CMA Retail Banking Market Investigation
Nationwide Building Society response to the Updated Issues Statement

1. Introduction

1.1 This paper is Nationwide Building Society's ("**Nationwide**") response to the Competition and Markets Authority's (the "**CMA**") Updated Issues Statement dated 21 May 2015 (the "**UIS**").

1.2 In the following sections we give a brief overview of the competitive landscape in the PCA banking market, the position of Nationwide, and the key challenges for the CMA. We then comment specifically on the Theories of Harm identified in the UIS.

2. Nationwide's view of the PCA competitive landscape

<u>The rise of digital and the implications for transparency</u>

2.1 The PCA market is in the process of transformation with digital banking growing exponentially. This can be expected to result in more complex customer relationships as customers use both "digital and mobile" and "bricks and mortar" in different ways.

2.2 As a member owned organisation, Nationwide is fully focused on meeting the various needs of its members both in branch and through new digital channels.

2.3 Nationwide is concerned that customers already face difficulty in making informed decisions in assessing their PCA provider. While Nationwide welcomes the additional choice and functionality that digital banking will deliver to customers, there is a risk that the likely increase in differentiation stemming from digital banking may add to the complexity already faced by customers seeking to make informed decisions in assessing their PCA provider.

2.4 Facilitating the assessment of PCAs requires both transparency (on price and service/quality) and products that are set out in ways which customers can compare.

<u>Nationwide as a champion of transparency</u>

2.5 Nationwide's approach is to do the right thing for its members, operating with fairness, honesty and transparency.

2.6 For example Nationwide was the first PCA provider to introduce monthly summaries.[1] Nationwide is also the only bank with a market share over 3% to have a five star "clarity

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[1] Nationwide's monthly summaries detail all transactions undertaken in the month and include a "Notice of Charges" where overdraft interest or charges have been incurred.

of statement" rating from Which?.[2] Nationwide has undertaken and is continuing to evaluate further transparency initiatives.[3]

The challenge for Nationwide (and other smaller PCA providers)

2.7 Nationwide invests heavily in providing both:

(i) The highest service levels. Being member owned, Nationwide focuses on customer satisfaction (not profitability) as the top metric for measuring its performance. Nationwide has been ranked number one in customer satisfaction among high street providers for three and a half years,[4] and continues to account for only a small fraction of total industry complaints;[5] and

(ii) Class leading products. In PCAs, Nationwide has made significant investment in its current account product and the underlying systems and processes. In particular, its investment in SAP has already allowed it to launch the FlexOne, FlexPlus and FlexDirect PCA products, [REDACTED]. It is also investing heavily in its digital and mobile strategy, which has recently led to upgrades to its internet and mobile banking services. A further estimated [REDACTED] of investment is planned across Nationwide's business as a whole over the next five years,[6] which includes £500m of investment in the branch network[7] and other investments.

2.8 Nationwide's member focused approach has allowed it to grow to become the UK's largest savings brand, the second largest savings and mortgage provider, and to allow it to develop a relationship with one in four households.

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[2] See Which?, "Best Banks for Customer Satisfaction – Bank Accounts", available online at: http://www.which.co.uk/money/bank-accounts/reviews-ns/bank-accounts/best-banks-for-customer-satisfaction/ (accessed 12 December 2014).

[3] These include [REDACTED]; providing guides for money management ("Helping you Manage your Money") and overdrafts ("Understanding Overdrafts"); and offering financial education support for holders of the FlexOne young people's account and their parents. Nationwide furthermore increased the standardisation of its product terms and conditions following a review of key trends in 2013. See Nationwide's Response to the Market Questionnaire, questions 2.9, 4a, 10 and 27.

[4] GfK NOP's Financial Research Survey (FRS), proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as Barclays, Halifax, HSBC, former Lloyds TSB Group (including Lloyds Bank, TSB and C&G), NatWest and Santander 12 month rolling data between Sept 2012-March 2015, c60,000 adults interviewed per annum. In addition, the CMA's own PCA customer survey data placed Nationwide second overall for customer satisfaction - see Figure 9 of Appendix D to the UIS.

[5] Based on industry complaints referred to the Financial Ombudsman Service.

[6] See SME case study response (December), paragraph 1.3.

[7] See Nationwide's "Preliminary Results Announcements for the year ended 4 April 2015", page 6.

2.9 However, despite its significant investments in developing class leading products (in particular since 2007), its 28 years' experience in the PCA market, and its award winning customer service, Nationwide's market share of PCAs has never grown higher than 6.8% of PCAs.[8] As has been the case for some time, the market is dominated by the established banks. The UIS notes that the combined market shares of the four largest banks for UK main PCA providers has remained stable at levels greater than 70%, and main, active and new PCAs remain concentrated.

2.10 The disparity between Nationwide's performance for its members and its relatively modest market position provides the CMA with clear evidence that the market falls short of "*a 'well-functioning' market; that is one that works well for customers.*"[9]

3. Objectives for the CMA

Transparency, simplicity and comparability

3.1 The CMA needs to ensure that customers are able to make informed decisions about their current account provider, based on both price and non-price factors. In seeking to facilitate this, the CMA should seek in particular to promote both of the following – each of which are already championed by Nationwide: transparency (giving customers the ability to compare price and non-price factors), and simplicity (products expressed in simple language which customers can understand). Applying these two principles would lead to a market where PCAs are truly comparable, and where customers' decisions can reasonably be described as "informed".

3.2 Regulatory intervention (by the CMA) is the only way to achieve a substantial market-wide improvement in transparency, simplicity and comparability. It cannot be expected to arise from unilateral initiatives from the larger incumbents with the most to lose. The CMA's investigation therefore represents a unique opportunity to address market-wide shortcomings.

3.3 Comparability cannot relate solely to price factors. Nationwide notes that the CMA's survey showed that non-price factors, such as quality of service, staff, and handling problems are viewed as the most important metrics to customers from their PCA provider when using their account, with over 80% of customers viewing them as very important or essential.[10] This sentiment holds regardless of how the data is split by demographic or bank type, which shows the importance of quality for all customers.[11]

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[8] Nationwide's share of main and packaged PCAs, as reported in Nationwide Preliminary Results for the year ended 4 April 2015, available at http://www.nationwide.co.uk/~/media/MainSite/documents/about/corporate-information/results-and-accounts/prelim-results-2015.pdf.

[9] Issues Statement dated 12 November 2014 ("Issues Statement"), paragraph 20.

[10] Figure 23 of the Survey Report.

[11] For example, see tabs T514, T515, T527, and T528 of the GfK survey excel file.

Conversely, price factors were seen as less important features of a customer's main PCA provider.[12] However, as it stands, there is little in the way of mechanisms available for customers to compare providers based on non-price factors. In Nationwide's view, should such a mechanism be more readily available, customers' ability to compare providers on an informed basis would be increased.

3.4 In addition, the survey evidence showed that while some customers are "engaged", a large share (73%) have not looked around to compare current accounts in the last three years.[13] In Nationwide's view, this highlights the "evergreen" nature of the PCA product. Going forward, customers must be able – and possibly prompted – to make those comparisons on an ongoing basis.

<u>Fair competition for all customers</u>

3.5 The CMA also needs to ensure that smaller providers are able to compete on a level playing field with the large incumbents and that competition benefits all customers – including customers who are currently less active on incumbent "back-books".

3.6 As discussed below, the use of multiple products and/or brands allows established banks to leverage their back-books in one product/brand to cross-subsidise aggressive competition for new business through another product/brand. Not only do such banks have little or no incentive to lower prices or improve quality for the vast number of customers in their back-book, but they are able to use their position to impede smaller providers seeking to win additional market share.

3.7 Transparency, simplicity and comparability for all customers should help mitigate this by ensuring that back-book customers are aware of the benefits of switching (which could include moving to a front-book product offered by their current PCA provider, as well as switching to a different PCA provider), and are able to make informed decisions about their PCA provider on an ongoing basis.

<u>Proportionate remedies</u>

3.8 The CMA should be careful not to impose corrective measures which are likely to have only limited – or disproportionally small – benefits to customers when compared with the cost imposed on PCA providers. In particular, the CMA should avoid remedies which impose disproportionately high or substantial costs on smaller "challenger" providers and deliver only limited benefits to customers.

3.9 Examples of such undesirable measures include:

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[12] For example, the level of interest received while in credit was only seen as very important or essential by 45% of customers. See Figure 23 of the Survey Report for further details.

[13] See tab T657 of the GfK survey excel file.

(i) Account Number Portability ("**ANP**"), which would allow customers to switch PCA providers while retaining the same account number. Although ANP might be expected to reassure some customers that their existing payments would be correctly transferred to their new bank, Nationwide believes the associated cost for the industry (which the FCA has put at between £2bn and £10bn[14]) would outweigh any material gains in switching activity, particularly given that the current CASS process already includes compensation measures intended to reassure customers that they will not lose money through the switching process.[15]

(ii) Reducing the CASS switching period for PCAs. Nationwide is concerned that this proposal could have significant cost implications with little potential benefit to customers. This conclusion appears to be shared by the FCA.[16] Moreover, the CMA's survey evidence indicates that the current switching process works well.[17] Nationwide has not seen any evidence that substantial changes to the switching process (and in particular the length of the CASS process) would deliver more than limited, or disproportionately small, benefits to customers.

3.10 Given that the CMA survey evidence indicated that 73% of customers had not even looked around to compare current accounts in the last three years, it does not appear that either introducing ANP or making the CASS process faster for those who do switch would make a significant difference to switching levels. The CMA should instead focus on increasing awareness of CASS and addressing mis-conceptions customers have as to the difficulties of switching.

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[14] See "Account Number Portability", March 2015; a report commissioned by the FCA from Moorhouse. Nationwide believes that its own costs of implementing ANP would represent a significant proportion of its total budget for discretionary spending. Moreover, investment by Nationwide in ANP is investment foregone in other areas, reducing Nationwide's ability to invest in providing customers with better products, service and innovation.

[15] CASS also includes: (i) a guarantee that payments going out (for example Direct Debits and standing orders) and those coming in (for example salary) will be redirected, and that money in the old account will be transferred; (ii) a guarantee that payments accidentally made on the old account will be redirected to the new one, and that the sender will receive the new account details; and (iii) the reassurance that any interest (paid or lost) and charges on either the old or new accounts as a result of this failure will be refunded for up to 18 months after the switch.

[16] The FCA has noted that for customers "*knowing the switch will happen on a particular date was more important than it being completed more quickly*"; see "Making current account switching easier", FCA, March 2015, at paragraphs 8.27 – 8.34. The CMA's survey evidence indicates that the large majority of customers did not view time as a factor which discouraged switching (after searching had taken place). In particular, only 26% of customers cited "Too much hassle / too difficult / cannot be bothered / lack of time" as a reason for not switching, and even for these customers it's not clear how many viewed time, and in particular the time for the switch to take place, as a reason for not switching. See GfK survey tables, sheet T880.

[17] The CMA survey shows that 84% of customers that switched their PCA between providers in the last year have found the process fairly easy or very easy. See tab T867 of the survey results excel file.

Remedies involving customer detriment.

3.11 In imposing remedies, the CMA should also have regard to the need to avoid remedies which would undermine a significant customer benefit.

3.12 In particular, Nationwide recognises that FIIC banking might be seen to diminish levels of engagement in the PCA banking market compared with other markets the CMA has investigated.[18]

3.13 Nationwide also recognises that there may be a degree of inequality inherent in FIIC banking, in that it may result in an element of cross-subsidisation between those customers who end up paying for use of their PCAs – for example through fees for unarranged overdrafts – and those who receive their PCAs for “free”.

3.14 However, Nationwide expects a significant proportion of its members to be in favour of FIIC.

3.15 The CMA would therefore have to consider very carefully any proposal to end FIIC. In particular, the CMA would have to have a high degree of confidence that such a step would both succeed in increasing customer engagement and work on the practical level, delivering real benefits to customers that would justify the likely costs of such a remedy.

3.16 Nationwide aims to act in the best interests of its members, so it could not support any measure which sought to end FIIC banking unless it could be demonstrated that such a step was indeed in its members’ best interests.

4. Theory of Harm 1: Impediments to switching

Lack of economic motivation to switch

4.1 As we discuss below (see paragraphs 4.2 to 4.4), the evidence suggests that customers currently perceive that there is limited economic motivation to switch based on price (as

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[18] See paragraphs 67 to 69 of the UIS. In its qualitative survey the CMA finds that when PCA services are seen as “free”, the incentive to shop around is reduced (see paragraph 12 of GfK NOP report). The survey also indicates that introducing a fee on an account that was previously free-if-in-credit would cause respondents to search and/or switch (paragraphs 216 and 217 of GfK NOP report). Of all customers on fee-paying accounts, 20% switched and 33% looked around in the past three years; while of all customers on FIIC accounts, only 12% switched and 25% looked around in the same time period (see GfK survey data tables, sheet T632). Similarly, customers of fee-paying accounts are less likely to consider switching as being a hassle than those who use FIIC banking (see GfK survey data tables, T1104). The CMA cited Tesco Bank as stating “*(…) the perception that your PCA is “free” is a key contributing factor to the lack of customer engagement in assessing the value they derive from their account.*” See Tesco Bank case study, paragraph 70c.

well as non-price) factors. This can be expected to contribute to observed levels of customer inertia.[19]

Benefits of switching: Importance of quality and service levels

4.2 The CMA acknowledges the importance of quality as a dimension of competition in banking markets,[20] a view which is strongly supported by the results of the GfK NOP survey.[21] 83% of respondents stated that "quality of staff and customer service" were "essential" or "very important" features of PCAs.[22]

4.3 As noted in paragraph 3.3 above, customers value non-price factors of their accounts more than price factors. Furthermore, there is some evidence to suggest quality of service can act as a "pull" factor for potential switchers. While the survey evidence shows that 10% of the customers that had searched and/or switched in the last three years did so for customer service reasons, if the analysis is restricted to only those who actually switched in the last three years this rises to 19%.[23] Conversely, while 31% of the customers that had searched and/or switched in the last three years did so due to interest rate reasons, if the analysis is restricted to only those who actually switched in the last three years this drops to 20%.[24] This shows potential disparity in the "push" and "pull" properties of non-price factors *vs* price factors, and may suggest that a tool to compare quality of service better would allow for more informed decision making.

4.4 This is particularly relevant in the context of FIIC banking - absent a simple process of comparing different providers on both price and non-price factors, customers may have fewer incentives to search and switch where a product is considered to be "free".[25]

4.5 Even if customers do not perceive significant monetary differences, they should still therefore be expected to be prepared to switch in order to obtain other benefits if those benefits outweigh the cost of switching.

4.6 In light of this, the CMA should ensure that customers are provided with simple, transparent information on non-price factors (as well as on price) so as to help customers properly to assess differences across providers.

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[19] Although the CMA finds a wide variation in prices across banks, it is not clear that these price differentials alone provide sufficient economic incentive to encourage switching given that customers perceive no (or limited) differences in quality across providers.

[20] See paragraph 38 of the UIS.

[21] See Figure 23 of the GfK NOP report for the CMA on Personal Current Accounts.

[22] Figure 23 of the Survey Report.

[23] T760 of the GfK survey results excel file.

[24] T760 of the GfK survey results file.

[25] See paragraph 12 and 190 of the GfK NOP report for the CMA on Personal Current Accounts.

Benefits of switching: Transparency, simplicity and comparability

4.7 As set out above, the CMA should ensure that customers benefit from transparency, simplicity and comparability - allowing them to make informed decisions (on price and non-price factors) on an ongoing basis.

4.8 In calling for simplicity, Nationwide is not advocating standardisation of products. Nationwide considers that customers are generally best served by suppliers being free to respond to their needs by innovating to provide the most appropriate products. Rather, "simplicity" refers to the need to present products in language that customers can properly understand – allowing them to make informed comparisons. As a result, Nationwide would welcome measures which resulted in customers having access to independent assessments of the available PCAs.

4.9 Nationwide nonetheless recognises that the impediments to switching currently impact particularly acutely on those with the most to gain from switching – overdraft holders.[26] In light of this, Nationwide accepts that, if the CMA finds that the customer benefits outweigh the expected costs, a possible capping mechanism could also be explored in relation to unarranged overdrafts in order to improve customer outcomes for overdraft holders.

Benefits of switching: Comparison over the life of the product

4.10 Customers will tend to stay with the same provider for long periods of time. The CMA's customer survey found that 37% of respondents had been with their main PCA provider for more than 20 years and a further 20% for between 10 and 20 years.[27]

4.11 It follows that the CMA should ensure that any PCA price comparison reflects the price and non-price benefits to customers over the lifetime of the product.

Cost of switching

4.12 The CMA must also ensure that the switching process itself – in particular its simplicity, reliability and efficiency – is fully understood by customers. Nationwide considers that the CASS process makes switching as easy as possible, and that effective promotion of this tool will be key to its impact on the market. The CMA should therefore focus on increasing awareness of CASS, and on ways to address any negative perceptions

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[26] See paragraph 63(b) of the UIS, where the CMA notes that "*There are a wide variety of different charges that can apply particularly when going into overdraft. The number of different charges and the different circumstances in which these apply are likely to make it difficult for customers to keep track of how costly using an overdraft is and to compare different overdraft charging scenarios across PCA providers.*" Of the customers that had switched their main current account in the last year, only 23% had used their overdraft facility in that year – 6 percentage points lower than the overdraft usage figure for the entire sample. See Question G4 of the GfK NOP customer survey commissioned by the CMA.

[27] Figure 1 of Appendix D to the UIS.

which customers may have of it. We note that the CMA survey evidence indicates that a significant proportion of people find switching better than they had anticipated and that the recent FCA review of CASS identified a lack of awareness as an area for consideration.[28]

Relevance of satisfaction levels

4.13 Nationwide agrees that a lack of switching is not symptomatic of a poorly functioning market if switching is not a rational choice for customers. In order to be a rational choice, the benefit from switching must outweigh the "cost" (or "perceived cost") of searching for an alternative provider and switching to their services.

4.14 In assessing the benefits of switching however, the CMA needs to be careful not to place undue weight on surveyed levels of customer satisfaction which have been gathered on an overly simplistic basis. As the CMA recognises,[29] satisfaction levels will be driven by customer expectations which are themselves determined by the mis-conception that there is no real difference between PCAs.[30] Instead, the CMA should continue to look at evidence from more granular surveys, such as the GfK NOP Financial Research Survey.[31]

4.15 The evidence does not indicate that the low levels of switching observed in PCAs can be justified by the likely costs and benefits of switching. The CMA reports a wide variation in prices[32] and should expect to find significant differences in quality and service.[33] That suggests that there are in fact clear benefits from switching, which – given greater transparency and comparability – should feed back into satisfaction levels.

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[28] The GfK NOP customer survey commissioned by the CMA shows that only 59% of customers that switched their PCA between providers in the last year expected the process of changing account to be fairly easy or very easy (T826 of the survey results excel file). In reality, 84% of customers that switched in the last year found the process fairly or very easy (T879 of the survey results excel file). Research commissioned by the FCA indicates that "*a clear majority of consumers had a positive experience with the CASS switching process.*" See paragraph 4.12 of "Making current account switching easier", FCA, March 2015. In the TSB case study, the CMA cited TSB as describing CASS as one of the three main factors that caused more switching away to competitors in July 2014. See paragraph 47 of the TSB case study.

[29] See paragraph 59 of the UIS.

[30] The GfK Survey report suggests only 49% of respondents tended to agree that there are real differences between banks in the current accounts that they offer. Results from the qualitative survey indicate that FIIC PCAs were perceived to be "*effectively the same generic product*".

[31] The CMA notes the use of this survey in Paragraph 59 of the UIS.

[32] See paragraphs 34 and 89 of the UIS.

[33] The CMA has begun to analyse differences in quality. See paragraph 38 of the UIS.

5. Theory of harm 2: Concentration

5.1 The CMA has identified two mechanisms through which concentration could lead to competitive harm:[34]

(i) The ability of banks with higher market share to differentiate their products, meaning they become less perfect substitutes for each other and giving banks the ability to raise prices above marginal costs and/or to lower quality.

(ii) Where it is difficult for banks to discriminate between active and inactive customers, banks with higher market shares may have weaker incentives to lower prices or improve quality/innovation than a bank with a smaller market share.

5.2 Nationwide agrees that these two mechanisms should be considered by the CMA as part of the investigation.

5.3 As outlined at paragraph 3.6 above however, the CMA also needs to investigate the ability of the large incumbent banks to leverage their back-books in one product/brand to cross-subsidise competition for active customers through another product/brand. This has the following actual/potential detrimental effects:

(i) The large incumbent banks are able to differentiate their products and have little or no incentive to lower prices or improve quality for the vast number of customers in their back-book (who are currently less active). Offers and/or new products are habitually made available to attract switchers, but equivalent benefits are not promoted to existing customers.[35] As noted above, customers typically stay with their banks for a considerable length of time, and having had a bank win their business a customer is currently at real risk of obtaining poor outcomes in the long term.

(ii) It potentially also gives the large incumbents an unfair advantage in competing with challenger banks to win new more active customers – thereby limiting the ability of such challengers to achieve growth and scale. Not only do challengers have a smaller "back-book" but it would be against Nationwide's principles to charge different prices to new and existing customers as Nationwide operates with fairness and therefore places weight on achieving good outcomes for all of its members.

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[34] UIS paragraph 99.

[35] An example of such behaviour is the offer from Halifax to pay switchers £100 if they use CASS to switch from an account with another bank to one of three named Halifax accounts. Notably, this offer is not available to Bank of Scotland account customers switching to the Halifax – see http://www.halifax.co.uk/bankaccounts/switch-to-halifax/.

6. Theory of harm 3: Barriers to entry / expansion

6.1 The UIS recognises that barriers to entry and expansion may allow incumbents to exercise market power.[36]

6.2 Nationwide considers that when looking at barriers to entry/expansion, the CMA needs to distinguish as between (a) barriers which are inherent to the costs of participation in the PCA market (exogenous costs); and (b) other barriers (endogenous costs). The former comprises of both "regulatory barriers" (authorisation, capital, anti-money laundering); and "intrinsic barriers" (funding, branches, IT systems and access to payment systems). The latter includes what the CMA has labelled "strategic advantages". Typically these costs may include investments in quality of service and advertising.

6.3 Nationwide notes that the CMA has identified some intrinsic barriers – in particular access to branches and to payment systems. Nationwide agrees that branches remain important to winning new customers (even if many PCA customers, having opened an account, may not visit a branch frequently).[37] This gives the big incumbent banks, with their large branch networks, an inherent advantage.

6.4 As outlined above, the CMA should also consider the extent to which the ability of the large incumbent banks to benefit from their large "back-books" of inactive customers, acts as a further barrier to entry and growth.

6.5 The key area for the CMA to address however remains the lack of transparency and comparability (on both pricing and quality/service) – see Section 3 above. The CMA needs to ensure that customers are able to make informed decisions about their PCA provider, based on both price and non-price factors on an ongoing basis. This is particularly the case in light of the additional choice and functionality that digital banking will deliver to customers, which is likely to increase complexity. Informed customers who are able to search effectively and, where beneficial to them, switch provider, will strengthen the demand-side and substantially improve the functioning of the market.

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[36] UIS, paragraph 110.

[37] Branch availability was essential or very important to 63% of respondents to the GfK NOP customer survey commissioned by the CMA, and fairly important to 27% of respondents (Figure 19). 48% of respondents indicated that their branch closing would lead them to switch to a bank with more convenient branch locations. (Figure 20). A national network was identified as essential or very important by 58% of respondents, see UIS, paragraph 129. Metro Bank pointed out the importance of a branch network to its business model as a bank with an all-channel offering. TSB identified a strong association between PCA sales and branch availability. Its customer research showed that branch location was an important selling point for its customers. A spike in customer losses in July 2014 was partially explained by the end of co-servicing in Lloyds' branches in August 2014. (TSB case study, Paras 30-34 and 47).