CMA Retail Banking Market Investigation
Response to the Statement of Issues
dated 12 November 2014

1 Introduction

This submission sets out the views of The Royal Bank of Scotland Group plc (“**RBS**” or “**the Bank**”) in response to the Statement of Issues published by the Competition and Markets Authority (“**CMA**”) dated 12 November 2014 (the “**Issues Statement**”) as part of its market investigation into the supply of personal current accounts (“**PCAs**”) and of banking services to small and medium-sized enterprises (“**SMEs**”) (the “**Market Investigation**”).

In light of the significant developments in the UK banking industry over recent years and the numerous ongoing market improvement initiatives, Section 2 of this document provides a brief account of RBS’s new strategic direction, and its resulting change in competitive positioning, since the start of 2014. This illustrates RBS’s own endeavour to tackle an existing market problem and suggests that any market-wide CMA intervention should likewise incorporate a focus on the following areas:

- Customer and product transparency
- Product rationalisation
- Simplified pricing
- Customer trust and confidence.

These initiatives are closely aligned with tackling the cornerstone demand-side inertia and disengagement issues identified in the CMA’s Theory of Harm 1. RBS is conscious that its unilateral efforts, while working with the grain of the CMA’s customer-focused agenda, cannot systematically improve the functioning of the entire market by themselves. It therefore welcomes the opportunity to engage further with the CMA on possible enhancements to this and other initiatives, such as those already tabled by RBS and others in the SME market study, to spur levels of customer engagement and ability to exercise informed choice.

In Section 3, we respond to the specific issues raised by the CMA in the Issues Statement, taking each of the CMA’s hypothetical theories of harm in turn.

The submission finishes with a brief conclusion in Section 4.

2 RBS’s Strategic Direction

In its press release announcing the provisional decision that there should be a market investigation, the CMA stated:

> "[O]*ur studies have found that despite some positive developments, significant competition concerns remain which mean that customers may not be getting consistently good service and value from their banks.*"[1]

RBS willingly acknowledges that it lost the trust of its customers, for reasons that range from insufficient capital strength to market misconduct, from pay structures to information technology failures. The CMA will form its own views on whether such failings arise from features of the market; for its part, RBS views it as its own responsibility to respond to these failings and become again a bank that earns its customers' trust.

2.1 A brief history

RBS has travelled a long way since 2008 when it was at the centre of the financial crisis. In that period, the Bank has reduced its total assets by £1.5 trillion, reduced its reliance on short-term wholesale funding from £297 billion to £32 billion,[2] improved its loan to deposit ratio from 154% to 97%,[3] and strengthened its Common Equity Tier 1 capital ratio from 4.0%, on a Basel II basis, to 10.8% on a fully loaded Basel III basis.[4] In addition, we have taken a number of steps to improve our customer facing proposition (listed below).

While the task of cleaning up RBS's balance sheet has been addressed with notable success, neither its customers' trust nor its profitability has recovered commensurately, despite the further efforts of the Bank. Net Promoter Scores ("**NPS**"),[5] although improved, remain weak (though somewhat stronger for NatWest than for the RBS brand, even though the two propositions are fundamentally the same), while RBS has recorded net losses for six years in succession – an aggregate total of more than £55 billion.[6]

These financial results reflected to a great extent unsustainable practices in relation to our customers, which have since given rise either to large loan impairments or to substantial customer redress. However, economic conditions also affected RBS's profitability, with persistent low interest rates sharply reducing liability margins from pre-crisis levels, while muted credit demand limited its ability to compensate for this through higher asset margins. At the same time, a number of sources of non-interest income that contributed significantly to profits in the years before 2008 have been substantially reduced as RBS now, learning the lessons from the past, focuses on sustainable income underpinned by responding to genuine customer needs.

Income from RBS's financial markets activities has declined sharply, reflecting both more difficult wholesale market conditions and a deliberate reduction in the amount of risk capital the Bank has allocated to this business. Finally, it is also worth noting that some products (particularly certain PCAs, such as basic bank accounts) offered to a significant proportion of RBS's customers are supplied by RBS because of the social value of financial inclusion, i.e. provision of banking services for all customers, notwithstanding their fundamental unprofitability (indeed, there is a considerable external emphasis on the obligation of the larger banks to perform such a societal role).

---

1 CMA press release, 18 July 2014.

2 RBS Q3 2014 Interim Management Statement, 31 October 2014.

3 RBS Q3 2014 Interim Management Statement, 31 October 2014.

4 A quantitative impact study by the Basel Committee on Banking Supervision found that for large, internationally active banks the application of Basel III definitions reduced measured core capital by an average of 41% and increased risk-weighted assets by an average of 23%, so the actual increase in capital strength is significantly greater. See, for example, "The future of financial reform", speech by Governor Mark Carney, 17 November 2014.

5 For a more detailed discussion of Net Promoter Scores, see below at Section 2.2.

6 Though the Bank has returned to profit for the first three quarters of 2014, reflecting in part the release of earlier impairment provisions as economic conditions improved in the UK and particularly in Ireland.

In sum, RBS's total income fell from £27.6 billion in 2009 to £19.8 billion in 2013, while it was unable to reduce its operating cost base commensurately. Given the increased capital requirements addressed above, overall profitability remains weak with revenues from many specific products and customer segments unable to cover the associated costs. Nor has the Bank observed any reduction in its cost of equity, as some academics and regulators have predicted would happen as a result of the substantial increase in equity capital.[7]

2.2 RBS's strategic response

Following the financial crash, RBS began to respond not only to the changed financial environment in which it operates but also to the more fundamental imperative of earning back its customers' trust. In February 2014 RBS also launched a new strategic direction, built around the ambition of becoming the number one bank for customer service, trust and advocacy by 2020.

Ross McEwan, RBS Chief Executive, stated:

> *"In February I placed trust at the heart of my new strategy for our bank. The reason is obvious but worth repeating: we aren't trusted by enough people who rely on us to help them manage their personal and business lives […] and on whom, in turn, we rely for our business success. And in banking trust is not a 'nice to have' – it is a commercial essential."*[8]

The new strategy includes financial elements: customer trust will not be regained without unquestioned financial strength, so RBS is targeting a Common Equity Tier 1 ratio above 12%, together with a leverage ratio above 4.0%. It also includes a plan to bring the Bank's cost base down so that it is properly aligned with the greatly reduced size of the business; this involves the removal of £1 billion of costs in 2014 and a cost base that will be reduced in the medium term to around £8 billion (compared with £13.3 billion in 2013[9]). In addition, RBS is investing £750 million over three years to improve the safety and resilience of its information technology systems.

The root of the strategy, however, is the rebuilding of customer trust. It revolves around deepening relationships with customers based on their needs and is underpinned by a set of corporate values that are becoming embedded across the Bank; these must become an enduring feature of RBS's culture if they are to be effective.

To measure its progress in rebuilding customer trust, RBS is targeting the best NPS in each of its chosen business areas and is reporting publicly on this measure.[10] In its Q3 2014 Interim Management Statement RBS reported that while NatWest's NPS was flat for Personal Banking at 7, it had made strong progress in Commercial Banking with a score moving from -3 to 15, where no other bank scored more highly in Q3 2014. For the RBS brand, NPS scores recovered from -17 to -4 in Personal Banking and from -5 to 0 in Commercial Banking. The fact that NPS scores differ so widely between NatWest and RBS is of note given that the proposition is essentially the same across both brands, and provides a good illustration of how customer perception of their bank is often informed by wider (negative) publicity than the specific service(s) being used by them. However, the Bank is under no illusions that it has much more to do in order to reach its goal of being number one for service, trust and advocacy by 2020.

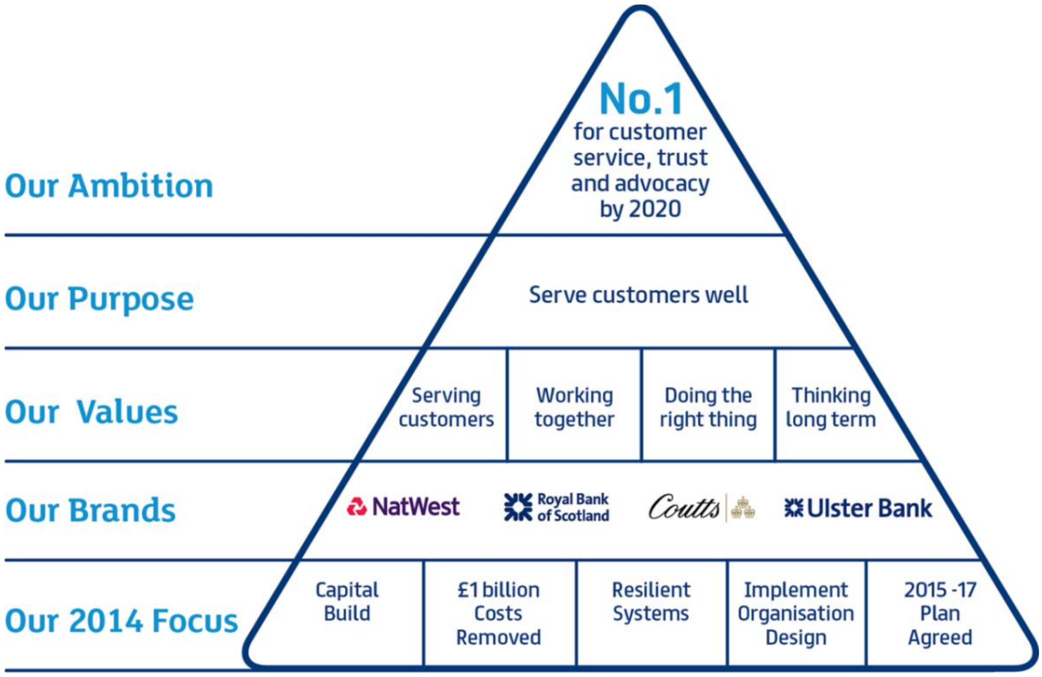
[7] See, for example, External MPC discussion paper No. 31 "Optimal Bank Capital" (David Miles, Jing Yang and Gilberto Marcheggiano), Bank of England 2011.

[8] Speech to BBA annual conference, 16 October 2014.

[9] Approximately £3.1 billion of this reduction will come from business disposals and run-off.

[10] RBS would be happy to provide a further explanation of NPS to the CMA as helpful.

RBS strategic blueprint[11]



2.3 Concrete actions to improve customer service and experience

RBS recognises that among the reasons why it lost its customers' trust was the complexity and lack of transparency surrounding a number of products. In response, RBS has undertaken a number of significant practical actions in rebuilding its customers' trust through improving these features of its products. These include:

- RBS now makes its best rates available to existing credit card and home insurance customers, adding to earlier progress on savings, mortgages, loans and current accounts. There is now no deal across the entire Personal Banking product set that is not available to existing customers, and we are working to do the same for our business customers.
- RBS no longer offers different rates to PCA and SME customers who apply online, in branch or by telephoning a call centre. Pricing is consistent, regardless of channel, across the RBS, NatWest and Ulster Bank brands.[12]
- RBS and NatWest customer letters and emails are being simplified for personal customers[13] so they are straightforward and transparent. The number of pages on the personal banking website has been reduced from 867 to 318, with language simplified. Following this simplification, the number of customers who visited the website page to compare accounts and who then went through to view a product increased by [**confidential**].
- RBS is aiming to reduce the number of SME and Personal Banking products by [**confidential**] under the RBS Products Rationalisation Programme. To date, the number of PCA products on offer under the RBS and NatWest brands has been reduced by around [**confidential**] since 2012 and Ulster Bank has reduced its deposit offering by [**confidential**] since June 2014.

[11] Speech by Ross McEwan to Bank of America Merrill Lynch Banking & Insurance CEO Conference, 30 September 2014.

[12] Although one basic Ulster Bank PCA is not currently available online.

[13] Similar simplification for SME customers will begin in early 2015.

- RBS and NatWest are aiming to be able to explain all personal and SME charges on one side of A4 paper [**confidential**] and have already taken steps to simplify sales processes and customer communications post-sale.
- RBS is targeting a cross-brand reduction in the amount of time it takes to open a "simple" PCA from [**confidential**].
- RBS is working to reduce the time taken to make small business lending decisions from [**confidential**], for all but the most complex applications or where the required documentation is not available.
- RBS has begun moving PCA customers from off-sale products to on-sale products, meaning that an increasing number of our existing customers have the same products as new customers.
- RBS has designed various free tools to allow our customers to better manage their accounts and avoid overdraft and other charges.
- RBS has introduced a number of innovations in our mobile, internet and telephony banking offerings (e.g., the introduction of our mobile app and RBS's "Pay your contacts" service).

These changes, taken together, amount to a significant shift in RBS's competitive positioning. Ross McEwan said:

> *"We are no longer competing with other banks in a number of areas.*
>
> *For example, we are not competing with those who offer zero per cent balance transfers on credit cards that trap over sixty per cent of your customers in spirals of ever increasing debt.*
>
> *We are no longer offending our loyal customers by offering teaser rates on any products to try to steal customers from you.*
>
> *We are no longer competing with any of you to design new products so clever that they require pages and pages of small print to even begin to understand.*
>
> *We are eliminating hundreds of products and working to explain all of our terms and conditions for personal and SME customers on one side of an A4 page."*[14]

2.4 Summary

RBS considers that its new strategic direction recognises many of the problems identified by the CMA and by other commentators as market-wide issues, addressing them unilaterally as a competitive imperative and illustrating areas of focus for any CMA market-wide intervention. Unless we significantly improve outcomes for our customers in a way that restores their damaged trust in us, [**confidential**].

In a context of long-term impaired profitability at Group level, with low or negative profitability in a significant number of customer segments and product lines, this growing competitive threat is something to which RBS must respond, and is responding.

[14] Speech to BBA annual conference, 16 October 2014.

3 Remarks in response to Issues Statement

3.1 General comments

3.1.1 Market definition

In its Issues Statement, the CMA proposes to take previous inquiry findings as a starting point for market definition. This is a clearly sensible, but not necessarily sufficient, approach, as set out below.

(i) Product market

Consideration of separate product markets for PCAs, BCAs and SME business loans offers an appropriate starting point to the Market Investigation given the observed dynamics of the industry together with previous analyses of the relevant markets.

(ii) Geographic market

As to geographic market definition, no clear and consistent line emerges from prior studies, and nor is it apparent that empirical work on this issue underlies such inquiries.

The CMA is correct to observe that previous studies have not defined separate local or regional markets, reflecting that competition was across areas at least as wide as (i) England & Wales; (ii) Scotland; and (iii) Northern Ireland. RBS endorses the general view that it will not be meaningful to examine competition on a narrower basis than these three cited and that a UK-wide lens may be more appropriate in many, if not most, instances.

RBS's views on market definition are informed by the principle that the appropriate market definition, in the flexible non-mechanistic approach signalled by the CMA, depends on the issue being tested. As RBS strongly believes that the root cause of inhibitors to competition in PCAs and SME banking arise on the demand-side, it welcomes the CMA's demand-side focus captured by Theory of Harm 1 ("**TOH1**"). For the purposes of this theory, RBS believes that the issues are sufficiently common across Great Britain and Northern Ireland such that a UK-wide geographic lens is entirely appropriate.

As far as Theory of Harm 2 ("**TOH2**") (concentration) is concerned, as explained during the Phase I study (and see further below), RBS does not believe that concentration itself is the *cause* of a competition problem: while concentration levels are high, these are largely the *symptom* of TOH1 (together with regulatory barriers). To the extent that the CMA agrees with RBS that concentration is a derivative of the main problem, rather than an independent source of concern, then the same general approach to market definition as for TOH1 will suffice.

However, to the extent that TOH2 examines concentration as a hypothetical problem in its own right, and in respect at least of the "branch network barriers" aspects of Theory of Harm 3 ("**TOH3**"), it would be inadequate to rely on a broad-brush approach to examining concentration (using the lenses of England & Wales, Scotland and Northern Ireland, for example).

Prior findings on geographic market definition are often inconclusive[15] and/or do not appear to be supported by any empirical evidence (which would in any event risk being

[15] The 2008 PCA market study and its 2013 update both focus on Great Britain and Northern Ireland; the 2014 update references Great Britain, UK and England & Wales / Scotland data, but without grappling with the question of geographic market definition.

out-of-date).[16] If the CMA were ultimately to conclude that concentration per se (or the existence of branch networks per se) might itself be a provisional adverse effect on competition ("**AEC**") then this would impact on the approach to geographic market definition. Specifically, the CMA's investigation would need to be conducted at least to the evidentiary standards applied to provisional (and ultimate) AEC findings made in prior retail inquiries such as *Groceries* and *Private Healthcare*, where concentration was found to be an AEC concern and structural remedies were considered (and in the case of central London in the latter inquiry, actually imposed).

In such circumstances, the CMA rightly devoted a great deal of empirical attention to the classic demand-side substitutability questions of geographic market definition, and in particular, local market definition / catchment areas around the relevant outlets (grocery stores or private hospitals). This past CMA approach is correct because concentration measures, where concentration is itself the "problem" being investigated, are only meaningful if they relate to a well-defined economic market, not a convenient political boundary.

For these theories, especially in relation to the most onerous and invasive of candidate remedies, it would be necessary to undertake a systematic, robust and empirical approach to market definition, starting at the local level. RBS would be happy to engage with the CMA further on this if required. As noted above, however, given the interconnectedness and derivative nature of TOH2 and the branch aspects of TOH3 to TOH1, this additional burden is not, in RBS's view, ultimately necessary.

3.1.2 Previous competition law studies and future developments in the area

In light of the various competition law studies and investigations conducted to date (including the recent market studies into PCAs and SME banking, both of which involved the submission of significant volumes of information), RBS is encouraged by the CMA's intention as set out at paragraph 26 of the Issues Statement to "take full account of the work done to date" in its Market Investigation. Subject to the caveats identified above on geographic market definition, drawing and building upon the information and analyses which the CMA has on file (to the extent possible and as updated where necessary) offers the most efficient approach to the current Market Investigation.

RBS also welcomes the CMA's intention to take account of the many developments currently underway. These include developments both within the banking industry as a whole (such as CASS and the increasing reliance by customers on internet and mobile banking) as well as initiatives by individual banks such as those by RBS discussed in Section 2 above. In order to optimise the outcome for banking customers, it is important that the cumulative impact of these multiple moving parts is considered as a whole.

It will not necessarily be easy to measure the likely long-term impact of some developments, as they have only recently launched. However, in order to avoid over-regulation and / or unintended consequences that might undermine recent developments, the CMA must avoid focusing exclusively on that which is easily measurable.

[16] Since the 2002 SME inquiry, where a market is not UK-wide, it has been traditional to define separate geographic markets for England & Wales, Scotland and Northern Ireland. It is not entirely clear why the market would be narrower for business than personal customers (the standard UK retail market intuition is that business customer markets are if anything wider than consumer markets). In any event, neither the 2002 inquiry nor reports since provide any serious evidence base for this approach.

3.1.3 Use of international comparisons

At a number of points in its Issues Statement, the CMA indicates that it is minded to conduct an analysis of how the experience of PCAs and SME banking in the UK compares with that in other countries and what lessons, if any, can be learnt in the process. RBS broadly favours this proposal, although it recognises the caution required in drawing parallels between retail banking in the UK and elsewhere where conditions for competition – including regulatory conditions – may make a material difference.[17] In particular, RBS recommends that approaches adopted to tackling difficult demand-side behavioural issues in other countries be analysed.

3.2 Theory of Harm 1: Core demand-side issues

3.2.1 Issues Statement

The CMA's TOH1 focuses on informational and behavioural impediments to customer engagement and switching. In particular these impediments relate to the role of:

1. accessible and transparent information (Hypothesis 1A);
2. product and pricing structures (Hypothesis 1B); and
3. perceived costs and risks (Hypothesis 1C).

RBS agrees that TOH1 should be the first – and foremost – theory of harm investigated, as it plays a cornerstone role in competitive dynamics and inhibitors to competition and addresses the CMA's overall objective of achieving a well-functioning market, that "*works well for customers*".[18] Further, RBS considers that TOH2 and TOH3 are symptomatic of TOH1 and do not raise competition concerns independently in and of themselves (as explained further below). Accordingly, RBS's undertakings in lieu proposals for SME banking (the "**UILs**"), in conjunction with three other banks, focused on addressing this cornerstone issue by offering three initiatives to enhance customer outcomes.[19] The following tracks RBS's thinking focused on customers ability to (1) *access* information; (2) *assess* that information; and (3) *act* (i.e. choose) to their benefit.

3.2.2 Accessible and transparent information (*"Access")*

RBS agrees that in order to exercise choice in an informed and meaningful way, customers require accessible and transparent information in relation to their PCA and SME banking products. Such transparency is important for a number of reasons, including as a means for customers to judge their current banking provider against competitors before deciding whether to open an account in the first place and whether to switch provider at a later point. RBS also agrees that historically, a good deal of information in relation to its PCA and SME banking products could have been presented in a more accessible and transparent manner, and for this reason has embarked on a programme to simplify product and pricing information.

---

[17] An example of such an multi-jurisdictional study is to be found in the European Commission's Interim Report II on current accounts and related services, 17 July 2006, Section 4.4 discussed further below at Section 3.3.4.

[18] Issues Statement at paragraph 20.

[19] As the CMA is aware, the UILs offered in relation to SME banking incorporated proposals to develop (i) an independent, combined comparison website and loan portal designed to increase transparency and lower barriers to entry and expansion by providing access to better information; (ii) standardised and simplified account opening procedures, enhancing competition and facilitating switching; and (iii) BCA annual summaries and other activities to stimulate SME engagement on an ongoing basis via a customer communication programme in order to raise SMEs' awareness of different competitive offerings, improve ease for comparison and thus facilitate switching and enhance the incentives to use the comparison website.

(i) RBS initiatives to promote product transparency and simplification

As set out above at Section 2, RBS has been working to improve this aspect of its service for some time and in particular since February 2014 by increasing transparency and simplifying its products for PCA and SME banking customers.[20]

Product simplification and transparency not only facilitate customers' informed decision-making as to the need to switch, they also improve RBS's competitive position by attracting customers and ensuring that decisions within the Bank are taken as quickly as possible. For example, in relation to lending, it is clear that where decisions are not made as speedily as they sensibly can be, the relevant business is more likely to be lost.[21] In this way, transparency and simplification of products are aligned with the Bank's business interests. Accordingly, alongside industry-wide developments (most notably the introduction of CASS) and technological developments (such as the introduction of a mobile banking app and the ability to pay mobile phone contacts), a number of RBS initiatives described above at Section 2.3 have aimed at ensuring that important information is readily accessible to customers in as simple a form as possible.

In relation to SME lending, following the Independent Lending Review by Sir Andrew Large in 2013, RBS has entered into a number of commitments including the development of a dedicated website showing clearly what information RBS uses to make lending decisions and setting out in simple and clear steps its lending process. RBS has also committed to publicly report on its progress against these commitments on an annual basis.

RBS's simplification and transparency initiatives are closely connected to and feed into its wider objective of improving the trust and confidence that customers have in the Bank with a view to making RBS number one for customer service, trust and advocacy by 2020 as described above.[22] The Bank is aiming to anticipate customer needs and expectations with an unrelenting focus on improving customer experience.[23] Each year, RBS conducts a Customer Satisfaction Survey across retail channels.[24] In addition, the Bank measures its customer satisfaction levels on the basis of NPS which (as noted already) asks how likely a customer would be to recommend their current provider to a friend or colleague. RBS is heavily involved at present in analysing the drivers behind NPS in order to help improve its performance. As such, NPS feeds directly into RBS's future strategy plans.[25]

(ii) Scope for further improvement

Of course, there remains scope to build upon these initiatives and RBS would welcome engagement with the CMA to further enhance its ongoing efforts. For instance, the introduction of a degree of standardisation in the way that banking products are described

[20] RBS's strategy in relation to current accounts is based on the following key proof points: simplicity, fairness, ease and value, with a particular focus on the last two elements. For example, one way of achieving its goal of simplicity is to have a PCA offer limited to only 5 account types. [**Confidential**].

[21] Sir Andrew Large concluded that attrition between initial SME borrowing approaches and loan completion was greater at RBS than at its competitors and attributed this in part to "*a time consuming process which uses relatively weak customer scoring models and infrastructure, and which takes longer to complete than those of competitors*" (Independent Lending Review (25 November 2013) at page 45).

[22] RBS's focus on customer trust and confidence reflects a trend across the banking industry. For instance, a survey of 198 senior banking figures worldwide conducted by Swiss Banking software company Temenos shows that 30% of respondents are concerned by customers weakening allegiance / decline of customer loyalty, this being for these 30% their biggest challenge.

http://www.ft.com/cms/s/0/ce06f15a-4f90-11e4-908e 00144feab7de.html?siteedition=uk#axzz3JPWOxZmY

[23] [**Confidential**].

[24] [**Confidential**].

[25] [**Confidential**].

would certainly assist in comparisons as between products, perhaps by way of an online comparison tool. Likewise, the simplification and possible harmonisation of account opening processes across banks would remove a further possible inhibition to changing provider.

However, there are inevitably limits to the extent to which RBS – or indeed any bank – can simplify its products and product information, reflecting the need to ensure that customers are fully aware of their banking choices. It is important to bear in mind that the needs of all customers will not necessarily be better met by simplification across the board as, for example, larger customers (in the SME space) or wealthy/more affluent customers (in the PCA space) are likely to find that bespoke or different products better fit their precise requirements compared to the majority of PCA or SME customers. In this respect, consideration of product (or related information) standardisation would, naturally, have to take account of the overall competitive impact including with regard to customer segments (sophistication and needs), and product innovation.

3.2.3 Product and pricing structures *("Assess")*

RBS likewise agrees that issues relating to transparency of costs and pricing may historically have impeded customers in their efforts to compare products from different banking providers.

(i) Ongoing RBS initiatives regarding transparency and simplification of pricing

As part of its efforts to simplify its product offerings overall, RBS has undertaken a simplification and clarification review of its pricing models in recent years. The focus of the review has been moving away from complex and towards more simplified pricing models, which will generally facilitate customers' ability to assess the cost implications of switching PCA and/or SME banking provider. These initiatives are intended to enable customers to understand the features and benefits of the products available to them. They help customers to assess the true cost of using the product and to understand whether the product will meet their needs and offer value to them. This will assist customers in making rational and well-informed decisions about their banking products. Of course, as with overall product simplification discussed above, pricing and product design for certain customers (and in particular certain SMEs and more affluent PCA customers) will not be as amenable to simplification as for others.

Specifically on the issue of pricing, in addition to those listed above at Section 2.3, a number of recent RBS initiatives have aimed at achieving this overall objective of simplification, including:

1. Ending teaser rates across all brands for personal and business customers.
2. Ensuring that third party sources such as Defaqto have access to the appropriate information to facilitate comparisons.[26]
3. Introducing a calculator on the RBS and NatWest websites to enable prospective customers to receive an approximate quote for loans.
4. Developing fee support tools to make it easier for customers to understand the charging structure of their account. For example, RBS and NatWest are aiming to rationalise relevant fees and charges onto a one page document.[27]

[26] This will be further expanded in light of the launch of the Midata current account tool from 1 April 2015, as announced in HM Treasury's Autumn Statement 2014, paragraph 1.171.

5. [**Confidential**].[28]

6. RBS and NatWest have introduced mechanisms to warn and protect personal customers against unexpected fees (such as Act Now Alerts which are sent to customers if either there are insufficient funds to cover a payment, or if a customer has been overdrawn for five or more consecutive days, buffer zones, and overdraft opt-outs known as the Overdraft Control Service).

7. RBS has recently launched an overdraft costs calculator on its website to help customers calculate the cost of using both arranged and unarranged services.

RBS believes it is a market leader in simplifying its pricing structures. It has taken the unilateral actions listed above as part of its ongoing efforts to achieve an overall better deal for its customers which also feeds into RBS's strategic objective in regaining customer trust. RBS considers that customers are responding well to these new initiatives and that this is reflected in improving NPS scores as discussed in more detail in Section 3.2.4.

As with the overall transparency and simplification of accounts, there is surely scope for extending these unilateral competitive measures aimed at improving transparency in the pricing of PCAs and SME banking products.

Consistent with its UIL proposals, RBS considers that an important and obvious initiative where the status quo could be improved relates to online price comparison tools, potentially accompanied by a degree of product standardisation (at least in relation to the terminology used and the way that fees are applied) as discussed above. Additionally, the introduction of enhanced information on pricing in regular bank statements or through automatic electronic updates could help to improve transparency. The role of technology in assisting in our drive towards greater transparency and simplification is already clear, and will increasingly prove important. For instance, recent survey evidence from the United States indicates that mobile banking apps have proven particularly effective in improving access to account information and thereby reducing unexpected overdraft fees.[29] As of May 2014, some [**confidential**] RBS customers use our mobile app.

RBS would welcome engagement with the CMA to explore ways to build upon its efforts to date.

(ii) Role of "bundling" and cross-selling

In relation to product structures and supply-side responses which might be seen as limiting the potential for customer engagement and in particular switching, the Issues Statement references the role of pricing and product structures such as bundling and cross-selling. RBS notes that bundling and cross-selling must be considered as distinct practices and deals with each separately below. RBS would also strongly encourage the CMA, going forward, to use terminology that minimises confusion between potentially anti-competitive (and in the case of BCAs, prohibited) bundling, better referred to as "tying", and "mixed" bundling, where products are offered to customers on both a package and stand-alone basis at the customer's option, which is typically pro-competitive, and where cross-selling becomes relevant.

---

27 [**Confidential**].

28 Annual summaries have been a feature of the Northern Ireland PCA market since the Northern Ireland PCA Banking Market Investigation Order 2008.

29 See http://blogs.wsj.com/totalreturn/2014/09/03/banking-apps-help-customers-avoid-fees/

Bundling (Tying)

In both PCA and SME banking, contractual tying is not a feature of how products are sold. Differentiated products are available and as such customers always have the option to take a simple current account or to opt for a packaged or loyalty account of some description (in PCAs) or a wider package of products. RBS notes that such packaged accounts offer customers a number of different potential benefits which are often key drivers in the customer taking out and retaining the account. These may require additional analysis in the course of the Market Investigation.

Likewise in SMEs, the behavioural commitments entered into following the Competition Commission's review in 2002 (the "**2002 Undertakings**") included a "bundling undertaking" which prohibited tying SME lending or business deposit account to BCAs. This commitment has prevented banks from leveraging the opening of a BCA into the opening of a loan account. While the CMA's recent review of the 2002 Undertakings revealed suboptimal staff awareness of this commitment in numerous banks including RBS, there was no finding of material volumes of, let alone systematic, breaches.[30] Therefore, the CMA's statistics relating to the share of SME loans and BCAs of the four largest providers need to be set in context that the underlying statistics emerge *despite the lack of "bundling"*. In RBS's view, this implies that it is customer rather than supplier behaviour that is driving the statistics which the CMA emphasises in relation to the combined share of the largest four banks in BCAs and SME loans.

Cross-selling

In relation to the role of cross-selling, RBS would note that cross-selling, far from being prohibited, often offers a pro-competitive sales technique. As noted above at Section 2, deepening relationships with customers does form an important aspect of RBS's strategy in particular given the low profitability of certain customers with only one product (particularly PCAs – large segments of the standalone PCA market, as opposed to the wider retail market, being generally unprofitable). For example, of RBS's approximately [**confidential**] personal customers, internal data indicate that approximately [**confidential**], with a further [**confidential**]. Accordingly, for the remaining [**confidential**], the deepening of the relationship, including through cross-selling, is fundamental to the Bank[31] and allows it to continue to support its extensive book of unprofitable customers.

Nevertheless, the impact of cross-selling is often overstated. On a measure of the needs met by individual banks per personal customer, RBS's score is [**confidential**] that of the industry worldwide leader (Wells Fargo). Indeed RBS's experience suggests that any assumption that a PCA is always (or even often) a gateway may be difficult to sustain and certainly should be tested in the light of actual levels of successful cross-sales across different banks. RBS also agrees with the CMA that "*even if PCA providers use PCAs to cross-sell other products, this does not preclude entry by other providers into other retail banking markets*."[32] This has been demonstrated by the willingness of new entrants (particularly the supermarkets) to enter other areas of retail banking (e.g., loans, insurance or credit cards) without a PCA offering (often driven by concerns as to the fundamental unprofitability of the standalone PCA market, see further below).

30 Although the CMA did note that "*First Trust and HSBC […] have breached the behavioural undertakings by having told some SMEs that they needed to open a BCA with the bank in order to get a business loan*" ("SME banking behavioural undertakings of 2002: Report on compliance*",* 22 October 2014).

31 [**Confidential**].

32 Personal Current Account Market Study Update, 18 July 2014, at Section 2.75.

In addition, it is important to bear in mind that cross-selling creates customer benefits as well as risks for the Bank. As a practical matter, cross-sales are in many ways a reflection of a customer's desire to keep their banking as simple as possible (e.g. by using one provider for a number of required banking products). However, customers will only extend and deepen their relationship with a bank if they trust that bank and value the service it provides. As noted above at Section 3.2.2, RBS places great importance on the trust that its customers have in it as a banking provider and is working hard to improve its standing in this regard and to improve levels of customer service.

Once those deeper relationships of trust are achieved, banks must work hard to maintain them. For SME customers in particular, where a multi-product customer loses trust or confidence in a bank and decides to close an account, there is a significant risk that these (typically more profitable) customers will end the overall relationship with the bank for all products, resulting in a reverse "gateway effect".

(iii) Pricing structures and profitability

RBS's overall profitability over the past 5 years has been very low, with liability margins compressed in the very low interest rate environment that has prevailed since 2008. In lending markets, while the mortgage market has offered attractive returns in recent years (though margins are now narrowing as more competitors return to the market), other segments including SME lending have proved particularly unprofitable.

In relation to SME lending, Sir Andrew Large concluded:

> *"Between 2000 and 2007, the interest rate charged by the banks generated a return on capital broadly in line with the hurdle rate expected by shareholders, given the regulatory capital requirements of the time.*
>
> *From 2007, the interest rate charged to customers fell as the BoE base rate was reduced sharply, although this reduction in the base rate was not fully passed on to customers and therefore the banks' margin over base rates increased from ~2% in 2007 to 3% in 2011. However, in the same period, the incremental funding costs for banks increased (from <0.5% to ~3.5%), as the financial crisis made it more difficult for banks to access funding.*
>
> *The overall cost of capital also increased* […] *as Regulators responded to the financial crisis by increasing the amount of capital banks are required to hold against lending. Because the increase in funding and capital costs was greater than the increase in the banks' margin over base rates, lending to SMEs became less profitable to banks than it was in the pre-crisis period.*
>
> *Since 2011, the incremental cost of bank funding over base rates has decreased again as economic confidence has improved. As a result, lending now generates a return on capital of approximately 3–7%. This means that lending – as a standalone product – does not yet meet the hurdle rate of return expected by shareholders.*
>
> *However, charges for other services (such as transaction services) typically mean that banks make a hurdle rate of return on their overall SME banking operations."*[33]

RBS reported a pre-tax loss of £8.2 billion and a Group operating loss of £2.3 billion for 2013.[34] [**Confidential**].[35] However, RBS strongly favours initiatives to encourage switching

[33] Independent Lending Review, Box 3, November 2013.

[34] See RBS Annual Report 2013 at page 4.

[35] [**Confidential**].

as discussed above. Moreover, its simplification agenda demonstrates that RBS's strategy is not to maintain complex pricing as a way (for the sake of argument) to protect high profitability and discourage switching.

Incumbent providers of PCAs and SME banking in the UK have, in particular relative to newer entrants, suffered in profitability due to the inability to grow their customer book quickly, the impact of back-book pricing and their vulnerability to cherry-picking from more nimble players focusing on more profitable customers. Whilst relatively new entrants are able to offer innovative products and services, incumbents can do so only after undertaking considerable analysis of the effect this may have on existing customers and how new products can be made to work within existing systems. Cherry-picking by third party rivals can have serious consequences for incumbent profitability and is an important source of competitive pressure, for which the metric of the individual or even aggregate market share of full-service entrants and expanders is no real gauge, as discussed below at Section 3.3.

3.2.4 Perceived costs, benefits and risks *("Act")*

In the last element of TOH1, the CMA calls into question why customers do not switch, even where they are in a position to access and assess the relevant information.

Concerns regarding customer inertia in PCA and SME banking and the associated behavioural biases are well-trodden competition law territory and RBS expects that they will form a central aspect of the Market Investigation in relation to which we look forward to engaging. RBS also notes that international comparisons on switching rates may prove helpful to the CMA. For example, the European Commission's 2012 Bank Fees Behaviour Study indicated an average switching rate of 4% across a core group of EU jurisdictions.[36]

Costs vs. quantifiable benefits of switching

In studying inertia, it could equally be asked why large absolute numbers (albeit relatively small percentages of total) of customers actually do switch, given the low actual costs of current accounts and the limited benefits to be obtained from switching, even to the most keenly priced competitive account. While current offers of direct financial rewards for switchers from a number of providers might help to drive some switchers, it is important to bear in mind the general limited financial attractiveness of switching. The CMA will wish to consider academic analyses on predicted current account search and switching ratios and the level of gain required to prompt customers to switch.[37] RBS would be happy to engage with the CMA on this issue.

Subjectivity in customer satisfaction vs. objective outcomes

A further issue worth serious exploration in CMA survey work is the issue of customer satisfaction and perception, particularly in light of the fact that the number of customers reporting dissatisfaction in some surveys substantially exceeds switching rates. There is no question that customer service levels have been inadequate and a core part of RBS's new strategy discussed above is aimed at addressing this deficit. However, what may be of interest to the CMA is that in the cases of RBS and NatWest, brands which offer the same products, use the same processes, with products delivered by very similar people, quite different net NPS results emerge: +7 for NatWest versus -4 for RBS in personal banking and -13 versus -27 in business banking. For RBS and NatWest, a combination of hostility

[36] See ec.europa.eu/consumers/archive/rights/docs/report_6146_bankfees_en.pdf.

[37] See, for example, "Searching and Switching: Empirical estimates of consumer behaviour in regulated markets" by Catherine Waddams Price et al, CCP working paper 13-11; "Losing interest: how much can consumers save by shopping around for financial products" by Malcolm Cook et al, FSA Occasional Paper 19, October 2002.

to RBS because of the financial crisis, a lack of awareness on the part of many customers that NatWest is part of RBS and the RBS name as the lightning rod for negative press explains much if not all of the RBS-NatWest NPS gap.

RBS believes that this discrepancy in RBS's and NatWest's NPS scores, despite the propositions being fundamentally the same, reflects the fact that customers' attitudes to the brands or companies often differ from their views about the quality of services supplied (i.e., customers may have negative perceptions of their bank (or the industry more generally) but are happy with the day to day services provided to them by that bank and so have no driver to switch despite their more general negative perceptions). This theory is supported by the experience of the Co-Op which saw significant falls in its NPS scores from 2013 onwards, for reasons that had little to do with service quality.

The NPS for brands, such as NatWest, which have not suffered particular reputational damage tend to be more reliable as an indicator of service quality. In any event NPS scores provide a helpful baseline from which the progress of a brand can be measured.

Accordingly, any evidence-led conclusions about the objective functioning of the market (i.e., are customers worse off?) that rely on necessarily subjective customer service scores must grapple with the distinction between service level and reputation. This should be borne in mind as the CMA engages in survey design for its PCA survey work (and may be an issue to consider in relying on existing marketplace surveys, whether in the PCA or SME banking spaces).

(i) Ongoing RBS initiatives to reduce perceived costs and risks

The CMA will want to unpack the various inhibitors at work in order to distinguish:

1. Those cases where there is genuine interest in switching but the perceived costs/risks and frictions act as a deterrent; and
2. Those where, based on information on potential savings, the customer is of the view that it is not worth their while to switch.

In the latter case, no amount of reform to the level of switching (even if improvements are made as to the ease with which customers can switch through CASS and other initiatives) will necessarily make a material difference.

Switching deterrents that are more readily addressable (frictional costs, inability to compare)

For those risks which are either avoidable or merely perceived, RBS has been working to ensure that they no longer act as a barrier to switching.

- *CASS.* For those who are inclined to change their provider, there is heightened awareness of the issue of switching through initiatives such as CASS. The success of CASS is generally measured against three criteria, namely: (i) customer awareness of the service; (ii) customer confidence in the service; and (iii) performance of the service. On each of these measures, CASS is performing well: (i) customer awareness has reached 70%, increasing from 60% in October 2013; (ii) customer confidence in the functioning of the service is approximately 61%; and (iii) user feedback is positive with 88% of customers and 87% of SMEs considering that moving bank account has been an easy process.[38]

[38] See http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/2798/ as well as the report of the Payments Council, "The Current Account Switch Service: One Year On" dated September 2014 at page 3.

PCA switching trends through CASS have revealed that switching is most prevalent for the under 35s and the over 65s with most switchers moving to PCA providers offering cash-based incentives, such as Halifax and Santander. First quarter switching figures through CASS of 306,240 switchers in Q4 2013 (including both SMEs and Retail customers) - a 17% increase on Q4 2012 - also reflect these early successes. In the 12 month period to the end of September 2014, there were 1,203,334 switchers representing a 22% increase on the same period the year before when there were 985,600 switchers.[39]

The FCA's ongoing review of the effectiveness of CASS and the CMA's proposal to conduct a comparative analysis of switching levels in other retail banking markets are welcome steps in further understanding switching dynamics and how these may be improved. Indeed, RBS, in particular given projections for improved transparency and satisfaction levels noted above, would foresee [**confidential**][40]. In short, we believe that general awareness of CASS, the effectiveness of CASS and the lack of burden it places on the customer (bar the completion of the initial form, all the work is done by the new bank) have removed a key barrier to switching. In the recent Autumn Statement, the Government also announced a number of further enhancements to CASS to include 99% of all SMEs and an extension of the redirection service to 36 months.[41]

- *Deeds of priority for SME banking.* In relation to the release of securities or deeds of priority, RBS is actively engaged in ensuring swift and effective action to improve these processes. As confirmed by HMT on 19 March 2014, RBS and the other larger banks have entered into a new protocol to consider requests for a deed of priority or waiver within seven working days, and for each bank to provide standardised documentation to simplify the process. This agreement will help level the playing field between incumbent banks and alternative finance providers and therefore improve SME choice and access to finance.[42]

Switching deterrents difficult to solve (lack of engagement, financial literacy, relationship factors)

For many customers, banking charges are simply not of a sufficient magnitude, relative to other costs, to warrant switching. Consumers and SME customers, in the main, do not appear to regard the issue of managing their finances in the most efficient possible manner either in absolute terms or relative to getting cheaper or better deals elsewhere as a priority (in the absence of material positive financial impact): rather they regard simplicity and spending the minimum time required on such issues as more important, even if they say they are not content with their bank (and as stated earlier there appears to be a difference between general discontent with banks vs the specific services provided to customers).

For a proportion of consumers, financial literacy also acts as an inhibitor to engagement with the question of banking provider. Whilst there are a number of existing industry initiatives such as the RBS/NatWest schools programme, RBS would welcome a discussion on how such initiatives to promote engagement could be increased and how the industry could better support the role of other bodies in the area (such as the Money Advice Service[43]).

---

39 See http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/3139/.

40 [**Confidential**].

41 HM Treasury, Autumn Statement 2014, paragraph 1.172.

42 https://www.bba.org.uk/news/press-releases/bba-response-to-budget-announcement-on-deeds-of-priority/#.VHMATHJF270.

43 See https://www.moneyadviceservice.org.uk/en

These issues can also, to some extent, be addressed through initiatives to increase transparency and to make engaging with financial management an exercise that is quicker and easier for consumers to do. These issues are discussed in Section 3.2.2 above.

As the CMA notes at paragraph 19(c) of the Issues Statement, a number of customers, particularly SMEs, also value long term relationships with their banks.[44] This will undoubtedly operate as something of a barrier to switching. However, this is not to say that such customers will never switch, simply that they value a service that their existing bank provides and will need to identify more by way of switching benefit in order to be persuaded that they will benefit from switching.

In terms of setting expectations as to what degree of switching is realistically achievable, there is no doubt that switching will in some circumstances, perhaps for SMEs more than PCAs, involve an unavoidable degree of risk or cost. For example, for an SME, the risk of switching from (for the sake of argument) an unsatisfactory relationship manager to one that is not materially better (or even worse) is an issue which it is almost impossible to avoid altogether: it is an “experience good”. Naturally, these risks must be outweighed by the benefits of switching in order for the customer to change provider.

3.2.5 Summary of views in relation to Theory of Harm 1

RBS considers that the CMA’s TOH1 captures the root cause of its concerns with PCAs and SME banking. As a result of numerous industry-wide and bank-specific reforms and initiatives designed to reduce customer inertia, RBS considers that a good deal of the groundwork for enhanced customer engagement is in place. However, there remains plenty of scope to build on this work through the Market Investigation. RBS would be happy to discuss further initiatives in the area with the CMA, potentially drawing upon previous work carried out in the UIL context.

3.3 Theory of Harm 2: Concentration

TOH2 focuses on concentration giving rise to market power for some banks and thereby leading to worse outcomes for some customers. In particular, the CMA proposes to consider industry structure and whether some banks are likely to exert market power and/or may have less incentive to compete vigorously for certain customers or in certain geographic markets.

RBS agrees that it is appropriate for the CMA to consider supply-side issues in its Market Investigation. It is undeniable that the larger incumbents (as in many markets) hold a large collective share of supply of the three main products at issue. But it is equally undeniable that UK customers have a lot of choices of banking provider: neither in PCAs, nor in BCAs or SME loans, is it at all plausible to suggest that customers have only three, four or even five options. Given these facts, RBS considers it important that discussions of concentration should not be abstracted from the array of choice available to customers: they are inter-related features of the market.

RBS would urge the CMA to recognise early on that there are factors that explain the simultaneous existence of (i) a lot of choice, and (ii) concentrated supply. RBS considers that two key factors explain why market shares are not distributed more evenly or symmetrically across all market suppliers (yielding lower concentration levels).

- First and foremost, demand-side issues, driven by many of the issues identified by the CMA under TOH1, create the primary barrier to customer acquisition. If for the

[44] Commercial Banking Snapshot, March 2014.

sake of argument challengers offer a much better deal, their problem is not another bank's market share or for that matter the share of the largest four or any other constellation of banks: their problem is that customers do not appear in sufficient numbers to recognise a better deal and act upon it. If demand-side inertia were overcome then one would expect organically to see the growth in challenger market share that the CMA is looking for (applying for these purposes the CMA's implicit Phase I assumption that challenger expansion would in fact benefit customers).

- Secondly, the aggregate effect of competition between larger incumbents, cherry-picking rivals and full-suite "challengers" is making the larger incumbents such as RBS have to work ever harder to retain and win customers, even if that dynamic is not neatly captured in quantum shifts in market share over a short period.

RBS notes that these factors are complementary, rather than mutually exclusive: no one seeks to argue that demand-side inertia means there is no scope for supply-side competition; merely that it makes competition less intense than it otherwise would be – and already is. Proper recognition of the tandem effect of these factors results in the conclusion that concentration per se is not a problematic reflection of a fundamental lack of choice or a barrier to entry or expansion, as may be the case in certain other markets. Rather, it is primarily a symptom of TOH1, coupled with the efforts of incumbents to respond to the current competitive dynamics.

Finally, insofar as market power remains a theme of the CMA's inquiry, RBS welcomes the CMA's proposal to focus its Market Investigation on unilateral effects rather than coordinated effects given that neither of the market studies found any evidence of coordination between banks.

3.3.1 Customer choice deriving from existing competitors

In order to justify measures to improve the intensity of existing competition by tackling the issues captured by TOH1, there is no need for an exaggerated emphasis or focus on market shares and concentration levels. Indeed, an objective evidence-led assessment will recognise competitors (outside the largest four) and the constraints they represent.

In this regard, it is important to repeat that competitive pressure comes not just from the wide range of full service current account providers but also (and in many cases more pressingly) from niche competitors seeking to cherry-pick more specific elements of a clearing bank's value proposition or more profitable segments of its customer base. Examples include the credit card market, where the historic link to current account holding has been very substantially eroded, or foreign exchange payments, where new entrants, including some innovative business models, have taken parts of the market from current account providers. Others such as PayPal, only choose to compete in respect of certain functions (i.e. payments) of the PCA market rather than compete for accounts per se. It is of note that the ease with which parts of the broader current account value proposition can be cherry-picked is greatly enhanced by real time or near real time payment mechanisms including Faster Payments and debit cards, which enable instant transfers to a competitor (for example between current accounts, or to a specialist foreign exchange provider, or to a competing savings account) and facilitate the use of new payment methods (such as PayPal).

Market participants which currently exercise significant competitive pressure include:

1. *Santander* which is a considerable and dynamic force in both PCAs and SME banking. Indeed, RBS considers Santander to be [**confidential**].[45] As such, it is a good example of how the competitive landscape can change considerably over time. Santander is on track to gain one million new customers during 2014,[46] and its total current account balances grew by 54% from September 2013 to September 2014, demonstrating that it is substantially benefiting from initiatives such as CASS. The impact of Santander as a strong and growing provider of PCA and SME banking services across the UK is an important factor to build into any analysis under TOH2. As noted below at Section 3.3.3, Santander (together with Halifax) has been a [**confidential**].

2. *Other SME banking players*. Co-Op, Yorkshire and Handelsbanken, as well as Clydesdale in Scotland, provide important competitive pressure, with new entrants also emerging (such as Metro and Aldermore) as well as specialist finance providers (see further below).

3. *Other PCA players*. Nationwide and TSB in particular provide well-publicised and very competitive alternatives at the current point in time. In the three months from May to July 2014, TSB opened 9.7% of all new and switching current accounts opened across the market, as measured by CACI[47] and accounted for a net gain of 6% as of September 2014.[48]

In Northern Ireland, there is a significant number of competitors particularly when compared to the scale of the market opportunity: the market is very “well banked”. Specifically many competitors based in Great Britain, as well as local banks, are present in Northern Ireland including Bank of Ireland, First Trust, Danske Bank, Ulster Bank, Santander, as well as HSBC and Barclays for SMEs and Nationwide and Halifax for PCAs. This group of banks compete for customers representing only approximately one thirtieth of the rest of the United Kingdom.

Accordingly, it is not credible to suggest that customers in the retail banking sphere lack choice. On the contrary, both in absolute terms and relative to most peer countries, UK customers are able to choose from a very significant number and diverse array of market participants of varying sizes and with different business models and product offerings.

3.3.2 Enhanced customer choice: new and expected entrants and models

Not only does a focus on market shares risk under-estimating the extent of existing competition for SME banking and PCAs, it also does not reflect the impact of new entrants or expected entrants and changing distribution models. The choices currently available to banking customers are likely to further expand in the short to medium term and RBS expects these changes to impact very substantially the competitive landscape for both PCAs and SME banking.

---

45 [**Confidential**].

46 http://www.santander.com/csgs/Satellite?appID=santander.wc.CFWCSancomQP01&c=DocumentoGS&canal=CSCORP&cid=1278699892987&empr=CFWCSancomQP01&leng=en_GB&pagename=Componentes%2FDocumentoGS%2FDocumentoGSPreview

47 TSB 2014 Q3 Interim Management Statement; CACI Current and Savings Account Market Database (CSDB) which includes current, packaged, youth student and basic bank accounts, and new account openings excluding account upgrades.

48 See http://www.tnsglobal.com/uk/press-release/current-account-switching-index-september-2014

1. *Newer entrants* in both PCAs (including TSB, Metro, Tesco Bank, Virgin Money, M&S Bank and the Post Office[49]) and SME banking (including Aldermore, Metro Bank and Secure Trust) can be expected to grow market share over the short to medium term and increasingly challenge incumbent banks. Given the brand recognition and brand loyalty that many of these new entrants already enjoy, their substantial pre-existing customer base and their existing geographic footprint, these players are able to differentiate their banking offerings from incumbent providers and constrain the behaviour of incumbents to a very significant extent. For grocery sector-origin banks, this pre-existing footprint would seem to undermine arguments that a large existing branch network provides a competitive advantage to the larger banks as these banks already have an extensive network. In addition, the Post Office's network is hugely extensive compared to any of the larger banks. For others, retail space on high streets, is readily available if they had a desire to extend their networks.

2. *Williams & Glyn.* Specifically as regards SME banking, the OFT concluded in its September 2013 advice to HMT that "*Rainbow has the ability to compete in a number of SME market segments including the £1 m to £25 million turnover range*."[50] RBS acknowledges [**confidential**]. However, once this is achieved, the divested bank will not only reduce the size of RBS, but will be expected to represent a further credible competitor, having a share of approximately [**confidential**] of SME banking and approximately [**confidential**] of PCAs in Great Britain. This is coupled with both the ability and the incentive to compete nationally and within an organisational structure that will allow it to respond dynamically to changes in the market, which a larger organisation such as RBS is less able to do.

3. *Non-bank rivals.* There is a significant number of non-bank competitors for SME business including crowd-funding and peer-to-peer lending through firms such as Zopa, Funding Circle and Ratesetter. This is an important market which is expected to grow significantly, in particular as a result of anticipated government reforms to remove barriers to growth.[51] It is estimated that alternative funding could account for up to £12.3 billion worth of business lending per year in the medium term.[52]

4. *New payments models.* The anticipated impact of technology companies such as PayPal, Amazon, Google Wallets and Apple Pay is likewise significant. Technology companies have globally recognised brands and an existing customer base often meaning that these companies already hold significant financial and consumer data about potential customers and, therefore, the ability to adopt targeted marketing strategies. RBS expects technological developments to have a significant impact on the banking industry in the short to mid-term and, therefore, considers new and potential entrants of this type to be a very serious competitive

[49] The Post Office expects to increase its customer base to 5 million customers in the medium term: http://www.telegraph.co.uk/finance/comment/11038917/Post-Office-the-sleeping-giant-in-the-challenger-bank-war.html

[50] OFT letter of advice to Chancellor, September 2013 at page 9.

[51] HM Treasury, Autumn Statement 2014, paragraph 1.169.

[52] Nesta Report, "Banking on each other: peer-to-peer lending to business evidence from Funding Circle". See also: http://www.economist.com/news/finance-and-economics/21597932-offering-both-borrowers-and-lenders-better-deal-websites-put-two;

http://www.ft.com/cms/s/0/318cd08e-dd8f-11e2-892b-00144feab7de.html?siteedition=uk#axzz3K5xaMxPb.

threat.[53] Furthermore, some technology companies, such as Ffrees, are directly targeting segments of the PCA market.

RBS also notes that regulatory barriers to entry have been reduced, with the FCA and PRA facilitating the licensing process discussed in more detail below in relation to TOH3. As a result, there were 25 applicants seeking a banking licence in March 2014 compared to only 6 in March 2013.[54] Given this increase, considerable further market entry is anticipated.

Moreover, it should be noted that current market features in certain ways already favour new entrants. For example, universal ATM access prevents banks from competing on the basis of their ATM networks or from charging fees (apart from modest inter-change fees) to customers of competitors for use of ATMs.

RBS considers that the sum total of these factors underscores the increasingly dynamic state of retail banking in the UK, as a counterfactual “baseline” for the CMA to contemplate improvements that unlock further benefits to customers.

3.3.3 Disadvantages faced by incumbents

In a differentiated market such as retail banking, by definition suppliers will have competitive advantages and disadvantages: they will not all look alike, or be larger or smaller versions of the same business model. Yet some commentary would imply that challengers are beset with disadvantages and that incumbents hold all the cards. This is not the case.

Agility and targeted customer acquisition

In reality, new entrants tend to be smaller and are, therefore, able to respond more quickly to changes in the market. Retail and SME banking channels are in the middle of dynamic change with cashless transactions, contactless payment systems and cloud based systems expected to dramatically change the market.

New entrants are able to cherry-pick customers, tailor their distribution models to meet changing demand and target their offerings at particular customer groups. For example, Santander has focused on SME customers at the smaller end of the sector with very notable success, claiming a market share of around 10% in this segment. Similarly, Handelsbanken has expanded significantly in the larger SME sector. On the PCA front, the imminent launch of Atom Bank with its digital-only offering in 2015, highlights the direction of travel for new entrants and the move away from relying on, or seeking, traditional banking models.[55] Similarly, Metro Bank’s success with the Temenos T24 Software as a Service ("**SaaS**") banking solution is a clear example of how new entrants can use new products and formats to capture market share from legacy players. By contrast, incumbent firms must necessarily cater for a much wider set of customers and expansion may be hindered, for example, by back book pricing.

Branch network

Secondly, a branch network (discussed in more detail in Section 3.4.3 below) can be a double-edged sword, bringing with it significant legacy costs. These should be seen in the context of the retail banking market moving away from the traditional forms of branch-based banking towards online banking, mobile banking and indeed new models of banking

[53] [**Confidential**].

[54] HMG’s 2014 Budget para 1.120 and Santander press release of March 2014.

[55] See http://www.theguardian.com/money/2014/apr/09/atom-digital-bank-metro-first-direct.

offered by firms such as Amazon, PayPal, Google and Apple.[56] For this reason many banks, including RBS as well as Barclays, LBG, HSBC, Clydesdale and the Co-Operative Bank have been reducing the size of their branch network considerably.[57]

This is not to say that it is rational for those with large branch networks such as RBS to reduce the number of outlets to the point of decimation, any more than any bricks-and-mortar UK retail player abandons the high street entirely because of Amazon, etc. But RBS does suggest that if starting without such a legacy, a new entrant or small expanding player would not rationally roll out a large branch network as its best (let alone only) way to compete: new entrants, particularly entrants such as TSB and Williams & Glyn, can use a more targeted branch network to sweep up a more profitable customer base in conjunction with a digital (online, mobile) distribution strategy. From a geographic point of view, many branches have also been in the same location for a substantial period of time (e.g., due to the length of the relevant lease), and with the passage of time have therefore become poorly placed in terms of footfall. Even where this is not the case, the maintenance and (especially) refurbishment and updating of the branch network carries a significant cost.

IT infrastructure

Thirdly, legacy IT systems also create significant costs for incumbent banks. These operate both as a cost base and as a constraint on how the business can operate and the speed at which innovations can be brought to market. By contrast new entrants have a clean slate to work from. They can design IT systems based on the newest technology and are, therefore, typically more able to respond quickly to shifts in the market (see further Section 3.4.3(ii) below).

Brands

Lastly, many incumbent banks have suffered significant reputational damage as a result of the financial crisis and backlash against investment banking. New and “challenger” banks are free of this taint and, indeed, several challengers make this point strongly in their marketing materials including, for example, TSB’s “How we’re different” campaign.[58] “Challenger” banks such as those connected to supermarkets and the Post Office which have existing customer networks, large pre-existing geographic footprints, and established reputations for reliability also benefit. In respect of Scottish customers, while historically there may have been some preference to bank with Scottish bank brands, the financial crisis has eroded this advantage as RBS and Bank of Scotland have suffered among the worst brand damage of any of the UK banks in light of the bailouts and restructuring. As mentioned above, the difference in NatWest and RBS NPS scores – despite the similarity of the propositions – also demonstrates this point.

The cumulative disadvantages faced by the largest four banks are reflected in a significant loss of customers, particularly since the introduction of CASS. RBS and NatWest have suffered a net loss of approximately [**confidential**] customers between September 2013 and October 2014 with some [**confidential**] of switchers going to either Halifax or Santander. Ulster Bank net losses through CASS amounted to [**confidential**] in the same period, with most switchers also going to Halifax and Santander. RBS has also experienced low profitability over the last five years (see above at Section 3.2.3(iii)) which again belies any indication of market power.

56 Around [**confidential**] of RBS and NatWest PCA customers are active online banking users and around [**confidential**] are active mobile banking users.

57 See http://www.ft.com/cms/s/0/5ea06dae-5adb-11e4-8625-00144feab7de.html?siteedition=uk#axzz3HKtpTPl6

58 See http://www.tsb.co.uk/how-were-different/.

3.3.4 International Comparisons

RBS considers that if retail banking concentration levels in the UK are compared to those elsewhere, it is clear that there is nothing out of the ordinary at work in the UK market.[59] RBS welcomes the CMA's intention to use international comparisons to assist its analysis (Issues Statement at paragraph 45) and would suggest that this comparison would prove valuable not only in the event that the CMA considers some banks likely to exert market power, but also at the earlier stage of considering whether concentration levels indicate that markets may not be functioning as well as they could.

3.3.5 Summary of views in relation to Theory of Harm 2

RBS agrees that in the context of the Market Investigation, the CMA should consider supply-side issues in the provision of PCA and SME banking. However, high levels of concentration are not in themselves the root of the competition law issue, but are instead a symptom of customer inertia concerns raised in TOH1. This much is borne out by the disconnect between the large number of alternatives available from challengers and newer entrants alongside the relatively static market shares of the largest banks. Some of the answer to that conundrum lies in the cherry-picking strategies of the newer banks that has an impact disproportionate to market shares and share fluctuation. But to the extent that demand-side issues require further attention, RBS considers that the Market Investigation offers a one-off opportunity in which to carefully design a plan to maximise the potential for customer engagement in order to provoke behaviour which leads to long-term and sustainable solutions to any concentration concerns.

3.4 Theory of Harm 3: Distribution concerns and other perceived barriers to entry and expansion

3.4.1 Issues Statement

The CMA's TOH3 considers the impact of (i) regulatory, (ii) structural, and (iii) conduct barriers to entry and expansion. These are each dealt with in turn below.

3.4.2 Regulatory barriers

The main regulatory barriers to entry and expansion within the PCA and SME banking markets relate to authorisation, capital and liquidity requirements. Of course, and as the CMA acknowledges in its SME banking market study, while these regulatory requirements do constitute barriers to entry and expansion, this is, as a general proposition, their intended effect. However, these barriers, when correctly pitched, should "*strike the right balance between achieving these aims* [i.e., acting as legitimate barriers] *and ensuring that competent firms are not unduly hindered from entering and expanding in the market*" (SME banking market study at paragraph 5.31).

In relation to the authorisation process for launching a new bank, as noted in the SME banking market study, as a result of changes to the system following the 2013 review by the FSA and the Bank of England, the authorisation process is now much quicker, more straightforward and cost-effective. Further initiatives from the FCA such as the development of a "mobilisation" phase where banks can secure authorisation albeit with limitations on the work they can do, are continuing to reduce the process as a competitive

[59] Concentration levels in the UK are very similar to those seen in other developed countries. The rare exceptions, including Germany and the US, are markets where historical legal constraints have left a regional market structure. See for example European Commission Interim Report II on current accounts and related services, 17 July 2006, Section 4.4.

impediment.[60] Nevertheless, these barrier reductions are in their early days, and their longer term impact is difficult to foresee.

Reforms to the authorisation process have been complemented by reductions in capital and liquidity requirements as a result of actions taken by the PRA. In its SME banking market study, the CMA did point to the potential impact of differing approaches from larger versus smaller banks as to the calculation of required capital holdings (with the "internal ratings based" (IRB) model used by larger banks as opposed to the "standardised model" used by smaller banks). RBS would be happy to discuss the workings of the IRB and the standardised models in more detail with the CMA in order to address any concerns in this regard.

In addition to formal regulatory requirements, there is ongoing political and regulatory pressure on banks to maintain certain largely outdated services such as cheques and to meet financial inclusion objectives serving intrinsically less profitable customer segments. This also constrains the functioning of the retail banking sector in the way of a "normal" retail market. As noted above at 3.2.3, some [**confidential**] of RBS's PCA customers are unprofitable to the Bank and large segments of the PCA market are unprofitable on a standalone basis. Any nuanced study of issues of cross-subsidy generally, and overdraft charges in particular, will recognise that the public policy drivers of financial inclusion affect how banks compete.

3.4.3 Structural barriers

The Issues Statement identifies the need for an effective distribution system (including a branch network) and the costs of establishing an IT system as barriers to entry and expansion. In addition, the CMA points to potential difficulties which new and smaller providers may face when it comes to accessing finance, payment systems and information regarding the creditworthiness of lending customers.

(i) Distribution

One aspect of distribution in PCAs and SME banking is the branch network. RBS reiterates the points it has made throughout the market study phase in this regard. In particular, although branch access remains an important aspect for some customers (such as those SMEs with high volumes of cash and cheque banking requirements) and in certain circumstances (obtaining advice regarding mortgages), RBS does not consider it to amount to a significant strategic entry barrier. In fact, rather than relying on the branch, banking customers increasingly look to telephone and digital channels as a convenient way to bank (and the functionality of such channels has increased dramatically over the last few years and continues to do so, e.g., the ability to pay mobile phone contacts, for example Barclays "Pingit" and RBS's "Pay your contacts"). [**Confidential**] of SMEs have used online, [**confidential**] use mobile and [**confidential**] also use telephone banking.[61] On the PCA side, [**confidential**] of RBS and NatWest PCA customers are active online banking users and [**confidential**] are active mobile banking users. Even customers who do value the branch network, may in fact place more weight on direct contact with a known relationship manager than the physical presence of a bank on the high street. With ever improving technology, such contact does not necessarily need to be provided through a branch network.

[60] See http://www.fca.org.uk/news/firms/creating-a-fair-and-competitive-environment-for-retail-banking-in-the-interests-of-consumers.

[61] Charterhouse data.

Recent market experience bears out the declining strategic role of branch-based banking for SMEs. A number of competitors (e.g. First Direct and Virgin Money) have demonstrated the viability of growing through direct models or through usage of existing payment networks such as IBACS (International Bankers Automated Clearing Service) and the Post Office. Indeed, the Post Office offers a range of services to customers of 22 banks (thus covering 95% of personal account debit card holders in the UK) with which it has a partnership, including RBS. Those services are available for current accounts, basic bank accounts and business accounts. Depending on the bank with which the customer holds its account, they may: (i) check their account balance, (ii) withdraw money, (iii) deposit money, and (iv) deposit cheques, all through the Post Office.[62] RBS's partnership with the Post Office has been active since September 2014 with internal estimates of approximately [**confidential**] deposit transactions carried out and, per month, [**confidential**] of withdrawals.

Overall RBS has seen a 30% decline in branch usage since 2010 and continues to invest in mobile and online banking to support and reflect the change in customer channel preferences.[63] A number of banks, [**confidential**], are in the process of scaling down their branch network to reflect changing customer preferences.[64]

However, as noted above, RBS acknowledges that for a limited set of customers and circumstances, the branch remains more important. But even for that limited subset, access and distribution options, potentially taking advantage of pre-existing networks such as that of the Post Office[65] offers a realistic response to concerns such as cash deposits and account access. In addition, RBS would urge the CMA to take account of how the distribution strategies of new entrants and expanders, such as Handelsbanken and Santander, which focus on particular segments of the market, are not disadvantaged by a smaller branch network which is, to the contrary, part of their strategic model.

As stated in 3.3.2, many challengers (notably the Post Office and the grocery sector-origin banks) already have large pre-existing physical networks which they could use to promote their services (should they wish, and it may be that many of the changes in how customers bank described above have deterred them from doing so). For others, retail space is available should they so desire.

(ii) IT systems

The Issues Statement notes that historic barriers to entry arising from IT systems are starting to diminish. RBS agrees fully that IT systems do not represent a meaningful barrier to entry or expansion. Indeed, if anything, newer entrants, unencumbered by legacy IT systems, are at a competitive advantage relative to the more established banks and can develop bespoke IT systems with relative speed. These newer IT systems are available at a relatively low cost and may be more readily updated than the older legacy systems.

(iii) Accessing payment systems and information on creditworthiness of lending customers

RBS welcomes the approach of the CMA to payment systems in the SME banking market study. While it is recognised that access to payment systems may amount to at least a perceived barrier, the planned work of the PSR, including the preparatory work already

[62] See http://www.postoffice.co.uk/branch-banking-services

[63] [**Confidential**].

[64] [**Confidential**].

[65] [**Confidential**].

underway to map out its priorities, is expected to focus on this issue and will undoubtedly feed into the Market Investigation. In its consultation document in November 2014, the PSR announced its intention to launch a market review into the ownership of, and competition in, the provision of infrastructure which will formally commence by April 2015.[66] The review will evaluate the expected outcomes for all service users as well as the possibility of different ownership models which might emerge. We would also note that this perceived barrier has not prevented others, such as PayPal, from providing significant competition in the area of payments.

With regard to information on the creditworthiness of lending customers, RBS agrees with the views of the CMA in the SME banking market study that while historically credit data and references may have amounted to a barrier, recent initiatives including legislation on sharing credit data through credit reference agencies[67] to be enforced by the FCA will address any potential barrier issues which might have existed.

3.4.4 Conduct barriers

The Issues Statement identifies the role of (i) cross-subsidies, (ii) bundling, (iii) delays in the grant of waivers of security or deeds of priority and (iv) restrictions on other participants from accessing SME banking services, as potentially amounting to "*incumbent benefits/practices which may make it harder for new entrants or smaller banks to compete effectively*" (Issues Statement at paragraph 49(e)).

The issues of cross-selling and bundling are dealt with above at Section 0.

In relation to the grant of waivers of security and deeds of priority, the CMA notes in its SME banking market study the protocol announced by the BBA on 19 April 2014 as agreed with RBS, Barclays, Lloyds and HSBC designed to avoid any potential barriers faced by alternative lenders through these "incumbency benefits".[68] Under the protocol, the relevant banks agreed to use standard templates and to notify customers of their decision within seven days as to whether they will agree to a waiver or deed of priority request. The protocol has been introduced successfully and RBS would be happy to engage with the CMA in monitoring its implementation.

3.4.5 Summary of views in relation to Theory of Harm 3

The overall lack of unnecessary barriers to would-be competitors in the UK retail banking sector is reflected in the significant (and increasing) number of new entrants in the space. This fact of a relatively level playing field viewed against continuing high concentration, underscores the importance of getting to grips with the solution to the cornerstone issues of TOH1 - customer inability and/or reluctance to engage, and to exercise choice effectively among the wide range of banking options in (or about to be) in existence.

4 Conclusion

Customer behaviour in UK retail banking is a complex issue that will benefit from close CMA scrutiny, and the scale of the task in TOH1 in the Market Investigation timeframes should not be underestimated. It is complex not only because customers have different needs, including within different categories of business within the SME spectrum, but because of a range of issues from customer contentment vs. dissatisfaction, apathy, issues

[66] A New Regulatory Framework for Payment Systems in the UK, dated November 2014, at page 26.

[67] Small Business, Enterprise and Employment Bill 2014-15.

[68] https://www.bba.org.uk/news/press-releases/bba-response-to-budget-announcement-on-deeds-of-priority/#.VHMATHJF270.

of financial literacy and the objective and subjective factors that go into the cost/benefit analysis of switching.

RBS's new strategy is unilaterally to work within the current constraints of customer behaviour (and, at least implicitly, the insights of behavioural economics with which the CMA is familiar) in an effort to win back the trust of UK customers in as deep and broad a fashion as possible, by making it easier for customers to engage with, and choose an RBS brand as a service proposition. RBS does this not just because of its new corporate ethic, but also for the economic imperative that – notwithstanding these demand-side issues – it faces very considerable opposition from competitors old and new. This threat is growing rather than receding.

The Bank believes that its recent unilateral actions and new strategic direction highlight existing problems in the markets and areas where any CMA market-wide intervention might be focussed. RBS is aware that unilateral actions alone, however well implemented, cannot systematically improve the market, only RBS's role within it. The Bank is also acutely aware that unilateral action cannot solve the problem of demand-side inertia: realising its goal of being the best on service and trust may not translate directly into market share gains and business success if customers are unable readily to differentiate suppliers and choose accordingly. As such, RBS takes comfort from the fact that its strategy works with the grain of what the CMA is intending to do to put customers, and customer welfare, at the centre of UK retail banking. RBS supports the CMA's objectives, whether their realisation makes RBS an ultimate winner or loser from greater competition and customer empowerment.

Its comments above are genuinely intended to support the CMA in focusing on the very real and difficult task in solving (rather than simply diagnosing) core issues captured by TOH1, and, as an integral part of this effort, to caution the CMA against interpreting a number of the derivative issues (symptoms, not causes) in TOH2 and TOH3 as key problems in their own right. Ultimately, the platform of a sufficient set of customer choices in a digital era is already present; the real prize will be a substantial improvement in the ability and/or incentive for customers to select effectively from among this set of choices and to benefit from doing so.

RBS looks forward to working constructively with the CMA throughout the Market Investigation.

5 December 2014