Metro Bank Response to CMA Issues Statement:

The UK banking sector is lacking in competition and, as a result, innovation and real choice for personal and business customers. There has been some progress, including several consultation requests from the Government, regulator and other groups to improve competition in the market. However, as the CMA identified in the July consultation, there is still significant work to be done to create the level playing field needed to generate real choice for consumers and businesses.

Our response to the CMA's issues statement is clear: we support its initial assessment of the PCA and SME banking sectors. Competition is heavily distorted and many of the factors that have been identified, for both PCAs and SME banking, are ones with which we agree. The result is customer detriment; customers are not being treated fairly by many banks, and this must change.

We believe there are two key points to be made relating to the hypotheses:

1. Driving fair customer outcomes must be the central goal:
   - We believe the personal current account market structure is not driving fair customer outcomes and this must change
   - Real competition is driven by differentiation – not price comparison, switching initiatives or simplicity
2. Numerous additional barriers, both to entry and expansion, continue to stifle challengers – including capital requirements, access to payment systems access and planning permissions

In the pages that follow we will explore these points in more detail, looking at suggestions and solutions that we believe will have an impact on competition in the banking sector.

1. Driving fair customer outcomes must be the central goal

The banking sector does not function as a competitive market should, with large banks leaving customers dissatisfied and yet retaining large market share. To increase competition we need more entrants with differentiated models, creating choice for consumers and businesses.

As an industry we need to work together to educate customers about how to choose a banking partner that suits them and their needs, as discussed in Hypothesis 1a. We agree with this assessment, and believe that is it difficult for personal and business customers to compare banking products. This in turn may lead to them choosing products that do not suit their needs. We believe there are several remedies to consider related to this. Firstly, bank branch workers should not be incentivised to sell products to customers, as this encourages them to put product sales first, and acts as a disincentive to thinking about what a customer actually needs. This goes against the FCA's principle of fair outcomes for customers. At Metro Bank, store colleagues are rewarded for providing superior service to customers, not for selling products. Secondly, comparison services that exist for banking tend to focus largely on the price of products. If the only way for consumers to compare products is by comparing prices, then price inevitably becomes the focus for banks. If we want banks to provide great service and treat customers fairly and transparently, then these should be the metrics on which they are compared. We believe that this MIR should look at how fair pricing can work alongside other factors, e.g. service and different models, to achieve the best possible outcomes for customers. This will encourage innovation in the industry.

We agree with Hypothesis 1b that product and pricing structures in the market exploit customers' cognitive limitations and behavioural biases. We believe this leads to two sources of harm. First, these cognitive limitations, in combination with current charging structures, can lead to poor customer outcomes. Second, these biases lead many in the industry to cross-subsidise profits from some sub-segments to drive down the market cost of lending, which restricts challengers from competing effectively. As you note with Hypothesis 3, as a result of their collective market power, we do not believe there is any incentive for the incumbent banks to change this situation.

More specifically, we see a number of clear examples of dysfunctional outcomes and customer detriment in the market, most notably:

- Overdrafts: We believe customers in overdraft can pay significantly over the bank's cost of funds when fees and rate are considered together. Behavioural biases may mean customers select an inappropriate account, do not realise the impact of decisions in the moment and ultimately have poor outcomes. This is not just an issue of transparency and information but also product structures and complexity.
- Savings: Back book savings customers receive lower savings rates than new customers, as existing products are replaced with new ones that offer better rates and terms or initial "bonus" or "teaser" rates fall away. Why switch when you might be "back booked" soon after joining a new bank? This perpetuates the impression that "all banks are the same" and treat customers poorly.

In a competitive market customers should be offered the best products for their needs. Many banks make it extremely difficult for customers to move their money to 'better' current or savings accounts within the same bank, and would never consider auto-upgrading customers to the best products for the customer. This is surely an unfair customer outcome that can distort competition, and one that we believe needs to be investigated.

These two practices allow banks to cross subsidise profits from one customer segment to compete in others. Effectively, incumbent banks receive cheap deposit funding from their less active loyal customers, creating a huge barrier to competition in the market for challenger banks. The incumbent banks are able to use this cheap deposit funding to drive down the cost of lending. Challengers, with much higher funding costs, are therefore forced to compete at an unfair price for lending, and in some cases take on higher risk lending in order to compete. This is anti-competitive and cannot be ignored by the CMA if its aim is to encourage competition in banking. We believe actions to remedy this situation may require more than education and information provision as the collective market power of the incumbent banks may allow the situation to persist.

While choice and variety in the market remain limited, it is inevitable that switching levels will remain anaemic. The Current Account Switch Service (CASS) facilitates switching but can only be truly effective in an already competitive market. In addition, in order for it to be a true success, we believe it needs more appropriate communication among consumers and businesses. As you note with Hypothesis 1c, we believe more could be done to minimise the real and perceived costs of switching for customers, including significant investment from UKPC to ensure the service is firmly entrenched in the hearts and minds of customers. However, we do not believe reducing the time period for switching from seven days to five days will have a significant impact.

2. Numerous additional barriers to entry restrict Challenger banks

The issues statement notes that there may be additional potential barriers to entry and expansion. As the first new bank in the UK in over 100 years, Metro Bank has faced, and continues to face, a number of barriers to expanding our business. These include capital requirements, access to payment systems, and planning permissions, all of which impact Challenger banks disproportionately compared to incumbent providers. These should all be assessed fully as part of this MIR and are detailed in our case study.

With regards to the assumption in Hypothesis 3 of the issues statement that banks must have an extensive branch network to be competitive, this is not one with which we agree. At Metro Bank we strongly believe that there is a place for a branch network in 21st century banking. The proliferation of technology for both personal and business customers is an extremely important development but there is often no replacement for a face to face conversation.

That's why Metro Bank offers banking services through every channel – whether it's face to face, by telephone, online or by mobile – and our customers choose to bank with us because all of those channels are important to them. However, as we discussed previously, competition should be about banks offering different models to customers; some will take an all-channel approach (like us) and others will choose different strategies. As a result, we do not think that a branch network should act as a barrier to competition – banks must choose models that suit them and their customers, concentrating on differences and choice rather than more of the same.

Summary

The goal of increased competition in the banking sector must remain high priority. As an industry we need long term solutions that encourage and generate true competition. A competitive market is one where we will see entrants with a variety of different models offering different things to customers; it recognises that customers have diverse needs and therefore banking solutions must reflect this. Ultimately, conquering competition issues across the board will result in better, fairer, outcomes for customers, and this must always be the industry's key goal.