

RETAIL BANKING MARKET INVESTIGATION
HSBC RESPONSE TO STATEMENT OF ISSUES

1. EXECUTIVE SUMMARY

1.1 HSBC welcomes the opportunity to comment on the CMA's Statement of Issues (the *Issues Statement*) and the intended approach it outlines. HSBC submits that four guiding principles – set out below - should frame the CMA's assessment of competition in the PCA and SME banking markets. All of these principles are consistent with the Issues Statement, but they draw out what we consider to be fundamentally important aspects of how the CMA goes about gathering and analysing evidence in order to get to the heart of how competition is working and will work going forward in these markets:

- (a) **Future-proofing the analysis** – PCA and SME banking markets are undergoing significant change. Regulatory and legislative developments, technological innovation and evolving customer requirements and preferences are fundamentally changing the features of these markets. The CMA's assessment needs to be forward-looking, taking the next three to five years (or more) as its frame of reference. HSBC considers that the rapid development of digital and mobile banking is fundamentally changing customer behaviour and expectations of their bank, and substantially increasing the dimensions and intensity of competition both amongst banks and between banks and non-bank providers of financial services.
- (b) **Gathering new evidence** – it is vital that the CMA does not rely on past evidence where this is out of date or does not get to the heart of key issues. Looking at these markets through an evidential 'rear view mirror' will be unsuitable to diagnose potential issues and, if necessary, prescribe effective solutions. The current and likely future state of the markets under review can only be adequately assessed by gathering new evidence, such as how customer behaviour and competitive dynamics are affected by the rapid take-up and development of digital banking services. In particular, the CMA should design and conduct new quantitative customer surveys and other empirical demand side research for both PCAs and SME banking. HSBC is submitting to the CMA two short papers written by Alix Partners (on behalf of HSBC), which provide further detail on:
 - (i) the key considerations associated with the design of surveys in each of these markets; and
 - (ii) the "gaps" in the existing customer survey evidence relating to SME banking.
- (c) **Benchmarking against a realistically defined "well-functioning market"** – if the CMA is to succeed in avoiding the "Nirvana Fallacy" when setting the "well-functioning" market benchmark, it will need to focus on the specific features of banking markets that render them inherently different from, for example, fast moving consumer good markets

and even other financial products. Moreover, a holistic assessment of market features and realistic view of customer outcomes is required in each of the PCA and SME banking markets.

- (d) **Examining PCAs and SME banking separately** – there are fundamental differences on both the supply-side and demand-side of the PCA and SME banking markets. In order to guard against bias and ensure robust conclusions, the CMA’s organisational arrangements, evidence gathering and analytical approaches need to build in clear separation between the PCA and SME sides of the inquiry and give each side equal weight. Only this way can the CMA avoid unduly assuming or inferring commonalities between PCA and SME banking market features and/or customer outcomes.¹

Given the “once in a generation” importance of this inquiry, HSBC submits that any CMA decisions to prioritise particular work streams should be in favour of gathering and analysing new evidence on the current and changing features of each of the PCA and SME banking markets, particularly on the demand-side, and defining realistic benchmarks against which to assess those features.

- 1.2 HSBC broadly agrees that the CMA’s three theories of harm are the areas that should be investigated. However, as outlined in Section 3, new evidence and analysis are required to reach robust conclusions on each of these theories of harm:

- (a) **Impediments to “assessing, accessing and acting”** – the CMA should consider:
- (i) the impact on customer awareness and decision-making of:
 - (A) recent regulatory and market-based transparency measures – the CMA should investigate the extent to which these initiatives and developments, including changes to overdraft pricing and the huge growth in the use of mobile channels, have increased the transparency and availability of information;
 - (B) increased adoption of digital and mobile banking tools – this will require new evidence-gathering, such as field trials to examine customers’ ability to use digital tools to compare offers; survey evidence on customer confidence in using such tools; and analytics data on changes in customer behaviour facilitated by such tools.
 - (ii) whether full account switching is a reliable indicator of customer engagement, and the reasons underpinning customers’ switching

¹ HSBC recognises the challenge the inquiry team and panel members face in completing what are in effect two separate market investigations within a single statutory process, but nevertheless it considers it important to resist shortcuts in this area.

behaviour – this will require an assessment of the impact of multi-banking, new account opening, “try-before-you buy” behaviour and soft-switching.

- (b) **Concentration and market power leading to worse customer outcomes** – the CMA needs to collect empirical evidence as to whether any banks can exert unilateral market power and whether this has led to pricing, quality, service or innovation that is inconsistent with effective competition in the relevant markets. In doing so, the CMA will need to refer back to the realistic counterfactual of what a well-functioning market can be expected to look like.
 - (c) **Barriers to entry and expansion leading to worse outcomes for customers** – many of the barriers identified by the CMA have been greatly reduced by recent developments in the relevant markets. The CMA should individually assess these barriers to determine the extent to which they do in fact hinder entry and expansion. Case studies of the kind proposed by the CMA could usefully supplement and add colour to this assessment, provided they are representative and fair examples. In particular, the studies should include both recent and anticipated examples of entry and expansion, involving providers with a range of different business models. The CMA should allow stakeholders to input into how case studies are selected and analysed.
 - (d) **Customer satisfaction** – there are intrinsic problems in relying on customer satisfaction as evidence of effective competition in the PCA and SME banking markets. First, interpretation of measures of consumer satisfaction is particularly prone to subjectivity and bias – the CMA will need to be alert to this when designing and interpreting its customer surveys. Second, it is meaningless to look at consumer satisfaction statistics without also seeking to understand the causes of customers’ relative satisfaction or dissatisfaction. Many stated causes of dissatisfaction are not necessarily indicative of weak competition.
- 1.3 HSBC explores each of these points further in the remaining sections of this response.
- 2. CMA’S APPROACH TO CARRYING OUT A MARKET INVESTIGATION: CONCEPTUAL FRAMEWORK FOR ASSESSING COMPETITION IN THE PCAS AND SME BANKING MARKETS**
- A. Future-proofing and a forward-looking assessment is key to robust analysis and outcomes**
- 2.1 This market investigation represents a once-in-a-generation opportunity to assess the state of competition in the PCA and SME banking markets and plot its course for the foreseeable future. In this regard, HSBC welcomes the CMA’s acknowledgement that it will “*be forward thinking, recognising that in the retail*

banking sector there are a number of changes currently taking place, or which will be taking place within the next few years.”²

- 2.2 It is imperative that the CMA undertakes a forward-looking assessment and ensures that its findings - and, if necessary, any related intervention - take account of the significant ongoing and forthcoming market developments, and the changing preferences of the markets’ customer base(s). This will ensure that its conclusions and actions are not rendered otiose or ill-judged by market developments.

Recent developments in the PCA and SME banking markets

- 2.3 The CMA has set out a number of recent and upcoming developments in the PCA and SME banking markets.³ HSBC has previously explained the impact of these developments in its previous submissions to the CMA, in particular:

- (a) new entry and bank and branch divestments;⁴
- (b) changes in the regulatory regime for authorising new banks⁵ and the introduction of seven-day current account switching services (**CASS**);⁶
- (c) the establishment of a payment systems regulator (the **PSR**)⁷ and the development of alternative payment systems such as PayPal;⁸
- (d) greater provision of online and mobile banking services;⁹ and
- (e) implementation of the EU Payments Accounts Directive aimed at increasing the information available on products and charges,¹⁰ as well as new legislation to increase the availability of SME creditworthiness information.¹¹

- 2.4 In addition to these important developments, there are several additional forthcoming developments that the CMA should take into account:

- (a) ring-fencing reforms (explained further at paragraphs 2.10 to 2.11 below);

² Issues Statement, paragraph 16.

³ Issues Statement, paragraph 19(j).

⁴ HSBC’s full submission to the CMA dated 23 May 2014 (**HSBC May 2014 Submission**), paragraphs 4.42 to 4.45 and 9.4 to 9.6.

⁵ HSBC May 2014 Submission, paragraph 4.24.

⁶ HSBC May 2014 Submission, paragraphs 5.3 to 5.8.

⁷ HSBC May 2014 Submission, paragraph 4.23.

⁸ HSBC May 2014 Submission, paragraphs 3.20 to 3.23 and 4.46 to 4.47.

⁹ HSBC May 2014 Submission, paragraphs 3.14 to 3.19 and 8.6.

¹⁰ HSBC May 2014 Submission, paragraph 3.5.

¹¹ HSBC May 2014 Submission, paragraph 8.52.

- (b) the Government's current MiData initiative, which will provide PCA customers with access to electronic records of their own transaction history in a standardised and downloadable format. This data can then be uploaded to comparison websites to calculate a more tailored, and therefore effective, comparison of different providers' PCA offerings;¹² and
- (c) legislative proposals requiring SME lenders to provide details of SME customers they decline to provide finance for to private sector platforms in order to help match these SME customers with alternative finance providers.¹³

Impact of digital banking and technological innovation

- 2.5 The CMA should consider the importance of digital banking and technological innovation. There are some 11 million people in the UK between the ages of 10 and 25 with a further 4.5 million aged between 25 to 30¹⁴ – “digital” is a key component of competition for this cohort of current younger and future customers. In particular, the ubiquity of smart mobile devices amongst this generation and the migration to 4G will continue to drive increased take-up of mobile banking. Mobile and e-payment technology, coupled with the development of cheque imaging and the growth of e-commerce (and corresponding decline in cash), is similarly driving SME demand for electronic transactions.
- 2.6 The current focus of the Issues Statement appears to be on the impact of digital banking on the costs of developing a branch network.¹⁵ HSBC considers that the rapid development of digital and mobile banking has significantly wider implications: it is fundamentally changing customer behaviour and expectations of their bank, and dramatically increasing the dimensions and intensity of competition both amongst banks and between banks and non-bank providers of financial services. HSBC suggests that understanding these dynamics should loom large in the CMA's evidence gathering and analysis – both when considering whether adverse effects on competition exist or are likely to persist and (if relevant) in terms of considering the case for and design of any intervention.
- 2.7 The pace of change in the use of digital banking services by PCA customers and SME customers is striking:

¹² HSBC May 2014 Submission, paragraph 3.28. See further: <https://www.gov.uk/government/policies/providing-better-information-and-protection-for-consumers/supporting-pages/personal-data>.

¹³ HSBC May 2014 Submission, paragraph 8.54. See further: <https://www.gov.uk/government/consultations/sme-finance-help-to-match-smes-rejected-for-finance-with-alternative-lenders>

¹⁴ Office for National Statistics. See: <http://www.ons.gov.uk/ons/rel/census/2011-census/population-and-household-estimates-for-the-united-kingdom/stb-2011-census--population-estimates-for-the-united-kingdom.html#tab-The-structure-of-the-population-of-the-United-Kingdom>

¹⁵ Issues Statement, paragraph 50.

- (a) In just over two years, total mobile banking log-ins increased from just under 30 million per year in 2011 to over 900 million in 2013¹⁶. The number of customers using banking apps per week doubled between 2012 and 2013, from approximately 9.1 million to 18.6 million.¹⁷
- (b) The Payments Council expects mobile and internet to account for 1.5 billion customer payments annually by 2022, a fourfold increase on 2012 levels.¹⁸
- (c) The CMA found that 85% of PCA customers use online banking and 37% of PCA customers use mobile banking.¹⁹ A recent survey²⁰ found that 94% of bank users log on to their online banking at least once a month, while 75% check in once a week. More than half (56%) of PCA holders use a banking app every week, with 10% doing this on a daily basis.
- (d) A survey of SMEs by BACS in 2013²¹ reported that:
 - (i) *“There has been a clear move away from cheques towards electronic methods of payment, with 75% more SMEs using online banking and 60% more SMEs using Bacs Direct Credit than 5 years ago.”*
 - (ii) *“The most significant prediction from SMEs is that 68% expect their use of online banking to make payments to increase over the next 3 years, with 55% expecting an increase in the use of Bacs Direct Credit.”*
 - (iii) *“The figures for receiving payments are similar at 67% (online banking) and 59% for Bacs Direct Credit. Cheque usage is expected to continue to fall with 74% of SMEs stating that their use of cheques to make payments will decline, while 72% state that the use of cheques to receive payments will also decline.”*

2.8 The CMA will want to consider how technological developments are increasing opportunities for innovation and rivalry across new dimensions and what impact this will have on customer engagement. For example, HSBC notes that:

¹⁶ CMA, Figure 3.1 on page 58.

¹⁷ PCA Market Study Report, paragraph 3.21.

¹⁸ Payments Council: “UK Payment Markets 2013”,
http://www.paymentscouncil.org.uk/media_centre/press_releases/2013_archive/-/page/3063/.

¹⁹ PCA Market Update, paragraph 2.54 citing Mintel, Packaged and Current Accounts – UK, July 2013, p. 67. Consumer survey of nationally representative sample of 1,959 Internet users aged 16+ with a current account.

²⁰ <http://www.finextra.com/news/fullstory.aspx?newsitemid=26707>

²¹ http://www.bacs.co.uk/Bacs/DocumentLibrary/Publications_SME_attitudes.pdf

- (a) Text alerts are now becoming more common, and all major providers and a number of smaller ones now offer some form of text alert service for both PCAs and BCAs.
 - (b) Smart mobile devices enable consumers to be continuously connected and informed about their banking activity, and greater consumer sophistication (in terms of comfort with digital technology and raised expectations) increases the number of parameters that consumers use to evaluate their bank.
 - (c) Mobile apps in particular deliver tangible benefits to customers in terms of ability to control finances and optimise income from their deposits. The FCA found that use of mobile apps triggered substantial declines in PCA overdraft fees,²² a trend which mirrors HSBC's own experience.²³
 - (d) Since 2011, when the introduction of CASS was first proposed, participating PCA providers have implemented 150 current PCA enhancements.²⁴
 - (e) In the PCA market, existing providers are innovating and differentiating their products through new mobile payment services, mobile banking, auto-enrolment text alerts, cash incentives to switch, attractive credit interest offers and additional rewards.
 - (f) In the SME market (where digital penetration is significantly higher than PCA), HSBC's market-leading internet banking propositions²⁵ have spurred innovations from competitors (e.g. Barclays): for example, HSBC was the first bank to launch a mobile business banking app and has developed a Multi-Channel Business Account Opening System to improve the speed and ease with which SME customers can open and/or switch their BCA by allowing the use of multiple channels (i.e. branch, Internet and phone) during the account opening process.
 - (g) All of the main banks offer tariffs to SME customers which incentivise electronic banking rather than the use of branches.
- 2.9 The CMA will then need to consider the implications of these trends for key parameters of competition – in particular:
- (a) ***Customer awareness and decision-making*** – to what extent is digital technology becoming a key element of banking provider selection and what impact does it have on the ability of customers to access information, compare alternatives across providers, and simplify the bank switching

²² See: <http://www.fca.org.uk/static/documents/market-studies/fca-response-cma-sme-banking.pdf>.

²³ HSBC May 2014 Submission, paragraph 3.16.

²⁴ Payments Council Submission, *CMA Market Study of the UK personal Current Account Market*, 30 May 2014, p. 7.

²⁵ HSBC was rated Moneyfacts' "Best Online Banking Provider" in 2011, 2012, 2013 and 2014.

process? HSBC notes that recent PwC research²⁶ found that “*ease of online banking service*” was the top response given for the most important factors in switchers’ decision to change current account provider. To explore these issues further, the CMA should consider:

- (i) conducting field trials to examine customers’ ability to use digital tools to compare offers;
 - (ii) gathering new survey evidence on customer confidence in using such tools; and
 - (iii) examining customer analytics evidence relating to changes in customer behaviour facilitated by digital tools (e.g. balance transfers to take advantages of credit interest differentials or to manage overdrafts).
- (b) **Reliance on branch** – to what extent are digital and mobile technologies changing how consumers interact with their banks? What is the impact of the ability to transact remotely on customer reliance on the branch channel for both transactions and product purchases? HSBC’s own view is that these technological developments lower barriers to entry and expansion, facilitating the emergence of digital-only players (e.g. Atom bank) and the entry and expansion of other players with new entrants who have less reliance on offering an extensive branch network (e.g. Metro). These issues should be explored through customer surveys and analysis of different bank models.
- (c) **Disruptive entry** – what are the implications of technological innovation for the likely business models of the future? To what extent is technology creating the possibility for even more disruptive entry and greater threats to traditional branch-based PCA banking? The CMA will need to consider the emerging threats posed by non-traditional players (e.g. Apple, Google, PayPal)²⁷ in the payments and banking space. HSBC notes that PayPal has entered the business loan market and that Accenture predicts that competition from non-traditional digital players could erode as much as one-third of traditional bank revenues by 2020.²⁸

²⁶ <http://www.pwc.co.uk/financial-services/financial-services-risk-and-regulation/how-financial-services-lost-its-mojo.jhtml>, page 12. When asked to name their top three reasons for deciding to change current account provider, ease of online banking was mentioned by 31% of respondents. Number of branches registered in 19% of responses.

²⁷ As well as developments in payments regulations by the PSR, the CMA will also want to have regard to the EU’s Payment Services Directive II (in particular the proposals regarding third party providers of payment initiation services) in the context of the European Commission’s drive to facilitate a single digital market. See: Directive of the European Parliament and of the Council on payment services in the internal market (COM(2013) 547).

²⁸ See: <http://www.accenture.com/SiteCollectionDocuments/PDF/Accenture-The-Everyday-Bank-A-New-Vision-for-the-Digital-Age.pdf>, p. 3.

- (d) ***Rivalry in innovation*** – what is the impact on the nature of rivalry in innovation? To what extent must banks increasingly innovate in terms of new product capabilities to meet changing customer expectations? Examples of innovative digital banking capabilities include (*inter alia*) mobile remote deposit capture,²⁹ mobile photo bill payments, mobile person-to-person payments (e.g. Paym, which went live on 29 April 2014, has already attracted approximately 1.6 million registrations and there are expected to be approximately 5.5 million registrations by the end of 2015³⁰), mobile personal financial management tools, mobile alerts, quick balance views (without having to log in to the account), digital couponing and digital wallets. [*confidential*].

Impact of ring-fencing

- 2.10 Under the Financial Services (Banking Reform) Act 2013 (and related secondary legislation), banking groups with £25 billion in value of deposits from individuals and businesses must place the majority of UK consumer and all small corporate deposit-taking and related banking activities into fully ring-fenced bodies. For these purposes, small corporates can be broadly defined as entities with less than £6.5 million turnover. The Government has stated its intention for ring-fencing to be implemented by 1 January 2019; in practice, however, the banks will need to aim to effect appropriate changes well in advance of this deadline and the scale of the task means that work is in train now to achieve that. As part of a forward-looking assessment, we suggest the CMA may want to consider how implementation of the ring-fencing requirements – and associated structural changes within the major providers - will impact providers' competitive strategies and incentives and market dynamics. At a minimum, it will also need to be a key consideration in the CMA's forward-looking assessment of profitability and - if relevant - any consideration of remedies.
- 2.11 For HSBC and other affected UK banks, ring-fencing implementation will represent an enormous internal change. [*confidential*]. HSBC is concerned that if the CMA were to recommend any action that would require an additional significant structural or organisational change to the planned design or implementation of ring-fencing, it could make achievement of the Government's desired ring-fencing deadline even more challenging.

B. Importance of gathering new evidence

- 2.12 The PCA and SME banking markets have been subject to a series of market reviews over the past 15 years and a large amount has been written about them as a result. However, it is vitally important that the CMA does not simply rely on past evidence where this is out of date or does not get to the heart of key issues; the CMA must gather new evidence that will allow it robustly to assess the current and

²⁹ This is typically accomplished by scanning a digital image of a cheque onto a computer or mobile and then transmitting that image to the bank

³⁰ The forecast for expected registrations at the end of 2015 is based on the consolidated forecasts of the individual Paym participants, which means there is a margin for error.

likely future state of competition in the relevant markets, having regard to customer and firm behaviour. This is consistent with the CMA's role and function as a second phase body in a market investigation reference.³¹

2.13 Gathering new evidence is critical for the following reasons:

- (a) If, as the CMA's first theory of harm³² suggests, the CMA intends to analyse the motivations and choices underpinning customer behaviour in both the PCA and SME markets, it is essential that it does this on the basis of new evidence, given that: evidence gathered in previous enquiries is for the most part either out of date (in some cases very) or too high level to enable root causes to be understood.
- (b) It is necessary to take account of the positive impact of recent, significant changes in the market, including regulatory and technological developments.
- (c) The CMA should use the latest tools available when undertaking its analysis, including a focus on behavioural economics and appropriate use of field trials and customer analytics (in particular, HSBC notes the CMA's intention to leverage customer analytic data to improve the efficacy of survey data which HSBC considers is sensible).

2.14 Previous investigations have not delivered a good analysis or understanding of what drives customer behaviour and choices. HSBC submits it will be critical for the CMA to get to the bottom of those difficult questions through gathering new customer survey evidence for both PCAs and SME banking. In the absence of this evidential base, the CMA's conclusions on whether market competition is delivering positive customer outcomes will lack credibility.

2.15 HSBC also considers that having a sound understanding of what drives customer behaviour is essential if there is to be any properly informed discussion of hypothetical remedies between HSBC, other parties and the CMA during the course of the market investigation.

2.16 HSBC has set out in this section and subsequent sections of this response the specific types of evidence that it considers the CMA should collect and analyse to ensure a full and proper examination of competition in each of the PCA and SME banking markets.

³¹ Competition Commission, *Guidelines for market investigations: Their role, procedures, assessment and remedies*, April 2013 (CC3 (Revised)) (the **CMA Guidelines**), paragraph 22. "the [CMA] proceeds wholly independently of the referring body; a [CMA] market investigation casts a 'fresh pair of eyes' able to look more deeply at new evidence and analysis of the market"

³² 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 (Issues Statement, paragraph 35).

Customer surveys targeted at both PCA and SME banking customers

- 2.17 Properly designed and executed, customer surveys are capable of providing valuable evidence concerning the rationale and decision-making process underpinning customer actions. Understanding customer needs, preferences and actions is a necessary precursor to an assessment of whether customers are able to access, assess and act on information available in the market.
- 2.18 HSBC therefore welcomes the CMA's decision to commission a quantitative PCA customer survey. In HSBC's view, the most critical unresolved questions a PCA survey should address are:
- (a) Which customer segments are most likely to switch or consider switching? Customer segments could be defined by a combination of value, age or channel preference.
 - (b) For those customers who do not consider that there are benefits to switching, how have they arrived at this conclusion (e.g. have they shopped around to compare competing offerings to reach this conclusion or does it simply reflect the fact that their provider has not given them a reason to consider switching their provider)?
 - (c) When comparing "considerers" (i.e. those customers who have considered switching but ultimately decided not to switch) and switchers, what is the extent of customers' price and service comparison activities? Why did "considerers" choose not to switch providers?
 - (d) What is the link between innovation and customer engagement? In particular, how important are digital and mobile features in customers' usage of bank services and choice between different providers?
 - (e) What is the relative importance of branch access compared to other factors? For example, to what extent would customers trade-off convenient access for longer branch opening hours or superior digital banking services etc.?
 - (f) What are customer preferences in relation to overdraft pricing structures?
 - (g) What are the customer benefits from holding multiple products with a bank?
 - (h) Behavioural issues, including how customers assess likely overdraft usage and assess "free-if-in-credit".
- 2.19 HSBC is very concerned, however, that the CMA has not yet decided whether to commission a similar quantitative survey to examine SME customer behaviour and would urge the CMA to do so. HSBC believes that relying on existing Charterhouse research to analyse SME banking customer behaviour will be inadequate for a full analysis of SME banking. This is because:
- (a) The Charterhouse research was designed to examine a particular set of issues, which are not on "all fours" with the CMA's objectives. In many instances, the existing survey material does not address important issues

relevant to the CMA's theories of harm (e.g. customers' willingness to trade off branch location against other aspects of a bank's competitive offering). Additional evidence is therefore required to understand customer motivations in these and other areas.

- (b) Supplementary evidence is required to understand competitive effects of customer behaviour. For example, existing survey evidence does not provide much insight into the reasons behind multi-banking or the disciplining effect of multi-banking on banks' offers.

These two issues are discussed in further detail in Alix Partners' paper on the "*Analysis of Likely Gaps in Customer Research for SME Banking*", which is also being submitted to the CMA.

2.20 The most critical unresolved questions an SME customer survey should address are:

- (a) To what extent and how do SME customers shop around and what difficulties are faced by customers who do so?
- (b) To what extent do digital banking features, such as mobile applications, lead to increased SME customer engagement?
- (c) For those SME customers who have not considered switching, what factors may lead them to consider switching in the future?
- (d) What are the "stopping factors" in the engagement process for non-considerers and considerers?
- (e) Does SME customers' assessment of the relative importance of the branch network vary among switchers and non-switchers?
- (f) To what extent are SME customers aware of digital product features and how do such features affect their choice of banking provider?
- (g) Given limitations on the usefulness of "customer satisfaction" as an indicator of customer outcomes, what are the key elements of banks' product and service offerings that customers value?
- (h) What are the benefits that customers derive from purchasing multiple products from one provider?
- (i) What are the reasons for SME customers having multiple BCAs and how does this affect their ability to discipline banks' offers?
- (j) To what extent do the needs of SME customers and the services demanded by them vary depending on the size and business type of SME customer?

2.21 HSBC understands that the CMA is intending to supplement any perceived gaps in existing SME banking survey data with qualitative research through focus groups. HSBC does not consider this has any realistic prospect of adequately addressing the gaps summarised above. Qualitative surveys do not provide a means for

drawing any robust conclusions about the broader population due to the small sample sizes and the nature of the interaction being a facilitated discussion. There is also a significant risk of biases affecting the results (including self-selection bias, impact of peer pressure, desire to say what is thought to be expected, moderator influence, etc.).

- 2.22 These issues are discussed in further detail in Alix Partners' paper on "*The Design of Customer Surveys*", which is also being submitted to the CMA.

C. Characteristics of the "well-functioning" market

- 2.23 The CMA has rightly highlighted the need to avoid a Nirvana Fallacy trap of seeking to measure competition in the market against "*idealised or theoretical notions of a perfect market*".³³ When considering the well-functioning market benchmark, the CMA's focus must be on real-world parameters of competition in the relevant PCA and SME banking markets and realistic outcomes.

Need to define the well-functioning market

- 2.24 HSBC firmly agrees with the CMA that there is a need to define properly a "well-functioning" market. In doing so, and as the CMA has recognised, it will be important for the CMA to take into account the specific features³⁴ of each of the PCA and SME banking markets and to adopt a forward-looking assessment. Therefore, defining the well-functioning market benchmark has implications for the evidence the CMA will need to gather.
- 2.25 In defining a realistic benchmark for the PCA and SME banking markets, HSBC believes that the CMA should consider (*inter alia*) the following questions, which relate to demand-side and supply-side characteristics that have been somewhat overlooked or under-represented in previous studies.
- 2.26 On the demand-side:
- (a) How extensive are underlying customer preferences "*to meet the majority of their banking needs from one bank*" and what are the perceived benefits of these?³⁵ Related to this, to what extent do customers value a long-term relationship with the bank and why?
 - (b) More fundamentally, what are customer expectations of the services they require from PCA and BCA providers? In particular, to what extent are customers demanding value added services (e.g. those giving them the

³³ The CMA's Statement of Issues dated 6 November 2014 (*Issues Statement*), paragraph 20.

³⁴ The CMA has set out a list of "*key characteristics*" of the market that will be "*important in assessing the nature of competition in the sector*" (*Issues Statement*, paragraph 19). HSBC considers that some of these are relevant to the well-functioning market benchmark (although these do not represent a comprehensive list of those factors), while others are relevant to assessing how the actual market performs against that benchmark.

³⁵ *Issues Statement*, paragraph 19(c).

ability to manage their finances or business more efficiently) in addition to basic deposit and payment handling services?

- (c) What is the realistic (and not “*idealised and theoretical*”) benchmark for customer engagement? In particular, what proportion of the customer base needs to be fully engaged in order for competition to function effectively? It will be important for the CMA to fully understand the degree of customer engagement and the drivers underpinning it. This is not easy and will require sophisticated customer insight.³⁶ However, it is striking that technology appears to be a key driver of customer engagement. For example, the development of SMS overdraft alerts and mobile banking apps have “nudged” PCA customers to be more engaged in managing their finances and reducing the extent to which they incur overdraft fees. Moreover, for SME customers, relationship management is a key driver of customer engagement.
- (d) What are realistic benchmarks for customer biases? For example, the CMA observes that customers may face impediments to assessing their “*optimum usage*” of accounts due to cognitive biases (such as underestimating overdraft usage).³⁷ This remark seems to conflict with the CMA’s objective of setting realistic and not “*idealised and theoretical*” benchmarks.
- (e) It will also be relevant to consider how these factors vary according to the type of customer (e.g. between PCA customers and SME customers, and also within different segments of the PCA and SME banking markets).

2.27 On the supply-side:

- (a) How significant are regulatory measures to meet capital, liquidity and consumer protection requirements in terms of their impact on economies of scale?³⁸
- (b) How significant are underlying economies of scope given customer preferences and other efficiencies for supplying products and credit to customers with whom the bank has a long-term relationship?

³⁶ In addition, the CMA will need to understand how customer engagement translates into competitive pressure. For example, switching statistics focus solely on those customers who fully switch accounts (rather than partial switching by opening multiple accounts and the competitive pressure from new customers) and fail to consider the value of customers lost (for example, competitors seeking to grow their market share would have incentives to focus on winning the business of more profitable customers and such customers would have the greatest incentives to shop around). Moreover, industry-wide average switching (whether full or partial) and the decisions made by new customers may also mask the extent to which an individual bank faces potential market share losses. Finally, the CMA should assess the efforts that banks make to incentivise their customers not to switch by improving their service offering.

³⁷ Issues Statement, paragraph 36.

³⁸ Issues Statement, paragraph 19(a).

- (c) What implications do the funding benefits of long-term stable (core) deposits have for the nature of competition to attract and retain customers? In particular, the CMA will need to understand the relationship between deposit-seeking activity and the Asset/Deposit ratio of different financial providers, as well as how this is likely to be affected in the future by the implementation of ring-fencing reforms.
 - (d) What are the implications of developments regarding digital and mobile technology for the assessment of competition in the PCA and SME banking markets?
 - (e) To what extent are providers innovating and providing value-added services in order to attract and retain PCA and SME customers?
- 2.28 As set out in the CMA Guidelines,³⁹ the CMA's analytical framework should focus on the process of rivalry. This has implications for setting realistic expectations for key indicators of effective competition. In particular, effective competition and positive customer outcomes do not require all customers to be switching or actively considering switching. Marginal customers and the relative value of those customers are the factors that drive competition. This means markets can function well even though not every customer is fully engaged. While this may result in some customers doing better than others, this differentiation in customer offers is important to ensure engaged customers have an incentive to shop around.⁴⁰
- 2.29 Similarly, the assessment needs to capture all dimensions of rivalry and how banks compete on key parameters, such as price, service quality and innovation. The CMA should focus on those factors that are most important for customer outcomes.

³⁹ CMA Guidelines, paragraphs 10 to 12.

⁴⁰ More formally, there is a trade-off between the "incentive effect" of lower prices for new customers and the "transmission effect", which is the degree to which competition for new customers disciplines prices to existing customers. At the extreme where there is no difference between prices offered to new versus existing customers, competition for new customers is fully transmitted to existing customers. However, in an environment where there are switching costs, there may be no incentive to shop around in the first place. More generally, switching costs may lead to lower prices overall. See, for example, Dube et al (2006), available at <http://neumann.hec.ca/cref/sem/documents/061207.pdf>. See also: "Promoting or restricting competition? Regulation of the UK retail residential energy market since 2008", Stephen Littlechild, 15 August 2014, available at <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/09/1415-PDF.pdf>. The abstract to this paper succinctly summarises Professor Littlechild's views: "Since 2008 UK energy regulator Ofgem has imposed increasingly severe restrictions on suppliers to the domestic (residential) retail market. Initially, non-discrimination conditions aimed to "remove unfair price differentials", particularly between suppliers' prices between regions, totalling £0.5 bn. This actually envisaged increasing prices to other customers by £0.5 billion, to maintain revenue neutrality. In the event, competition reduced, customer switching fell by half, and profits of major suppliers increased by nearly £1 billion, at the expense of customers. Later, restrictions on the number and types of tariffs aimed to encourage customers to engage in the market. However, there is no empirical evidence to justify this, and the policy prohibits many discounts and tariff types that customers value, especially vulnerable customers."

For example, innovations which help customers manage their money efficiently and borrow more easily may be more important than price discounts (e.g. 5% off a PCA product costing £125 a year, including foregone interest and fees, is only approximately £6).

Need to undertake a holistic assessment of each market

2.30 When assessing the competitive functioning of the market, the CMA will need to consider each market as a whole and take account of the interaction between different market features – for example:

- (a) HSBC agrees that “*high levels of concentration might not give rise to market power in the absence of high barriers to entry and expansion*”.⁴¹ Levels of concentration may also matter less if there is sufficient rivalry between large players. HSBC notes that no bank individually has sufficient market share in either the PCA market or the SME banking market to give rise to concerns of market power. The aggregate level of constraint from all providers operating in each market, including smaller providers, underpins effective competition. Concentration also matters less where there is the threat of significant disruption through technology.
- (b) Barriers to entry (e.g. regulatory and capital requirements) may be less important if other advantages for late entry (e.g. lower costs and more up-to-date IT systems, absence of negative PR and the ability to locate and design branches more in line with customer demand) are more significant.

2.31 The CMA will also need to take account of certain inherent tensions between different customer outcomes, and the fact that some market features may have both positive and negative effects. In many cases, these positive effects may outweigh the negative – for example:

- (a) Transparency and simplicity of tariff structures (e.g. in overdraft charges for PCA customers and BCA charges for SME customers) may entail significant dispersion in the costs that individual customers incur depending on their usage.⁴² However, this is likely to enhance the ability of customers to compare products and services provided by different providers.

⁴¹ Issues Statement, paragraph 29.

⁴² The CMA’s observation in the PCA Market Study update that price structures are “unlikely to be perfectly cost-reflective” (paragraph 2.68) would appear to have limited relevance. As the OFT has previously noted, different customers making different contributions to fixed costs is entirely consistent with a well-functioning market. Evidence of John Fingleton to House of Commons Treasury Committee (2011) “Competition and choice in retail banking” Ninth Report of Session 2010-11, HC 612-I (April 2), paragraph 78: “*cross-subsidy is not in itself something that would concern us*” “*If you think about airline pricing, people who book late cross-subsidise people who book early, and that happens in quite a competitive market. So we don’t necessarily think that cross-subsidies are inconsistent with the competitive market situation.*”

- (b) Similarly, lower prices offered to new customers compared to existing customers may lead to higher overall levels of competition.⁴³
- (c) The “evergreen” nature of both PCA and BCA relationships may mean that customers do not face switching triggers as with insurance or mobile phone products. However, this may lead to banks competing more to attract and retain customers.

D. PCAs, BCAs and SME business loans are separate markets with unique characteristics requiring separate assessment

2.32 PCAs and SME banking are separate markets: their respective competitive dynamics operate differently and they each have different demand-side and supply-side characteristics. This results in a number of important differences between the two markets which HSBC believes the CMA should take into account in its investigation. It would be inappropriate and misleading simply to impute specific PCA market features to SME banking and vice versa. For example:

- (a) PCA customers and SME banking customers demand a range of different services from their providers (for example, SME customers generally require significantly more transactions, cashing up, greater access to account managers, financial advice and different financing options, while PCA customers increasingly demand sophisticated multi-channel offerings). Further, the CMA’s definition of SME banking customers⁴⁴ captures a disparate range of business types and sizes. Although at the sole trader / microbusiness end of the SME spectrum there may be some similarities with the needs of PCA customers, this is not the case for the larger businesses within the CMA’s frame of reference;
- (b) the use and function of PCAs differs materially from BCAs, with the latter experiencing typically significantly higher volume of transactions with associated transaction charges;
- (c) certain issues, such as waivers over security, only arise in relation to SME banking customers;
- (d) charging fees and structures are generally different between PCAs and BCAs, for example “free-if-in-credit” is only a feature of the PCA market;
- (e) approaches to using banking services differ between PCA and SME banking customers, for example branch usage and digital uptake varies materially; and
- (f) the very significant volumes of SME customers entering and exiting the market for banking services is a significant point of distinction between the two markets.

⁴³ See footnote 40.

⁴⁴ i.e. SME customers with annual turnover below £25 million.

- 2.33 Therefore, HSBC urges the CMA to ensure that it considers and reflects the inherent differences between PCA and SME banking fully throughout the market investigation.

Product markets

- 2.34 PCAs, BCAs and SME business loans each constitute separate product markets with little or no substitutability from a demand-side perspective.
- 2.35 In relation to SME lending products, HSBC considers that the CMA should only consider the markets for alternative forms of finance (such as invoice finance, asset finance and peer-to-peer lending) to assess whether these act as a competitive constraint on general purpose business loans.

Geographic markets

- 2.36 HSBC agrees with the CMA that the relevant geographic markets for each of the product markets are national and therefore at least as wide as (i) England & Wales, (ii) Scotland and (iii) Northern Ireland. Competition for each of the reference products operates on a national basis: product pricing, customer servicing, digital platforms and sales and marketing all operate at the national level.

3. THEORIES OF HARM

- 3.1 HSBC agrees that the CMA's three theories of harm are broadly the areas that should be investigated. However, in addition to gathering the new evidence discussed above, the CMA should also consider the following points when exploring these theories.

A. 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 ("access, assess, act" framework)

Transparency and availability of information

- 3.2 As discussed in HSBC's previous submissions to the CMA, a number of measures have already been taken to increase the transparency and availability of information in the PCA market.⁴⁵ There are also a number of forthcoming developments listed in paragraphs 2.3 and 2.4 above which will positively impact the transparency and the availability of information in both the PCA and SME banking markets.
- 3.3 The CMA should investigate the extent to which these initiatives and developments, including changes to overdraft pricing and the huge growth in the

⁴⁵ HSBC May 2014 Submission, paragraphs 3.5 to 3.8 and 3.24 to 3.29.

use of mobile channels, have individually and cumulatively increased the transparency and availability of information.⁴⁶

Banks are not deliberately exploiting customer biases

- 3.4 The CMA has questioned whether banks are exploiting or exacerbating the cognitive limitations and behavioural biases of its customers.⁴⁷ HSBC recognises that customer behaviours and biases are a feature of the PCA and SME banking markets. However, these behaviours would appear to affect the nature of competition rather than the extent – no evidence was adduced at Phase 1 to support the theory that banks have weaker incentives to compete as a result of customer behaviour.
- 3.5 Furthermore, no evidence was put forward at Phase 1 to suggest that banks are deliberately exploiting customer biases. HSBC would treat any such allegation very seriously and would therefore request that the CMA considers very carefully whether there is in fact any evidence of this happening. HSBC is committed to putting customers at the heart of all its businesses [*confidential*].

Switching

- 3.6 The CMA notes that customers may be dis-incentivised to shop around and switch banking providers.⁴⁸ HSBC considers that levels of switching cannot simply be judged by reference to absolute levels. In analysing the extent, importance and competitive constraint of switching, the CMA should:⁴⁹
- (a) assess whether switching is a reliable indicator of competition or customer engagement against the appropriate well-functioning market backdrop, including the use of customer survey evidence to assess the reasons and motivations behind customer decisions on whether to switch or not;
 - (b) analyse the awareness and effectiveness of current initiatives, such as CASS; and
 - (c) collate data on the impact of churn, multi-banking (as well as partial or gradual switches), new account opening, “try-before-you buy” behaviour, soft-switching and individual (re-)negotiation of terms and conditions on

⁴⁶ The FCA is currently assessing the impact of transparency measures on mobile banking and is expecting to publish its findings as an Occasional Paper. The CMA should have regard to the FCA’s scope of work on transparency measures in the PCA and SME banking markets.

⁴⁷ Issues Statement, paragraphs 36 to 38.

⁴⁸ Issues Statement, paragraph 39.

⁴⁹ Many of these issues were identified in HSBC’s response to the CMA consultation on provisional findings dated 16 September 2014 (*HSBC September 2014 Submission*), paragraphs 7 and 9.

exerting competitive constraints in the market.⁵⁰ For example, GfK estimates that 30% of PCA customers now hold more than one account.⁵¹

- 3.7 Any discrepancy between the perceived and actual cost of switching may be resolved through increased awareness and utilisation of CASS. [*confidential*].⁵²

Banks have strong incentives to compete for customers

- 3.8 As noted above, HSBC recognises that customer behaviour will have an impact on the *nature* of competition in the PCA and SME banking markets. For example, customer desire for a long-term relationship with their bank will inevitably lead to greater focus on servicing that relationship compared to a market with very high levels of switching. Whether the resulting *extent* of competition is insufficient requires a holistic assessment of customer outcomes in terms of price, quality and innovation.
- 3.9 HSBC considers that there remain strong incentives for banks to compete for customers. For example, there is intense competition in the BCA market for SME start-ups and in the PCA market for students. Furthermore, for both PCAs and BCAs, banks offer attractive switching incentives.
- 3.10 HSBC does not consider that any impediments to choosing between and switching suppliers necessarily results in weak incentives to compete. Well-functioning markets may not be free of such impediments and it is necessary to have a realistic benchmark for “weak”. Nevertheless, HSBC recognised at Phase 1 that addressing any demand-side issues – particularly in the SME banking market – would likely stimulate further competition.
- 3.11 HSBC does accept that such impediments will affect the *nature* of competition. Accordingly, addressing demand-side issues is likely to change the nature of competition. For example, in the SME banking market this may lead to additional price competition to retain existing SME customers. However, to the extent this lowers the expected value of new customers, there may well be less aggressive price competition for new SMEs. This may affect the distribution of outcomes across different types of customers. However, whether this results in a “more competitive” market is unclear and may be subjective.

B. Concentration giving rise to market power of some banks leading to worse outcomes for customers

Impact of concentration on competition

- 3.12 HSBC considers that concentration levels in both the PCA and SME banking markets are modest:

⁵⁰ HSBC May 2014 Submission, paragraphs 5.9 to 5.15 and 8.32 to 8.35.

⁵¹ HSBC May 2014 Submission, paragraph 5.11.

⁵² HSBC May 2014 Submission, paragraph 8.29.

- (a) In the PCA market, six banking groups have market shares of 7% or more (and TSB has a share of 3%). The market share for the HSBC brand is currently below 10%, which is smaller than Santander.
- (b) In the SME banking market, concentration levels are slightly higher but no individual bank has a market share at the level which is typically associated with market power.
- 3.13 As explained in Section 2 above, in the context of HSBC's comments on the well-functioning market analysis, concentration, in and of itself, is not a concern. What is more important is the degree of rivalry (for all key competitive dimensions: e.g. price, service quality and innovation), and the aggregate constraint provided by all players both large and small. HSBC notes that the CMA appears to acknowledge this, pointing to the UK retail mobile sector as "very competitive"⁵³ in spite of concentration levels (at the network level) that are significantly higher than the PCA and SME banking markets.⁵⁴
- 3.14 The Issues Statement does not set out how the CMA will assess the implications of current concentration levels for the process of rivalry, but HSBC assumes that it will want to do so in light of evidence on profitability and international comparators. HSBC considers that international comparisons require great care to ensure that meaningful comparisons can be made and would be happy to discuss this further with the CMA. Profitability evidence also requires significant work to ensure an accurate view of long term economic profitability is reached.
- 3.15 HSBC notes that in Phase 1 the CMA articulated a view that larger banks were less incentivised to compete (due to having a larger installed base of customers). Although this view is not reflected in the Issues Statement, for completeness, HSBC notes that any theoretical relationship between size and ability to raise price above incremental cost is not problematic in light of fixed and common costs and modest levels of overall market share held by individual banks. Whether this amounts to market power also requires considering the efficiency benefits of economies of scale and scope to determine the overall outcomes for customers.
- 3.16 More importantly, HSBC notes that the CMA has not identified any relationship between bank size and customer outcomes in terms of price, and has so far relied on a finding of a negative correlation between size and customer satisfaction: *"those banks with relatively lower reported satisfaction levels have not significantly lost market share and those with higher reported satisfaction levels have not gained sufficient market share"*.⁵⁵

⁵³ MIR decision, paragraph 2.16.

⁵⁴ This is based on the European Commission's merger decision for T-Mobile/Orange (Case M.5650) on 1 March 2010. HSBC also notes Ofcom's estimation of a post-merger HHI of 2888 (see: <http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/cmr11/telecoms-networks/5.48>), which compares to the CMA's estimates of current HHIs for PCAs and SME banking of 1838 and 1974 respectively.

⁵⁵ Issues Statement, paragraph 19(g).

3.17 As noted elsewhere in this response, these findings are highly subjective. This is illustrated keenly in the CMA's interpretation of the findings of the SME Charterhouse survey, which turn on the CMA's view that when respondents deemed service to be "good" they were in fact dissatisfied.⁵⁶ HSBC recognises that satisfaction scores have some relevance: as an institution, it spends significant resources trying to understand the drivers of customer engagement and satisfaction with a view to improving service. However, HSBC considers that great care is required when measuring satisfaction for the reasons set out in Section D below.

C. Barriers to entry and expansion leading to worse outcomes for customers

Case studies

3.18 In order to analyse barriers to entry and expansion, the CMA has proposed looking at a "*selection of case studies of past entry and expansion (successful and unsuccessful) ... and the costs and lead times for entry/expansion*".⁵⁷ HSBC agrees with the CMA that case studies are a useful tool for examining the extent to which certain features operate as barriers to entry and expansion in practice.

3.19 However, care will be needed to ensure the case studies are representative and fair examples of how potential barriers may be practically working now and in the future. The CMA should allow stakeholders to input into how case studies are selected and analysed and HSBC would be happy to discuss this further with the CMA. HSBC's initial thoughts are:

- (a) The CMA should ensure that its case studies include both recent and anticipated examples of entry and expansion. In a fast-changing regulatory and technology environment, barriers faced in the past by both new entrants and businesses on the cusp of entering the markets may no longer be relevant.
- (b) The case studies should include a full range of banking models, rather than just those seeking to reproduce traditional banking models with, for example, national branch networks.

3.20 However, since the case studies are unlikely to cover all relevant issues, the CMA must still adduce evidence concerning each of the identified regulatory, structural and conduct barriers individually in order to analyse whether they do in fact hinder entry and expansion. This approach will allow the CMA to take full account of the impact of recent and forthcoming developments on barriers in a holistic manner. Case studies could usefully supplement and add colour to the assessment of individual barriers.

⁵⁶ MIR Decision, paragraph 2.49.

⁵⁷ Issues Statement, paragraph 50.

Individual assessment of possible barriers

- 3.21 Many of the barriers to entry and expansion identified by the CMA under its third theory of harm have been greatly reduced by recent developments⁵⁸. Some, such as regulatory and prudential obligations are a necessary safeguard in the overall sector, and should therefore be reflected in a properly calibrated benchmark of the well-functioning market:
- (a) **Regulatory obligations**, including authorisation processes and capital and liquidity requirements, pose a necessary barrier to entry in order to protect both consumers and the banking system. HSBC agrees with the CMA that this is an important distinguishing characteristic of the banking market that should be taken into account when assessing competition in the sector.⁵⁹ Nevertheless, as the CMA acknowledged in its MIR Decision⁶⁰, recent changes made by the FCA and PRA to the regulatory regime for authorising new banks, and to capital and liquidity requirements, have significantly reduced this barrier for new entrants. HSBC suggests the CMA seeks input from the FCA and PRA on the efficacy of these changes.
 - (b) The CMA specifies **economies of scale** as a separate barrier to entry.⁶¹ If the CMA is to consider this point further, HSBC would urge it to:
 - (i) identify what particular aspects of economies of scale may act as a barrier to entry or expansion;
 - (ii) consider and gather evidence on the efficiencies that can be passed on to customers (e.g. in the form of lower prices) which flow from economies of scale; and
 - (iii) consider and gather evidence on the disadvantages to having a large incumbent business (e.g. legacy IT systems that are slow and costly to maintain and update, as well as branch networks that are much larger than needed to meet customer needs and potentially located and designed in a manner that focuses on physical security rather than customer interaction). The CMA should have regard to all such factors when assessing the overall impact of any economies of scale on competition in the PCA and SME banking markets.
 - (c) The existence of a **branch network** is no longer a barrier to entry or expansion due to technological developments and rapidly changing customer behaviours. The fact that certain customers “*still place*

⁵⁸ HSBC May 2014 Submission, paragraphs 4.16 to 4.47 and 9.4 to 9.27.

⁵⁹ Issues Statement, paragraph 19(a).

⁶⁰ The CMA’s decision on market investigation reference for personal current accounts and banking services to small and medium-sized enterprises dated 6 November 2014 (**MIR Decision**), paragraph 3.31.

⁶¹ Issues Statement, paragraph 49(b).

*considerable value on having a local branch*⁶² does not undermine the conclusion that:

- (i) a significant portion of both the PCA and BCA markets are contestable without any branches (as shown by Atom's business model) – the CMA should identify the size of this contestable market; and
 - (ii) an “extensive” branch network is not required to serve local customers, such that banks can grow organically by focusing on certain areas (as shown by Metro Bank's business model) – the CMA should seek evidence on present and likely future customer branch usage, and the evolution of different providers' branch networks, to explore this issue further.
- (d) The cost of establishing **IT systems** is no longer a barrier to entry or expansion due to off-the-shelf IT solutions and the ability to outsource IT to third parties. The CMA concluded at Phase 1 that it had “*not received evidence to suggest that new and potential entrants face significant and insurmountable difficulties in acquiring IT systems*”.⁶³
- (e) In relation to access to **payment systems**, the CMA acknowledged in its MIR decision that “*evidence on this issue is currently insufficient to conclude that smaller or newer banks are in fact disadvantaged...*”.⁶⁴ Importantly, the Payment Systems Regulator is already looking at this issue and has the necessary regulatory powers to intervene if necessary.
- (f) **Cross-selling** other products to acquire and/or retain customers is a feature of the PCA and SME banking markets. However, there are significant customer benefits to this that should be explored by the CMA:
- (i) Firstly, there are economies of scope in providing multiple products. These economies may allow providers to offer additional products at lower cost to customers. The CMA should consider evidence on the tendency of providers to compete across multiple products for customer “share of wallet”.
 - (ii) Secondly, HSBC agrees with the CMA's suggestion that “*customers generally prefer to use a single bank to meet the majority of their banking needs*”.⁶⁵ The CMA should confirm this through its customer survey.

3.22 When examining each of these potential barriers, the CMA should have regard to any customer benefits and the need to discourage inefficient entry. The CMA

⁶² *Ibid.*

⁶³ SME Market Study Report, paragraph 5.98.

⁶⁴ MIR Decision, paragraph 3.31.

⁶⁵ Issues Statement, paragraph 19(c).

should have regard to the implications of any intervention to address perceived barriers to entry for customers. For example, measures taken to support sub-scale or sub-scope entrants may lead to very significant downsides for customers in terms of loss of convenience, restricted access to credit and or higher prices due to lost efficiencies and choice value by customers.

D. Customer satisfaction alone is not indicative of effective competition in the market

- 3.23 The Issues Statement does not articulate how customer satisfaction levels may interrelate with the three theories of harm identified. However, the CMA has stated, in its list of sector characteristics, that “*those banks with relatively lower reported satisfaction levels have not significantly lost market share and those with higher reported satisfaction levels have not gained sufficient market share*”.⁶⁶ This was the only clear finding of the CMA at Phase 1 in terms of poor consumer outcomes.⁶⁷
- 3.24 HSBC believes that, there are intrinsic problems in relying on the “customer satisfaction” metric as an indicator of whether there is effective competition in the PCAs and SME banking markets.
- (a) First, as the CMA acknowledged in its Market Study reports, the evidence reviewed on consumer satisfaction is mixed.⁶⁸ Part of the explanation for this is that measures of consumer satisfaction are particularly prone to subjectivity and bias. The way that questions on satisfaction are posed, and the order in which they are posed, can have a material impact on responses. The CMA will need to be alert to this when designing its customer survey – HSBC is submitting a separate paper by Alix Partners to the CMA on “*The Design of Customer Surveys*”.
 - (b) Second, it is meaningless to look at high-level consumer satisfaction statistics without seeking to understand the causes of customers’ relative satisfaction or dissatisfaction. Many causes of dissatisfaction – such as being declined credit – are not necessarily indicative of weak competition but a reflection of important prudential considerations.
 - (c) Thirdly, customer biases are particularly important when interpreting reported customer satisfaction. In terms of negative biases, the financial services sector has been subject to significant and sustained criticism from politicians and the press since the financial crisis – this has had a deleterious effect on the public perception of banks. To the extent that this is influencing customers, and they consequently report lower satisfaction levels with their banking services, this is not reflective of the state of competition in the market. There is also evidence that positive biases may be in play – [*confidential*].

⁶⁶ Issues Statement, paragraph 19(g).

⁶⁷ PCA Market Study Report, Chapter 6; SME Market Study Report, Chapter 9.

⁶⁸ PCA Market Study Report, paragraph 6.39; SME Market Study Report, paragraph 9.66.

3.25 The CMA should therefore treat evidence of customer satisfaction with caution. Particular care will be needed when designing survey questions around satisfaction and evidence on satisfaction should be viewed alongside more objective measures of customer outcomes, such as service standards and innovation.

4. CONCLUSION

4.1 HSBC agrees with much of the CMA's focus of the market investigation, but it would urge the CMA to adopt the four guiding principles discussed above when conducting its analysis:

- (a) ensure the analysis is **future-proof** by taking account of the various market developments;
- (b) **gather new evidence** (including surveys of both PCA and SME customers) and do not place undue reliance on outdated evidence from previous reviews;
- (c) **define the "well-functioning market"** by reference to real-world parameters of competition and realistic outcomes, avoiding a "Nirvana Fallacy"; and
- (d) conduct a **full and separate assessment of the PCA and SME banking markets** and do not assume a commonality of issues between these different markets.

4.2 HSBC suggests that the CMA apply these principles when exploring each of its theories of harm.

- (a) When considering potential impediments to "assessing, accessing and acting", the CMA should consider the impact of recent regulatory and market-based transparency measures and the increased adoption of digital and mobile banking tools. The CMA should also consider whether switching is a reliable indicator of customer engagement, and the reasons underpinning customers' switching behaviour.
- (b) When assessing concentration and market power, the CMA should adduce empirical evidence as to whether any banks can exert unilateral market power and whether this is affecting competition.
- (c) When exploring barriers to entry and expansion, the CMA should individually assess potential barriers and use case studies to support its findings. The CMA should allow stakeholders to input into how these case studies are selected and analysed.
- (d) When considering customer outcomes, the CMA should recognise the intrinsic problems in relying on customer satisfaction as an indicator of effective competition.