrowing through an overdraft facility. This ratio fell from 32 pence of revenues per pound of debit balance in 2011 to 31 pence per pound in 2013 (–3.9%). This

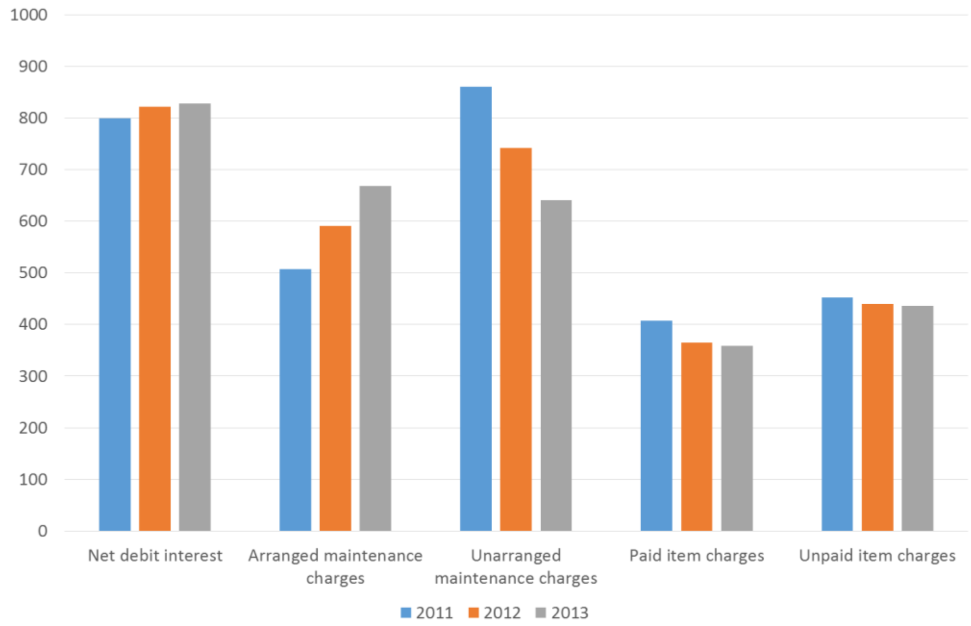
[186] Mintel – Consumes and Retail Banking, October 2013, p75, Figure 53.
[187] And 43% of all active PCAs with an overdraft facility.
[188] Analysis from responses to CMA Information request.

is in a period where wholesale funding rates decreased very significantly as reflected in the fall in NCI (please see Annex A for a full discussion).

6.34 Significantly, overdraft revenues have only reduced by 3% over the last couple of years, despite significant falls in wholesale funding, indicating that the pricing of overdraft lending is not particularly responsive to changes in funding rates, which could be a sign of weak competition.

FIGURE 6.6

Composition of overdraft revenues (£m)



Source: CMA information requests.

6.35 The trend observed by the OFT in 2013[189] regarding a shift from unarranged overdraft income to arranged overdraft income appears to be continuing. In the past, arranged overdraft charges have been considered more transparent than unarranged overdraft charges and so the move towards providers generating more revenue from arranged overdrafts was considered generally positive. However, difficulty in comparing arranged overdrafts has increased significantly and it is now more difficult to compare arranged overdraft propositions across providers. *Which?* has reported, for example, that customers could avoid overdraft fees if they switch to a PCA that better suited their needs. However, it noted that consumers found it difficult to compare

[189] The OFT's 2013 report found that as revenue from unarranged overdrafts fell, revenue from arranged overdrafts increased (see paragraphs 5.48–5.69 of the 2013 report).

accounts and that charging structures were so complex that they could not work out the costs of running an account.[190]

6.36 In any event, we are concerned that the complex and varied overdraft charging structures means that consumers are not able to understand the charges they incur and compare different PCA overdraft features. This means that PCA providers are unlikely to have an incentive to compete on overdraft charges, which is likely to result in charges being higher than they would otherwise be. On balance, we do not consider that consumers are being served well in relation to overdrafts.

6.37 Given the amount of money spent by customers on overdrafts, any change in the cost of this debt could have significant implications in terms of customer welfare. There are various ways in which the cost of this debt might decrease. For example, a proportion of customers who use overdrafts may have access to other, cheaper sources of finance to fund their cash shortfalls (eg withdrawing money from savings account, or taking personal loans), and they might find it easier to switch to such alternatives if they have a better understanding of the cost of their overdraft and/or more control over their PCA balance. It is also conceivable that greater transparency over the cost of overdrafts would lead to greater customer engagement and would incentivise PCA providers to compete more intensely on this feature of PCAs, and this might, in turn, lead to a reduction in the cost of overdrafts. The resulting reduction in overdraft revenues might lead PCA providers to amend their broader pricing policies for PCAs, and move away from ‘free if in credit’ models of pricing towards more cost-reflective charging structures.

Conclusion

6.38 The evidence on customer outcomes is mixed. There have been positive developments in terms of technological innovation over the last couple of years and PCA providers have also started to innovate in the area of payment services as well as introducing new products and services. However, some of it is still centrally driven and not all innovation has been the result of strong competition between PCA providers. The introduction of CASS has had some effect and PCA providers have responded by introducing new products to the market and by differentiating themselves in terms of service levels. But by and large this has tended to come from small and medium providers and we have not seen an increase in switching.

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[190] *Which?* ‘Are you paying for being with the wrong bank? research November 2013.

6.39 Evidence on customer satisfaction is mixed. While it is reported that only 3% of consumers are unhappy with their PCA, complaints are substantial and there is evidence of dissatisfaction with the larger PCA providers, yet market shares remain stable. The evidence shows that the PCA providers with the lowest customer satisfaction rating have the highest market shares, while those with high customer satisfaction struggle to expand as market shares remain stable. This is not what one would expect in a well-functioning competitive market, and suggests that there are limited competitive incentives to improve customer service.

6.40 In terms of overdrafts, we are concerned that consumers are not being served well by their PCAs. The difficulty in comparing charging structures has arguably increased over the last two years and, as we discussed in Chapter 3, consumers are not able to compare costs across providers to assess which PCA is most suitable for them. MiData may provide a solution for this but its impact is unlikely to be felt in the short term and we cannot, at this point in time, gauge how significant its impact would be in practice.

6.41 Overall, our assessment of changes in the market in relation to high levels of concentration, barriers to entry and expansion, low switching and lack of transparency regarding overdraft charges shows that these are closely interrelated and mutually reinforce one another, resulting in competition being more limited than it would otherwise be.

ANNEX A: Analysis of PCA revenues

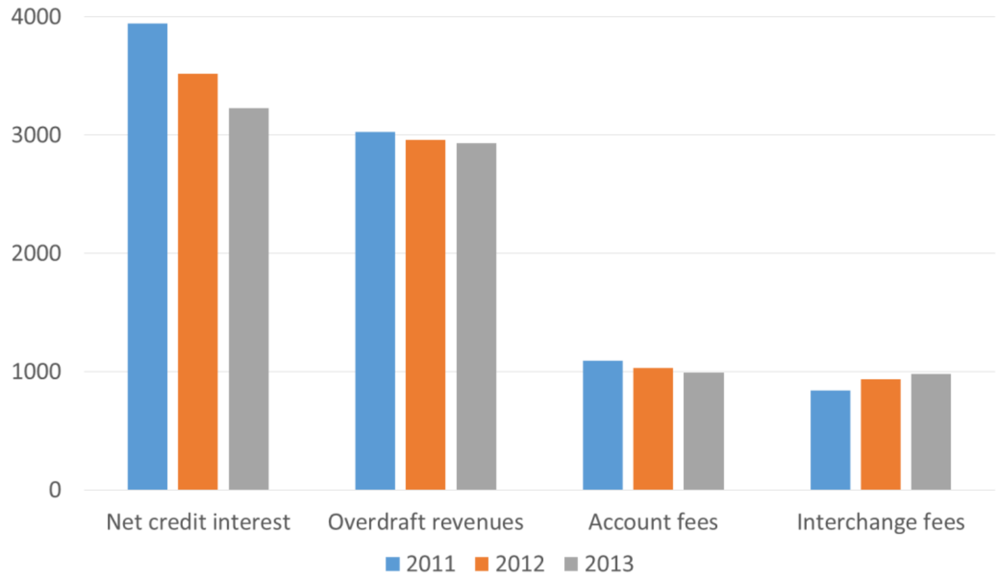
1. In 2013 the OFT examined the revenues derived from PCAs to provide some insights into the economics of PCAs. We updated this analysis with a view to identifying changes in revenues, and whether they could be attributed to changes in competitive dynamics and/or exogenous changes in macro-economic conditions. PCA providers incur costs to provide PCAs, for example the cost of developing and maintaining IT systems, the operational expenditure associated with the branch network, impairment costs on overdraft balances, marketing costs, the cost of the equity base, etc. We did not consider these costs, and as such the analysis below should not be interpreted as an assessment of the profitability of PCAs for providers.

2. PCAs generate several revenue streams for PCA providers. Traditionally the most important of these revenues streams has been net credit interest (NCI), which is the difference between the interest paid on deposits and the interest paid on these funds by the treasury functions of the PCA providers. The second largest revenue stream comes from overdrafts and is the sum of net debit interest (NDI) and revenues from maintenance and transaction charges. PCA providers also earn revenues from account fees (paid mainly on packaged accounts but also sometimes on standard accounts), and interchange fees.

3. Total PCA revenues fell from £8.9 billion in 2011 to £8.1 billion in 2013, a drop of 8.7%. This change was primarily driven by the fall in NCI, from £3.9 billion in 2011 to £3.2 billion in 2013 (–18.2%). Overdraft revenues also decreased marginally, from £3.0 billion in 2011 to £2.9 billion in 2013 (–3.1%). This means that PCA providers now derive almost as much income from overdrafts (36.1% of total revenues) as from NCI (39.7% of total revenues).

FIGURE 1

Total PCA revenues (£m)



Source: CMA information requests.
Note: Account fees are shown net of cashback costs for providers.

4. The total number of PCAs increased from 75.9 million in 2011 to 79.5 million in 2013 (+4.7%) and the number of active PCAs increased from 62.0 million to 65.0 million over this period (+4.8%). PCA numbers have increased faster than the UK population, suggesting an increase in the share of customers using more than one PCA, a trend sometimes referred to as 'multi-banking'.

5. Table 1 below shows that the number of standard accounts has grown while the number of packaged accounts has dropped, and the number of accounts in other categories has remained broadly stable. Certain providers have told us that they stopped marketing packaged accounts during the FCA's review of this market, which may account for this trend.

TABLE 1 **Number of active PCAs by type**

	2011	*2012*	*2013*
Standard	42.2	43.8	46.0
Packaged	10.5	10.8	10.0
Basic	5.6	5.3	5.4
Student	1.7	1.7	1.6
Other	1.9	1.9	1.9
Total	**62.0**	**63.5**	**65.0**

Source: CMA information requests.

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6. These two trends – falling PCA revenues and growing PCA numbers – mean that the revenue by active PCA has fallen over this period, from £143.7 per

account in 2011 to £125.2 per account in 2011 (–13%). We examined the changes in the largest revenue streams in more detail to determine whether they were due to a change in macroeconomic conditions or a change in PCA usage and/or pricing.

Changes in net credit interest

7. The amount of NCI earned by PCA providers depends on the value of credit balances and the spread earned on these balances (ie the difference between the interest rate paid on deposits and the interest rate received from the bank's treasury functions). Most PCA providers have internal transfer mechanisms where a central treasury function 'borrows' PCA deposits in return for an internal transfer rate before 'lending' the funds to other businesses in return for another transfer rate. PCA providers use different methodologies and hedging policies to calculate the transfer rate paid on PCA deposits, but this is typically based on a combination of rolling averages of three- and five-year forward swap rates and shorter-term inter-bank lending rate.

8. Total credit balances grew substantially since the last review, from £140.3 billion in 2011 to £177.0 billion in 2013 (+26.1%), which implies that the fall in NCI was due to a very significant tightening of the NCI spread in the industry. These changes – the increase in credit balances and the reduction in the NCI spread – were partly driven by the growth of Santander's 1-2-3 account which has attracted large credit balances due to the 3% interest rate paid on balances up to £20,000. However, even excluding Santander we found that the most important driver of the fall in NCI for PCAs was the tightening of the NCI spread for the other PCA providers.

9. We sought to assess whether this tightening of the NCI spread was due to an increase in interest rates paid on PCA credit balances or a reduction in interest rates received on these balances. We noted that, with the exception of Santander (which was excluded from our narrow sample for the reasons given above) and Nationwide, no bank appeared to have changed the credit interest rates on their PCAs over this period (Lloyds, TSB and Tesco introduced interest-bearing PCAs more recently).

10. We also noted that three- and five-year forward interest rates, which typically form the basis of the internal transfer rates used by PCA providers to estimate NCI, fell very significantly over this period (see Figure 2).[1] We concluded that

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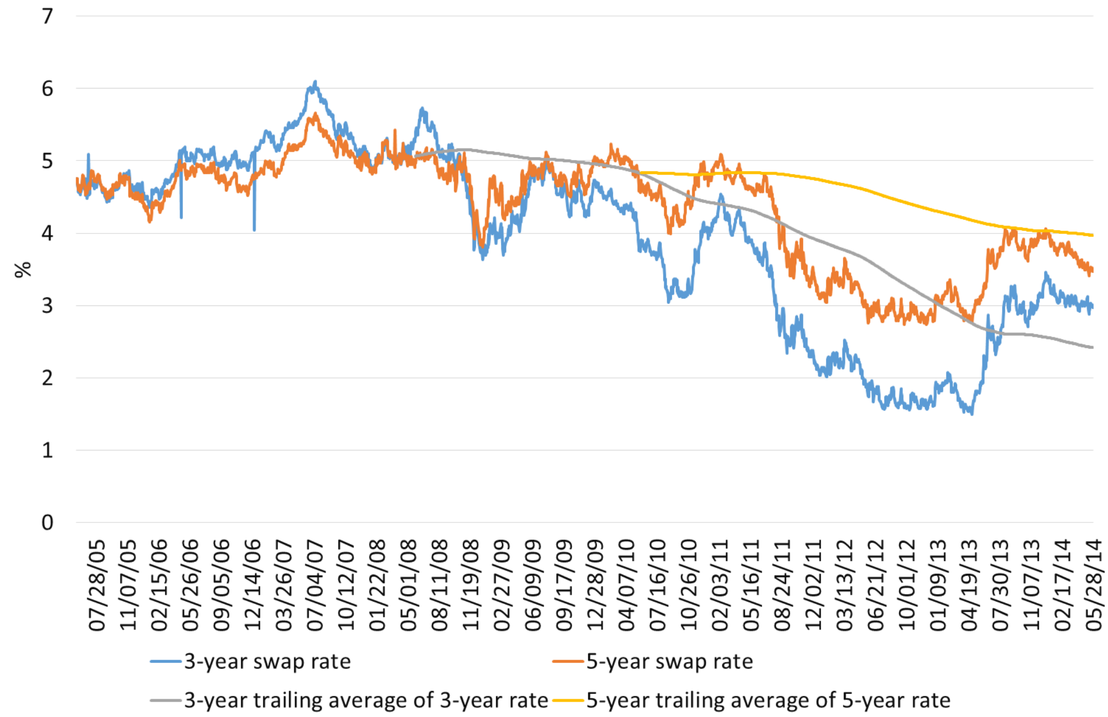
[1] Banks use a variety of notional hedging policies to calculate internal transfer rates. The most common approach is to use three- and five-year notional hedging policies for the largest share of balances. This means that at any given time the internal transfer rate will largely reflect the three- and five-year trailing averages of three- and five-year forward swap rates.

the bulk of the fall in NCI was attributable to the fall in wholesale interest rates, and therefore the reduction in interest rates PCA providers received on PCA credit balances. This trend might be reversed in the future if interest rates rise (the three-year swap rate is already above its three-year average). However, we recognise that more recently certain providers have started to market PCAs with positive credit interest, and that this may cause some further pressure on the spread, especially if interest rates rise slowly.

FIGURE 2

Three- and five-year GBP swap rates



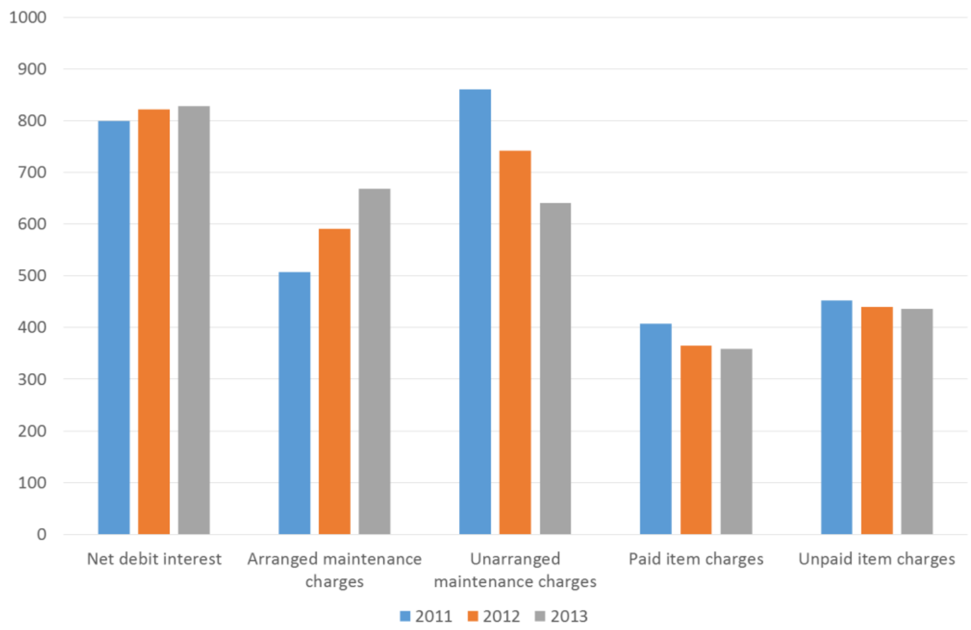
Source: Bloomberg data, CMA calculations.

Changes in overdraft revenues

11. The distribution of overdraft revenues has changed materially since 2011, even though total overdraft revenues dropped only slightly by 3%. Arranged maintenance charges increased by £161 million while unarranged maintenance charges dropped by £220 million. Transaction charges fell slightly and net debit interest increased slightly (see Figure 3).

FIGURE 3

Composition of overdraft revenues (£m)



Source: CMA information requests.

12. Over this period aggregate overdraft balances increased slightly, from £9,369 million in 2011 to £9,445 million in 2013 (+0.8%). This is in a context where the total amount of unsecured consumer credit outstanding in the UK economy rose more significantly, from £44.3 billion in 2011 to £50.9 billion in 2013 (+15.0%).[2] This includes overdrafts, but also other forms of unsecured credit such as credit card balances and personal loans.

13. We calculated the ratio between total overdraft revenues and debit balances as a high-level proxy for the 'all-in cost' of borrowing through an overdraft facility. This ratio fell from 32 pence of revenues per pound of debit balance in 2011 to 31 pence per pound in 2013 (–3.9%). This is in a period where wholesale funding rates decreased very significantly (as indicated in Figure 2 and as reflected in the fall in NCI analysed above). On that basis, it appears that the pricing of overdraft lending is not particularly responsive to changes in funding rates, and this could be a sign of weak competition in the provision of this service.

[2] Based on data from the Bank of England on monthly amounts outstanding of other consumer credit lenders (excluding the Student Loans Company) sterling net unsecured lending to individuals not seasonally adjusted (series LPMB4TF).

Changes in interchange fees

14. Interchange fees increased from £842.9 million in 2011 to £981.1 million in 2013 (+16.4%). We do not have data on transaction numbers or unit fees over this period, but given that the number of accounts only rose by 4.9% over this period it is likely that this rise was driven by an increase in unit fees.

15. The European Parliament is currently debating a Regulation to cap interchange fees for card-based transactions. The proposed text would see interchange fees capped at 0.3% of the transaction value for credit card transactions and 7 euro cents,[3] or 0.2% of the transaction value (whichever is lower) for debit card ones. The exact effect of these caps on interchange fees for UK PCA providers is as yet unclear.

16. A reduction in interchange fees – potentially in combination with other pressures on revenues – could threaten the viability of the ‘free if in credit’ pricing model for certain PCA providers or certain categories of customers as PCA providers seek to reduce the loss of revenue from interchange fees by charging for PCAs that are in credit. In turn, this could lead to more heterogeneous pricing structures applied in the market as PCA providers seek to offer products which appeal to different types of customers who previously all benefited from ‘free if in credit’ banking.

[3] European Parliament press release, ‘MEPs push for card payment fee caps and online payment safeguards’, 3 April 2014.