CMA Retail Banking Investigation
Nationwide Building Society response to the Statement of Issues

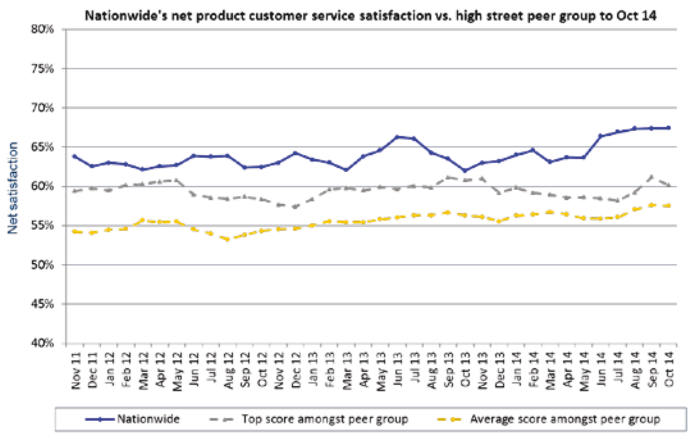
1. Introduction

1.1 This paper is Nationwide Building Society's ("**Nationwide**") response to the Competition and Markets Authority's (the "**CMA**") Statement of Issues dated 12 November 2014.

1.2 We look forward to working with the CMA to ensure the PCA market works well for consumers. In the following sections, we briefly summarise our strategic objectives before commenting on the Theories of Harm identified by the CMA in its Statement of Issues and remedies which may address those concerns.

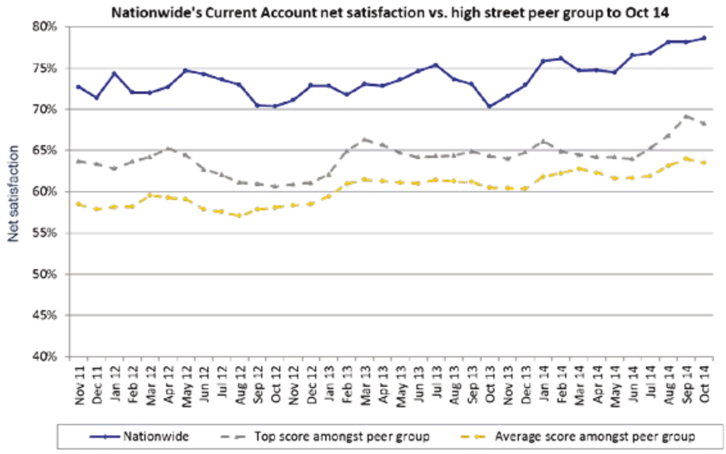
2. Nationwide's Strategic Objectives

2.1 Nationwide aims to be the first choice brand for personal financial services. As a mutual institution with a strong sector heritage, Nationwide is focussed on meeting the requirements of its members and is committed to delivering quality of service and quality of product for their benefit. In support of this agenda, Nationwide has invested heavily in new payment and banking platforms, a mobile banking proposition and product innovations and features. Our overall drive to improve service and design products to meet member needs has contributed to us being first for customer satisfaction for three years. More specifically, we have been first for customer satisfaction relating to personal current accounts on the high street for three years.[1]



Source: GfK NOP's Financial Research Survey (FRS), 3 month rolling data
Net product service satisfaction = proportion of extremely/ very satisfied customers minus proportion of extremely/ very/ fairly dissatisfied customers summed across current account, mortgage and savings
High street peer group = Barclays, Halifax, HSBC, Lloyds Bank (inc Lloyds TSB, TSB and C&G), NatWest and Santander

[1] Source: GfK NOP's Financial Research Survey (FRS), 12 months ending September 2014, September 2013, September 2012, c60,000 adults interviewed per year. Customer satisfaction is the proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers. The high street peer group is defined as Barclays, Halifax, HSBC, Lloyds Bank (including Lloyds TSB, TSB and C&G), NatWest and Santander.



Source: GfK NOP's Financial Research Survey (FRS), 3 month rolling data
Current Account net satisfaction = proportion of extremely/ very satisfied customers minus proportion of extremely/ very/ fairly dissatisfied customers
High street peer group = Barclays, Halifax, HSBC, Lloyds Bank (inc Lloyds TSB, TSB and C&G), NatWest and Santander

2.2 Nationwide's long-term strategic objective is to grow its share of main standard and packaged PCAs from its current level of 6.6%[2] to 10% (by number of accounts). [REDACTED]. The key challenges which Nationwide expects to face in achieving its objective of 10% of PCAs are multi-faceted, and include:

(i) ***Low levels of customer engagement and switching*** (see further paragraphs 3.4 et seq below);

(ii) ***The incumbency advantages of the four largest banks***[3] (see further paragraphs 4.2 and 4.3 below); and

(iii) ***The need for a branch network*** (see further paragraphs 5.3 and 5.4 below) – in this respect Nationwide notes that there is a strong correlation between PCA market share and share of branches.[4] As explained at paragraph 5.3 below, Nationwide considers that branches may become increasingly less important for the conduct of transactions, but they remain a key factor which customers take into account at the point of choosing their PCA.[5]

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[2] Nationwide's Interim Results to 30 September 2014.

[3] Barclays Bank plc, HSBC Bank plc, Lloyds Banking Group and The Royal Bank of Scotland Group plc (the "big four").

[4] Based on data available in October 2014 for seven banks.

[5] See Appendix 6 to Nationwide's response to the CMA's Phase 1 Request, in which Nationwide provided TNS data illustrating that branch/opening hours is the largest single reason customers choose a particular provider. GfK Market Report for June 2014 also shows that "convenient location" was the largest single reason customers switched to a particular provider.

3. Theory of harm 1: Impediments to switching

3.1 The CMA's first Theory of Harm is *"Impediments to customers' ability to effectively shop around, choose and switch products or suppliers, resulting in weak incentives for banks to compete for customers on the basis of price, quality and/or innovation"*.[6]

3.2 The CMA puts forward three sub-hypotheses in respect of this Theory of Harm:

(i) Hypothesis 1a (Access): A lack of accessible and transparent information means that customers do not have the information they need to compare offers or make informed decisions about how they use their existing banking services;

(ii) Hypothesis 1b (Assess): Product and pricing structures exploit customers' cognitive limitations and behavioural biases and inhibit their ability to compare offers and understand true costs of banking products; and

(iii) Hypothesis 1c (Act): The costs and risks of switching and the absence of prompts due to the evergreen nature of banking products, act as a disincentive for consumers to shop around and switch.

Hypotheses 1a and 1b – "access" and "assess"

3.3 Hypotheses 1a and 1b overlap to some extent and for the purposes of this response we consider them together. The CMA identifies two key issues in the PCA market which it considers contribute to low switching levels and a lack of competition between PCA providers:

(i) A lack of easily comparable information, due to complex and diverse charging structures for PCAs. This leads to an inability on the part of customers to compare products;[7] and

(ii) An inability on the part of customers to understand the true cost of PCA products, or to use those products in the optimum way, in particular because they fail to predict accurately their transaction patterns or are limited by other behavioural biases (e.g. anchoring through headline rates). This results in customers making sub-optimal decisions when choosing, and using, their PCA.[8]

3.4 Nationwide recognises that these issues may contribute to the current low levels of customer engagement in PCAs.[9] In Nationwide's view, it is crucial that customers are

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[6] See paragraph 27 of the Statement of Issues.

[7] See paragraphs 32 to 34 of the Statement of Issues.

[8] See paragraphs 34, 36 and 37 of the Statement of Issues.

[9] According to the Mintel report on "Packaged and Current Accounts" from July 2014, over half of current account holders have never switched their main provider, while a large proportion switched more than five years ago - see

not only able to observe and compare the monetary cost of PCA products,[10] but also that they are well-informed as regards other aspects of PCA offerings, in particular ***quality of service and overall customer experience***.[11] Making such information easily available to customers could potentially increase competition between PCA providers and fuel innovation in service quality.[12]

3.5 Nationwide nevertheless considers it difficult to gauge how important transparency is as a contributory factor leading to customer inertia, as compared with other factors, in particular customer's general perception that there is little differentiation between PCA providers.[13] Such perception in turn results in a lack of engagement (customers regarding PCAs as an "unexciting" product) which means that, having made the initial decision to bank with a particular PCA provider, many customers give little or no further consideration to this issue during their lifetime.[14] As the number one for current account satisfaction on the high street,[15] Nationwide would expect to benefit from the removal of such perceptions and the resultant impact on customer willingness to compare PCAs.

3.6 Nationwide acknowledges that survey evidence to be obtained by the CMA during the course of its investigation may provide insight into the reasons behind customer

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pages 21 and 95 of the Mintel report. In addition, 45% of the "affluent" market have never switched current account provider, and of those that have, over 60% did so over five years ago (see the Mintel report on "Premium Mass and Affluent Banking" from 2014, pages 16 and 75).

[10] According to Mintel's report entitled "Consumers and Retail Banking – UK", September 2014, one of the reasons for low levels of switching is that, *"despite efforts to increase transparency and the rise of comparison websites, consumers still find it near impossible to compare products offered by different providers."* Even for those customers who are set on switching, *"it takes a spreadsheet and an inordinate amount of patience for most people to work out if they're actually going to be financially better off by switching"*.

[11] According to Payments Council data from June 2012, the primary reason for switching was a customer's new bank having better service (a 'pull' factor, 27% of customers) followed by its old bank having poor service/errors (a 'push' factor, 25% of customers). See Payments Council document entitled "Account Switching", June 2012, slide 7.

[12] For example, in June 2014, Nationwide unveiled an updated version of its top rated mobile banking app, introducing two new innovative features: "Quick Balance" and "Impulse Saver". These features allow customers to manage their money in a faster, easier and more engaging way. "Quick Balance" allows customers to see their account balance at a glance without first logging in. "Impulse Saver" allows customers impulsively to save small amounts of money by allocating small savings made in everyday life from their PCA to their savings account e.g. £2 for a cup of coffee. For more information see Nationwide's website at http://www.nationwide.co.uk/about/media-centre-and-specialist-areas/media-centre/press-releases/archive/2014/6/04-june-new-features-of-top-rated-banking-app (accessed 12 December 2014).

[13] See paragraph 19(d) of the Statement of Issues. See page 22 of Mintel's report entitled "Consumers and Retail Banking – UK", September 2014: *"almost a quarter of potential switchers (24%) cannot identify a provider they would consider switching to, with the sentiment "they're all the same" being the most commonly cited explanation."*

[14] See for example page 98 of the Mintel report on "Packaged and Current Accounts" from July 2014: *"Despite efforts to increase switching behaviour in the current account market, providers will continue to face a large degree of inertia. […] Most adults are simply not that bothered about switching and it would probably take a severe failing on their existing bank's part to make them move."*

[15] See paragraph 2.1 above.

disengagement and low switching levels. Nationwide assumes that the CMA will provide it with adequate opportunity to comment on the design of any survey.

3.7 As an advocate of transparency,[16] Nationwide welcomes measures to improve transparency and enhance customers' ability to access and use information. In this respect, Nationwide:

(i) ***Welcomes MiData – provided it is properly formulated.*** Despite the costs and complexities it entails, MiData provides a potential solution. Nationwide therefore welcomes the recent announcement that Gocompare is committed to launching a MiData current account tool which it intends to make available from April 2015.[17] In order to provide customers with meaningful comparisons across PCA providers however, Nationwide considers that any comparison tool must (a) include product feature, service level and overall customer experience metrics (alongside price comparisons) and (b) cover the life of the PCA. These steps would help to address the CMA's findings that PCA providers with the highest satisfaction levels have not been able to gain market share and *vice versa*;[18] and

(ii) ***Supports some measures to standardise PCA charging structures*** (although not to the extent this may reduce customer choice or limit PCA providers' ability to innovate), and in particular increased transparency/simplification of arranged and unarranged overdraft charges.[19]

3.8 [REDACTED].

3.9 The CMA should also be careful to avoid measures which may limit entry/expansion or innovation in the PCA/SME markets, to the detriment of consumers. In particular:

(i) ***The CMA should consider carefully how it structures any industry-funded mechanisms.*** To the extent any proposed measures are to be funded by the industry, the charging mechanism should not be structured in a way that serves

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[16] For example, as noted in Nationwide's response to Question 9 of the CMA's Phase 1 Request, Nationwide was the first PCA provider to introduce monthly summaries. Nationwide is also the only bank with a market share over 3% to have a five star 'clarity of statement' rating from Which? - see Which?, "Best Banks for Customer Satisfaction – Bank Accounts", available online at: http://www.which.co.uk/money/bank-accounts/reviews-ns/bank-accounts/best-banks-for-customer-satisfaction/ (accessed 12 December 2014).

[17] See Autumn Statement 2014, available online at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382327/44695_Accessible.pdf (accessed 12 December 2014).

[18] See paragraphs 5 and 16 of the Statement of Issues. The CMA has found that *"despite customer satisfaction levels below 60% for the four largest PCA providers, there is little switching"*.

[19] For example, the CMA's report "Personal current accounts – Market study update", July 2014 (the "**PCA Market Study Update**") found that it is difficult to compare overdraft charges and that this may have worsened over time - see pages 61 to 64 of the PCA Market Study Update.

to make entry or expansion in the PCA market less attractive to "challenger" PCA providers relative to incumbents;[20]

(ii) ***The CMA should recognise the importance and potential benefits of cross-selling***. Nationwide considers there is a clear distinction between cross-selling in order to meet clear member need and demand, and the CMA's view that there may be significant linkages between products which are not representative of a competitive market. Each of Nationwide's retail banking products stands alone as a value proposition for customers, and Nationwide considers that considerable customer benefits can arise from cross-selling to meet the needs of its members. In this respect:

(a) Nationwide's ability to understand customers' data across products (for example, a customer's financial needs and creditworthiness) enables Nationwide to offer customers products tailored to their needs and take prudent/reasonable lending decisions;

(b) As a mutual, Nationwide believes it is appropriate that it rewards members for the length of time they have been with the Society and also for the breadth of their relationship. Nationwide therefore offers certain benefits only to its main current account customers;[21] and

(c) [REDACTED]

(iii) [REDACTED].

Hypothesis 1(c) – "act"

3.10 The CMA's third hypothesis is that customers are disincentivised from switching due to the costs and risks involved and the absence of prompts during the life cycle of a PCA.

3.11 In Nationwide's view, the switching process itself is no longer likely to be a significant impediment to switching. Although levels of switching remain relatively low, that is more likely to be the result of low levels of transparency and customer engagement (reflected

[20] Nationwide notes in this respect the OFT's view in its January 2013 Review of the personal current account market that, *"for the new system* [i.e. CASS] *to have a tangible affect* [sic] *on the PCA market, the funding of the new switching service should not impose any disproportionate costs on new entrants or smaller providers."* See paragraph 6.40 of the OFT's "Review of the personal current account market", January 2013.

[21] As explained in more detail in Nationwide's response to Question 1(i) of the CMA's Phase 1 Request, Nationwide's FlexAccount, FlexDirect and FlexPlus customers have access to exclusive Nationwide products and offers, known as "Flexclusives" (in the case of Flex Account customers, provided £750 or more is deposited in the account for three consecutive months).

in apparently low levels of expressed dissatisfaction). Once customers have made the decision to switch, they are unlikely to be put off by the process.[22] [23]

3.12 Given these points, Nationwide considers that CASS provides an appropriate framework for PCA switching,[24] and that any further remedy should be limited to:

(i) Continued promotion of CASS and dispelling any remaining concerns regarding the risks of switching; and/or

(ii) Iterative enhancements to CASS (such as those proposed by Vocalink (i.e. a central mandate store and central "know your customer" database)). Nationwide notes the announcement in the Autumn Statement that the FCA has been asked to consider the benefits of a 5-day switching period. Nationwide will adopt best market practice in the event of switching periods reducing but is concerned that there could be significant cost implications with little potential benefit.

3.13 More extensive measures (for example the introduction of Account Number Portability) risk giving rise to diminishing returns, being costly to implement with no clear additional benefit to customers.[25]

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[22] The switching process is an impediment to switching to the extent that customers misconceive the costs and risks involved, however there may still be other impediments to switching (e.g. misconceptions of the benefits of switching).

[23] A Consumer Focus survey entitled "Stick or Twist", October 2010, showed that only 10% of consumers who had not switched and not thought about doing so did not feel confident that they knew how to switch – see page 20. Furthermore, Mintel's report entitled "Premium and Mass Affluent Banking", 2014, suggests that customers that have previously switched (and, therefore, have been through the switching process) are more likely to switch again in future - see page 80.

[24] Nationwide notes in this respect the figures quoted by the CMA that switching statistics show an increase in switching of 22% in the first year of CASS' operation – see paragraph 2.19 of "Personal current accounts and banking services to small and medium-sized enterprises – Decision on market investigation reference", 6 November 2014 (the "**MIR Decision**"). There is evidence that competition has increased in the PCA market following the launch of CASS – for example, several providers have launched new products or made adjustments to their current products, including Lloyds Banking Group (launch of Club Lloyds), M&S Bank (launch of first fee-free account and discount on car insurance), Tesco Bank (launch of PCA), TSB (new PCA with a chance to earn 5% on balances up to £2000) and Halifax, Lloyds Banking Group and RBS/NatWest (launch of cashback/reward schemes) – see Mintel report on "Packaged and Current Accounts" from July 2014, page 16.

[25] Nationwide notes in this regard the Payments Council's view that the implementation of Account Number Portability would be complex, carry an unreasonable degree of risk and come at a significant cost which would ultimately be passed on to consumers – see paragraph 6.49 of the OFT's "Review of the personal current account market", January 2013. Research of consumers, businesses and charities/voluntary organisations which was commissioned by the Payments Council and published in June 2013 notes that *"*[CASS] *meets consumers' needs and is perceived to be comparable to account number portability"*. See page 4 of the report entitled "Account Number Portability, Qualitative Market Research Results", June 2013.

4. Theory of harm 2: Concentration

4.1 The CMA's second Theory of Harm is *"Concentration giving rise to market power of some banks leading to worse outcomes for customers"*.[26]

4.2 Nationwide agrees that the PCA market is concentrated, with shares having remained broadly stable over time. Moreover, Nationwide recognises that the "big four" do not have the same incentives as "challenger" banks like Nationwide. Their large installed base, strong position with new and "young" customers,[27] very extensive branch networks,[28] economies of scale and deep pockets to spend on brand marketing mean:

(i) These banks have limited incentive to compete for "switchers" on their core PCA product, electing instead to target switchers with alternative PCA products; and

(ii) They are likely to have a higher proportion of customers who are disengaged and unlikely to switch.

4.3 Nationwide is therefore not surprised by the CMA's finding that larger banks tend to attract lower levels of customer satisfaction than smaller banks.[29] In contrast, Nationwide continually invests in the products and services it offers to its members, and is a market leader in terms of customer service and satisfaction.[30]

5. Theory of harm 3: Barriers to entry / expansion

5.1 The CMA's third Theory of Harm is *"Barriers to entry and expansion leading to worse outcomes for customers".*

5.2 The CMA identifies as key barriers to entry / expansion: (i) regulatory barriers (FCA authorisation and capital/liquidity requirements); (ii) structural barriers (economies of

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[26] See paragraph 27 of the Statement of Issues.

[27] Parents are likely to open bank accounts for their children with the same bank they use (maintaining the incumbent's position). Furthermore, the larger banks have a 'campus presence' that is not replicable by challengers, allowing access to young customers. Mintel note that "*A lack of switching in the current account market is one of the reasons why there is strong competition in the student/graduate sector. Current account providers offer a number of incentives to young adults in order to win over their custom, knowing that customer inertia will mean that a large number of these adults will not move their account in the future"* - see Mintel's report entitled "Packaged and Current Accounts", July 2014, page 19.

[28] According to Mintel, the top five banking groups operate nearly 9,000 branches – see Mintel's report entitled "Premium and Mass Affluent Banking – UK", November 2014, page 62.

[29] See paragraph 2.24 of the MIR Decision. Furthermore, Which? finds that the 'Big Four' all scored in the bottom half of its "Best Banks for Customer Satisfaction" survey. See online at: http://www.which.co.uk/money/bank-accounts/reviews-ns/bank-accounts/best-banks-for-customer-satisfaction/ (accessed 12 December 2014).

[30] See paragraphs 2.1 and 3.5 above.

scale, brand, branch network, access to finance, access to payment systems and IT systems); and conduct barriers (cross-selling and other practices by incumbents).[31]

Branches

5.3 Whilst branches may become increasingly less important for the conduct of transactions (due to the use of telephone, mobile and online banking), they remain a key factor which customers take into account at the point of choosing their PCA.[32] [33]

5.4 Although the CMA may decide that branch divestments might represent part of the solution, we would point out that any divestment may not be straightforward given the systems and regulatory issues that could be expected to arise, as evidenced by the experiences of Lloyds Banking Group and The Royal Bank of Scotland Group plc during the divestments required under state aid rules.

5.5 Nationwide would not support branch sharing as this would significantly dilute our member and service proposition and give rise to very considerable operational issues and risks.

Authorisation and capital/liquidity requirements

5.6 Nationwide does not consider authorisation and capital/liquidity requirements to be as significant a barrier as they might have been in the past. In this respect, Nationwide notes the CMA's findings that recent reforms of the authorisation process have simplified the process and that steps taken by the PRA since 2013 to reduce capital and liquidity requirements may have reduced regulatory barriers.[34] Nationwide would point to the number of new banking licences in progress as support for its view that these issues no longer pose a significant barrier to entry.[35]

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[31] See paragraph 49 of the Statement of Issues.

[32] See Appendix 6 to Nationwide's response to the CMA's Phase 1 Request, in which Nationwide provided TNS data illustrating that branch/opening hours is the largest single reason customers choose a particular provider. GfK Market Report for June 2014 also shows that "convenient location" was the largest single reason customers switched to a particular provider. Nationwide believes this is the case regardless of whether the customer opens its account online or in branch – since consumers will generally want the comfort of knowing that there is a convenient branch to be accessed as necessary. See also Nunwood's "Customer Experience Excellence Centre 2014 UK Analysis", which states at slide 28 that *"50% of people would not choose a bank that did not have a local branch, despite the fact that many of us regularly bank on the web".* See also GfK FRS on Current Accounts, which finds that convenient location is the most widely cited reason for switching to a new bank – see page12.

[33] Branch network also continues to have relevance for customers requiring higher value services or advice - see Mintel's report entitled "Premium and Mass Affluent Banking", 2014, page 62.

[34] See paragraph 49(a) of the Statement of Issues. Nationwide considers that any further easing in the regulatory and capital / liquidity requirements for PCA providers must be balanced against the need for financial stability and customer security.

[35] Nationwide understands there are currently a significant number of banking licences in the pipeline.

Payment Systems

5.7 Nationwide recognises the work of the Payment Systems Regulator but nevertheless considers the CMA should conduct its own investigation of these issues, given their central relevance to the CMA's third Theory of Harm.[36] In doing so, the CMA should seek a balance between increased competition on the one hand and encouraging innovation in payment systems architecture and ensuring adequate consumer protection on the other.

Cross-selling

5.8 As explained at paragraph 3.9(ii) above, cross selling can give rise to considerable customer benefits. Furthermore and importantly, rather than being a barrier to entry, cross-selling may:

(i) Underpin the PCA proposition of many providers (see further paragraph 3.9(ii)(c) above); and

(ii) In some instances provide a gateway to entry into related markets (such as the SME market).

5.9 More generally, Nationwide would emphasise that providing PCAs is inherently expensive, in light of the significant investments required in, for example, infrastructure, data security, IT resilience and, most importantly, service and innovation. [REDACTED].

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[36] Nationwide nevertheless welcomes comments from the CMA and the Payment Systems Regulator that they will work closely to avoid duplication in this area – see paragraphs 2.6 and 3.31 of the PCA Market Study, 18 July 2014.