<u>Aldermore response to CMA investigation on retail banking competition</u>

Background:

The CMA has invited parties to tell them, with reasons, if we believe that the issues identified should not be in the scope of the market investigation or if there are further issues which should be considered. The issues statement is based on evidence the CMA has reviewed to date and sets out its initial hypotheses of what features, if any, of the supply of retail and SME banking services might give rise to an adverse effect on competition.

The CMA has identified three groups of high-level hypotheses, or “theories of harm”, that “may explain” how certain market characteristics (or combinations of characteristics) may be adversely affective competition and leading to possible adverse outcomes:

- Theory of harm 1: 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.
- Theory of harm 2: Concentration giving rise to market power of some banks leading to worse outcomes for customers.
- Theory of harm 3: Barriers to entry and expansion leading to worse outcomes for customers.

Proposed Aldermore response:

Aldermore Bank welcomes the opportunity to respond to this investigation. As a fast growing financial services provider we are keen to ensure that the UK has in place the right regulatory environment to support the UK business community and to improve access to finance for small and medium sized enterprises (SMEs).

Competition in the UK banking sector is undoubtedly improving, particularly as consumers have more choice and information about products on the market. But government and regulators alike need to look at the current marketplace and realise that the larger banks are still suffocating economic recovery.

The fallout from the financial crisis proved that it is time for a new generation of banks who offer consumers and SMEs banking as it should be. It is important that action is taken by the Government and regulators in order to encourage this new generation and to improve services for consumers. As such, Aldermore welcomes this action from the CMA and fully supports the intentions behind this investigation.

Broadly Aldermore is supportive of the issues and the three groups of high-level hypothesis as outlined by the CMA in the issue statement from November 2014. This document sets out comments in more detail under each of the relevant hypotheses.

Theory of harm 1: 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.

Aldermore believes that it is crucial to take action against all impediments preventing customers from shopping around effectively and hindering banks from competing effectively. In particular we believe that it is important to provide SMEs with as much support as possible in finding sources of finance.

As such we are supportive of fresh policy action to match SMEs rejected for loans with alternative banks and finance providers, and participated in the Government consultation earlier this year on helping to match SMEs rejected for finance with alternative lenders.

We already often take action to suggest alternative providers to SMEs that we are unable to support and we occasionally receive referrals from other providers. Thus we recognise the worth of a more formalised marketplace process to ensure that all lenders and SMEs are able to access a fair and secure referral process.

At Aldermore we believe in simple and transparent banking, and we fully support the action underway from Government and regulators to further develop simple financial products across the banking industry. All of our savings accounts take only 15 minutes to open and fund online. Aldermore does not use bonus rates or teaser rates either. Teaser rates, though they are an established part of the market and incentivise savers when making an initial decision where to place their money, often do not work in the long term interest of savers and indeed are fundamentally designed to exploit savers. We believe that transparency is key to providing our customers with exceptional service. In 2013 we began publishing un-edited ratings and reviews on our website. These offer customers independent insight into our products and services. The reviews also provide us with valuable feedback to help us improve our products and processes. Transparency is a core feature of how we do business and this is something that needs to established across the industry.

We believe more needs to be done to promote product awareness (i.e. the benefits of invoice financing, asset financing) to aid customers' awareness of what products are available, specifically through smaller/specialist providers.

Theory of harm 2: Concentration giving rise to market power of some banks leading to worse outcomes for customers.

We believe that competition could be rapidly stimulated if the Government considered breaking up the state-owned banks, - particularly the parts of those banks servicing SMEs - and allowed challengers like Aldermore to acquire them, thus adding instant competitive scale to the SME market.

The Government and regulators need to look at the current marketplace and realise that the incumbents are still suffocating economic recovery. Competition can only exist if the Government breaks-up the state-owned banks, and particularly the parts of those banks servicing SMEs, and allows challengers like Aldermore to compete on a level-playing field. Otherwise we are simply cutting up the same cake into smaller portions.

Theory of harm 3: Barriers to entry and expansion leading to worse outcomes for customers.

Generally we see the barriers of entry to traditional banking fall into two broad categories: regulation; and infrastructure.

Regulatory barriers, such as obtaining licenses in the first instance followed by ongoing regulatory requirements, are stringent and may prevent smaller banks without appropriate experience and backing from entering the industry. However, these requirements are important in maintaining confidence in the industry as whole and that confidence is essential for a competitive market that appeals to new entrants.

New entrants must compete with the incumbent banks' larger infrastructure in relation to branch networks, brand investment, payments processes, IT systems, access to funding etc. Even by leveraging digital technology, new entrants struggle to compete in the traditional banking sphere meaning they must find new and attractive packages to establish banking relationships with SMEs. Over and above the footprint advantage, the incumbent banks have access to a wider variety of funding – such as retail current accounts or wholesale markets – which allows them to reduce funding costs and puts pressure on price.

Relaxing the rules on capital for smaller banks would be a welcome move which would have a positive effect on competition and encourage more new entrants to the sector. The current risk weighting formulation for banks puts small banks at a disadvantage to large banks.

While large banks are required to use an “advanced approach” to risk weighting, smaller banks are required to use a “standardised approach”, meaning that proportionally smaller banks have to hold more capital than the large banks. We would like to see one approach applied to all banks to ensure an even playing field for bank finance. Specifically to lending against residential property as being an area to focus on when trying to level the playing field on capital.

Whilst it is easier for new entrants in the banking market than it has been in the past, as evidenced by there being more around, we still have an uneven playing field with the established banks. More transparency is needed in how the banks work, for example in areas such as balance sheet reporting.

Part of the problem for creating genuine competition has meant that banks like Aldermore face unnecessary regulatory hurdles and capital costs to access the payments infrastructure. This is not in the interests of ordinary consumers or SMEs across the UK who ultimately want a banking system that works in their interest. If we are intent in making changes and seeing a shift away from the status quo then the road towards a better payments infrastructure will have benefits to all.