YBS GROUP

CMA RETAIL BANKING MARKET INVESTIGATION:

UPDATED ISSUES STATEMENT

RESPONSE FROM YORKSHIRE BUILDING SOCIETY ("YBS")

Background

Yorkshire Building Society ("YBS") Group welcomes the opportunity to respond to the Updated Issues Statement (the Statement) from the CMA as part of its Retail Banking Market Investigation (the Investigation). YBS is the second largest building society in the UK. It has 230 branches and assets of £37.6 billion and employs approximately 4,600 people and has 3.3 million customers.

Our primary business areas are deposit-taking activities, mortgage sales and administration and mortgage related insurances. We operate via a number of distribution channels including branch, telephone, postal and the internet. In terms of the personal current accounts market, YBS offers personal current account ("PCA") services through its Norwich and Peterborough Building Society (N&P) brand. This service from N&P has been a longstanding proposition with a base of around 100,000 customers, 86% of which are from within the N&P heartland of East Anglia and Lincolnshire. YBS has a stated intention to expand its current account services across its network and brands for the benefit of its own members as a 'mutual alternative' to challenge the dominant providers of the market and to increase diversity.

Introduction

YBS believes that a competitive and well-functioning PCA market should provide a climate for new entrants and challenger institutions across a variety of business models – including consumer owned mutuals. YBS is concerned that very few mutuals are actively participating within the PCA market, and considers that the participation of more mutuals would provide a very different set of choices for consumers and stimulate, amongst other things, localised competition. YBS believes that this would represent a significant step in providing a diverse, dynamic and innovative banking market in the best interest of consumers and go beyond the simple entry of more banks

Although YBS does not participate in the small and medium sized enterprise ("SME") market it believes that the same principles apply, and that the mutual sector ought to be well placed, if not better placed to provide banking services and lending to SMEs within its community and that consumer appetite might be high for such an offering.

YBS notes that it responded to previous stages of the Investigation, including the Consultation issued in July 2014 and the Statement of Issues issued in November 2014. YBS is pleased to offer this further submission to the CMA after having also called publicly for reform when publishing our Annual Results earlier this year.

YBS supports the CMA's continued focus on both the PCA and SME markets. As with its previous submission to the Investigation, YBS has focused its concerns on the PCA market, given this is a market YBS wishes to expand our reach within in the immediate future.

YBS agrees with the characterisation of the market set out in the Updated Issues Statement and also agrees with the CMA's approach and analysis concerning the features of the supply of retail banking services which might give rise to an 'adverse effect on competition'. YBS welcomes and agrees with the three groups of hypotheses, or 'theories of harm', which the CMA has identified in the previous stages of the Investigation.

On the subject of mutuality, YBS feels that there is not yet enough focus in the investigation in relation to why there are only a small number of building society participants, and what the specific impediments to mutuals might be; For instance, the lack of ability to raise capital as easily as banks can, which prevents a level playing field in the PCA market. In a market with such poor levels of consumer engagement, to reduce barriers sufficiently to enable many more national and local mutual alternatives would produce a more genuinely diverse and competitive environment. If the only outcome of this review was to enable more banks to enter the market, with the dominance of shareholder over stakeholder owned institutions being further perpetuated, an opportunity would be missed to help enable full, free and fair competition and improved outcomes for consumers.

Theory of harm 1: Impediments to customers' ability to effectively shop around

With regards to the 'Theory of Harm 1', YBS agrees with the CMA's assertion that there are significant impediments to customers' ability to shop around and switch their PCA and also that there are weak incentives for banks to compete for customers on the basis of price, quality and innovation. YBS agrees with the CMA's current thinking that low switching rates may not be consistent with a well-functioning market and that more engaged customers would be expected to drive better competitive outcomes.

ACCESS

"Can a customer get hold of information about the costs and features of their bank account"

YBS has concern with the lack of transparency in charging structures – particularly with regard to unplanned overdrafts. Many of the dominant providers use overdraft fees and charges – which are not readily transparent or understandable, and which are not a key factor in the decision making process for customers selecting a current account provider – as a key source of revenue and use this revenue to effectively cross-subsidise other products and services in the market. The observations, made in particular at 63(b) in the statement, are ones YBS would agree are particularly important. Some of these fees and charges are significant and there is a risk they could represent poor value for customers. They are potentially also incurred by those customers who are least able to afford them, this being particularly the case for unplanned overdrafts which we believe still represents a significant proportion of some PCA providers income from the product which they then use to offset loss-leading acquisition pricing. In some cases, the costs of overdraft fees are greater than interest charged by payday lenders. Potential remedies could include mandating that overdraft pricing must be based on interest only and not fees which would avoid a small number of customers providing the greater proportion of the revenue for providers. An alternative would be to force banks to show a very visible APR for planned and unplanned overdraft lending (to include fees) which currently they do not do.

ASSESS

"Can a customer then compare it to similar data for other banks and building societies, allowing them to draw conclusions"

YBS is aware of some of the work in play which will improve consumer ability to compare and contrast bank account features, prices and service levels. YBS considers this to be an essential "eye opener" for consumers and as such continues to observe that at this stage more still needs to be done in this area, particularly (as discussed at point 63 (c)) that consumers should have the ability to compare different levels of service experience as well as price and features. YBS believes that there are markedly different levels of price and servicing capability across the industry and that this will be a key area for competition in the future. Consumers are simply unaware of the better alternatives available.

ACT

"Can a customer act on the information"

Account switching has only grown modestly since the launch of the Current Account Switching Service (CASS) in 2013, and a proportion of the uplift that was evident in the early days is likely to be due to customers switching between Lloyds and TSB as a result of the sort-code based approach of the TSB separation which led to a number of customers being separated from their local branch. It is cited at point 74 of the statement that the CMA has identified that only 2% of customers switched through CASS in 2014.

CASS was proposed and implemented after the plc banks which dominate the current account market made the case it would give a more efficient and predictable switching process. However, there remain outstanding problems, such as that the forwarding of payments only lasts for a limited period and even though this has now been extended, after this time they will still be bounced. A significant number of customers, 35% in research recently published by the Financial Conduct Authority, said they would be more likely to switch if they could have a fully portable account number. YBS welcomes the CMA also acknowledging this issue in the statement.

YBS believes much more consideration should be given to the inability of the customer to take account history with them as they move account. At the most basic level people lose the information itself, especially if their entire financial history is on paperless statements (because a sizeable quantity of data is only available through the online banking platform of the bank they wish to leave). YBS is pleased to see the CMA also accept the evidence that this issue is important.

Lower levels of overdraft switching and fewer older switchers is clear. In addition, the level of the inertia resulting from fear of losing account history and deteriorating credit score are all factors which need further research.

For example, YBS believes those with large overdrafts are not switching, due to concerns that their present overdraft facility might not be matched by the new bank (a valid concern) which, effectively, “locks them in” to their existing poor value deals with existing providers. Even additional measures to improve transparency and comparability (which YBS believes are essential) will not address this particular issue if consumers are not physically able to replicate their existing arrangements elsewhere.

YBS believes that the inability to replicate core existing features such as overdraft limits, together with the loss of historical account data may be an even more significant barrier than the issues which would be resolved through full portability of the account number.

Furthermore, in terms of opening accounts and the anti-money laundering Know Your Customer (KYC) checks there are further barriers to acting. There is a significant hassle factor in opening an account, up to an hour in branch for instance. Even on web and mobile channels providing details for KYC checks can be difficult. In order to speed up and improve the switching process YBS believes some focus should be given to the ease with which accounts can be opened initially as well as the subsequent switch process transferring an old account to a new provider.

As a market participant with a stated intention to expand its PCA offering Group-wide, YBS believes that the barriers to switching experienced by consumers will make it difficult for new entrants and challenger mutuals to build a customer base, regardless of whether they can offer a superior or more competitive product.

Theory of harm 2: Impact of Market Concentration

YBS has stated before that it agreed that market power is exerted unilaterally when this was put forward in the initial Issues Statement produced by the CMA. YBS would agree that both the mechanisms at 99(a) and (b) of the Statement are operating in the PCA market. With regard to the market power of larger banks YBS is concerned on a number of fronts.

Firstly, larger providers operate current accounts on a “loss-leader” basis with cross-subsidies coming from other product lines, or punitive and unreasonable fees and charges. This enables price-led propositions to be launched which are essentially unsustainable and will lead to customers being transferred to poor paying back books or incurring fees during financial distress all in the fullness of time. This could be thought of as bonus rates by stealth, and does not result in good customer outcomes.

The Society highlighted this in its previous response to the initial statement of issues. YBS would cite again those same examples, such as the use of large current account books to drive cross selling into the savings market, and using in credit balances, for which little or no interest is often paid, to cross subsidises loss leading savings products to attract retail deposits. These are often then closed to new business, converting them to back book and attracting significant returns over time by paying well below what is available for open accounts. These practices have been highlighted in the course of the FCA Cash Savings Market Review. YBS would argue pricing distortions in savings and in mortgage markets, where cross selling to customers by their PCA provider is also a dominant market feature, should be brought in scope for the investigation if there is to be no full market wide profitability assessment.

Secondly, because larger providers have significantly more branches and resources available they are able to source customers at important times in their lives. A good example of this might be students. A significant proportion of the relevant population open and then retain the same current account from the time they were students, and they therefore form a critical future market for providers. Whilst a large bank can place a small branch in a University campus location, smaller providers with fewer branches are left with a decision over serving the high street or the student population. The issues of lack of transparency in charging structure referred to earlier can be seen here operating through the customer journey. Does a student receiving a product incentive of a free overdraft know how much they could pay in overdraft fees and charges when that incentive expires on the product. If only interest could be charged, rather than a fee, or if a visible APR had to be displayed, the customer could make an informed choice. Overall YBS does not believe enough information is made available to make customers aware that they are incurring in some cases large monthly costs which could be significantly reduced.

YBS takes the view that financial education is paramount to the younger elements of society and potentially campus branches could be run using a model which allowed all providers access to this population should they have a product offering available.

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

YBS supports and welcomes the CMA's analysis on its 'Theory of Harm 3', in respect of identifying the barriers to entry for potential new providers into the PCA market. YBS notes that many of the key barriers identified – specifically those relating to the costs and investment associated with infrastructure (including payment systems), capital requirements, capability and regulatory barriers – are particularly applicable to those operating in the mutual and credit union sector. The additional factors for building societies in raising additional capital, largely relying on retained profits and with Core Capital Deferred Share issuance still more costly than for PLCs issuing shares, requires additional steps to ensure a level playing field. This should be included in the discussion of of regulatory barriers discussed in the statement at 113 (a). One option may be legislation giving a duty to the Prudential Regulation Authority and Financial Conduct Authority to encourage diversity, which may help offset some of the challenges which at the moment work against a diversity of ownership models being retained and extended in retail banking as a whole.

YBS is disappointed that, to date, there hasn't been analysis or comment from the CMA on the prospective benefits that fostering greater levels of diversity in financial services would bring to levels of PCA market competition and consumer choice. YBS believes that greater consideration should be given to how increased product offerings from the building society and credit union sectors models may improve outcomes for consumers through offering superior levels of service and customer satisfaction. The evidence is clear that mutuals provide better service to consumers on average than the PLC banks, including the NPS (Net Promoter Score) and other robust validated consumer surveys.

YBS believes that a lack of diversity in retail financial services, in respect of ownership models among financial institutions, would continue to restrict levels of innovation and consumer choice in the PCA market, regardless of the numbers of new bank entrants and challenger brands. Specifically, the continued concentration of profit-making shareholder-owned institutions would not address the adverse impacts of their commercial pressures on their consumer offerings. For example, the need to maximise profit margins in the short term.

As a prospective entrant into the PCA market at a Group-wide level, which will see a dramatic expansion to the current N&P only proposition, YBS is in the early stages of identifying the exact capabilities required to grow this area of its business. While YBS's aspirations are focused on providing a full PCA service across its UK-wide network, it has become acutely aware, throughout the process, of how IT costs, provision of indirect payment services and capital constraints can act as major inhibitors for organisations below a specific size looking to enter or expand, or with aspirations to serve only a smaller regional market. This has been evidenced by the fact that so few building societies or mutuals have entered the PCA market. YBS believes that unless these inhibitors are addressed, there will continue to be very few additional full service providers.

Without intervention YBS itself may need to review its own appetite or ability to fulfil the ambition of becoming a national, full-services challenger.

YBS believes that the CMA should give further consideration to how smaller mutual providers and credit unions can seek to challenge established PCA providers by combining their resources and providing shared propositions to consumers. The recently published report by the Centre for Social Justice "Future Finance" we think provides some very interesting ideas in this area which may be of value to the CMA.

YBS also believes it is important that greater levels of joint-working and the formation of consortia allow mutuals without their own national branch presence to reach customers, providing significantly enhanced additional choice.

In line with the statement at 113 (b) where natural and intrinsic barriers are raised, the lack of a free and fair access to the payments system and the utility infrastructure of retail banking, prevent any level playing field between the incumbents and challengers banks and mutuals, including YBS. N&P (which is now part of the YBS Group) having since launch relied on an agency bank, considers that functionality and proposition issues are impacted by what the third party agency bank provider has the capability to offer, which is why direct access to the payments system for new entrants and smaller providers on fair commercial terms is important.