CMA Retail Banking Market Investigation, Updated Issues statement, June 2015.

Response by the Community Investment Coalition

About the Community Investment Coalition

The Community Investment Coalition is a partnership of national organisations including financial providers, charities, trade associations and academic bodies. Our mission is to promote access to affordable financial services for families, businesses and communities.

CIC campaigns for:

- Increased transparency and public accountability of financial service providers to support consumer choice and allow effective intervention in under-served markets.
- Increasing diversity of providers and choice for consumers in the financial services sector, with more providers offering a wider range of fair and affordable products to households, individuals, communities and businesses.
- More innovation in the financial services sector so that affordable financial products are delivered accessibly to all communities.
- Sustainable local economic growth with a greater share of locally generated income remaining within communities.
- Improvements in financial literacy for all sections of the community.

In June 2014, the Community Investment Coalition (CIC) launched its Community Banking Charter, which champions a fresh approach to banking in the UK so that every household, adult and business has access to basic financial tools, including access to a transactional bank account. Road-tested by community groups in low income communities, the Charter calls for everyone to have access to a basic package of financial tools. A video regarding financial exclusion by CIC partner Local Trust can also be found here.

Background to response

When incomes are not keeping up with price rises, it is even more important for people to be able to manage day-to-day financial transactions and this means having access to an appropriate account or equivalent product into which income can be paid, held securely and accessed easily; a method of paying and spreading the cost of household bills and regular commitments; and a method of paying for goods and services, including making remote purchases by telephone and on the internet.

Although an EU directive has enshrined a citizen's right to a basic bank account, there are still currently around 1.4 million unbanked individuals in the UK. Yet, at the same time, alternative providers of financial services, such as credit unions, continue to suffer from a low level of membership and awareness.

The 'Big Five' banks (Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland and Santander) have an 85 per cent market share of the personal current account market (PCA) market and 81 per cent of business current account (BCA) market. This lack of competition has squeezed the market to the extent that consumers are not being adequately served either in terms of breadth or depth of provision.

Therefore, CIC welcomes this investigation as stated by the CMA, but would like to make the following additional comments.

Building an overall understanding of the financial performance of banks at the PCA and SME level.

Having campaigning extensively for transparency in the disclosure of lending by financial service providers in the UK, CIC welcomes analysis of how the UK's main banks construct their business models and, subsequently, how this relates to their financial performance. Equally, we would advocate greater transparency by banks on how they achieve their financial results, so that customers can better navigate the market and choose appropriate products.

For example, one issue that is extremely pertinent in the PCA market is the profit made through overdraft fees, which contribute 34 per cent of total revenue from PCAs. Indeed in 2014, research by the FCA concerning the overdraft market found that many consumers were paying too much for overdrafts, with consumers owing £8 billion in overdrafts to banks and building societies.

Many customers do not understand the true cost of unauthorised overdrafts, due to the fact that they are not required to be expressed as an APR percentage. This had led them to be excessively misused by too many customers, who use them as an extension of their income, rather than as a borrowing facility. Equally, banks have raised further revenue by increasing overdraft limits and have subsequently profited from the additional interest levied on consumers.

This leads CIC to believe that lower income customers are hit so hard by overdraft charges that they are in fact paying a premium for their PCA relative to the amount of profit banks make in comparison to high income customers. There are two main consequences of this effective cross-subsidy by low income consumers for higher income consumers. Low income individuals are either heavily disincentivised to open a PCA – restricting their ability to participate fully in the economy – or they become trapped in a debt spiral.

Developments in both technology and regulation.

New technology, driven by ever increasing levels of mobile phone ownership and internet access, in addition to differing consumer expectations are creating demand for financial services that are tailored and innovatively delivered to individual needs. This is creating real opportunity for new entrants to the sector who are revolutionising the quality, range and accessibility of financial services.

For this reason, CIC warmly welcomes innovation in financial services as a way of stimulating competition in the sector. Indeed, we hosted a discussion roundtable in April 2015, which brought financial technology practitioners, including Squirrel, Ffrees and QuidCycle UK, alongside community groups to discuss how financial service providers could harness technology to provide suitable and affordable products for all communities and businesses.

However, at the same time, we feel that the existing mainstream banks need to direct customers towards the most suitable products and services as opposed to the most profitable. Currently the culture within banks is to look at what is most beneficial for themselves as opposed to balancing this with what is best for their customers.

One way to significantly tackle this would be for banks to increase their customers' access to money management advice. Evidence has shown that basic understanding of financial language is extremely low across all age groups and increasing resources in this area would allow customers to be better placed to make important financial decisions.

Furthermore, we recommend that more robust regulation is put in place so that banks refer their declined SMEs to alternative lenders, such as Community Development Finance Institutions (CDFIs). The CDFI referral scheme is a joint venture between the BBA and the CDFA whereby SMEs that have been rejected by banks are subsequently matched with a CDFI. CIC believes that, in principle, the bank-to-CDFI referral scheme is a good initiative because it provides an additional gateway for SMEs to access finance when they were previously unable to. However, CIC notes that the implementation of the scheme, at the time of writing, has been unsatisfactory, with the referral scheme recording a 40 per cent acceptance rate (from just 1,600 clients).

This indicates that the banks participating on a voluntary basis have not effectively tackled the gap in SME finance that exists. Yet the development of referral relationships between banks and CDFIs are vital in serving the riskier SME market, and creating new market opportunities for CDFIs. Formalising and building referral relationships and networks is a key part of the financial services sector, and in increasing access to finance for consumers.

CIC would like to see a firmer commitment by the banking industry to building strong referral networks with alternative and community lenders. Similarly, resources also need to be directed towards enhancing the skillset of bank staff so that they are better placed to identify appropriate businesses that would benefit for being referred.

The pricing structures of PCA and BCA products and the impact it has on customers choosing the most appropriate product.

CIC believes that there needs to be far greater transparency in the terms of conditions for various financial products. This will not only allow customers to navigate the market more easily, but also empower them to make better informed decisions and thus choose the most appropriate product. As the CMA investigation states, there aren't just different products, but also different brands within the same banks that provide special offers for new customers making comparisons more difficult.

The three theories of harm.

CIC agrees with the three theories of harm, as stated by the CMA in its issues statement.

The CMA analysing aspects of PCA switching and, in particular, the 'free if in credit' model.

Payment Council figures have shown that in the 12-month period from 1 April 2014 to 31 March 2015 the use of the Current Account Switch Service rose by 7 per cent to 1.14 million switches. However CIC notes that, among consumers, there has been a general reticence to change current account provider and this has led to a limited use of this service. This is illustrated by the fact that those 1.14 million switches represent just 3 per cent of the total number of accounts last year; meanwhile 37 per cent of consumers have been with their bank or building society for 20 years and a further 20 per cent have remained loyal for between 10 and 20 years.

Therefore, CIC welcomes proposals for continued analysis into PCA switching by the CMA. Low levels of trust towards banks by consumers – a YouGov poll showed that two-thirds of banking customers no longer trust their lender to look after their money and around half believe high street banks are dishonest – is a significant factor in low switching rates. Reasons for this primarily lie in a frequently complex charge and fee regime, which makes consumer choice extremely difficult to exercise, as it is unclear what the benefits and penalties of switching would be.

Indeed, another substantial element of the PCA market is the widespread availability of the 'free if in credit' model and the market's apparent acceptance that this is the status quo. However, CIC believes that the entire concept of the 'free if in credit' model must be thoroughly examined because evidence is increasingly suggesting that such a model is not only unsustainable, but also detrimental to consumers.

CIC notes that in March 2015, the chief executive of Barclays, Anthony Jenkins, stated that the 'free if in credit' model "was probably not helpful for consumers because it's very hard to make a judgement about something when there's no price attached to it." CIC agrees with the principles of this analysis; if the cost of a current account is merely calculated overdraft fees or interest foregone, the lack of genuine transparency and comparability discourages people from engaging with switching process. This subsequently acts as a significant barrier to entry.

This has been supported by new entrants to the market. In a parliamentary report, Virgin Money stated that "'free banking' makes it very difficult for new entrants to the PCA market" and that "new entrants are not able to compete by offering lower prices (than zero) or by innovating with simpler, lower-cost products." Meanwhile, in the CMA's own case study, Tesco Bank put forward an extremely compelling case for the limits of the 'free if in credit' model, stating that incumbent banks "were able to support competitive new business offerings at the expense of their existing customers."

Equally, alternatives such as credit unions, who charge weekly fees for their PCAs, struggle to compete and attract customers from banks and other institutions that operate on the 'free if in credit' model. This, coupled with the restrictions of the 'common bond' that are placed on credit unions', limiting their scope to grow, means that they are also unable to compete on a level playing field.

Therefore, we believe that further analysis will show that these types of account are anti-competitive and not beneficial for consumers, as incumbent banks earn income from PCAs through an array of hidden charges. And, as challengers must build the infrastructure to support PCAs, they are obliged to bear a substantial deadweight cost; the result is severely limited competition within the PCA market.

SMEs' satisfaction with their bank

Whilst CIC accepts the Charterhouse survey that the majority of SMEs are satisfied with their main bank, we would like to highlight that the satisfaction levels are lower with smaller business and newer businesses. Awareness of alternative providers of finance, such as the Community Development Finance Institutions (CDFIs), in the nearby locality is low, which at the very least restricts SMEs in their ability to get the most appropriate and affordable product. CIC would strongly urge that the CMA advocate a comprehensive, accurate, and up to date information system on national and local providers and lenders, so that SMEs (and, for that matter, all consumers) are made aware as to what is available to them. This would ensure that they are adequately served.

Moreover, CIC advocates the CDFI referral scheme, but, as mentioned earlier, this can only be successful with the support from all banks. CIC notes that the majority of the referrals from the BBA-CDFI referral scheme were from Barclays, whereas HSBC and the Co-Op Bank have referred no customers.

The two main mechanisms in relation to unilateral market power.

CIC agrees that the two main mechanisms highlighted by the CMA in relation to unilateral market power are correct and welcomes their further investigation.

The asymmetry of information puts existing banking relationships at an advantage over competitors.

CIC agrees that the asymmetry of information between existing, mainstream banks against new entrants gives the former a significant advantage in them being able to retain customers. Clearly, this is not always for the benefit of the customer and, in fact, can potentially be used by a bank to cross-sell further products that benefit the bank at the cost of the consumer. We feel this is an avenue that needs to be explored further. Therefore, CIC welcomes the CMA's commitment to investigating this further through its third theory of harm.