Retail banking market investigation

Summary of entry and expansion in retail banking

14 July 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 **by midday Tuesday 28 July 2015**.

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 [✂]. [Some numbers have been replaced by a range. These are shown in square brackets.]

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Background

1. To provide context for our work on barriers to entry and expansion in retail banking (see our barriers to entry and expansion working paper: capital regulation, IT and payment systems, published alongside this paper), we have examined the nature of recent and planned entry to the sector. We distinguish between entry by firms with a personal current account (PCA) offering and firms with a small and medium-sized enterprise (SME) offering. From the evidence we have collected, we have sought to gain an understanding of how the market has developed over time, the motivations for firms' entry, and the challenges or barriers encountered.

2. We have also published more detailed case studies on Metro Bank (Metro), Nationwide Building Society (Nationwide), Tesco Bank (Tesco), Virgin Money and TSB Bank (TSB), as well as a summary of the barriers to entry and expansion faced by prospective entrants (namely, Atom, Starling, Civilised Bank, OakNorth and Fidor).

3. We have identified three possible channels of entry into the UK retail banking market:[1]

   (a) Organic entry, whereby a firm with no prior involvement in the UK financial services market enters the retail banking market. Metro was the first organic entrant to the UK market in more than 100 years when it launched in 2010. There is further planned organic entry, including Atom, Starling, Civilised Bank and OakNorth, all of which are preparing to launch later this year or next year.[2] These prospective entrants are planning to enter with innovative business models, perhaps most notably with no, or very limited, branch presence, and to adopt the latest technology. Our case study on prospective entrants provides more detail on banks that are planning to launch soon having obtained authorisation from the regulators, and on firms that are currently going through the authorisation process to become banks. We have also looked at the entry of Handelsbanken, a Swedish banking group which entered the UK market in the early 1980s. Initially Handelsbanken focused on serving its domestic customers, until 1999 when it extended its operations to offer personal and corporate customers in the UK a range of banking services.

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[1] See our Terms of reference: retail banking market investigation for a definition of the retail banking market.
[2] Atom plans to be UK's first all-digital bank, *Guardian*, 9 April.

(b) Divestment, whereby an existing bank divests/sells off a part of its business. A recent example of entry to the retail banking market via this method is that of TSB, which entered the market as a result of a divestiture from Lloyds Banking Group (LBG) in 2012. Williams and Glyn (W&G), currently part of the RBS Group (RBSG), will also be launched as a new bank by the end of 2016.[3] Each of these divestments has resulted from a European Commission ruling following the UK government's financial assistance programme in 2008–9.[4]

(c) Entry by a firm with ancillary financial services products, whereby a firm with an established presence in an area(s) of retail banking expands to include PCAs and/or BCAs (business current accounts), as well as other SME banking services, as part of its proposition. This has, in recent years, been a common channel of entry to retail banking in the UK. For example, Virgin Money, the Post Office, Tesco Bank and Marks and Spencer (M&S) Bank[5] have expanded their product offerings to include PCAs. The Co-operative Bank developed a BCA proposition for its business customers as well as general purpose business loans and deposit accounts. Notably, all of these banks also had strong brands outside of retail banking.

4. Our Guidelines state that entry or expansion may upset established patterns of market conduct or introduce new technology and fresh approaches to product design, marketing and delivery.[6]

5. We recognise that the acquisition of existing businesses is not entry as such. However, Santander's entry in the UK through the acquisitions of Abbey National plc, Bradford & Bingley Building Society and Alliance & Leicester Building Society has created a stronger competitive constraint in the market than the three acquired entities were able to achieve by acting independently. We therefore discuss Santander's acquisitions below.

Provision of personal current accounts in the UK

6. The UK's PCA market is serviced by 20 banking groups, 7 of which have more than 5 million active PCAs on their books. Although the largest four

[3] RBS (2014), *We're creating a new bank, Williams & Glyn*. As a condition of the state aid received by RBSG, the group was required to divest the RBS branches in England and Wales and the NatWest branches in Scotland, with the associated personal and SME customers, direct SME customers and a portfolio of mid-corporate customers (RBS (2013), *Return of Williams & Glyn moves closer*, press release, 27 September).

[4] State aid No. N 428/2009 United Kingdom Restructuring of Lloyds Banking Group. State aid No N 422/2009 and N 621/2009 United Kingdom Restructuring of Royal Bank of Scotland.

[5] M&S Bank is a wholly owned subsidiary of HSBC.

[6] See *Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3)*, paragraph 206.

players account for more than 70% of the PCA market,[7] some entry has occurred over the past four years.

Table 1: Snapshot of recent entry to PCA banking market

Bank	*Year of entry*	*Method of entry*	*Market share in 2014 (%)**
Virgin Money	2014	Ancillary product provider	[✂]
Tesco Bank	2014	Ancillary product provider	[✂]†
Post Office	2013/14	Ancillary product provider	[✂]†
TSB	2013	Divestment	[✂]
M&S Bank	2012	Ancillary product provider	[✂]
Metro	2010	Organic entry	[✂]
Santander	2004	Acquisition	[✂]

Source: CMA analysis based on information provided by the banks and FRS.
*Share of total number of PCAs from PCA aggregate data request.
†From Financial Research Survey data.

7. The cases of recent entry set out in Table 1 are discussed below by entry channel. In addition, we examine Atom's and Starling's plans to enter with a PCA proposition later this year.

Organic entry

Metro

8. Metro received its UK banking licence from the Financial Services Authority (FSA) in March 2010 and opened its first branch in July 2010. It is a deposit-taking and lending institution which services retail (personal) and business customers in London and its wider commuter belt area.[8] Metro told us that its decision to launch in the UK a direct response to what it called a lack of choice for consumers and businesses.[9] Its launch in the UK was based on a successful antecedent in the United States – Commerce Bank – for which the branch was key. Similarly, Metro states that its key differentiators include accessibility (its branches are open longer than most high street retailers and operate seven days a week) and convenience (it offers, for example, on-the-spot account opening, chequebook printing and debit card issuance). Metro 'places strong emphasis on being a local business with strong community links'.[10] Despite its emphasis on its high street presence, Metro describes itself as 'channel agnostic' and provides services across all channels, including online, by telephone and on mobile devices.

[7] Share of total number of PCAs in 2014. CMA analysis based on banks' responses to data request.
[8] Metro case study, para 6.
[9] Metro case study, para 9.
[10] *Customer Insight* (2011), *No stupid bank rules*, November.

9. Metro offers only one PCA which is a free-if-in-credit (FIIC) account.[11] It told us that this is part of its strategy to offer simple and transparent products that are not segmented by customer type. Metro current accounts must be opened in one of its branches, and personal overdrafts are available on an 'opt-in' basis (subject to acceptance). At the end of 2014, Metro had [✂] PCAs, corresponding to [✂]% of the total PCA market, and it plans to grow these to [✂] by the end of 2015. In 2014, PCAs accounted for about [✂]% of its accounts. Metro's chief financial officer, Mike Brierley, believes the bank is on track to make a profit in 2015/16. He feels that if Metro stopped investing, it would 'be profitable tomorrow'; but in order to generate long-term profit it must continue to invest in its infrastructure, IT and staff.[12]

10. Metro entered the market with 4 branches (which it calls 'stores'); by the end of 2014 this had grown to 31 branches. It plans to open 13 branches in 2015 and a further 14 in 2016. By 2020, it expects to have around 200 branches, all located in and around London and south-east England.[13] Its growth in account numbers has closely followed its growth in branch numbers.[14] The growth of Metro's branch network is entirely organic – through new branches rather than acquisitions of existing branches. Each branch costs a minimum of £2 million to build and requires £20–30 million of deposits to underpin its lending operations.[15]

11. Metro says that it targets consumers who are not 'rate-seekers' but rather value quality customer service. It claims to have lower costs of deposits compared to other UK banks by providing fair but not market-leading rates, thus driving the profitability of the overall business. Metro continues to plan towards an initial public offering (IPO) on the London Stock Exchange and, assuming favourable market conditions, is targeting 2016 for this.[16]

Prospective organic entrants to the personal current account market

12. A number of firms are currently seeking authorisation to become banks or have recently attained authorisation. These include Atom, Starling, Civilised Bank and OakNorth.[17] Table 2 summarises the current status of these firms and the products they plan to offer.

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[11] Metro Bank (2014), Current account.
[12] Richard Crump (2014), Interview with Metro CFO Michael Brierley, *Financial Director*, 19 September.
[13] Metro website.
[14] Metro case study, para 22 onwards.
[15] Richard Crump (2014), Interview with Metro CFO Michael Brierley, *Financial Director*, 19 September.
[16] Metro Bank raises £387.5m as it postpones IPO plans (19 January 2014).
[17] This is not an exhaustive list and we are aware of other banks in the pipeline awaiting UK authorisation.

Table 2: Prospective entrants to the PCA market

Prospective entrant	*Focal product(s)*	*Authorisation status*	*Discussed*
Atom	PCA and SME banking	Acquired banking licence on 24 June 2015[18]	In this section
Starling	PCA	Application under FCA (Financial Conduct Authority) review	In this section
Civilised Bank	SME banking (including BCA)	Pre-application	Under Provision of BCAs and SME lending products
OakNorth	SME banking (no BCA)	Authorisation granted in March 2015 with restriction. 12 month period provided to remove restriction (ie until March 2016)	Under Provision of BCAs and SME lending products

Source: CMA analysis.

13. Atom expects to launch in 2015 as the UK's first full-service digital-only bank.[19] Atom told us that it believes it can enter the UK market with 'brand new systems and without the constraints of legacy technology and damaged loan books … to ultimately provide better value for customers'. Further, it stated that 'the faster banking licence application process' has meant it can launch more quickly, and with less capital.

14. On its decision to be a fully digital bank, Atom has noted that the costs associated with acquiring and running branches are prohibitively expensive.[20] Atom intends to reduce its running costs by adopting the latest technology, and this, it says, will be reflected in a 'competitive and fair charging structure' for its customers. Atom will serve both personal and SME business customers, and its offering will be optimised for smartphones and tablets (via an app), with telephony services as support rather than as an alternative channel.

15. Atom expects to compete on quality of service and reliability rather than product differentiation. It hopes that its technological niche will allow it to enhance customer service. Atom's current predictions are for approximately [✂] PCA customers and approximately [✂] SME customers by the end of its fifth year (end of 2020, assuming Atom's launch goes ahead as planned in 2015).

16. In contrast to Atom, Starling is planning to enter with a niche PCA (including overdraft) offering before subsequently building a platform that will offer third-party financial services. Starling's business model is, like Atom's, purely digital; basic branch services will be available to its customers in [✂]

[18] Atom Bank acquires banking licence from UK financial regulators (24 June 2015).
[19] Atom will not have any branches of its own but its customers will be able to access counter services in [✂] branches.
[20] Atom's chairman, Anthony Thompson, said: "The rate of change in mobile in particular has just been so fast that opening a bank with bank branches would be like BT putting telephone kiosks back on the high street" (Jessica Winch (2014), Metro founder to set up Britain's first 'phoneless' bank, *Daily Telegraph*, 9 April).

branches.[21] Although Starling told us that it is targeting young (18–35-year-old) 'urbanites', it believes its niche offering will prove attractive to a wide audience.

17. Starling believes that it will be able to differentiate itself from existing services by focusing on a single product. In particular, it told us that its current account will be customisable and controllable online (eg 'turning on and off' cards), and that there will be no charge for services where there is no associated marginal cost (eg rejected direct debits). It also intends to combine its PCA product with financial guidance, such as offering suggestions to customers who experience cash-flow problems towards the end of each month.

18. Starling also commented on the faster authorisation process and told us that the mobilisation of this expedited option made it possible for Atom to launch a bank.

19. Starling projects that it will have 100,000 customers after its first year of business, with an acquisition cost of approximately £[✂] per customer. Its approach will be to encourage large numbers of people to try its mobile app and then persuade a proportion of these potential customers to close their existing accounts and transfer to Starling (eg through the Current Account Switch Service (CASS)) once they have seen the benefits of doing so.

Divestment

TSB

20. LBG was born out of Lloyds TSB's acquisition of HBOS in January 2009.[22] Under its brands Lloyds TSB, Halifax and Bank of Scotland (BoS), LBG offered a full range of retail banking services. In 2009, the European Commission ruled that the government's financial assistance to LBG constituted state aid.[23] As a condition for approving this recapitalisation, LBG was required to dispose of a standalone UK banking business that met certain criteria.[24]

21. TSB was launched as a standalone retail banking brand on 9 September 2013. It was created with multi-channel distribution capabilities supported by a 'resilient systems infrastructure' that LBG provided on a commercial basis.[25]

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[21] See our Prospective entrants case study.
[22] Lloyds TSB (2008), Recommended acquisition of HBOS plc by Lloyds TSB Group plc, press release, 18 September.
[23] State aid No. N 428/2009 United Kingdom Restructuring of Lloyds Banking Group.
[24] Refer to our TSB case study for more details about TSB's divestment from LBG.
[25] TSB Bank plc response to the CMA Issues Statement, para 7.

TSB also benefited from an established customer base,[26] but it has invested considerable resources in promoting its brand and differentiating itself from competitors through its customer service and products.[27] Specifically, TSB has branded itself as a provider of 'local banking', where 'money belonging to local communities stays in local communities'.[28]

22. TSB currently offers a range of seven PCAs,[29] all of which are based on a FIIC banking model. Its market share (including all seven PCAs) increased from [✂]% in 2013 to [✂]% in 2014. TSB exceeded its 2014 target of gaining 6% of all new current accounts by gaining [✂]% in that year.[30] These figures provide some evidence that TSB is performing well as a standalone business, but the bank told us that its current levels of growth may not be sustainable.

23. TSB's IPO prospectus notes that its PCA growth is an important enabler of medium-term profit growth and a critical enabler of long-term value as PCAs provide a key source of low-risk liabilities. In addition, current accounts provide an opportunity to develop customer relationships and meet more of their other banking needs over time. PCAs, therefore, are both a 'gateway' product, enabling cross-sales of other products, and a low-cost and low-risk source of funding for TSB.

24. Branches are central to TSB's strategy, and it believes its branch network gives it a competitive advantage over other new entrants. TSB inherited 631 branches from LBG which are located across the country and represent approximately 6% of the total UK branch estate. TSB plans to upgrade its existing branches and acquire more (it expects to have a total of [✂] branches by [✂]).[31] We note that on 30 June 2015 the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) approved a bid by Banco de Sabadell, announced in April 2015, to acquire all of the shares of TSB Banking Group plc.[32]

Williams & Glyn

25. In December 2009, the European Commission published its decision requiring RBSG to divest W&G as a condition of the state aid it received in 2008.[33]

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[26] Mintel (September 2014), Consumers and Retail Banking UK.
[27] At the time of writing TSB offers the highest credit interest rate on the market: 5% AER variable interest on balances up to £2,000 (no interest is paid on balances over £2,000).
[28] TSB, *How we're different*.
[29] Two of which are available only as upgrades for existing holders of current accounts (and provide access to insurance products and assistance services)
[30] TSB case study
[31] Comprising [✂] new branches and [✂] co-locations.
[32] UK authorities give green light to acquisition of TSB by Sabadell Group.
[33] State aid No N 422/2009 and N 621/2009 United Kingdom Restructuring of Royal Bank of Scotland.

W&G is due for IPO by the end of 2016 and full disposal is expected to be complete by the end of 2017.

26. W&G, which will offer PCAs and SME banking services (including BCAs and lending products), will launch with around 300 branches geographically biased towards the north-west of England. It also expects to expand into Scotland. In December 2014, W&G had approximately [✂]% market share of the UK's PCAs and [✂]% in SME banking. W&G told us that it will [✂].While W&G considers its branches and existing brand to be an advantage, it told us that its [✂].

27. W&G told us that it will differentiate itself from larger banks by [✂].

28. W&G will focus on [✂].

Entry by firms with ancillary financial services products

Tesco Bank

29. Tesco Bank expanded to become a full-service retail bank after launching its first PCA in June 2014. It told us that it believes current accounts remain the key relationship product that a customer has with its bank, and it launched its PCA so that it could meet the full financial needs of its customers.

30. Tesco Bank designed its PCA in response to consumer demand, after surveying more than 20,000 Tesco customers. Tesco Clubcard is central to how Tesco Bank recognises and rewards loyalty; it offers points on debit card spend (as well as on credit card spend and mortgage repayments). In terms of product positioning, Tesco Bank views its PCA as standing between the more universally accessible 'basic' accounts and typically fee-based 'premier' accounts that are available.[34]

31. The main channels for banking with Tesco Bank are over the phone, online and on mobile devices. Since June 2014, 450,000 of Tesco Bank's customers have downloaded its mobile banking app, which was launched in conjunction with its current account. Tesco Bank also currently operates three branches at Tesco stores in Corstorphine, Coventry and West Durrington, but the technological capability in these branches is limited. In-store deposit and withdrawal capability is available for Tesco Bank's current account and instant access savings products in 300 Tesco stores throughout the UK. Tesco Bank told us that its success in the credit card and car insurance markets, without a

[34] Tesco Bank's current account customers incur a £5 monthly fee if less than £750 is deposited each month (Tesco Bank, *Current accounts*).

meaningful branch network, has resulted from an online- and telephone-based strategy and competitive product sets. However, it considers that the cost to the customer is not as transparent for PCAs as it is for credit cards and insurance products, and this could lead it to reconsider its approach, depending on customer demand.

32. Tesco Bank's development and promotion of its PCA product required a substantial multi-year investment, with the final cost of the programme totalling £[✂] over [✂] (from 2010/11). Given the scale of this investment, Tesco Bank anticipates that the PCA will be profitable on a standalone basis within [✂] of launch. By 2024, Tesco Bank expects to have a [✂]% share of the PCA market, equivalent to [✂] customers.

Post Office

33. The Post Office, which offers retail banking services under Bank of Ireland's (BoI) banking licence,[35] launched its PCA in 2014, following a pilot rollout involving 29 branches across East Anglia in 2013. The pilot was intended to help BoI understand customer demand, the drivers of demand, and the types of consumers attracted to the Post Office's PCA.

34. In respect of the Post Office's PCA, BoI told us that it has aimed to 'establish an alternative to the traditional UK banks by providing simple, relevant products, delivered through an unparalleled distribution network'. The launch of this PCA is part of the Post Office's strategy to become 'the credible challenger to mainstream banks'. BoI also recognises that the Post Office PCA account will deepen customer relationships over the longer term, leading to 'stickier savings books and higher-margin lending'.

35. Post Office current account holders can bank at the Post Office's 11,500 branches, as well as online and over the telephone.[36] There are currently three Post Office PCA products:

(a) the Packaged account, which provides 'added benefits' in return for an £8 monthly fee and is targeted at the mass market/mass affluent;

(b) the Standard account, which does not have a monthly fee and is also targeted at the mass market/mass affluent; and

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[35] BoI and the Post Office formed a partnership in 2004. This allows the Post Office to offer retail banking services under BoI's banking licence. In 2012 this exclusive contract was extended until 2023 (Bank of Ireland (2012), *Bank of Ireland Extends Exclusive Partnership with the Post Office*, press release, 3 August).
[36] However, only 239 Post Office branches are authorised to sell (BoI) PCAs, and there have been two increases in the number of authorised branches since May 2013 (at which point there were 29 authorised branches).

(c) the Control account, which 'helps protect customers from unexpected charges and accidental overdraft usage' for a £5 monthly fee and is targeted at the basic/inclusive segments.

36. The Post Office expects demand for its products to be driven by a 'strong dissatisfaction with larger providers'. It has run a number of campaigns to encourage customers to switch. These have included offering 'One4All' gift vouchers and hotel stays for full or partial switching.[37]

37. In relation to customer acquisition, BoI envisage a gradual increase over the six years from launch to a steady acquisition rate of [✂] current accounts per year. By its own calculations, this translates to the Post Office capturing a share of [✂]% of PCAs opened each year, rising to [✂]% by 2020. BoI expects to recover its capital investment of around £[✂] approximately five years after full rollout. It told us that IT investment and improved capability will allow it to 'enhance its proposition in all its markets, and increase BoI's attractiveness to other financial services partners'.

38. According to BoI, broad areas of strategic focus for the Post Office PCA include improving access for customers to infrastructure, platforms and capability, and minimising operational and capital costs. The Post Office recently launched its 'current account mobile app' and a review of the Post Office current account has almost concluded. The conclusion of this review will result in further recommendations, earmarked for implementation in the first half of 2016.

Marks and Spencer Bank

41. In 2004 Marks and Spencer sold M&S Money to HSBC. M&S Bank is a wholly owned subsidiary of HSBC Bank plc. It has its own separate banking licence, and a profit-sharing agreement with Marks and Spencer plc.[38] M&S Bank launched its first current account – the Premium account – in 2012. HSBC told us that M&S Bank is differentiated from its other brands and those of its competitors through its use of a UK retail brand. This is reinforced through a range of offers that are linked to Marks and Spencer's retail arm.

42. M&S Bank's PCA is intended to act as its 'gateway proposition to strengthen and deepen customer relationships'. The Premium account is a packaged account for which customers pay a monthly fee of £10.[39] It is designed to appeal to Marks and Spencer's retail customers, who, on opening an account,

[37] Trialling and repetition of variants of these offers took place between the fourth quarter of 2013 and the fourth quarter of 2014.
[38] Marks and Spencer, *About M&S Bank*.
[39] Correct at time of writing for PCA without insurance. M&S Premium account.

gain access to a range of benefits such as vouchers and M&S loyalty points. HSBC told us that, historically, Marks and Spencer's typical customer has been older and more affluent than average. However, recent growth in its PCA market has been within a much wider age and affluence range, driven by a digital acquisition.

43. M&S Bank observed that the number of customers in the fee-paying packaged bank account market as a whole fell in 2013, for the first time since 2008. It believes this reflected a wider change in sentiment about fee-paying accounts in light of the FCA's regulatory action on packaged bank accounts. M&S Bank told us that some of its competitors began to withdraw their fee-paying accounts and it became aware of others' intentions to bring fee-free PCA products to the market.

44. In response to changing market dynamics, M&S Bank launched its free (when in credit) Standard account,[40] with a link to its M&S loyalty scheme, in May 2014. M&S Bank, based on consumer research it undertook, understood that to expand it needed to offer a current account without a monthly fee. A survey of 600 of its customers showed that 42% would never consider opening a current account with a monthly fee. Through the launch of its Standard account, M&S Bank aimed to:

(a) create a hierarchy of accounts, positioning the account as an entry product, and providing customers with the option to 'upgrade' to a fee-paying account in the future;

(b) create a gateway product to facilitate wider product penetration of existing and future products;

(c) be a more direct competitor of other current accounts in the market;

(d) grow its PCA customer base [✄]; and

(e) reach out to an audience who would not consider paying for their banking but find appeal in banking with M&S .

45. M&S Bank describes the sales performance of the Standard account as 'encouraging' since its launch in May 2014. During 2014, customers opened [✄] new personal current accounts, bringing the total number of open M&S current accounts to [✄] by the end of that year. Roughly [✄] PCAs opened with M&S Bank in 2014 were fee-free Standard accounts.[41]

[40] Free when in credit banking model, with the first £100 of overdraft also being offered free of interest.
[41] The precise figure was [✄]%.

46. According to Mintel's consumer research, 10% of people surveyed said they would consider moving to M&S Bank for their main current account, compared to 6% who would consider Metro.[42] At the end of 2014, M&S Bank had a [✂]% share of the PCA market in the UK. One of its key priorities remains driving PCA uptake, particularly through targeting its existing customer base (eg M&S credit card holders).

Virgin Money

47. Virgin Money, which launched in 1995 as Virgin Direct, a seller of financial investments, attained a banking licence with the acquisition of Church House Trust, a small private bank, in 2010.[43] Virgin Money has now 'grown into an online financial supermarket', offering personal loans, credit cards, insurance policies and savings vehicles.[44] On 1 January 2012, Virgin Money acquired Northern Rock. Through this acquisition, it gained 75 high street branches, some of Northern Rock's current account customers,[45] associated IT systems and access to UK payment systems.

48. Virgin Money launched its Essential Current Account (ECA) in July 2014. It expanded its offering to include personal current accounts primarily to become a full-service bank and to signal its intention to become a major competitor in the PCA market. Virgin Money limited the rollout of its ECA to branches in Scotland and Northern Ireland initially but expected a national rollout to be completed in the first half of 2015. To date, according to Virgin Money, this rollout has not resulted in an increase in local competitor activity.

49. Virgin Money's ECA is a basic bank account (BBA), which is fee-free and does not offer an overdraft facility.[46] Virgin Money hopes the ECA will help customers to 'stay in control of [their] money'.[47] The product was originally designed with the 'financially excluded' segment in mind, but it is now positioned as a more general offering to anyone seeking close control over their finances. ECA customers can manage their account through Virgin Money branches ('stores') and at any Post Office branch. Some limited services are also available online and over the telephone.

50. To date, Virgin Money has confined its rollout to branches in order to control volumes and monitor customer service – from which it can learn and build

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[42] Mintel (September 2014), Consumers and Retail Banking UK. Base: 799 customers.
[43] Richard Anderson (2011), *Virgin Money looks to join the mainstream*, BBC News, 17 November; Graeme Wearden (2010), Virgin Money moves into retail banking, *Guardian*, 8 January.
[44] BBC News (2011), *Q&A: Northern Rock and Virgin Money*, 18 November.
[45] These accounts were closed to new customers in June 2012.
[46] The ECA meets the product specifications of a BBA: see HM Treasury and Andrea Leadsom MP (2014), *Revised basic bank account agreement*, 15 December.
[47] Virgin Money, *Virgin Essential Current Account*.

capabilities to extend its offering. It has rebranded its 75 acquired branches (Virgin Money Stores), which offer customers financial planning advice, insurance and a savings review. It has also recently launched Virgin Money Lounges in Edinburgh, Norwich and Manchester. These are designed to be places for 'customers to relax and local communities to come together'.[48] Virgin Money emphasises the importance of branches and notes that its Virgin Money Lounges are part of its strategy to be a 'very different kind of bank.'[49]

51. Virgin Money has launched its ECA as a limited-volume product; it is not expected to provide any contribution to Virgin Money's profitability due to the loss-making nature of BBA provision.[50] Virgin Money intends to acquire around 6,000 customers each year initially, and no more than 10,000 each year, at an annual cost of less than £[✂].[51] Virgin Money told us that its decision not to invest materially to grow market share of current accounts is a direct result of the barriers to entry created by larger banks that limit a new or smaller bank's ability to compete at scale or cost effectively.[52]

52. According to Virgin Money's website, it is working towards launching a number of alternative current accounts.[53] Virgin Money confirmed to us that it plans to launch at least one more sophisticated product in the future, with the focus on ease of payment. Over 35,000 people have registered their interest in a Virgin Money account once a fully functioning PCA becomes available.

Acquisition

Santander

53. Santander, a Spanish banking group, entered the UK retail banking market through the acquisition of three businesses: Abbey National plc, Bradford & Bingley and Alliance & Leicester.[54] Abbey National plc became a part of the Santander Group upon its acquisition in November 2004, and in 2010 it was rebranded as Santander. In 2008, Santander acquired Bradford & Bingley's retail branches and Alliance & Leicester. The branch networks of Bradford & Bingley and Alliance & Leicester were also rebranded as Santander in 2010.

54. In 2014, Santander had [✂] current accounts, of which [✂] were classified as 'main'. This corresponded to an [✂]% share of the main current account

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[48] Virgin Money, *Virgin Money Lounges*.
[49] Virgin Money, *Virgin Money Lounges*.
[50] Virgin Money case study, para 45.
[51] Virgin Money case study, para 41.
[52] Virgin Money case study, para 49 onwards.
[53] Virgin Money, *Current accounts*
[54] Santander, *History of Santander Group*.

market in the UK – an increase of [✂] since 2011.[55] Santander had the highest share of new accounts in 2014 (and the second-highest share of new main accounts).

55. Santander told us that it has a very clear retail strategy (which it has developed since 2011/12) and that this has set the direction of several initiatives.

(a) Product development: in 2012, Santander launched its 1|2|3 current account, which it said would be the bank's key tool for acquiring new customers. The 1|2|3 account rewards customer loyalty on an ongoing basis through a combination of cashback and interest on balances.

(b) Product simplification: Santander wanted to develop a portfolio that was simple and transparent for both customers and staff. As such, it has reduced the number of current accounts it offers from fourteen to four and removed its added value accounts, also known as packaged accounts. Santander currently offers the 1|2|3 account, Everyday current account, Choice current account and Basic current account. Monthly fees are payable on the 1|2|3 account and the Choice current account (£2 and £10, respectively), while the Basic and Everyday accounts do not have monthly fees.

(c) Quality of customer service: Santander is focusing on making improvements for its customers, including customer switching and account opening processes.[56]

Provision of business current accounts and small and medium-sized enterprise lending products in the UK

56. The Office of Fair Trading (OFT) and FCA's joint market study on SME banking found that the market for BCAs and business loans is concentrated, as it has been for the last ten years. In 2014, RBSG, Barclays, LBG and HSBCG accounted for [80-85]% of BCA market share and over 85% of general purpose business lending.

[55] The quoted growth in market share is organic growth over and above Santander's growth from acquisitions.
[56] Customers who knew which product they wanted could complete the process [✂]. Customer satisfaction has increased from 50% to 59% (source FRS).

57. There has, however, been some movement in market shares since 2012. These four banking groups have experienced a reduction in their combined share of BCAs of around three percentage points.[57]

58. In contrast with PCA provision, where a number of new providers have entered the market, only one new provider (Metro) has entered the BCA market in recent years. TSB entered in 2013 as a result of LBG's enforced divestiture, while RBSG has plans to divest W&G in 2016 (see paragraphs 25-28 above).

59. Other banks, such as Handelsbanken and Santander, entered the market in 1999 and 2004, respectively.[58] However, it is only in recent years that they have started to have a clear presence in the market and have begun to provide some competitive constraint on market participants. While there has been very limited new entry into the BCA and business loan market, a number of specialist banks – such as Aldermore Bank plc (Aldermore), Shawbrook Bank (Shawbrook) and Paragon Bank (Paragon) – have entered the SME market, offering specific products such as asset finance, invoice discounting and mortgages.

60. Finally, there are some prospective entrants to SME banking, notably Civilised Bank, which is in the pre-application phase of obtaining a banking licence, and OakNorth, which has acquired conditional authorisation until March 2016.

Organic entry

Metro

61. As noted above, Metro entered the UK retail banking market in the first half of 2010, making it the only organic entrant to SME banking in the UK in recent years. It currently offers four BCAs for different business categories:[59]

    (a) the Business bank account – for SMEs with annual turnover of up to £2 million – is a BCA that is subject to a monthly maintenance fee, transaction charges and service charges;

    (b) the Commercial current account – for SMEs with annual turnover of greater than £2 million or complex needs – has no set-up fee or fixed

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[57] There is considerable variation between the four banks within this overall fall: for instance, [✂]'s share of BCAs in the UK has increased by [✂], whereas [✂]'s share has declined by [✂].
[58] Although Handelsbanken entered the UK market in 1982, it did not become a bank for individual and corporate customers until 1999.
[59] Metro also has two BCAs that are closed to new business: the Start-up BCA and the Switcher BCA. Metro told us that these accounts were its standard BCAs, but they have been simplified and replaced by its Business bank account (in October 2013) for SMEs with turnover of up to £2 million.

monthly fee, but it is subject to transactional charges (based on the volume of activity on the account) and service charges;

(c) the Community account – for charities, societies and clubs with annual turnover of up to £2 million – has no fixed monthly fee, the first £10,000 (cash) paid in or withdrawn each month at Metro counters is fee-free and up to 200 transactions may be made free of charge each month; and

(d) the Foreign Currency account, which is a basic transactional account in a range of currencies.

62. In addition to its BCA products, Metro offers deposit accounts for SMEs and a range of secured and unsecured business lending products. It also offers business credit cards and business overdrafts to its SME customers as well as invoice finance facilities (including invoice discounting and factoring) and core asset finance.

63. At the end of 2014, Metro had [✂] open BCAs with a total value of around £[✂] million, of which [✂] were active. This represents a market share of BCAs of [✂]%. Metro also lent around £[✂] million in general purpose business loans (GPBLs) in 2014, equivalent to a share of [✂]%.[60] Commercial mortgages and business credit cards do not appear to be as important to Metro's revenue growth as BCAs.

64. Metro told us that its SME business is key to its wider banking strategy. At the end of 2014, its SME customers (including corporate customers) represented [✂]% of its total deposits and [✂]% of its lending.

65. As with its PCA business, Metro aims to differentiate itself through its customer service. It believes that customers switch to Metro primarily because they have received poor service from their previous bank and/or wish to secure further lending. Metro's model is designed to attract all types of business customers rather than to be selective.

66. Metro has locally based business managers and commercial banking managers which it claims enables it to build strong relationships with local businesses. The local business managers are based in Metro's branches and serve the needs of smaller businesses with annual turnover of less than £2 million. Relationship managers serve the needs of larger businesses and focus on specific sectors, such as property, healthcare, not for profit, franchising, leisure and Asian banking. Metro's branches are currently located

[60] Share of GPBLs is by number of loans outstanding.

only within and around London, and it does not yet offer an alternative for SMEs based outside of this region.

Handelsbanken

67. Handelsbanken, a Swedish banking group, entered the UK market in 1982 and opened its first UK branch in 1989.[61] In 1999, Handelsbanken extended its operations (limited until then to Nordic-related corporate business) to become a full-service bank for individual and corporate customers in the UK. It expanded into Scotland in 2007. In 2011, Handelsbanken had 100 branches in the UK, and by March 2015 this had grown to 190.

68. Handelsbanken offers a variety of SME banking products: a BCA to which an overdraft facility may be applied; and two types of deposit account (an instant access account and a 35-day notice account), with rates agreed by the branch and customer and applied above Handelsbanken's managed rate. It also offers lending products to SMEs: one loan product, one mortgage product, invoice discounting, credit cards, asset finance and trade finance.

69. Handelsbanken views itself as a specialist provider that offers very high levels of personal service delivered by locally based decision-makers. Its UK branch operations, which are based on its Swedish model, are organised into regional banks with regional head offices around the country. Handelsbanken told us that its branches operate within a flexible framework that gives them the freedom to provide bespoke products tailored around the specific financial circumstances and needs of each customer, including its SME customers. As such, it does not have an 'off-the-shelf' BCA offering that has set characteristics, such as specific interest rates and fees.

70. Despite its recent growth, Handelsbanken remains a relatively small player in SME banking. At the end of 2012, it had [✂] BCAs, corresponding to market share of [✂]% of BCAs. By the end of 2014, its BCA market share had grown to [✂]%, with a total of [✂] BCAs.

Prospective entrants to the small and medium-sized enterprise banking market

71. Civilised Bank is currently in the pre-application stage of the authorisation process to become a bank. It believes that advances in IT and changes to the authorisation process have created an opportunity for it to make a successful entrance into the market. It told us that it intends to bring back a 'traditional, relationship-led' style of banking for SMEs, led by highly autonomous

[61] Handelsbanken Great Britain, *Handelsbanken in Great Britain*.

relationship managers. It will also provide a relatively small amount of personal banking, primarily to support the SME offering. Civilised Bank plans to offer a BCA (with overdraft facility), asset-based lending and other loan products, and potentially invoice discounting subject to customer demand.

72. Initially, Civilised Bank's primary retail offer will be a range of online deposit products, including limited personal loans. It will also offer personal banking products for directors and employees of SME customers. Civilised Bank told us that its offering will be supported by a high-quality IT platform that will minimise the cost base and provide scalability.

73. Civilised Bank does not plan to have a formal physical presence, except for some offices that relationship managers may use if and when required. Its model will rely upon relationship managers travelling to visit customers from regional hubs.

74. OakNorth, which has been granted conditional authorisation until March 2016, initially plans to offer short-term business loans (between two and twelve months), business lending solutions and property development finance.[62] Its distribution model will be a hybrid of fintech alternative finance providers and traditional banking services.

75. OakNorth's lending will be financed by retail deposits. It told us that it will launch with simple savings accounts (one-to-three-year fixed rate), and progress to easy access accounts that support transactional banking. It told us that obstacles to accessing payment systems had prevented it from offering a current account from day one.

Divestment

TSB

76. As described above, TSB launched as a standalone retail bank in 2013, following its split from LBG. TSB now offers a range of current accounts, deposit accounts, secured and unsecured loans and third-party services to SMEs.

77. TSB told us that although its business banking is an important part of the business, growth within this area is not currently a strategic priority for the bank. With respect to business banking, TSB is concentrating on first

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[62] OakNorth Bank website.

stabilising the business before developing propositions and building the capability that will enable it to grow in the future.

78. TSB's share of the BCA market is considerably smaller than its share of the PCA market: [✂]% as opposed to [✂]%.TSB's customer profile of BCA business is weighted towards the smaller end of the SME market, with sole traders comprising almost 40% of its business banking customer base, and clubs, charities or societies accounting for almost 30%. TSB notes that, as a result of this, its share of the business lending market (less than 1%) is smaller than its share of the BCA market.

79. TSB notes that growth in its business banking, particularly in relation to BCAs, lending and distribution, is important as a longer-term goal. [✂].

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80. See paragraphs 25-28 above. W&G, which is due for IPO by the end of 2016, will offer a range of SME banking services including BCAs and lending products alongside its PCA proposition.

Acquisition

Santander

81. As stated above, Santander entered the UK retail banking market in November 2004 through its acquisition of Abbey National plc, which was followed by its acquisition of Bradford & Bingley and Alliance & Leicester four years later.[63]

82. In addition to its PCA offering, Santander currently offers three types of current account to its corporate customers, including SMEs:

(a) the Business current account – for SMEs with an annual turnover of up to £250,000 – which has a fixed monthly fee based on monthly cash deposits;

(b) the Treasurer's current account, for not-for-profit organisations with an annual turnover of up to £250,000; and

(c) the Corporate current account and the Corporate plus current account, for businesses with an annual turnover in excess of £250,000; the Corporate account pays interest on credit balances and is not subject to a monthly

[63] Santander, *History of Santander Group*.

fee, while the Corporate plus account is subject to a monthly fee of £15 but offers a 'more competitive tariff on banking and higher interest on credit balances'.

83. Santander offers two types of overdraft, depending on business turnover, as well as a range of deposit accounts. In addition, it offers lending products to businesses, including GPBLs, commercial mortgages, invoice finance, asset finance and trade finance.

84. In 2010, Santander had [✄] BCAs. Twelve months later, it had [✄] BCAs. This large growth reflects the rebranding of Alliance & Leicester's BCA business ([✄] accounts in 2010), the rebranding of Abbey National's BCA accounts ([✄] accounts in 2010), and organic growth of [✄]. In 2014, Santander's market share of BCAs was almost identical to what it had been in 2011. According to Santander, however, its overall share of SME banking (including lending and savings products) had increased by [✄] since 2012.

85. The majority of Santander's growth has come from the provision of services to smaller SMEs with an annual turnover of less than £2 million.[64] In each year between 2011 and 2014, Santander was the fifth-largest SME banking provider by number of BCAs for businesses with less than £2 million in annual turnover. For SME customers with more than £2 million in annual turnover, Santander remained the eighth-largest provider over the same period.

86. Santander told us it was a 'scale challenger', and noted that it has made significant investment in the infrastructure that will be needed alongside its product portfolio if it is to continue to grow its market share. It also told us that it is continuing to invest in [✄] its SME proposition. Santander recognises that a large number of its customers have a single-product relationship with the bank, and it appreciates the importance of having customers who have their primary banking relationship with Santander. It told us that its strategy is based upon organic growth through a strong customer proposition [✄].Its objective is to 'be the SME bank of choice for UK businesses, no matter their turnover or complexity, by providing a range of value for money propositions backed up with excellent service to support them across their banking needs'. It did, however, tell us that it [✄].

[64] CMA estimates based on data provided by Santander.

Entry into niche small and medium-sized enterprise products

87. In addition to the entry outlined above, several new players have recently entered the niche SME lending market, including Aldermore, Shawbrook and Paragon.

88. Aldermore was founded in May 2009. Its primary business is the provision of banking services to SMEs and residential mortgages. It offers a range of business finance solutions, including invoice finance, asset finance and bridging finance. As stated in Aldermore's annual report and accounts for 2014, SME deposits in 2014 exceeded £1 billion and were almost double the balance at the end of 2013. In addition Aldermore lent £2.2 billion to UK SMEs in 2014.

89. In 2011, Shawbrook entered the UK market with a range of lending and savings products for personal customers and SMEs. According to its website, Shawbrook lent in excess of £2.3 billion in 2014, and it has attracted more than £2.4 billion in deposits since its launch.[65] Its core product offering to SMEs includes commercial mortgages, asset finance (targeted predominantly at SMEs with an annual turnover of less than £2 million) and business credit (targeted primarily at SMEs with revenues of between £2 million and £100 million).

90. Paragon, which launched in February 2014, is a wholly owned subsidiary of the Paragon Group of Companies plc. In its first year of operation, it launched four product ranges: savings, car finance, personal loans and buy-to-let lending. Paragon told us that demand for its savings products had been positive and this will enable it to fund its future growth in lending (including lending to SMEs).

[65] Shawbrook Bank website.