Retail banking market investigation

Virgin Money case study

5 June 2015

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which accompany it. These papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in September 2015, taking into consideration responses to the consultation on the updated issues statement and the working papers. Parties wishing to comment on this paper should send their comments to retailbanking@cma.gsi.gov.uk.

The Competition and Markets Authority has excluded from this published version of the working paper information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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Case studies

In previous investigations we have found that case studies on market entry and expansion can provide powerful insights into the practical difficulties that firms may face trying to enter and/or expand into particular markets. Such studies have contributed to the identification of possible adverse effects on competition and where appropriate have helped us to develop remedies designed to remove or lower barriers to entry or expansion.

We have undertaken six case studies looking at examples of entry and expansion in the provision of personal current accounts (PCAs) and retail banking services to small and medium-sized enterprises (SMEs). We have in addition obtained information on a number of prospective new entrants in the process of seeking bank authorisation. The value of each case study lies in its ability to provide a detailed understanding of the way particular types of event unfold. They are therefore written as factual accounts of events.

We are publishing each case study as a separate working paper and each case study will inform our assessment of barriers to entry and expansion. We are also publishing separate working papers pulling together the evidence from the case studies and from other sources on potential barriers to entry and expansion. The first such working paper – Barriers to entry and expansion: regulation, IT systems and payments systems – will be published shortly and a further working paper on branches will be published in due course. Our updated issues statement published on 21 May 2015 sets out our current general thinking on barriers to entry and expansion.

Executive summary

1. This case study focuses on Virgin Money's launch of its personal current account (PCA) in the UK.

2. Virgin Money acquired Northern Rock plc (NR) in January 2012, which transformed it from being a comparatively small online bank to having a high street banking presence with 75 branches.

3. Thereafter, Virgin Money considered a number of different strategic alternatives, and launched its first PCA, its 'Essential Current Account' (ECA) – a type of basic bank account (BBA), in Scotland and Northern Ireland in July 2014, and in the rest of the UK in March 2015.[1,2] It [✂] considers this launch to be the first step towards offering more PCA products in the future.

4. Although Virgin Money has launched its ECA, and has plans to offer a wider range of PCA products, it does not intend to substantially grow its current account business in the near future. It told us that it faced some impediments to further expansion. These included: the free-if-in-credit PCA model, a lack of product diversity in the market, perceived difficulties of account switching, and the competitiveness of payment systems.

5. Developing a suitable IT platform was not considered to be an impediment by Virgin Money to enter the PCA market because it acquired much of the required capability with NR. However, it told us that further investment in IT would be required if it sought to create a 'me-too' PCA product and compete directly with the larger banks. It does not consider its limited network of 75 branches to be an obstacle to its further expansion.

6. Through its launch of its ECA, Virgin Money appears to have adopted a cautious and phased approach towards offering PCAs, and has attempted to identify areas where it considers it will not face head-on competition from the major PCA providers. Its PCA strategy appears to be driven by a desire to limit the scale of its investment (for example in customer acquisition and IT platform) and therefore risk, due to its belief that it is difficult to achieve the required scale to recover these costs.

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[1] A BBA is a PCA that does not have an overdraft facility but allows the customer to receive payments, pay in cheques, withdraw money, and set up a direct debit or standing order. It does not carry a monthly fee, does not usually offer any in-credit interest but may provide the customer with a debit card. Money advice service; British Bankers' Association.

[2] An agreement was announced in December 2014 between the UK government and the banking industry to establish new BBAs under which customers will not incur bank charges if a direct debit or standing order fails. Nine high street banks have agreed to offer such accounts to customers. See HM Treasury news story New basic fee-free bank accounts to help millions manage their money.

7. Virgin Money told us that in light of its views on the current market and regulatory environment, it does not expect to become a major PCA provider in the near future, and is likely to remain predominantly a retail-funded mortgage bank.

Introduction and background

8. This case study focuses on Virgin Money's launch of its ECA in the UK. The paper begins with a brief background of its businesses, which is followed by a chronological analysis of events leading up to the launch of its ECA, including Virgin Money's strategy and business model. Finally, the paper considers the extent to which Virgin Money's experience suggests the presence of barriers to entry or expansion.

9. Virgin Money is a UK-based retail bank, which was established in 1995.[3] It initially offered a personal equity plan, the forerunner of its personal savings accounts, and investment plans. It added credit cards and personal loans in 2002, car and home insurance in 2004 and life insurance a year later to its portfolio, but did not have a PCA offering. In 2010, with the acquisition of Church House Trust plc, Virgin Money acquired a UK banking licence.[4]

10. Virgin Money acquired NR in 2012, which transformed it from being a comparatively small online bank to having a high street banking presence. This acquisition included 75 branches, one million customers, £14 billion mortgage book, £16 billion retail deposit book and 2,100 employees.[5] Virgin Money also acquired around 100,000 NR PCA customers, an IT platform, and access to relevant UK payment systems.

11. At the end of 2014, Virgin Money had 2.8 million customers which it serviced through a range of channels, including online and mobile, and a network of 75 branches and five customer centres (which it terms 'Lounges').[6,7]

12. Virgin Money operates exclusively in the UK with the exception of wholesale funding and liquidity management activities which it undertakes both in the UK and in limited overseas markets. Its operations are broken down into three business units: Mortgages and Savings; Credit Cards; and Current Accounts,

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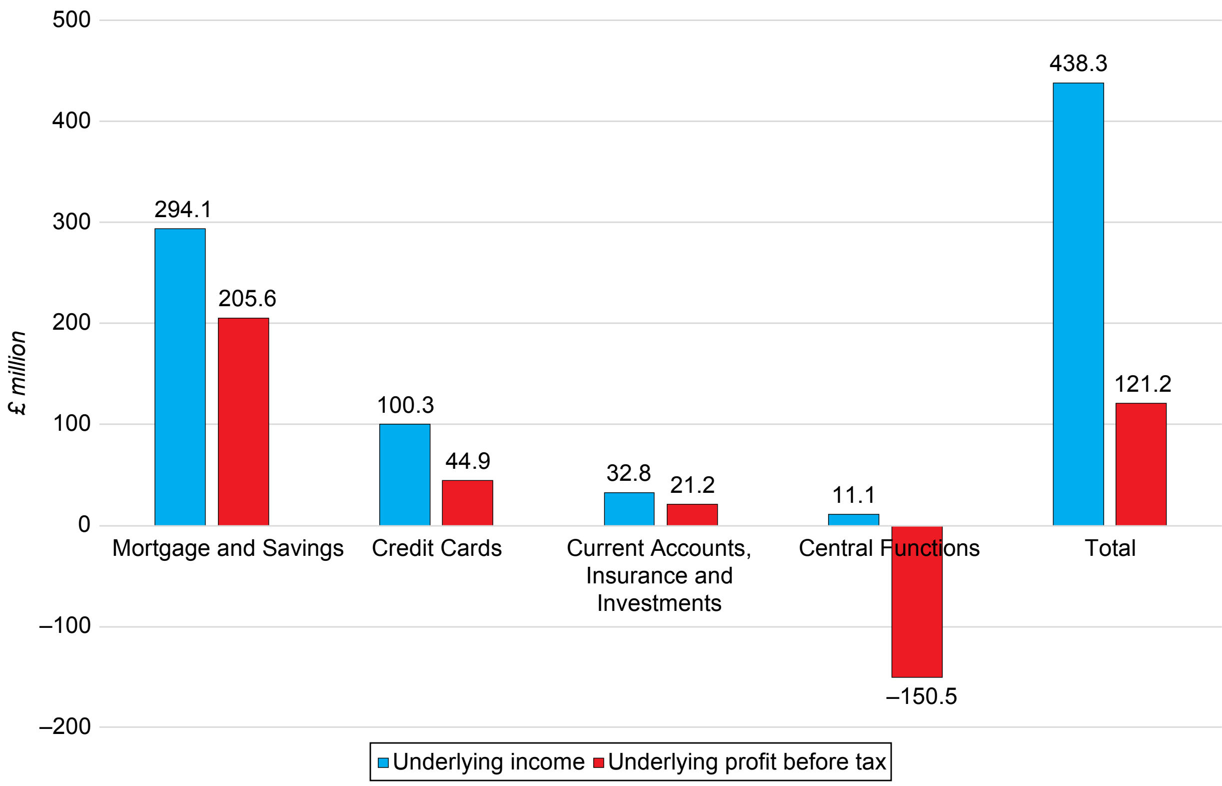
[3] Virgin Money is part of the Virgin family of companies which have businesses in sectors ranging from mobile telephony, travel, financial services, leisure, music, holidays, and health and wellness. Virgin Money website.
[4] BBC News (17 November 2011), Virgin Money looks to join the mainstream.
[5] Virgin Money completes the acquisition of Northern Rock.
[6] Virgin Money Group Annual Report 2014, p20.
[7] The location map of Virgin Money's branches (called stores) is provided in Appendix A.

Insurance and Investments, all of which are supported by its Central Functions unit which provides support services to these business units.[8]

13. Figure 1 shows the underlying income and profits of Virgin Money's business units in 2014.[9] As can be seen, Mortgage and Savings is its largest business unit, accounting for 69% of underlying income and 76% of underlying profit before tax in 2014.[10]

Figure 1: Income and underlying profit of Virgin Money business units



Source: Based on data in Virgin Money Group Annual Report 2014, p27.

14. Virgin Money believes that its business model positions it well for cost-effective growth in an increasingly digital world.[11] It considers its brand, customer-focused culture, financial strength and the fact that it is unburdened by legacy as key enablers in providing a distinctive customer proposition.[12] According to Virgin Money, its ability to grow has been enhanced by a successful listing on the London Stock Exchange following an Initial Public Offering (IPO) in November 2014.[13]

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[8] Virgin Money Group Annual Report 2014, p27.
[9] Further details of Virgin Money's financial performance during 2011–2014 are provided in Appendix B.
[10] Excluding Central Functions.
[11] Virgin Money Group Annual Report 2014, p20.
[12] Virgin Money Group Annual Report 2014, p20.
[13] Virgin Money Group Annual Report 2014, p12.

15. In its IPO prospectus, Virgin Money stated that its strategy was focused on:

(a) continuing strong growth in its core mortgages, savings and credit cards businesses, along with further product extensions over time;

(b) maintaining high asset quality and a low cost of risk through a robust risk management approach; and

(c) delivering strong returns by increasing net interest margins, driving operating leverage, growing non-interest income and optimising capital efficiency.

16. In the IPO prospectus, Virgin Money also stated that it was targeting a return on tangible equity in the mid-teens range by the end of 2016, and expected to deliver continued improvement on this measure beyond 2016.

Launch of Essential Current Account (ECA)

17. In its submission to the House of Commons Treasury Select Committee ('Select Committee') in 2010, Virgin Money referred to the difficulty of launching a PCA; it stated that since PCA switching rates were low, it would take some time for a new entrant to achieve scale – during which time the incumbent banks could respond to threats from new entrants.[14] It began exploring its options to launch a PCA after its acquisition of NR in January 2012, since it felt that as a mass consumer brand, it should make clear its intention to become a competitor in the wider PCA market.

18. Virgin Money launched its ECA in Scotland and Northern Ireland in July 2014, and in the rest of the UK in March 2015. Its strategy has been evolving since it acquired NR, and currently includes plans to launch more PCA products in the future that will be fee paying, have more digital functionalities, and cater to a wider target market including customers who use overdrafts, mortgages, and look to build their savings. Virgin Money told us that these plans are subject to it considering the regulatory landscape being favourable.

19. A chronological summary of key events leading up to Virgin Money's launch of its ECA is provided in Figure 2.

[14] House of Commons Treasury Select Committee. Competition and Choice in retail banking. Written evidence submitted by Virgin Money (September 2010), paragraph 3.6.

Figure 2: Launch of ECA – key events

Source: Collated by CMA based on information provided by Virgin Money.

Cessation of sales of NR current account, June 2012

20. After the NR acquisition, Virgin Money began a detailed evaluation of the acquired current account book and systems. Its assessment identified a number of challenges which led to a decision (in June 2012) to close the (NR) current account offering to new customers.[15] These challenges included a recognition that the NR PCA proposition lacked some basic functionalities (for example online capability), and a desire to avoid confusion in the market through the conflation of the Virgin Money and NR brands.

21. Virgin Money stated that ceasing sales of the acquired NR PCA product to new customers also enabled it to devote efforts on improving its systems and processes, whilst building an enhanced PCA product proposition.

[15] While it ceased its sale of current accounts, it continued (and continues) to service the acquired NR customers.

Board approval of PCA strategy with CAD as the entry product, September 2012

22. A board paper of September 2012 noted that:

> 'We appear to be an inflexion point for the PCA market where the powerful incumbents may no longer be able to resist pressure for change. This will create an opportunity for new products and participants, but only if
>
> - Customer and regulators can be convinced the provision of basic banking is safe and reliable;
> - All observers can be assured of the transparency and fairness of charging;
> - The standards of service, including speed and reliability of switching, is high.'

23. Virgin Money believed that while the acquired NR PCA had been withdrawn in June 2012, it provided a foundation for building a future PCA product. At that time, it was considering launching a product called the Current Account Deposit (CAD) which combined its existing deposit capability with current account functionality, and which could be the first of a range of current account related products.

24. [✂]. Figure 3 illustrates [✂].

Figure 3: PCA programme

[✂]

Source: [✂].

25. [✂].

26. [✂].

Revised approach – to launch a BBA, February 2013

27. In February 2013, Virgin Money revised its strategy and proposed to launch a BBA, offering a 'quicker and less risky' launch, addressing the most 'underserved' part of the market and supporting its 'Building Better Banking' philosophy (see Figure 4).

28. It made the decision to launch a BBA 'after considering a number of different strategic alternatives and discounting them on the basis of the scale of

investment required in an unfavourable regulatory environment.' The proposed BBA was a free product but was thought to support Virgin Money's positioning on monthly fees for subsequent, more functionally rich PCA propositions when it considered the market and regulatory conditions to be favourable.

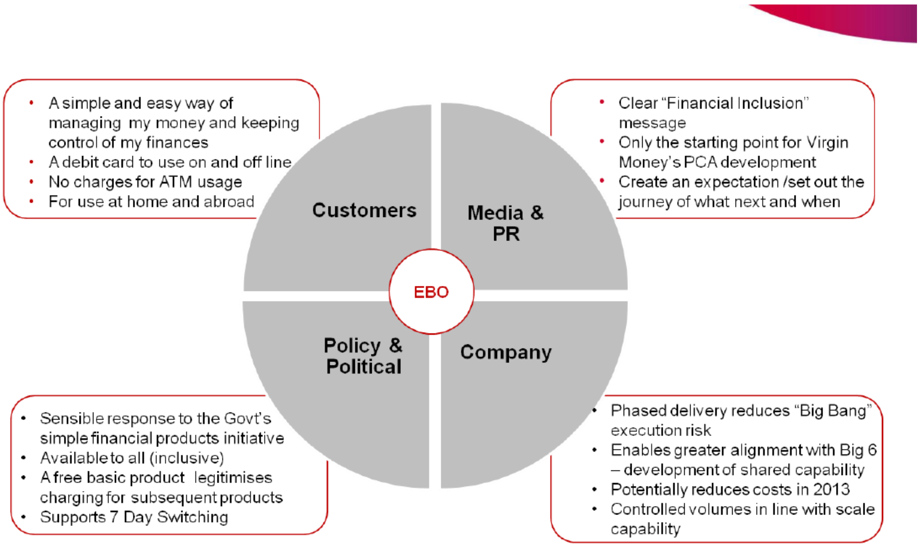
Figure 4: PCA strategy

[✂]

Source: [✂].

29. An internal strategy paper of February 2013 noted that alternative delivery options needed to be explored in order to get to the market more quickly and cheaply, whilst still making a sensible first step on the road map to a full PCA offering. Key to this revised strategy was the launch of a BBA, which was to help 'reduce the execution risks' and 'enable a stronger Virgin narrative for customers, the media and the political environment.' Figure 5 shows Virgin Money's strategic rationale for proposing to launch a BBA.

Figure 5: Virgin Money BBA – strategic rationale



Source: Virgin Money.

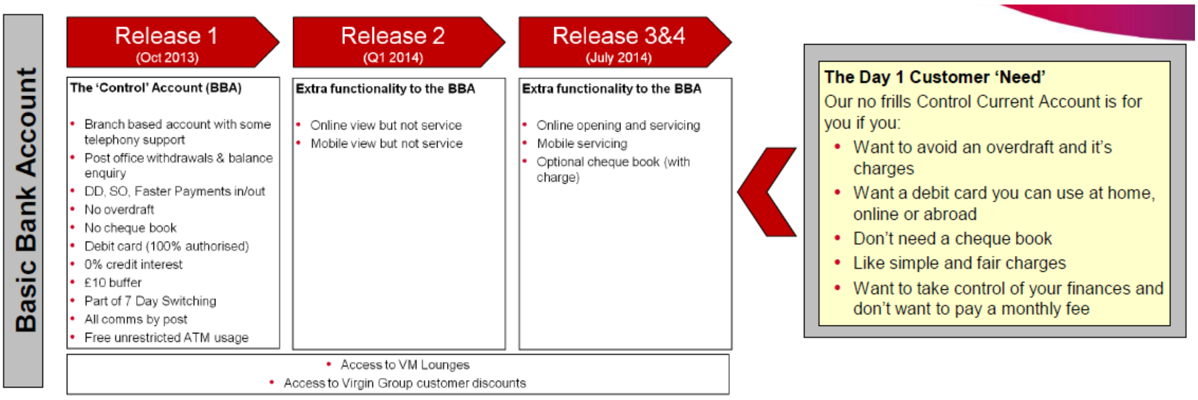
30. The strategy paper explained the background and purpose of a BBA as follows:

(a) A current account with limited functionality.

(b) Originally designed to cater for the financially excluded but then positioned as an account which enabled customers to take better control of their finances, since it did not offer an overdraft.

31. The strategy paper noted that a phased delivery of current account products de-risked the original CAD launch plan and enabled costs and resources to be re-planned. Figure 6 shows the proposed road map to Virgin Money's proposed phased delivery of PCAs, as well as how the different products were intended to meet the requirements of the target market segments.

Figure 6: Scope of PCA programme



[✂]

Source: Virgin Money.

32. The strategy paper also stated that the primary driver for Virgin Money's PCA programme was not profitability but rather enabling a broader customer relationship strategy. However, according to its estimates, the programme was expected to deliver a neutral to positive contribution in its own right – see Table 1.

Table 1: PCA programme – high level financial assessment

[✂]

Source: Virgin Money.

33. [✂].

Figure 7: Contribution comparison

[✂]

Source: Virgin Money.

Board approval of new strategy to launch the Essential Bank Account (later renamed the Essential Current Account (ECA), March 2013

34. A board paper of March 2013 set out the plan for launching Virgin Money's Essential Bank Account (EBA) in October 2013, which was to be a 'simple and free current account without an overdraft facility, for those who want convenience and control.' This product was not to offer credit interest, was to

be sold only through Virgin Money branches, although it could also be operated through other channels – post offices, online and via mobile (view only), enabling careful control of volumes.

35. The paper pointed out that the EBA was the first step of Virgin Money's PCA road map, which was to deliver a range of fee-paying current accounts to savers, spenders and homeowners in the future – see Figure 8.

Figure 8: PCA road map

[✂]

Source: Virgin Money.

36. [✂].

Table 2: Indicative financials – PCA programme

[✂]

Source: Virgin Money.

37. [✂].

Current account programme delivery and customer research, March to September 2013

38. During March to September 2013, Virgin Money worked through its product proposition, design, process mapping etc, and carried out primary research to ensure that its offering was in line with the requirements of the target market.

Board approval to roll out strategy for the ECA with limits on volumes, September 2013

39. In a board update of September 2013, Virgin Money stated that it was ready to launch its ECA in November 2013. It mentioned that the ECA was being built on its existing infrastructure, thus ensuring a low risk of delivery, and would establish the engine for future product launches.

40. The update also stated that being a type of BBA, the ECA did not carry a monthly fee, and therefore posed a profitability challenge for Virgin Money.

41. As a mitigation measure, Virgin Money proposed an annual cap of 6,000 to 10,000 on ECA volumes which limited the negative contribution of the ECA to less than £[✂] million a year until 2017. Virgin Money 2014 Annual Report stated that 'our current account offering will be extended, although we will carefully control volumes ahead of expected future market changes such as

those that might be introduced following the decision of the CMA to refer the PCA market for a full market investigation'.[16]

42. An initial staff pilot during November and December 2013 was to be followed by a phased public roll-out of the ECA starting in Scotland and Northern Ireland in Quarter 1, 2014. The board update stated that 'The ECA enables us to take a strong challenger position with a best of breed Basic Bank Account for a large but underserved part of the market.' It went on to say that 'entering the market with a brilliant Basic Bank Account strengthens our [Virgin Money's] voice in the political debates about competition, switching and "free in credit" banking.'

43. The board update spelt out the benefits of launching the ECA, which included the following:

(a) It closed a product gap in its portfolio.

(b) It enabled low risk market entry.

(c) It was very hard to criticise.

(d) It helped to build future charging products.

44. Virgin Money believed that an ECA was likely to be the first bank account for customers, who were likely to manage their money closely checking their balance regularly.

45. Although Virgin Money expected its ECA to make a loss on a stand-alone basis (see Table 3), it expected the product to serve as a platform for the launch of its future PCA offerings. The annual running cost of ECA started at approximately £[✄] per account due to low volumes, and was expected to reach approximately £[✄] by 2020. [✄].

Table 3: Financials – Essential Current Account (ECA)

[✄]

Source: Virgin Money.

46. The board update stated that the next step on Virgin Money's PCA strategy was the delivery of an account which was to charge a monthly fee and offer a richer functionality; this offering was expected to appeal to a broader range of customer groups including savers and spenders, and be the vehicle through which it planned to drive higher PCA volumes. [✄].

[16] Virgin Money Group Annual Report 2014, p22.

Figure 9: PCA strategy and roadmap

[✂]

Source: Virgin Money.

ECA launched – in Scotland and Northern Ireland, July 2014 and in the rest of the UK, March 2015

47. Virgin Money's ECA which was launched in Scotland and Northern Ireland in July 2014 and in the rest of the UK in March 2015,[17] has the following key features:[18]

(a) It can only be opened in a Virgin Money branch.

(b) It is designed to be managed through Virgin Money branches and at any post office, with some services available online and over the phone.

(c) It has no overdraft facility.

(d) It has free withdrawals at almost all high street cash machine.

(e) It has 1% gross (variable) interest on the balance held in the account.[19]

48. According to Virgin Money, launching an ECA enabled it to ensure that it had fully tested and had robust capability to drive its further expansion at an appropriate time. It told us that the ECA volumes so far had been in line with its expectations.

Barriers to entry and expansion

49. Although Virgin Money has launched an ECA, it does not plan to grow its current account portfolio at scale in the near future. It told us that it faced some impediments to further expansion. These related to:

(a) free-if-in-credit banking;

(b) a lack of product diversity in the market;

(c) the account switching process; and

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[17] Virgin Money told us that the phased launch enabled it to manage PCA volumes and test its systems and processes.
[18] Virgin Money Essential Current Account, January 2015.
[19] According to Virgin Money, credit interest (currently 1%) was applied to all ECA balances without restriction. However, the maximum balance allowed under the ECA terms and conditions is £100,000. Virgin Money stated that where customers exceeded this limit, it continued to pay the interest on the total balance but insisted that the balance was brought down below £100,000 within a reasonable period.

(d) access to payment systems.

50. These impediments, in Virgin Money's view, had constrained the ability of the 'challenger' banks to compete with the incumbent banks. It said, 'despite our powerful brand and acquired systems capability, the cost and barriers to entry at scale into the full current account market would be prohibitive.'

Free-if-in-credit banking

51. Virgin Money believes that product cross-subsidisation is inconsistent with treating customers fairly. It said: 'We believe that cross-subsidisation within financial services has the potential to create conduct risk and consumer detriments, as has been shown by banks selling profitable PPI to subsidise personal loans with low interest rates.'

52. Virgin Money told us that larger banks derived cost and liquidity advantages from credit balances in PCAs especially since these tended to be stable and long term, and had lower costs than the other short-term sources of funding. This, according to Virgin Money incentivised the larger banks to maintain the status quo rather than to engage in innovation and competition, which might undermine their incumbency advantages.

53. According to Virgin Money, the above 'systemic' issues (related to product and customer cross-subsidy and cost and liquidity advantages for the larger banks) primarily arose from the free-if-in-credit banking model, which made it difficult for the 'challenger' banks to achieve scale in the provision of PCAs, since the cost of entry was high, and could not be recouped from a 'free' PCA offering.

54. It appears that Virgin Money's perceived disadvantages arising from the free-if-in-credit PCA model contributed to its cautious and phased approach towards developing its PCA proposition.

Lack of product diversity and account switching process

55. Virgin Money said that in its view, the main incumbent banks had not changed or improved their primary PCA offering for many years, PCAs were broadly indistinguishable between one bank and another. This had resulted in a static market where customers did not want to change their PCA provider, thus providing the main incumbent banks with a source of stable funding, and driving their profitability.

56. Virgin Money considered that customers did not want to change their PCA provider because of a combination of perceived difficulties in switching, the

lack of product differentiation, and the difficulty in assessing costs and benefits of different PCAs.[20]

Access to payment systems

57. Virgin Money stated that although having acquired NR,[21] gaining access to payment systems had not been an impediment to entering the PCA market, but it questioned if a system could be competitive and open to new providers with new ideas, when access to that system was 'controlled' by the main incumbent banks. It also pointed out that it was not clear if the fees charged by sponsor banks to agency banks like Virgin Money[22] for accessing payment systems was loading a 'penalty' on new entrants, thereby increasing the economic barriers to entry.[23]

58. In an internal note prepared in 2013, Virgin Money mentioned that for a new entrant, it was probably quicker, cheaper, easier and more practical to interface through a sponsor bank (agency banking) rather than building and maintaining costly infrastructure for lower volumes. However, it also elaborated issues which it thought were caused by agency banking relationships:

    (a) Service standards whereby the agency bank could find it difficult to offer the same standard of service on payments as its sponsor bank.

    (b) Potential brand damage which could result if payments were delayed.

    (c) Delay in hearing about industry-wide issues since agency banks relied on their sponsor banks to keep them informed of any industry-wide issues.

    (d) Project delays which could result due to reliance of agency banks on sponsor banks during a project life cycle.

    (e) Inadequate new initiatives since these tended to be directed by sponsor banks, and therefore solutions could end up fitting the requirements of those banks.

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[20] To address the perceived difficulties of account switching, Virgin Money is in favour of the introduction of full account number portability.
[21] As a result of Virgin Money's NR acquisition, it obtained access to the UK payment systems.
[22] Further details on payment systems are set out at paragraphs 140 to 150 of our updated issues statement and will be set out in our working paper on barriers to entry: regulation, IT systems and payment systems.
[23] Virgin Money stated that pricing differed between sponsor banks and is subject to individual negotiation.

59. In response to a query by the CMA, Virgin Money made the following comments regarding its indirect membership of the following payment systems:

(a) Faster Payments: Virgin Money stated that although it was happy with the service provided and did not feel that costs were egregious, some capability gaps existed since no payments were possible during weekly SWIFT outage (between Saturdays 3pm and Sunday 6am).[24] Further, indirect membership did not allow it to join Paym or Zapp.[25]

(b) Cheque and Credit: Virgin Money said that it was happy with the service provided, and the costs were reasonable.

(c) CHAPS: According to Virgin Money, costs and service were reasonable, and there were no proposition gaps by being an indirect member.

60. Thus, although Virgin Money pointed out potential difficulties for agency banks and potential issues arising from the ownership of payment systems by the main incumbent banks, in practice it did not appear to have any major concerns regarding the cost and quality of service of its indirect membership of payment systems.

IT systems

61. Virgin Money told us that developing a suitable IT platform had not been an impediment to its entering the PCA market, since it acquired much of the capability from its acquisition of NR in 2012. However, it told us that it had subsequently needed to spend approximately £[✂] million to support its PCA programme.[26]

62. Since Virgin Money did not have a PCA offering when it acquired NR, there were no integration costs per se. It stated that the need to integrate the NR IT platform with its IT systems was limited because its other major businesses – mortgages and savings – were also run on systems acquired from NR.

63. Virgin Money said that further investment in IT (1.5 to 2 times the amount it had already invested) would be required if it sought to create a 'me-too' PCA product and compete directly with the larger banks (which according to Virgin

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[24] SWIFT stands for Society for Worldwide InterBank Financial Telecommunications. It operates a network which facilitates the exchange of payment and other financial messages between financial institutions and eligible corporates throughout the world. A SWIFT payment message is an instruction to transfer funds; the exchange of funds takes place over a payment system or through correspondent bank relationships. KPMG (31 August 2014), *UK Payments Infrastructure: Exploring Opportunities*, p91.
[25] Paym and Zapp are services that enable making payments using a mobile phone.
[26] [✂]

Money was not the best approach for them). However, Virgin Money also stated that the obstacle was not the ability to fund this investment, but rather that the features of the PCA market did not justify making this investment.

Need for a branch network[27]

64. In its comments on the CMA's statement of issues, Virgin Money stated that while a branch network appeared to be important for a significant proportion of customers, it believed that this factor was of declining importance for many retail banking products, largely due to the growing popularity of alternative channels such as the internet.[28]

65. Virgin Money told us that in the future, customers would want to access its services through all available channels. It felt that although branches were important to enable some customers to build personal relationships, it expected the majority to want to access its services through digital and online technologies. It stated that in 2014, it had over 47 million interactions with customers, of which 38 million (81%) were via digital (website or email) channels. Similarly, 71% of its service interactions and 78% of its product sales took place through digital channels.

66. Virgin Money believes that through its 75 branches, it already has a good coverage of the major urban centres in the UK, and it was also working to provide more advanced digital banking capabilities to its customers.[29] Virgin Money stated that while it had considered different scenarios while finalising its PCA roadmap, an extension of the branch network had never been part of this strategy.

67. Virgin Money has no plans to expand its branch network in the near future, but it does not consider this to be an obstacle to its further expansion.

Capital requirements and regulatory barriers

68. Virgin Money told the Select Committee that:

> Given the riskiness of the business model of large banks, and the limitation of their risk models, our conclusion is that a level playing field should be achieved by requiring large banks to hold at least

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[27] Virgin Money does not currently use any advertising to promote itself, and instead relies on its branches and word of mouth to acquire customers.
[28] Virgin Money's response to the issues statement, paragraph 12.
[29] Virgin Money's ECA has been designed to be managed through Virgin Money branches and at any post office, with some services available online and over the phone.

as much capital (proportionately) as new entrants- and perhaps more at some times in the economic cycle.[30]

69. It told us that capital requirements were not a major concern for PCAs, but it was something that larger banks could manage more optimally due to their greater experience/sophistication, with better historical data and models.[31]

70. Virgin Money stated that it had all regulatory approvals necessary to build on its current PCA capability.[32] Similarly, in its response to the CMA's statement of issues, it had stated that 'the [banking] authorisation process has been simplified and capital requirements for new banks have been reduced – which should have positive consequences in terms of barriers to entry and growth in the PCA market.'[33]

Conclusions

71. Virgin Money gained a bank licence in 2010, but began exploring its options to launch a PCA after its NR acquisition in 2012 which also included a PCA product, a pool of PCA customers, 75 branches, an IT platform and access to relevant payment systems. After closing the NR PCA offering to new customers, it considered a number of alternative strategies to enter the PCA market before deciding to launch its ECA in 2014.[34]

72. Although Virgin Money has launched its ECA, and has plans to offer a wider range of PCA products, it does not intend to substantially grow its current account business in the near future. It told us that impediments which stand in its way include the free-if-in-credit PCA model, a lack of product diversity, perceived difficulties of account switching, and the competitiveness of payment systems.

73. Although developing a suitable IT platform was not considered to be an impediment by Virgin Money to enter the PCA market, it told us that further investment in IT would be required if it sought to create a 'me-too' PCA

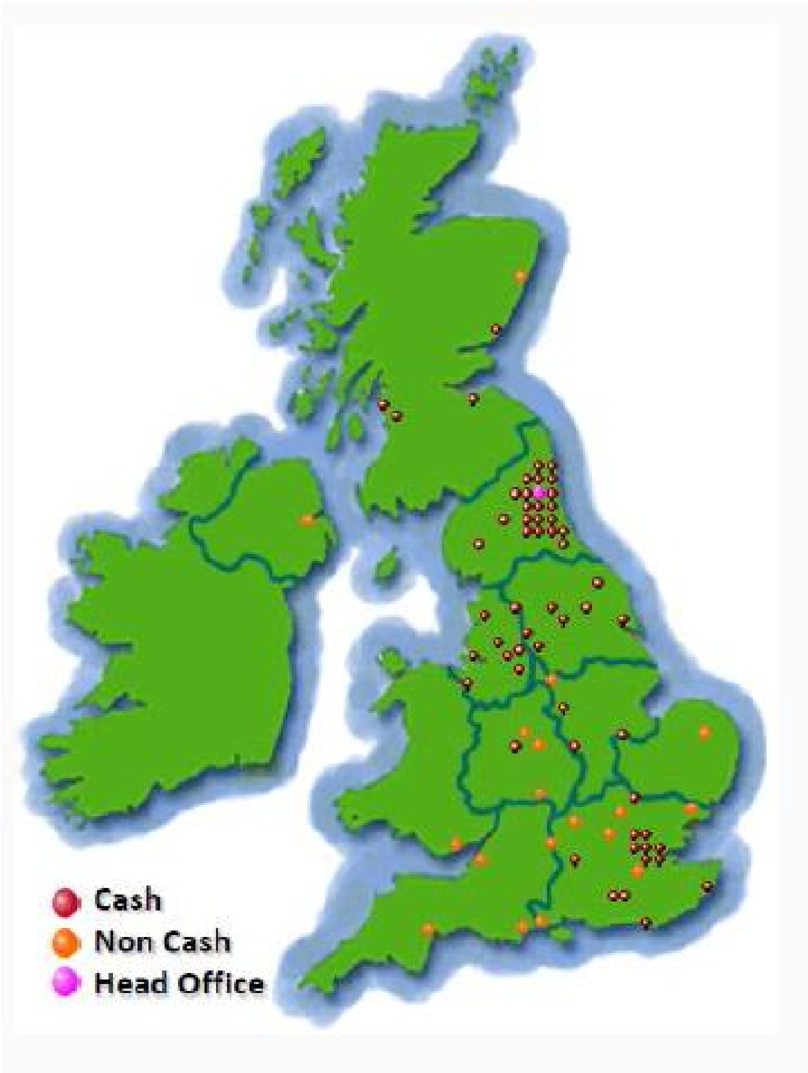
[30] House of Commons Treasury Select Committee, Competition and Choice in retail banking. Written evidence submitted by Virgin Money, (September 2010), paragraph 3.27.
[31] After acquiring NR, Virgin Money uses the IRB approach for its capital requirements.
[32] Virgin Money did not need formal approval to launch a current account since it already had the necessary bank licence and current account permissions in place following its acquisition of NR.
[33] Virgin Money's response to the issues statement, paragraph 12. It went on to say (para 33) that 'retail banking is highly regulated, and the complexity of the regulations and costs of ensuring compliance with them may still form a barrier to entry and growth in retail banking.' Virgin Money clarified this comment by stating that regulation was not a PCA-specific issue but more generally something that was a challenge for smaller banks with less advanced risk management infrastructure to address.
[34] Its ECA was launched in Scotland and Northern Ireland in July 2014 and in the rest of the UK in March 2015.

product and compete directly with the larger banks. It does not consider its limited branch network to be an obstacle to its further expansion.

74. It appears that Virgin Money has chosen to target the BBA market segment, due to its belief that it would be difficult to succeed in directly competing with the larger, more established banks in the provision of non-BBA PCAs. It stated that 'We aspire to be a major player in the PCA market, but only when market and regulatory conditions allow.' Its strategy appears to be driven by a desire to limit the scale of its investment (for example in customer acquisition and IT platform) and therefore risk, due to its belief that it is difficult to achieve the required scale to recover these costs.

75. Virgin Money stated that in light of its views on the current market and regulatory environment, it does not expect to become a major PCA provider in the near future, and is likely to remain predominantly a retail-funded mortgage bank.

Appendix A: Location map of Virgin Money branches in the UK



Source: Virgin Money.

Appendix B: Virgin Money 2011 to 2014 performance

Results 2011-14		2014	2013	2012	2011[1]
Growth					
Gross mortgage lending	£bn	5.8	5.6	4.9	3.7
Mortgage balances	£bn	21.9	19.6	16.8	13.9
Credit card balances	£bn	1.1	0.8	–	–
Deposit balances	£bn	22.4	21.1	18.0	16.2
Total assets	£bn	26.5	24.6	21.8	19.6
Quality					
Cost of risk[2]	%	0.11	0.15	0.02	–
Fully-loaded Common Equity Tier 1 capital ratio	%	19.0	15.5	15.5	18.7
Leverage ratio	%	4.1	3.8	3.6	4.0
Loan-to-deposit ratio	%	102.8	96.4	93.1	85.8
Returns					
Underlying total income	£m	438.2	361.5	234.6	161.7
Underlying profit/(loss) before tax	£m	121.2	53.4	(2.5)	(59.1)
Statutory profit before tax	£m	34.0	185.4	160.2	23.5
Underlying net interest margin	%	1.50	1.26	0.54	0.36
Underlying cost:income ratio	%	68.7	77.2	100.2	148.1
Underlying return on tangible equity	%	7.4	2.3	(1.1)	(5.2)
Underlying basic earnings per share	p	21.4	8.1	17.0	(33.9)

1 The 2011 results of Virgin Money Holdings (UK) plc have been presented as if Northern Rock plc had been part of the Group during 2011.

2 Cost of risk excludes benefit of debt sale of £8.9 million.

Source: Virgin Money Group Annual Report, p2.

Appendix C: Cost to deliver the PCA programme

[✂]

Source: Virgin Money.