# Retail banking market investigation

## Retail banking financial performance

**14 August 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 Friday 28 August 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 [✂].

**Contents**

## Introduction

1. In this paper, we analyse the financial performance of the UK retail banking, and the personal current account (PCA) and small and medium-sized enterprise (SME) banking operations of a selection of banks. In our analysis at retail banking level, we present data on the five largest UK retail banks, while our analysis of PCA and SME banking includes data from the eight largest banks (the five largest, and the three next largest retail banks in the UK).[1]

2. In our analysis of retail banking performance, we provide some background information, and an analysis of the recent financial results and key performance metrics of the five largest UK retail banks during the period 2012 to 2014.

3. In our analysis of the financial performance of PCA and SME banking operations, we present financial data on total revenues and number of accounts, average revenues per account, revenues by source, and impairment margin during the period 2011 to 2014.

## Retail banking financial performance[2]

### *Background*

4. Retail banking generally refers to the provision of products and services that banks provide to personal customers and businesses, including SMEs, through a variety of channels including branches, internet and mobile technology. Banks typically organise their retail banking activities either by the type of customer served (eg personal versus business), products offered (eg mortgages, credit cards) or size (eg small versus large businesses). The main functions of retail banks (sometimes referred to as 'high street banks') include accepting deposits, making loans and providing payment services.

5. Retail banking includes PCA and SME banking services, the reference products for our investigation, but also other products such as residential mortgages, personal loans and insurance. Many large UK retail banks have separate retail banking divisions or business units, with their own management and reporting structures, although there are differences in the

[1] The five largest UK banks are: Barclays plc, HSBC Bank plc, Lloyds Banking Group plc (LBG), The Royal Bank of Scotland Group plc (RBS), and Santander UK plc, and the smaller three banks are the Co-operative Bank plc, National Australia Bank (NAB) (Clydesdale) and Nationwide Building Society. All eight banks provide PCA and SME banking services with the exception of Nationwide which does not provide SME banking services.
[2] In this section, we have relied upon selected research reports and banks' annual reports to provide an overview of the financial performance of UK retail banks during the period 2012 to 2014.

way these banks define, organise and describe their retail activities – see Box 1 below.

**Box 1: Examples of description of retail banking activities by UK banks**[3]

**Barclays plc:** Personal & Corporate Banking (PCB) provides banking services which fulfil the fundamental banking needs of individuals and businesses: storing, receiving and paying monies in a safe, reliable and regulated manner. PCB is subdivided into four main units, bringing together its Personal, Mortgages, Corporate and Wealth businesses.

**HSBC Bank plc**: Retail Banking and Wealth Management (RBWM) takes deposits and provides transactional banking services to enable customers to manage their day-to-day finances and save for the future. It offers credit facilities to assist customers in their short or longer-term borrowing requirements, and provides financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

**Lloyds Banking Group (LBG):** Retail Banking offers a broad range of financial service products, including current accounts, savings, personal loans and mortgages, to UK personal customers, including Wealth and small business customers. It is also a distributor of insurance, protection and credit cards, and a range of long-term savings and investment products.

**RBS**: UK Personal & Business Banking (UK PBB) offers a comprehensive range of banking products and related financial services to the personal and small business market.

**Santander UK plc**: Retail Banking offers a wide range of products and financial services to individuals and small businesses, through a network of branches and ATMs, as well as through telephony, digital, mobile and intermediary channels. Retail Banking's main products are residential mortgage loans, savings and current accounts, credit cards and personal loans as well as insurance policies.

Source: Banks' 2014 annual reports, CMA research.

6. Typically, individuals and small businesses constitute the core of the retail banks' customer base. Some UK banks also have wealth management and private banking activities within their retail activities to serve high-net-worth individuals. Retail divisions of the UK banks tend to serve start-ups and smaller SMEs, while larger SMEs and corporates are generally served by commercial or corporate banking divisions. Most banks categorise SMEs by annual sales turnover and/or borrowing requirements to determine which of their divisions would cater to these businesses, although the cut-off for separating SMEs and larger corporate customers varies between banks.

7. We reviewed selected industry publications, reports by equity analysts and consulting firms to understand key profitability drivers of the retail banks in the

[3] These examples do not constitute an exhaustive list of retail activities or divisions of these banks, but are meant to provide a sample of the information provided by these banks in their 2014 annual reports about their retail businesses.

UK, as well as emerging trends from their recent financial performance. Key findings from these are discussed below.

8. A report on UK retail banking by Oliver Wyman in 2012 stated that 'Leaving aside Payment Protection Insurance (PPI) compensation provisions, banks' core returns in UK remain high and stable…'.[4]

9. In a 2014 report on European retail and business banking, Oliver Wyman noted that:

> despite 2013 profits being slightly lower compared to 2012 profits, 'we see a good return on equity (ROE) – after adjusting for the many one-off Profit and Loss (P&L) impacts and regulator fines – in the retail and business banking market as a whole, and opportunities for further improvement. We also observe widening differences across markets, ranging from rising returns in the UK and Swedish markets to weakening returns in Spain and Italy.[5]

10. A 2014 Credit Suisse (CS) report on UK retail banking concluded that based on reported return on equity (ROE),[6] mortgages were the most profitable lending product, followed by credit cards, with SME lending and consumer credit having lower returns – see Figure 1 below.[7]

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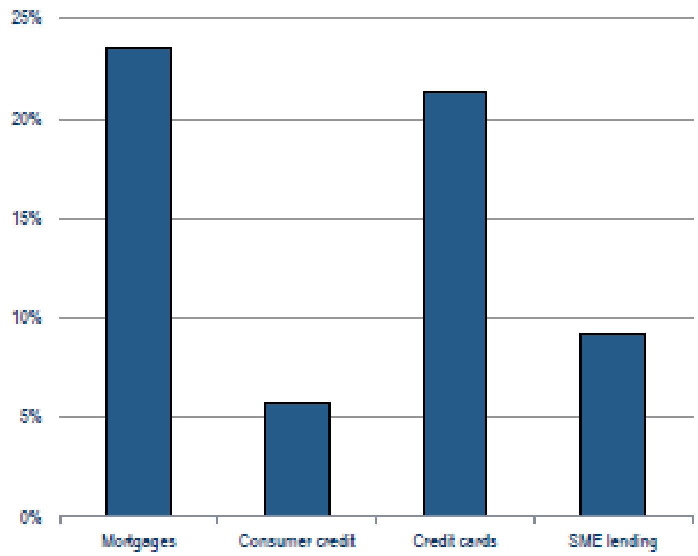
[4] Oliver Wyman (2012), *Perspectives on the UK Retail Banking Market*, p3.
[5] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p1.
[6] ROE is a common financial measure used to assess financial performance in banking and other industries. The typical formula for calculating ROE is profit for the year/shareholders' equity. The ROE can be compared to the cost of equity to determine the relative profitability of a business or an industry.
[7] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 10. This report covered 13 UK retail banks.

**Figure 1: Aggregate 'clean' Return on Equity by product – 2013**[8]




Source: Credit Suisse Retail Banking Seminar. 2014. slide 10.

11. CS concluded that the level of a retail bank's profitability depended on a combination of the following:[9]

*(a)* Scale, although that alone was not enough.

*(b)* Weight of mortgages – since mortgages were the most profitable product for many banks, alongside credit cards, albeit on a much smaller scale.

*(c)* Funding structure – having a proportion of low interest bearing accounts was an advantage, as well as having a purely deposit-funded retail banking franchise.

12. A 2012 report by the Association of British Insurers (ABI) pointed out that retail banking profitability was a function of (i) product mix, including the secured nature of mortgage lending versus the unsecured nature of credit card lending, (ii) efficiency ratios, and (iii) charges and provisions (eg PPI claims).[10]

13. According to a 2014 Deutsche Bank (DB) report, the key drivers of the retail banking profitability in the UK were mortgages and customer deposits which consumed fairly little capital and delivered fairly stable returns over time.[11] Based on its analysis, DB concluded that UK retail banking was a 'high return,

[8] 'Clean' ROE refers to what was reported by banks for 2013, excluding the so-called below-the-line items: bank levies, customer redress and litigation, reinvestment spend and higher capital requirements. Ibid. slide 7.
[9] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 8. This report covered 13 retail UK banks.
[10] ABI (2012), *Investibility of UK Banks*, p16.
[11] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p8.

stable industry', which produced an underlying Return on Tangible Equity (ROTE) of 22% over the 14 years 2000-2013.[12] [13] [14] DB stated that since 2009, retail banks' returns had been lower, producing an average underlying ROTE of 17% between 2009 and 2013.[15] It also reported that the actual ROTE for the sector including PPI and re-structuring costs was much lower at 10% between 2009 and 2013.[16]

14. KPMG, in an analysis of the 2014 financial results of five UK headquartered banks, stated that while these banks were organisationally very different,[17] there were a few general themes emerging from their recent financial performance. These included the following:[18]

   *(a)* some signs of improvement in net interest margins (NIMs);

   *(b)* continuing effect of customer remediation and conduct charges; and

   *(c)* reduction in impairment charges, as a result of strengthening economic conditions.

15. A T Kearney, in a recent report on retail banking in Europe, concluded that although profitability was rebounding as retail banks recovered from the financial crisis, the future success depended on building a banking model that captured new revenues and increased cost efficiency.[19] It also stated that tightened regulations were likely to continue to drive up equity requirements and the cost of doing business while limiting revenues.[20] Further, the report noted that persistent low interest rates, slow economic growth together with deflationary pressures could continue to limit profits, even as banks' risk provisions declined from the 2012 historical highs.[21] A T Kearney pointed out that retail banks in the UK still struggled due to spread compression, primarily on mortgages.[22]

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[12] In general terms, ROTE is computed using profit attributable to shareholders and shareholder equity less intangible assets. ROTE typically is higher than ROE.
[13] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p5.
[14] Ibid. Deutsche Bank defined ROTE (based on historical capital) as Underlying Profit before tax ÷ (Risk Weighted Assets X Core Tier 1 capital ratio average that year) or an estimate of equity base. Underlying Profit before tax excludes exceptional items such as PPI and restructuring costs, p5.
[15] Ibid. p5.
[16] Ibid. DB did not state a benchmark cost of tangible equity in its report.
[17] The report analysed 2014 results of Barclays, HSBC, Lloyds, RBS and Standard Chartered Bank (SCB). KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?*, p17.
[18] Ibid. pp11–13.
[19] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* cover page.
[20] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p1. See Appendix 2 for A T Kearney summary of the effect of regulation on profitability in Europe's retail banking sector.
[21] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p1.
[22] Ibid. pp4.

16. According to A T Kearney, UK retail banks faced a competitive market and growing regulatory intensity, resulting in the lowest income per customer in the Western Europe region, about €300 in 2014.[23] It also reported that in 2014, UK's retail banks had the highest net interest to total income ratio in Europe at 82%, as banks struggled to increase fee-based revenues.[24]

17. Based on the reports we looked at, UK retail banking performance and outlook paints a mixed picture. The reports suggest that although banks appear to be gaining from improved economic conditions, lower impairments and improved NIM, they continue to face high customer remediation and conduct costs, which has an adverse impact on profitability. They are also becoming more reliant on net interest income rather than fees to increase their total income. Mortgages appear to be the most profitable business segment within UK retail banking, although it faces some pressure on margins. Large banks continue to gain from having access to stable customer deposits, which remain an important source of relatively low-cost funding.

***Key financial metrics – UK retail banks***

18. In this section, we present some data and metrics on the recent financial performance of the five largest UK retail banks, using their most recent published annual reports and accounts.[25] Although using data from published reports and accounts has the advantage of having been reviewed by the banks' management, and being largely based on audited financials, it also has many limitations, including the following:

   *(a)* Each bank is organised differently, and there is no common definition of retail banking followed. Banks' divisions include businesses that are not relevant, or exclude the ones, which are relevant to understand financial performance of their UK retail banking operations.

   *(b)* Some banks allocate their common/central costs to their main business divisions or units, while others keep them in a central division.

   *(c)* Where banks have undergone organisational changes, they have not always reported or re-stated prior years' financial data at a divisional level.

   *(d)* Lastly, reported results are affected by the accounting policies and definitions of metrics, each bank follows; some banks present profits and

[23] Ibid. p8.
[24] Ibid. p 4,7.
[25] These are Barclays plc, HSBC Bank plc, LBG, RBS Group (RBS), Santander UK plc.

financial metrics net of what their management considers exceptional or non-recurring items, while others do not.[26]

19. Due to these limitations, financial data and metrics reported in annual reports and accounts may not be directly comparable between banks. That said, financial accounts provide a useful overview of the banks' performance, especially of the evolution of a bank's financial metrics over time. For our analysis, we present financial data for three years 2012 to 2014.[27]

*Divisional structures*

20. Table 1 shows the business divisions or segments of the five largest UK banks that provide retail banking services, including PCA and SME banking. It shows that banks' divisional structures vary considerably, and do not align with the definitions of PCA and SME banking services in our terms of reference. For our analysis, we report results of the main banking divisions in Table 1 that provide retail banking services in the UK.[28]

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[26] These exceptional items can be large (eg PPI remediation), thus increasing the difficulty in comparing financial results across banks.
[27] We would have liked to present data across a wider time period/full economic cycle, but this was not possible due to the lack of comparability between years and banks due to changes in the banks' reporting structure, as the time period increases.
[28] From the divisions listed in Table 1, we exclude from our analysis, LBG's consumer division and Santander's commercial banking division. These divisions contribute a relatively lower proportion of these banks' total income.

### Table 1 : Divisions/business segments included in 'retail banking'

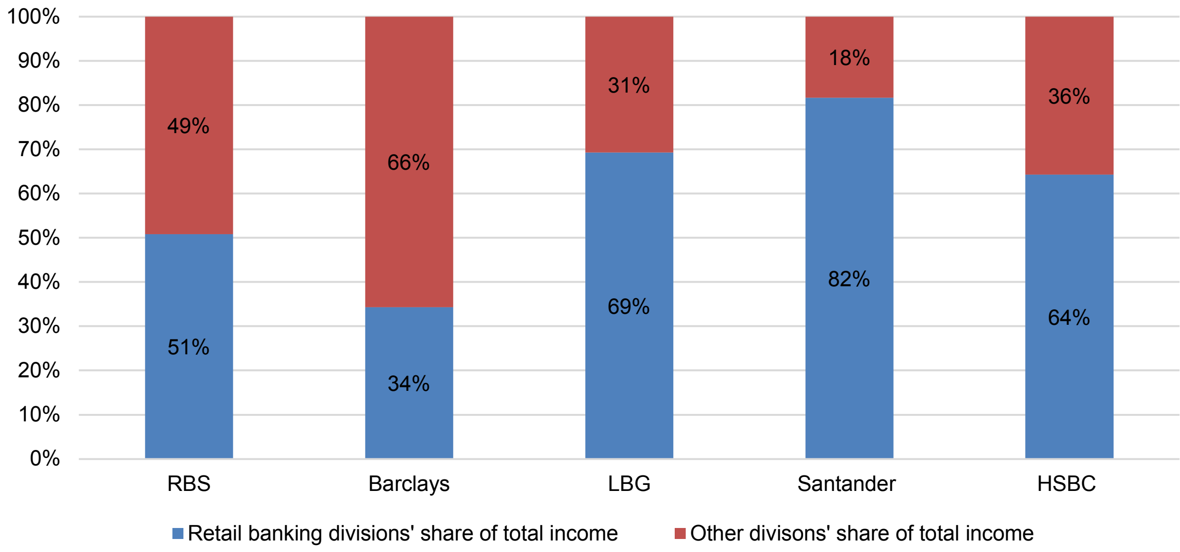
| *Bank* | *Division/segment* | *Activities* | *Geographical focus* | *Comments* |
|---|---|---|---|---|
| **Barclays plc** | PCB | • Personal banking including PCAs<br>• Corporate banking (including SME banking services)<br>• Mortgages<br>• Wealth management | UK & selected international markets | New divisions implemented in May 2014; earlier UK retail banking a separately reported segment |
| **HSBC Bank plc** | RBWM | • PCAs, deposits, lending, advisory, broking, insurance, investment services | UK/Europe | |
| | Commercial banking (CMB) | • Banking services to businesses, including SMEs and large corporates | UK/Europe | |
| **LBG** | Retail | • PCAs, savings, loans and mortgages to personal customers, and SMEs with an estimated annual turnover of less than £1 million and borrowing less than £50,000 | UK | LBG introduced a new divisional structure in January 2014 |
| | Commercial Banking | • Lending, deposits and transaction banking services to large corporates and SMEs with an estimated annual turnover between £1 million and £25 million or borrowing greater than £50,000 | UK | |
| | Consumer | • Asset finance, credit cards to consumer and commercial customers including SMEs | UK | |
| **RBS** | UK PBB | • Range of banking products to personal and private banking customers and smaller businesses with annual turnover of £2 million or less | UK | New divisional structure implemented in February 2014 |
| | Commercial Banking (within Commercial & Private banking (CPB) | • Banking services to UK business customers with an annual turnover of at least £2 million | UK | |
| **Santander UK plc** | Retail banking | • Serves mainly personal banking customers, but also covers SMEs with straightforward banking needs/annual turnover <£250,000 | UK | New reporting segments introduced in 2014 |
| | Commercial Banking | • Serves SMEs with an annual turnover between £250,000 and £50 million | UK | |

Source: Banks' 2014 annual reports, CMA analysis.

21. Figure 2 shows that the 'retail banking' divisions constituted an important source of income for the five largest UK banks. In 2014, these banks on an average, derived close to 60% of their total revenues from the retail divisions.[29]

[29] The share of retail banking income is calculated by dividing total income of retail banking divisions in scope by the total income of the individual banks.

**Figure 2: Share of 'retail banking' divisions' income in 2014**



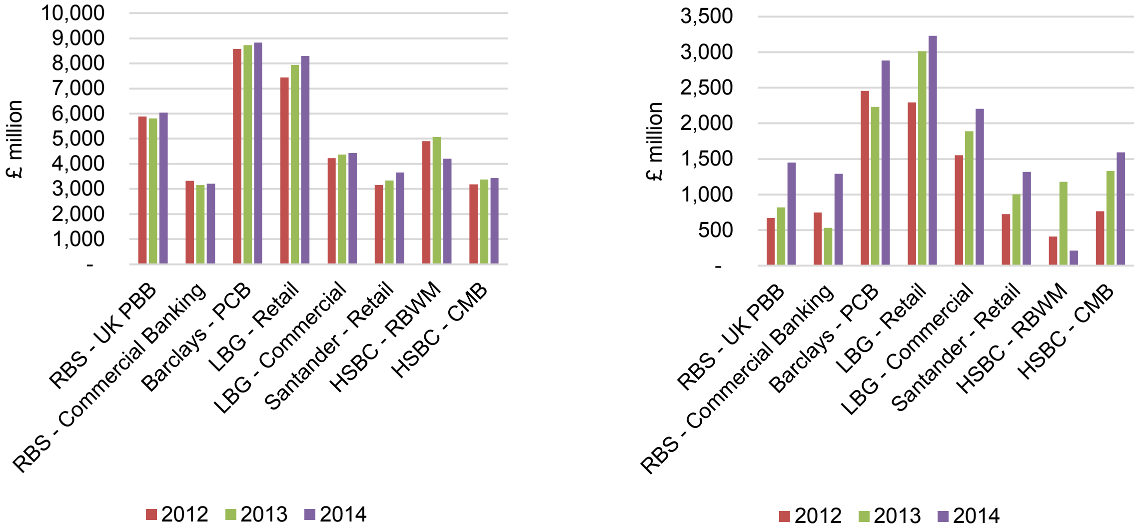

Source: Collated by the CMA based on banks' annual reports.

22. The retail banking divisions across the five banks reported a total income of £42.1 billion and profit before tax of £14.2 billion in 2014.[30] Figures 3(a) and 3(b) show that, while total reported income of the banks has remained relatively stable between 2012 and 2014, the reported profit has, in general, shown an upward trend during this period.[31] [32]

[30] Based on the banks' 2014 annual reports.
[31] Profit before tax reflects the following in banks' published accounts: RBS – Operating profit; Barclays plc – Profit before tax; LBG – Underlying profit; Santander UK plc – Profit on continuing operations before tax; HSBC Bank plc – Profit before tax.
[32] Appendix 1 provides a summary of the recent financial performance of the retail banking divisions in scope of our analysis.

**Figure 3: Income and profit before tax – retail banking divisions**[33]

**3(a) Total income** **3(b) Profit before tax**



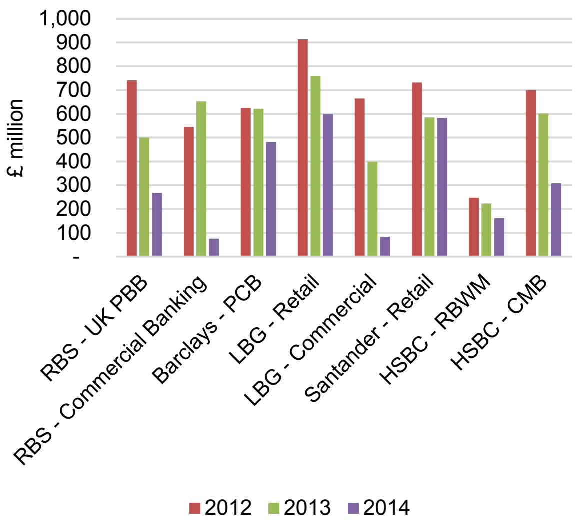

Source: Collated by the CMA based on the banks' annual reports.

23. Figure 4(a) shows that impairments and other provisions for the retail banking divisions declined sharply during 2012 to 2014. As shown in Figure 4(b), in aggregate, impairments of these divisions fell by 50% from around £5.2 billion in 2012 to around £2.6 billion in 2014.[34]

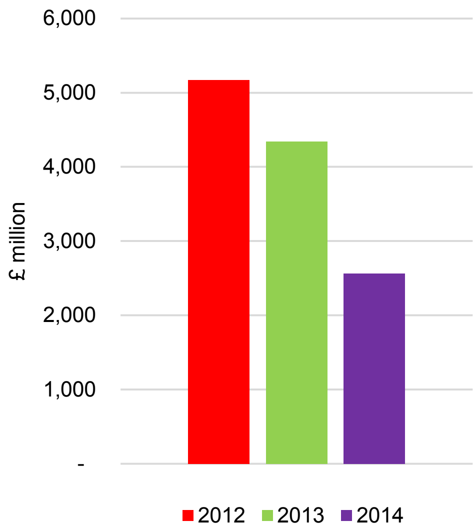
[33] Due to different business activities and geographies included in these divisions, the absolute level of the reported total income and profits are not directly comparable between banks.
[34] Description of 'impairments and other provisions' is as follows: RBS – Impairment losses; Barclays plc – Credit impairment charges and other provisions; LBG – Impairment; Santander UK plc – Impairment losses on loans and advances, provisions for other liability and charges; HSBC Bank plc – Loan impairment charges and other credit risk provisions. Source: Banks' annual reports.

**Figure 4: Impairments and provisions, 2012 to 2014**

**4(a) By bank/division**




**4(b) Retail banking divisions (total)**




Source: Banks' annual reports, CMA analysis.

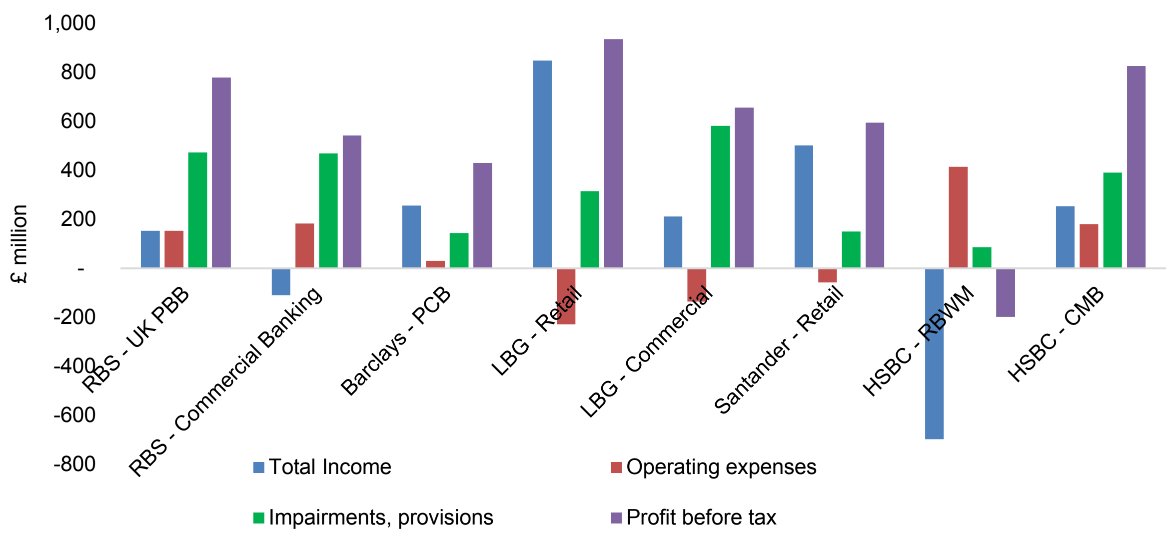
24. Figure 5 shows the components of change in the retail banking divisions' reported profits during 2012 to 2014.

25. Figure 5(a) shows that all banks gained because of lower impairments during this period. Figure 5(b) shows that in aggregate, the £4.6 billion increase in profits between 2012 and 2014 for the retail banking divisions was largely contributed by lower impairments and provisions (£2.6 billion), and to a lesser extent by higher total income (£1.4 billion) and lower operating costs (£0.6 billion).

26. Thus, changes in impairment charges accounted for over half of the profit changes during this period.

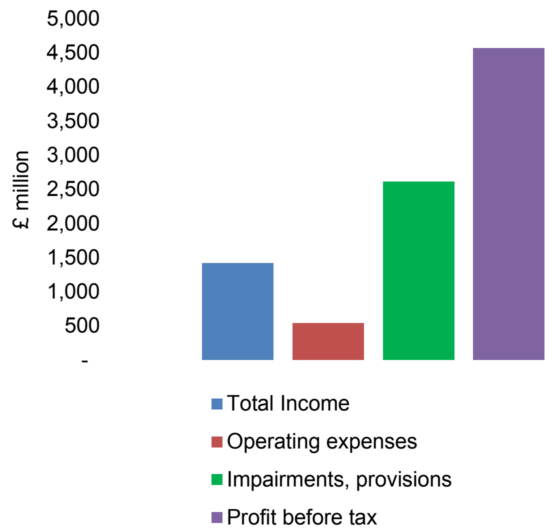
**Figure 5: Components of change in profit before tax between 2012 and 2014**

**5(a) Change in profit before tax by bank/division**




Source: Banks' annual reports, CMA analysis.
Note: Positive values in the chart represent higher income, lower operating expenses and impairments, provisions, in 2014 compared to 2012 (and vice versa for negative values).

**5(b) Change in profit before tax for retail banking divisions (total)**




Source: Banks' annual reports, CMA analysis.

27. We now present summary charts showing financial metrics during the period 2012 to 2014 for the following divisions of the five largest UK retail banks:

(a) Barclays plc – PCB;

(b) HSBC Bank plc – RBWM and CMB;

(c) LBG – Retail banking and Commercial Banking;

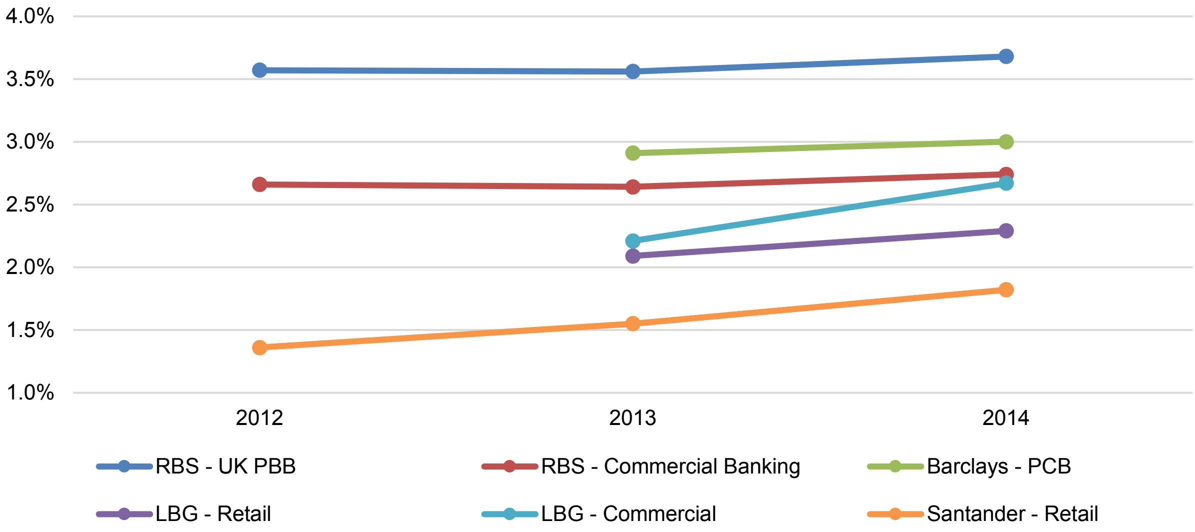
(d) RBS – UK PBB and Commercial Banking; and

(e) Santander UK plc – Retail.

28. As noted earlier in the paper, due to the limitations in respect of the financial data, these metrics may not be directly comparable between banks, but the observed trend can provide an insight into banks' financial performance during this period.

*Net interest margin (NIM)*[35]

**Figure 6: Net interest margin**




Source: Banks' annual reports, CMA analysis.
Note: NIM for HSBC RBWM and CMB not reported in published accounts. 2012 NIM for Barclays PCB not reported in published accounts. 2012 NIM for LBG Retail and Commercial Banking not reported in published accounts. NIM for Santander Retail is for Santander UK plc.

29. Figure 6 shows that average NIM ranged between 1.5% and 3% during the period 2012 to 2014 except for RBS UK PBB, which had an average NIM of 3.6% during this period. NIM for the banks was either stable or showed an upward trend, with an increase in the overall average for all banks from 2.5% in 2012 to 2.7% in 2014.

30. The average NIM presented here are broadly similar to those reported by DB, which found the UK retail banking average NIM to be 2.4% during 2012 and 2013.[36]

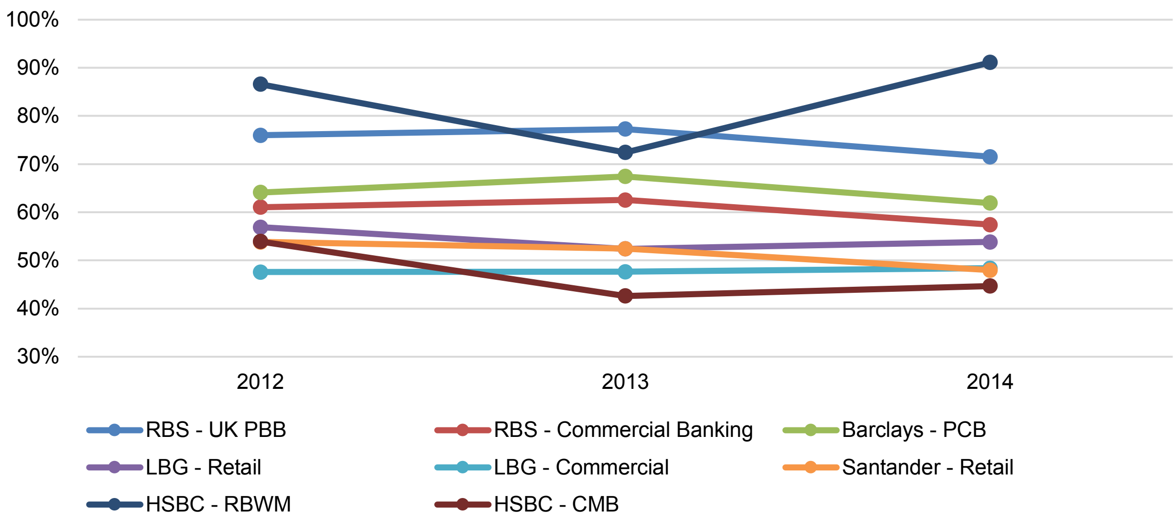
[35] NIM is a key performance metric used in retail banking, and in general terms, refers to the spread earned between lending and borrowing costs. The reported data is based on each bank's definition of NIM.
[36] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p 5. This report did not cover 2014 performance.

31. KPMG in its analysis of 2014 financial results of the five large UK-headquartered banks reported that the predominantly UK-focused banks achieved an improvement in NIM due to re-pricing deposits and targeting specific customer portfolios.[37] According to KPMG, the average NIM of the five banks it analysed was 2.13% in 2014 compared to about 2.1% in 2013 and about 2.07% in 2012.[38]

32. A 2015 report by A T Kearney noted that interest margins for retail banks in Western Europe had been affected by low interest rates, and should remain so as long as the central banks keep the reference rates at historical lows.[39] Similarly, a Bank of England working paper found that high interest rates were associated with large interest income margins.[40]

*Cost income ratio*

**Figure 7: Cost income ratio**




Source: Banks' annual reports, CMA analysis.
Note: Cost reflects the following in banks' published accounts: Barclays plc – Total operating expenses; HSBC Bank plc – Total operating expenses; LBG – Total costs; RBS – Operating expenses; Santander UK plc – Total operating expenses.

33. As Figure 7 shows, there was a general downward trend in the cost income ratio, which declined for all retail banking divisions except HSBC's RBWM and LBG commercial divisions during the period 2012 to 2014. The average of

[37] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?* p11.
[38] Ibid. KPMG reported average NIM in basis points (bps), a unit that is equal to 1/100 of 1%. The reported NIMs in bps were 213.0 for 2014, 209.9 for 2013 and 206.6 for 2012.
[39] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p7.
[40] According to the paper, 'In the long run, both level and slope of the yield curve contribute positively to [banks'] profitability. In the short run, however, increases in market rates compress interest margins, consistent with the presence of non-negligible loan pricing frictions'. Bank of England (2012), Working Paper No. 452: Simple banking: profitability and the yield curve. Abstract to the paper.

cost income ratios of all retail divisions, declined from about 63% in 2012 to about 60% in 2014.[41]

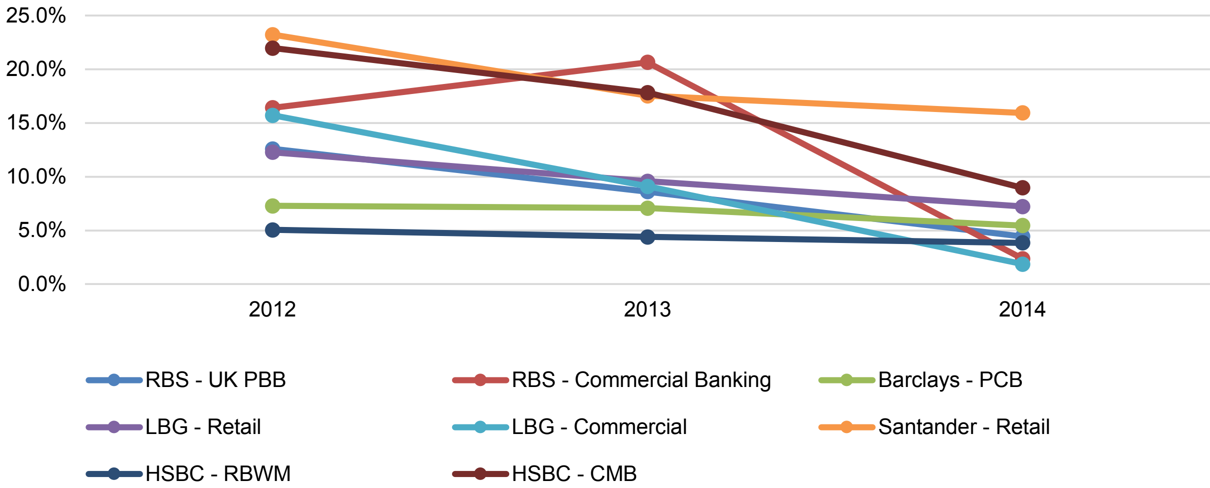
34. According to a recent KPMG report, the average cost income ratio for the 'Big Five' UK banks was 63% in 2014, which was similar to that of 'Challengers' (excluding NAB) at 64%.[42] Further, the report stated that smaller challengers produced a much lower cost income ratio of 53% in 2014, which according to the report could be down to a range of factors, including a number of one-off costs offset by a simpler business model and product set.[43]

35. A 2015 report by A T Kearney concluded that bringing European retail banks' profitability to pre-crisis level would require a significant reduction in their cost income ratios.[44]

[41] Based on 'adjusted' results reported by HSBC Bank plc, the adjusted cost income ratio for its RBWM division was much lower than the reported ratio – 66%, 62% and 68% in 2012, 2013 and 2014 respectively. The adjustments mainly related to customer redress costs, and provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK. HSBC Bank plc annual reports 2014 (p18), 2013 (p16).
[42] Large challengers included in the analysis were Bank of Ireland UK (Post Office), National Australia Bank, TSB and Virgin Money. Small challengers were Aldermore Group, Handelsbanken, Metro Bank, OneSaving Bank, Shawbrook Group and Secure Trust Bank. 'Big Five' UK banks included in the study were Barclays, HSBC, Lloyds Bank, RBS and Santander (UK subsidiary). The KPMG (2015), *The game changers – Challenger Banking Results*, p3 & 22.
[43] Ibid. p3.
[44] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p12.

*Impairments and other provisions*

**Figure 8: Impairments and other provisions as % of total income[45]**




Source: Banks' annual reports, CMA analysis.
Note: Impairments and other provisions reflect the following in banks' published accounts: Barclays plc – Credit impairment charges and other provisions; HSBC Bank plc – Loan impairment charges and other credit risk provisions; LBG – Impairment; RBS: Impairment losses; Santander UK plc – Impairment losses on loans and advances, provisions for other liability and charges.

36. As Figure 8 shows, the percentage of impairments and other provisions to total income saw a decline for all banks during 2012 to 2014. For all retail banking divisions taken together, this percentage declined from an average of 14% in 2012 to about 6% in 2014.[46]

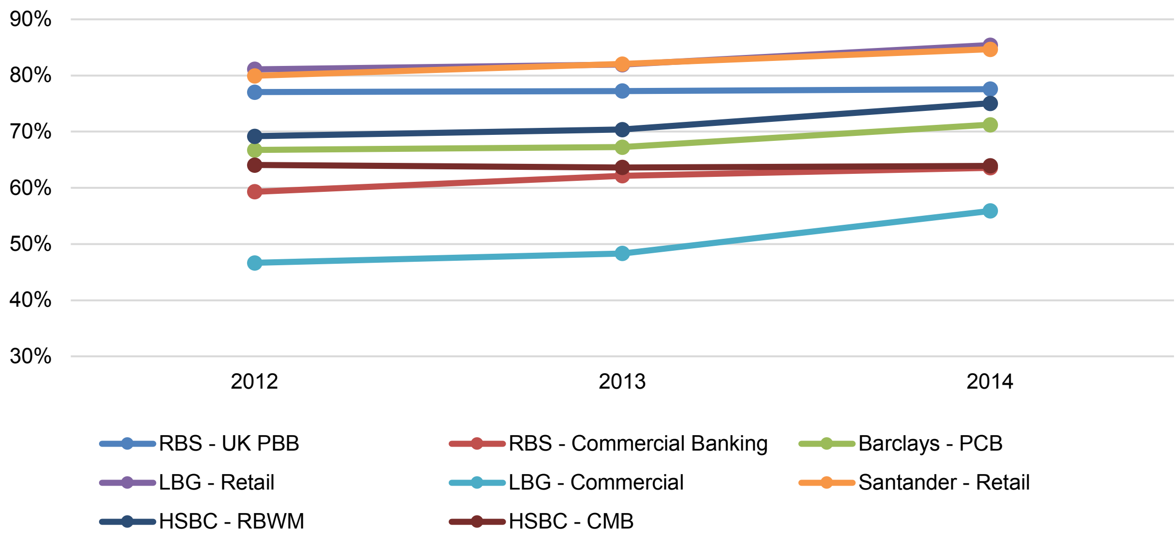
37. The trend of decline in impairments was also observed by KPMG which stated that 'This year's [2014] [annual] reports confirm that strengthening economic conditions have helped to reduce the impairment charges…'[47]

38. As we noted earlier, lower impairments driven by economic recovery in the UK, were the biggest contributor to improved reported profits of the UK retail banking divisions between 2012 and 2014.

[45] [✂] told us that this measure was an uninformative metric; it told us that impairments were driven by customers' credit quality and lending balances, whereas total income was driven by customers' credit and debit balances. We considered that, given the data we had to hand, our measure was nonetheless a useful metric, especially to understand impairment trend for a bank over time.
[46] After excluding 'provisions for other liability and charges', Santander Retail's 'impairment losses on loans and advances' were much lower at 5.1% of total income in 2014, and about half of what it reported for 2013. Figures are based on Santander UK plc 2014 annual report, p193.
[47] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?*, p13.

### *Share of net interest income*

**Figure 9: Net interest income as % of total income**




Source: Banks' annual reports, CMA analysis.

39. Figure 9 shows that net interest income to total income ratio for the retail banking divisions increased from an average of 68% in 2012 to about 72% in 2014.

40. This upward trend was corroborated by a 2014 CS report, which stated that the share of interest income in UK retail banks' total income had increased significantly – from 65% in 2008 to around 75% in 2013.[48] According to CS, beyond cyclical trends, 'there has been a more structural shift in the industry's ability to generate peripheral revenues beyond pure interest-related income.'[49]

41. A T Kearney made a similar point in a recent report, noting that the share of net interest income relative to total income for European retail banks continued to be above pre-financial crisis level, as banks struggled to increase fee-based revenues.[50] It stated that 'Different regulations, such as free current accounts, lending fee limitations, and caps on interchange fees, have impacted (and will continue to impact) banks' ability to generate fee-based revenues.'[51] A T Kearney also reported that the share of net interest income in UK retail banks' total income was the highest in Europe at 82%.[52]

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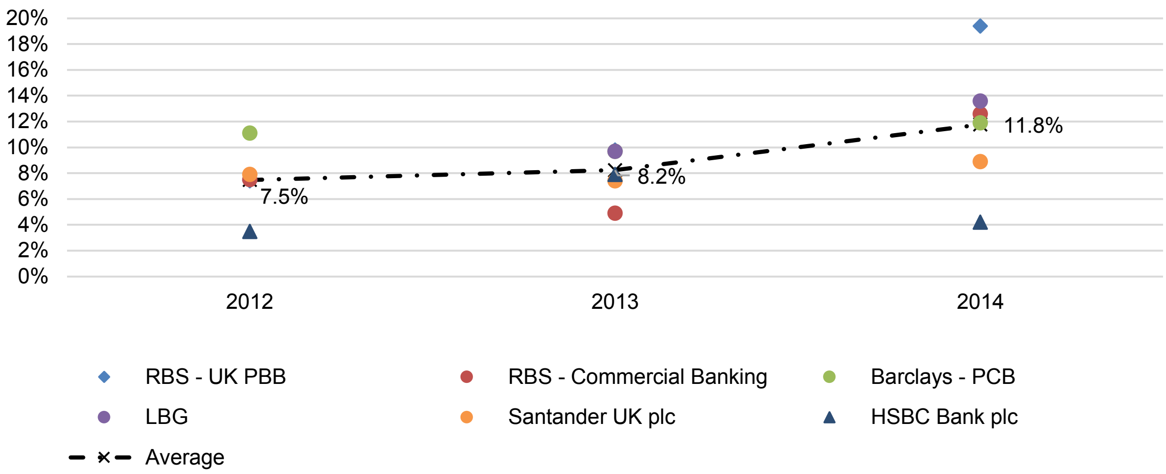
[48] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 14.
[49] Ibid.
[50] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p4.
[51] Ibid.
[52] Ibid, p7.

*Return on equity (ROE)*

42. ROE is a commonly used performance metric used by many retail banks in the UK. However, the methodology used to calculate the ROE, and the disclosure of ROE at divisional level in the published accounts varies across banks. Some banks report ROE only at the group rather than divisional level. Some banks report ROE on a statutory basis, while others also report ROE after making adjustments for exceptional or non-recurring items. As a result, there are comparability issues regarding the ROE reported by banks.[53]

43. Despite these limitations, the trend of ROE can provide an insight into banks' financial performance over a given period. In Figure 10, we present ROE of the five largest UK retail banks during 2012 to 2014, as reported in their annual reports. The reported ROE is for the retail banking divisions where available, or for the bank as a whole.[54]

**Figure 10: Return on equity**




Source: Banks' annual reports.
Note: LBG ROE for 2012 not available in published accounts.

44. Figure 10 shows that reported ROE for retail banking divisions improved during 2012 to 2014. The average reported ROE for all divisions increased from 7.5% in 2012 to 11.8% in 2014.

[53] We also note that ROE is an accounting based performance measure, and only one of the indicators of the banks' underlying profitability.
[54] We present data as presented by banks in published annual reports, which reflects their definition and calculation methodology. Barclays ROE reflects PCB's 'Return on average equity', Barclays plc 2014 annual report, p233. HSBC ROE reflects HSBC Bank plc's 'Return on average shareholders' equity of the parent company', HSBC Bank plc 2014/2013 annual reports, p1. LBG ROE reflects LBG's 'Underlying return on required equity', LBG 2014 annual report, p39. RBS ROE reflects respective division's 'Return on equity', RBS 2014 annual report, pp130, 138. Santander ROE reflects Santander UK plc's 'Return on ordinary shareholders' funds', Santander UK plc 2014 annual report, p355.

45. We also looked at estimates of ROE in selected industry and analyst reports. These are discussed below.

46. According to Oliver Wyman, the ROE for retail and business banking in the UK (after excluding PPI redress costs) in 2013 was 20.9%, which was higher than ROE of 19.6% in 2012.[55] [56] Oliver Wyman reported that there were notable differences between the ROE for 'individuals' and 'small business' segments within retail banking; in the UK, the 2013 ROE (excluding PPI redress) for these segments was 24% and 15% respectively.[57] Oliver Wyman stated that cost reduction provided the main lever for profit improvement in the near term in many markets.[58]

47. According to CS, the 'Adjusted' ROE of UK retail banks was approximately 9.9% in 2013 compared to the reported 'clean' ROE of 13.2%, after including the below-the-line items of which a significant portion had become a more recurrent feature of UK retail banking.[59]

48. KPMG in its analysis of 2014 financial results of five UK-headquartered banks stated that although profitability of the five banks had increased in 2014 compared to 2013 driven by lower loan impairments and conduct costs, none of the banks achieved a ROE of higher than 8%. It also pointed out that costs remained high on the agenda for UK banks, and that banks were going through optimisation programmes.[60]

49. According to a recent (2015) report by EY, UK bankers anticipate that the industry will report an average ROE of 9.5% in 2015, which would lead the UK banks to cover their cost of equity (approximately 9.1%) for the first time in six years.[61,62]

[55] Oliver Wyman defined ROE as total profit after tax divided by equity. ROE was normalised with capital calculated as a percentage of risk-weighted assets, represented by the average of the Top 5 banks Core Tier 1 ratio. Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, pp3–4, p24.
[56] In a 2012 report, *Perspectives on the UK Retail Banking Markett*, Oliver Wyman stated that major, full-service retail banking providers were returning about 20% on equity (when removing exceptional charges), p4. Appendix 3 provides ROE from 2004 to 2011 as calculated by Oliver Wyman for UK retail and small business banking. 2011.
[57] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p5.
[58] Ibid. p4.
[59] These items included bank levies, customer redress and litigation, reinvestment spend and higher capital requirements. Credit Suisse UK Retail Banking Seminar. 14 July 2014. Slides 6 & 7.
[60] The ROE represented return on average shareholder's equity for all banks except for RBS, which represented return on tangible equity, Lloyds which reported return on required equity and SCB, which reported ROE on an underlying basis, KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?,* pp9–10.
[61] EY (2015), European Banking Barometer.
[62] A report by the ABI in 2012 had suggested that the cost of equity for retail banking business was in the range of 8% to 10%. ABI (2012), *Investibility of UK Banks*, p6.

50. Thus, the ROE estimates in different reports we referred to, varied substantially. The 2014 Oliver Wyman report stated that the retail banking industry in the UK has earned high (around 20%) ROE in the recent years after excluding exceptional items such as PPI redress costs. Estimates provided by other reports (eg EY, CS and KPMG) were relatively lower, in the range of about 8% to 13%.[63] Some of the reasons for the differences between these estimates could be due to a combination of the following:

*(a)* Treatment of conduct penalties and charges; for example Oliver Wyman's report excluded PPI redress, while KPMG used the reported results of the banks, which would have included the effect of conduct penalties and charges.

*(b)* Coverage: for example CS's report covered 13 UK retail banks, while Oliver Wyman's report covered 'the total retail and small business banking activity [in the UK]…provided by both local and foreign banks' in a country.[64]

*(c)* Methodology: for example, Oliver Wyman reported ROEs 'normalised' with capital calculated as a percentage of risk-weighted assets, represented by the average of the Top 5 banks Core Tier 1 ratio in each country; other reports did not appear to make a similar adjustment.

51. Due to the differences in definitions and methodology to calculate the banks' ROE in different reports, we cannot make any definitive conclusions about the relative profitability of the retail banks in the UK from the data presented here. However, we note from our analysis, that overall, the retail banks' reported ROE (and therefore profitability) has improved during 2012 to 2014, as banks continue to recover from the financial crisis, and gain from lower impairment costs.

*Conclusion on retail banking financial performance*

52. Overall, the general highlights of the financial performance of the retail banking divisions of the largest five UK banks during 2012 to 2014 were:

*(a)* stable total income;

*(b)* stable or increasing NIM;

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[63] Our analysis (Figure 10) showed that UK retail banks' average reported ROE during 2012 to 2014 was about 9%.
[64] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p23.

*(c)* declining cost income ratio and impairments;

*(d)* improving profits and returns; and

*(e)* declining share of non-interest income in banks' total income.

## PCA and SME banking performance

53. We examined the revenues and margins of the eight largest banks' PCA and SME banking businesses,[65] using the financial data collected from banks. We set out our analysis on PCAs first, then SME banking.

54. Due to issues surrounding the allocation of costs we considered that examining a full profit and loss account for the PCA and SME operations would not be appropriate, so we have focused on an analysis of revenues, and an examination of impairments.

55. The financial data was originally collected in order to carry out the market-wide profitability analysis and as such cannot be segmented (for example, between larger and smaller SMEs, or between different types of PCA customers). Further, we were not able to undertake an analysis of the banks' PCA and SME banking businesses by devolved nation because the banks did not collect, analyse or present the data to us, in this way.

56. In this section, where we refer to any named bank, we are referring to its PCA and/or SME banking business only, and not the whole of its UK banking operations or its UK retail banking operations.

### *PCA*

*Total revenues and number of accounts*

57. Figure 11 shows total PCA revenues[66] by bank, 2011 to 2014 for the eight largest banks.[67] PCA revenues for the eight largest banks totalled £7.44 billion in 2014. There was a small decline in PCA revenues between 2011 and 2014: most significant during this period was the separation and subsequent divestiture of TSB from LBG (LBG excluded TSB from the PCA figures it submitted to us from 2013 onwards).

58. [✂] can be seen as the largest provider of PCAs with [✂] second and [✂] third. After [✂] and [✂], there is a big gap in size between the five larger

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[65] Nationwide does not provide SME banking services.
[66] Includes value of funds.
[67] Data missing for [✂] in 2011 – not provided to CMA.

banks and the smaller three. Apart from the decline in LBG’s revenues between 2011 and 2012, and between 2012 and 2013 after adjusting for the exclusion of TSB, each bank’s PCA revenues do not show much change between years.

**Figure 11: PCA revenues by bank, 2011 to 2014, £m**

[✂]

Source: CMA analysis based on data provided by the parties.

59. Figure 12 shows the average number of PCAs by bank, 2011 to 2014 for the eight largest banks.[68,69] We looked at main accounts only, which we define as one with average credit inflow of more than £500/month.[70]

60. Size of bank ranked by number of accounts is the same as by total revenues. [✂] and [✂] are very similar in size by number of accounts.

**Figure 12: Average number of PCA accounts by bank, 2011 to 2014**

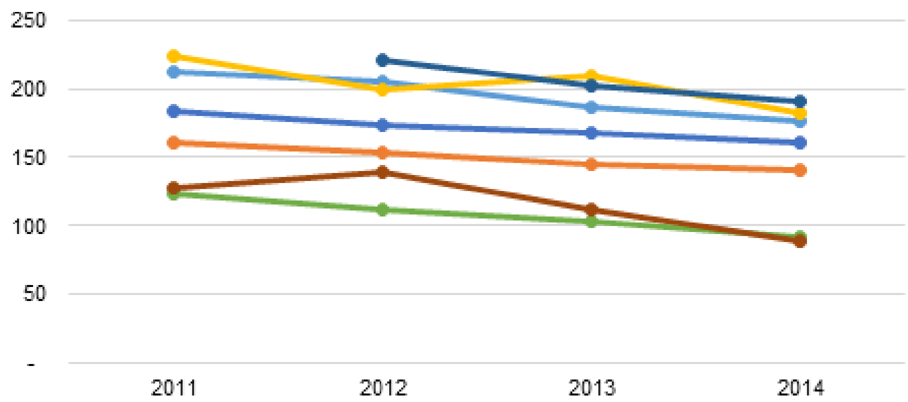
[✂]

Source: CMA analysis based on data provided by the parties.

*Average revenues per account*

61. Figure 13 shows average revenues per PCA,[71] for 2011 to 2014 for the eight largest banks.[72,73]

**Figure 13: PCA average revenues by bank, 2011 to 2014, £**




Source: CMA analysis based on data provided by the parties.
Note: One bank has been excised from this figure.

[68] Data missing for [✂] in 2011 – not provided to CMA.
[69] [✂] data is not shown for 2011 and 2012 because the data provided was not internally consistent: [✂].
[70] [✂] questioned our use of ‘main accounts’ instead of all accounts on the basis that it earned income on all accounts. Our approach normalises revenues and as such we do not need to make adjustments between banks for the proportion of non-main accounts held.
[71] Main accounts only, and includes value of funds.
[72] Data missing for [✂] in 2011 – not provided to CMA.
[73] [✂] data is not shown for 2011 and 2012 because the data provided was not internally consistent: [✂].

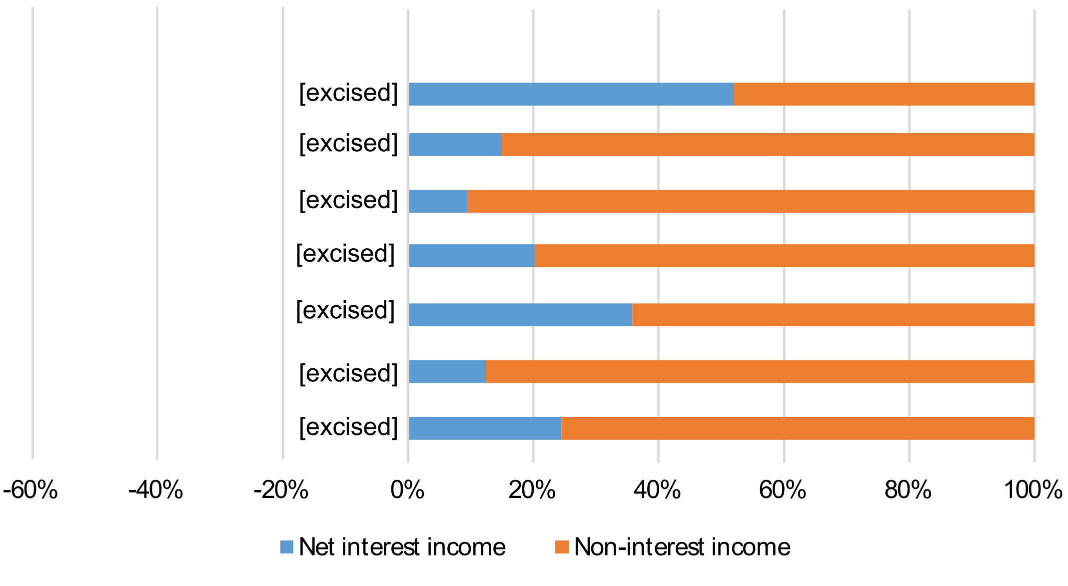
62. PCA average revenues declined over the period for all banks. This appears to be partly due to the increase in the average number of accounts (see Figure 12 above), as well as the slight decrease in total revenues for most banks (see Figure 11 above).

63. In general, larger banks have higher average revenues (with the exceptions of [✂] and [✂]).

*Total PCA revenues by source*

64. We assessed the split of revenues for each bank, between net interest income and non-interest income. Net interest income is comprised of interest income less interest paid; non-interest income is comprised of fees from overdrafts, packaged accounts, returned items and VISA/ATM charges. We excluded amounts relating to value of funds: we noted that funds transfer pricing arrangements are necessarily provider specific and will reflect each provider's individual circumstances, including its balance sheet position, credit rating and possibly its business strategy. We totalled each bank's revenues over the four-year period (three years for [✂], as 2011 data was not provided), and examined the split between net interest income and non-interest. Figure 14 shows PCA revenues by source, for 2011 to 2014.

**Figure 14: PCA revenues by source, 2011 to 2014**




Source: CMA analysis based on data provided by the parties.
Note: One bank has been excised from this figure.

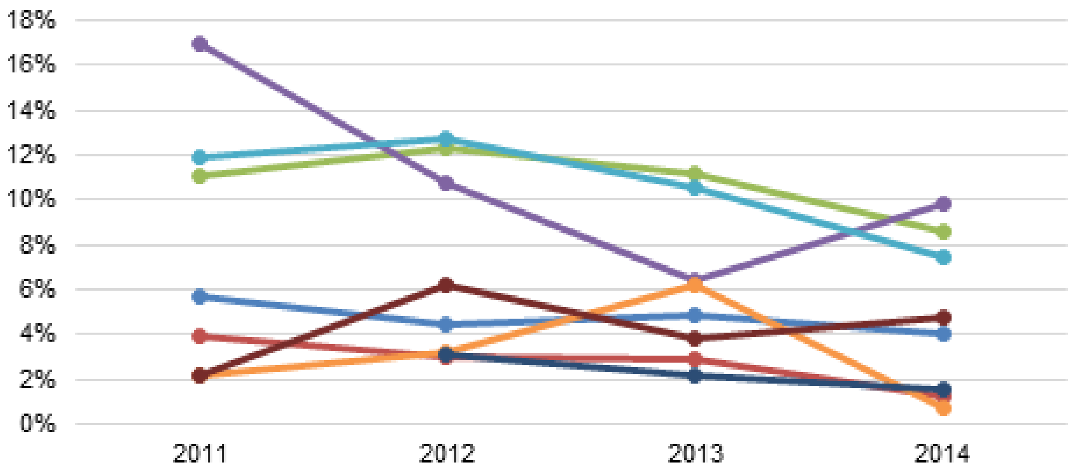
65. In general, non-interest income makes up a large proportion of PCA revenues, and a larger proportion of PCA revenues for the smaller banks than the larger ones ([✂] is an exception).[74] [✂]

66. However, banks appear to treat interest and non-interest income differently. We expected to see amounts relating to fees in non-interest income. [✂] told us that it included overdraft fees in customer interest receivable to ensure total net interest income reconciled to its management accounts, in line with published accounting policies. This includes recognition of fees within net interest income where appropriate and required using the effective interest rate method. RBS stated that from 2011 it transferred [✂]. This appears to reflect the underlying nature of some elements of non-interest income.

*Impairments*

67. We looked at impairments as a percentage of revenues, including value of funds.[75] Impairments are credit and first party (customer) fraud losses.[76] Figure 15 shows the impairment rate for each of the eight banks, for 2011 to 2014.

**Figure 15: PCA impairments as a proportion of total revenues, 2011 to 2014**




Source: CMA analysis based on data provided by the parties.

[74] [✂] told us that amounts included in other income (non-interest income) related to internal financial management of the PCA balances, rather than direct customer interest payable or receivable or funds transfer pricing. [✂] financial data response included line items for customer interest and funds transfer pricing for the deposits and lending income sections; all remaining net interest income was included in 'other income'.
[75] [✂] told us that this measure was an uninformative metric to compare between providers: it told us impairments were driven by customers' credit quality and lending balances, whereas total income was driven by customers' credit and debit balances. We considered that, given the data we had to hand, our impairment measure was nonetheless a useful metric.
[76] Third party fraud losses are included in direct costs.

68. In general, impairment rates improved over the period and by 2014 were, for all banks, just under 10%.[77] This appears to reflect in part an improving macro-economic environment resulting in lower provision levels than in previous years. There appears to be two broad groupings among the eight banks: [✂] and [✂] with higher impairments, and [✂], and [✂][78] with lower impairments (the last three have particularly low rates).

69. We asked the banks about their treatment of impaired borrowing and unsettled fees and charges. The banks told us that amounts (both borrowing and fees), whether authorised or unauthorised, were all impaired/written off at the same rate and included in impairments, with some minor exceptions.[79]

### *SME banking*

*Total revenues and number of accounts*

70. Figure 16 shows total SME revenues[80] by bank, 2011 to 2014 for the seven largest banks.[81] There was a very small decline in total SME revenues over the period (approximately 0.6%).[82]

71. SME revenues for the seven largest banks totalled £7.1 billion in 2014.

72. [✂] can be seen as the largest provider for SME services with [✂] and [✂] second and third. [✂] and [✂] are the smallest of the seven banks. Although [✂] shows an average annual decline of approximately 4%, the other banks' revenues do not show much change between years.

**Figure 16: SME revenues by bank, 2011 to 2014, £m**

[✂]

Source: CMA analysis based on data provided by the parties.

[77] The impairment rate for [✂] declined steeply between 2011 and 2013 and rose in 2014. [✂] told us that the decline from 2011 was mainly due to lower defaults, and that the small increase in 2014 was due to 2013 including higher one-off adjustments from provision adequacy (balance sheet) adjustments in 2013 than in 2014.
[78] [✂] told us that the increase in 2013 was due to methodological changes to credit model parameters on loss rates, and that the figures prior to 2014 included fraud costs.
[79] The banks told us about the following exceptions, where write-offs were against revenues instead of impairments: [✂] told us that it refunded fees/charges queried by a customer in branch, etc against revenue (instead of impairments); [✂] told us that it made write-offs against revenue (instead of impairments) to derecognise unsettled accrued fee income on an account which defaulted; [✂] told us that, for customers who were not in collections or recoveries, where [✂] charged a fee that was subsequently waived or refunded, it would be debited to revenues instead of to impairments ([✂] told us that fees were suspended for customers in collections or recoveries, as [✂] would not expect to collect this and therefore it was not recognised in income).
[80] Includes value of funds.
[81] Data missing for [✂] and [✂] in 2011 – data not provided to CMA. Nationwide does not provide SME services.
[82] 2011 to 2014 excluding [✂] and [✂] data; 2012 to 2014 including [✂] and [✂] data.

73. Figure 17 shows average number[83] of unique SME customers, for 2011 to 2014 for the seven largest banks.[84,85] With the exception of [✂] and [✂], and [✂] and [✂], whose ranks swap around, size of bank ranked by number of accounts is the same as by total revenues.

**Figure 17: average number of unique SME customers, 2011 to 2014**

[✂]

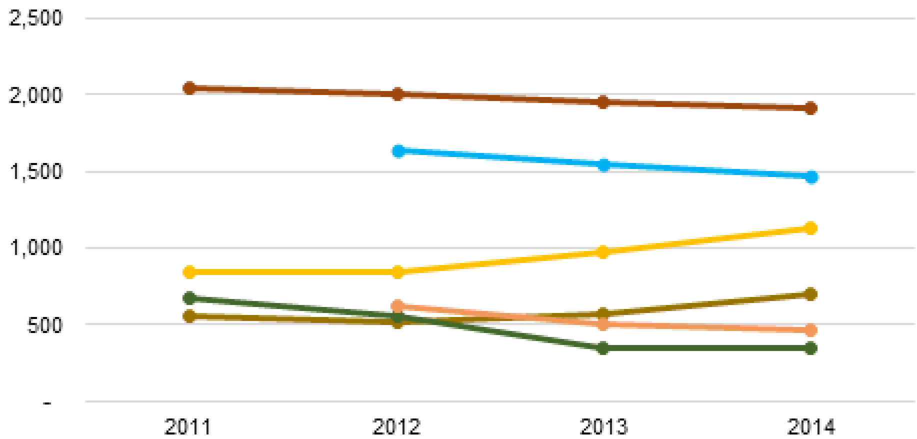
Source: CMA analysis based on data provided by the parties.

*Average revenues per unique customer*

74. Figure 18 shows average revenues per unique SME customer, 2011 to 2014 for the seven largest banks.[86,87]

75. Overall, average revenues declined over the period, although [✂] and [✂] showed an increase. There is a difference in average revenues between [✂].

**Figure 18: Average revenues per unique SME customer, 2011 to 2014, £**




Source: CMA analysis based on data provided by the parties.
Note: One bank has been excised from this figure.

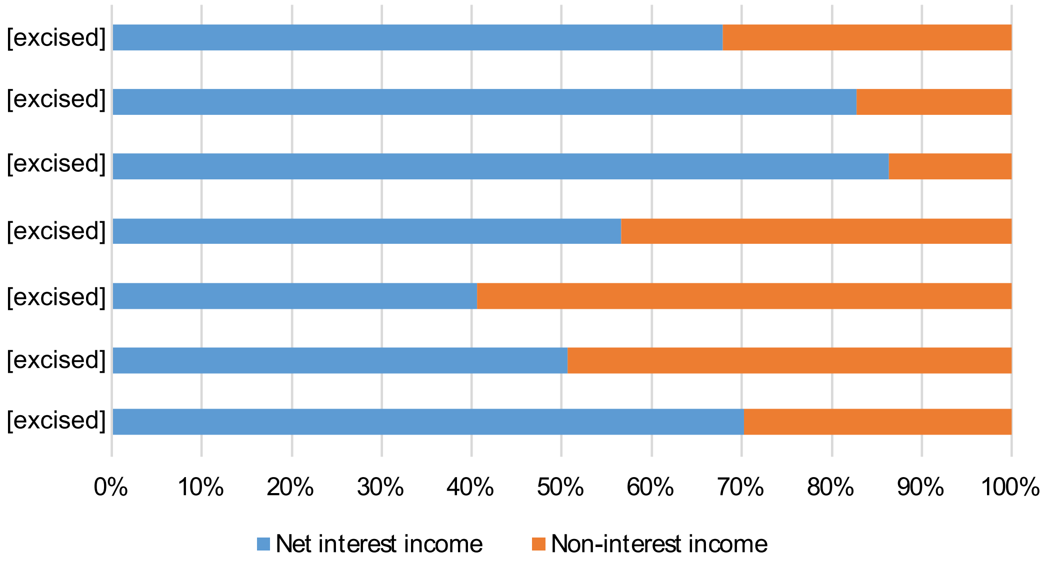
*Total SME revenues by source*

76. We looked at the split of revenues for each bank, between interest income and non-interest income. As explained in paragraph 64, net interest income is comprised of interest income less interest paid; non-interest income is comprised of fees from overdrafts, packaged accounts, returned items and VISA/ATM charges. We excluded amounts relating to value of funds for the

[83] Average number of unique SME customers.
[84] Data missing for [✂] in 2011 – data not provided to CMA.
[85] [✂] data is not shown for 2011 to 2013 because the data provided was not internally consistent: [✂].
[86] Data missing for [✂] and [✂] in 2011 – data not provided to CMA.
[87] [✂] data is not shown for 2011 to 2013 because the data provided was not internally consistent: [✂].

same reason set out in paragraph 64. We totalled each bank's revenues over the four-year period (three years for [✂] and [✂], as 2011 data was not provided), and examined the split between net interest income and non-interest. Figure 19 shows the proportion of total SME revenues by source, for 2011 to 2014.

**Figure 19: Split of total SME revenues by source, 2011 to 2014**




Source: CMA analysis based on data provided by the parties.

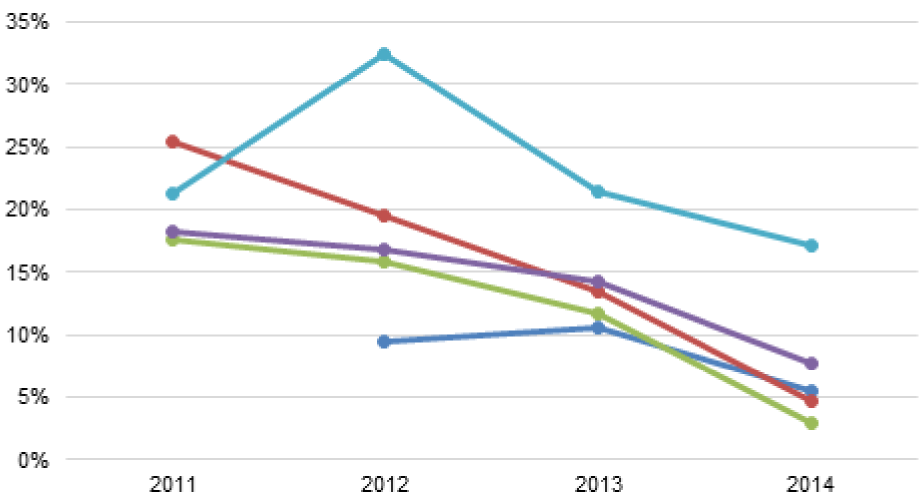
77. There appears to be no relationship between size of bank and proportion of net interest income from SMEs. As stated in paragraph 66, banks appear to treat net interest and non-interest income differently: for example [✂] told us that it amortised overdraft fees to the balance sheet and released them to the profit and loss account in net interest income.

*Impairments*

78. We looked at impairments as a percentage of revenues, including value of funds. Figure 20 shows the impairment rate for five banks, 2011 to 2014.[88] There is an overall improvement in impairment rates, which appears to track the recovery of the UK economy. [✂] told us that the peak in impairment rate in 2012 mainly related to the loss crystallisation on loans arising from the prolonged downturn. It told us that in particular, 2012 impairments were reflective of losses from loan vintages written before the financial crisis for 2008 which, typically, had an effective term of five years. Impairment losses in the years following 2012 had been lower, reflecting the actions taken by [✂] to work out, exit or restructure substandard and non-performing loans.

[88] [✂] (2012) and [✂] (all years): data excluded as anomalous; [✂]: 2011 data not provided to CMA.

**Figure 20: SME impairments as a proportion of total revenues, 2011 to 2014**




Source: CMA analysis based on data provided by the parties.

### *Conclusion on PCA and SME financial information*

79. We note the following in relation to PCAs for the eight largest banks we examined:

*(a)* There was a small decline in total revenues between 2011 and 2014.

*(b)* Size of bank ranked by number of accounts is the same as rank by total revenues.

*(c)* Average revenues per account declined over the period.

*(d)* In general, the larger banks have higher average revenues than the smaller banks (with the exceptions of [✂] and [✂]).

*(e)* In general, non-interest income makes up a large proportion of PCA revenues, and a larger proportion of PCA revenues for the smaller banks than the larger ones.

*(f)* In general, impairment rates improved over the period.

80. We note the following in relation to SME banking for the seven largest banks we examined:

*(a)* There was a very small decline in total revenues between 2011 and 2014.

*(b)* With the exception of [✂] and [✂], and [✂] and [✂], whose ranks swap around, size of bank ranked by number of accounts is the same as rank by total revenues.

*(c)* Average revenues per unique SME customer declined over the period, with the exceptions of [✂] and [✂].

*(d)* There is a difference in average revenues between [✂].

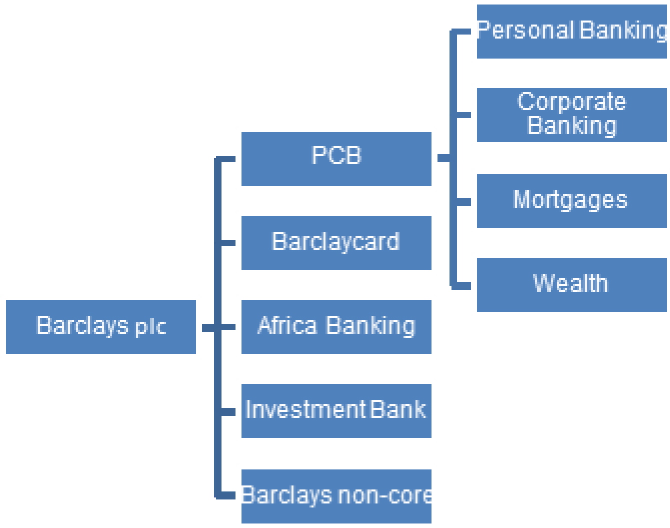
*(e)* Overall, impairment rates improved over the period.

# Appendix 1: The five largest UK banks' financial performance

## Barclays plc

1. Since May 2014, Barclays plc has run its operations through five divisions: PCB, Barclaycard, Africa Banking, Investment Bank and Barclays Non-Core (see Figure 1 below).

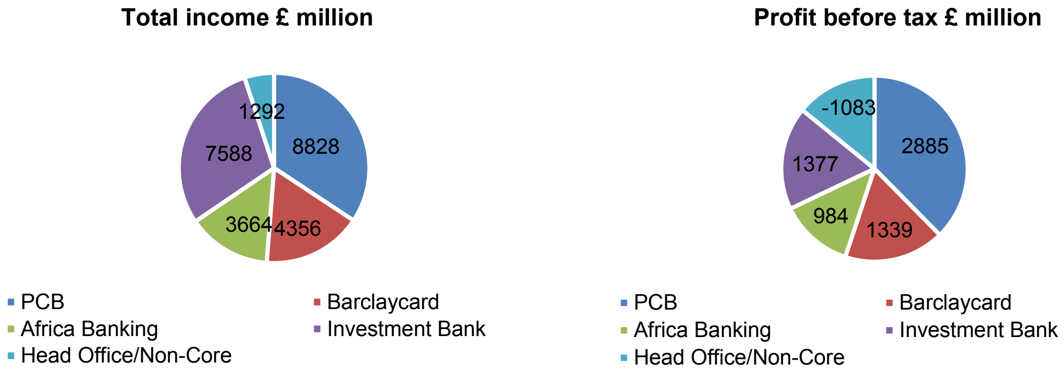
**Figure 1: Barclays divisional structure[89]**




Source: Based on Barclays plc 2014 annual report.

2. Figure 2 provides a breakdown of Barclays' total income and profits by main divisions.

**Figure 2: Barclays total income and profit before tax by business**




Source: Barclays plc 2014 annual report, pp229–230.
Note: Total income and profit before tax exclude group level statutory adjustments.

[89] We refer to banks' reporting segments or business units as divisions. Barclays non-core division includes non-strategic business units, including European Retail and Corporate operations. Barclays plc 2014 annual report. p17.

3. As Figure 2 shows, the PCB is Barclays' largest business unit, and reported total income of £8.8 billion and profit before tax of £2.9 billion in 2014 which constituted 34% and 52% of the group's total.[90] The PCB provides banking services to individuals and businesses in the UK and selected international markets, and is subdivided into four main businesses: Personal Banking, Mortgages, Corporate Banking and Wealth.[91]

4. Personal Banking customers including PCA holders are served by the Personal Banking division. Barclays has recently brought together its former Business Banking and Corporate Banking businesses into one unit, which now sits within the Corporate Banking division of the PCB. Until recently:

   *(a)* Business Banking dealt with businesses with turnover typically of up to £5 million (and sat within Barclays Retail and Business Banking); and

   *(b)* Corporate Banking dealt with businesses with turnover typically exceeding £5 million.[92]

5. Table 1 summarises PCB's recent financial performance.

[90] Excluding group level statutory adjustments.
[91] Personal Banking and Mortgages businesses constitute Barclays' 'UK retail banking' operations. Barclays plc 2014 annual report. pp17 & 231.
[92] Barclays' response to financial questionnaire, question 1.

**Table 1: Barclays PCB financial results, 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 5,730 | 5,893 | 6,298 | 7% | 3% |
| Net fee and commission income | 2,777 | 2,723 | 2,443 | | |
| Other income | 72 | 107 | 87 | | |
| **Total income** | **8,579** | **8,723** | **8,828** | **1%** | **2%** |
| Credit impairment charges and other provisions | –626 | –621 | –482 | –22% | –1% |
| Net operating income | 7,953 | 8,102 | 8,346 | | |
| Operating expenses | –5,456 | –5,460 | –5,005 | | |
| UK bank levy | –49 | –66 | –70 | | |
| Costs to achieve Transform | - | –384 | –400 | | |
| **Total operating expenses** | **–5,505** | **–5,910** | **–5,475** | **–7%** | **7%** |
| Other net income | 7 | 41 | 14 | | |
| **Profit before tax** | **2,455** | **2,233** | **2,885** | **29%** | **–9%** |

| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest margin | na | 2.9% | 3.0% | 0.1% | na |
| Cost income ratio* | 64.1% | 67.4% | 61.9% | –5.5% | 3.3% |
| Impairment and other provisions % to total income† | 7.3% | 7.1% | 5.5% | –1.6% | –0.2% |
| Net interest income % to total income‡ | 66.7% | 67.2% | 71.2% | 4.0% | 0.5% |

Source: Barclays plc 2014 annual report, p232, CMA analysis.
*Total operating expenses/(Total income + Other net income).
†Credit impairment charges and other provisions/(Total income + Other net income).
‡Net interest income/(Total income + other net income).
Note: na means not available or reported in published accounts.

6. Key points from PCB's 2014 performance included the following:[93]

*(a)* Profit before tax grew 29%, which was driven by growth in personal banking income, lower impairment due to the improving economic environment in the UK, and the continued reduction in operating expenses due to progress on the Transform strategy.[94]

*(b)* Net interest income increased 7% to £6.3 billion driven by lending and deposit growth and margin improvement. Net interest income makes up around 71% of total income (the rest is accounted for mainly by fees and commission income).

*(c)* NIM improved 9 basis points to 3% primarily due to the launch of a revised overdraft proposition, which recognises the majority of overdraft income as net interest income as opposed to fee income, and higher saving margins with personal banking and wealth.

*(d)* Credit impairments and other provisions were 5.5% of total income (compared to 7.1% reported in 2013), due to the improving economic

[93] Based on Barclays plc 2014 annual report, p232. Comparisons are with 2013 results.
[94] Barclays launched its 'Transform' programme in 2013 to generate sustainable returns and to meet the needs of all its stakeholders. Barclays plc 2014 annual report. p8.

environment in the UK, particularly impacting Corporate, which benefited from one-off releases and lower defaults from large UK corporate clients.

*(e)* Cost/income ratio was lower at 62% in 2014 compared to 67% reported in in 2013 reflecting savings realised from restructuring of the branch network and technology improvements to increase automation.

## HSBC Bank plc

7. HSBC Bank plc is structured into four divisions: RBWM, CMB, Global Banking and Markets (GB&M) and Global Private Banking.

8. The RBWM division takes deposits and provides transactional banking services to customers in the UK and Europe.[95] Its main types of services include personal banking, HSBC Premier, HSBC Advance and wealth management.[96]

9. The CMB division provides a broad range of banking and financial services to business customers ranging from small businesses to large corporates. It is predominantly UK-focused, but also offers services to corporates operating internationally.[97]

10. HSBC's GB&M division is a global business that provides wholesale capital markets and transaction banking services to major governments, corporate and institutional clients.[98]

11. The Global Private Banking division provides private banking, investment and wealth management services to high net worth individuals.[99]

12. Figure 3 shows HSBC's 2014 net operating income[100] and profit before tax by division. As can be seen, RBWM, CMB and GB&M are HSBC's largest divisions by revenue.

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[95] HSBC Bank plc 2014 annual report, p5.
[96] HSBC Premier provides a dedicated relationship manager to its mass affluent customers. HSBC Advance offers its emerging affluent customers access to range of preferential products, rates and terms. HSBC Bank plc 2014 annual report, p5.
[97] HSBC Bank plc 2014 annual report, p5.
[98] Ibid. p6.
[99] Ibid. p7.
[100] Net operating income before loan impairment charges and other credit provisions.

**Figure 3: HSBC 2014 total net operating income and profit before tax by division**


Source: HSBC Bank plc 2014 annual report, p135.

13. HSBC provides PCA and SME banking services in the UK through its RBWM and CMB business units respectively. These business units have operations across Europe including the UK, Channel Islands & Isle of Man, France, Germany, Turkey and Malta. Therefore, HSBC's financial performance metrics in this section refer to HSBC's total UK and certain European operations. Table 2 summarises the recent financial performance of HSBC's RBWM division. Key points from the 2014 performance included the following:[101]

*(a)* Reported profit before tax of £213 million, which was £964 million or 82% lower than in 2013.

*(b)* A fall in loan impairment charges mainly in the UK as a result of improved delinquency rates in the improved economic environment, and reduction in outstanding credit card and loan balances.

*(c)* HSBC also estimated adjusted profits' by adjusting reported results for effects of significant items, which could distort year-on-year comparisons.[102] On an adjusted basis, RBWM profit before tax was £1.3 billion compared to £1.7 billion in 2013, the decrease mainly explained by spread compression, primarily on mortgages in the UK.

[101] Based on HSBC Bank plc 2014 annual report, pp19–20. Comparisons are with 2013 results.
[102] The main adjustments to the reported profits related to UK customer redress programmes and provisions arising from the on-going review of compliance with the Consumer Credit Act in the UK. HSBC Bank plc 2014 annual report, pp18–19.

**Table 2: HSBC RBWM financial results, 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 3,394 | 3,569 | 3,158 | –12% | 5% |
| Net fee and trading income | 1,564 | 1,649 | 1,207 | | |
| Other income | –52 | –147 | –157 | | |
| **Total income** | **4,906** | **5,071** | **4,208** | **–17%** | **3%** |
| Loan impairment charges and other credit risk provisions | –248 | –223 | –162 | | |
| Net operating income | 4,658 | 4,848 | 4,046 | | |
| **Total operating expenses** | **–4,248** | **–3,673** | **–3,834** | **4%** | **–14%** |
| Other net income | 1 | 2 | 1 | | |
| **Profit before tax** | **411** | **1,177** | **213** | **–82%** | **186%** |
| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
| Net interest margin | [✂] | [✂] | [✂] | [✂] | [✂] |
| Cost income ratio* | 86.6% | 72.4% | 91.1% | 18.7% | –14.2% |
| Impairment and other provisions % to total income† | 5.1% | 4.4% | 3.8% | –0.5% | –0.7% |
| Net interest income % to total income‡ | 69.2% | 70.4% | 75.0% | 4.7% | 1.2% |

Source: HSBC Bank plc 2014 annual report, p19. 2013 Annual Report, p15, information provided by HSBC, CMA analysis.
*Total operating expenses/total income.
†Loan impairment charges and other credit risk provisions/total income.
‡Net interest income/total income.
Note: The data reflects the results for HSBC's Europe focused RBWM operations. UK profit before tax was £381 million in 2014.

14. Table 3 summarises the recent financial performance of HSBC's CMB division. Key highlights included the following:[103]

*(a)* Profit before tax was £1.6 billion which was £259 million or 19% higher than 2013. On an adjusted basis, CMB profit before tax was £1.7 billion reflecting an increase of 28% over 2013.

*(b)* The increase in profit was primarily in the UK due to a reduction in loan impairment charges reflecting lower levels of individually assessed provisions in the UK, together with effective cost efficiency and increased levels of deposits.

[103] Based on HSBC Bank plc 2014 annual report, p21. Comparisons are with 2013 results.

**Table 3: HSBC CMB financial results, 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 2,037 | 2,144 | 2,195 | 2% | 5% |
| Net fee and trading income | 1,073 | 1,166 | 1,174 | | |
| Other income | 70 | 60 | 65 | | |
| **Total income** | **3,180** | **3,370** | **3,434** | **2%** | **6%** |
| Loan impairment charges and other credit risk provisions | –699 | –601 | –308 | | |
| Net operating income | 2,481 | 2,769 | 3,126 | | |
| **Total operating expenses** | **–1,715** | **–1,437** | **–1,535** | **7%** | **–16%** |
| Other net income | - | 1 | 1 | | |
| **Profit before tax** | **766** | **1,333** | **1,592** | **19%** | **74%** |

| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest margin | [✂] | [✂] | [✂] | [✂] | [✂] |
| Cost income ratio* | 53.9% | 42.6% | 44.7% | 2.1% | –11.3% |
| Impairment and other provisions % to total income† | 22.0% | 17.8% | 9.0% | –8.9% | –4.1% |
| Net interest income % to total income‡ | 64.1% | 63.6% | 63.9% | 0.3% | –0.4% |

Source: HSBC Bank plc 2014 annual report, p20, 2013 annual report, p15, information provided by HSBC, CMA analysis.
*Total operating expenses/total income.
†Loan impairment charges and other credit risk provisions/total income.
‡Net interest income/total income.
Note: The data reflects the results for HSBC's CMB activities that consolidate into the UK operating entity. UK profit before tax was £1,377 million in 2014.

## LBG

15. LBG is predominately UK-focused, and operates through four business divisions: Retail, Commercial Banking, Consumer Finance and Insurance.[104] Its Retail, Commercial Banking and Consumer Finance divisions provide retail banking services within the CMA's terms of reference:

  *(a)* Retail is responsible for providing PCAs, savings accounts, personal loans and mortgages. It also distributes insurance, protection and credit cards, as well as serving retail business banking (RBB) customers.

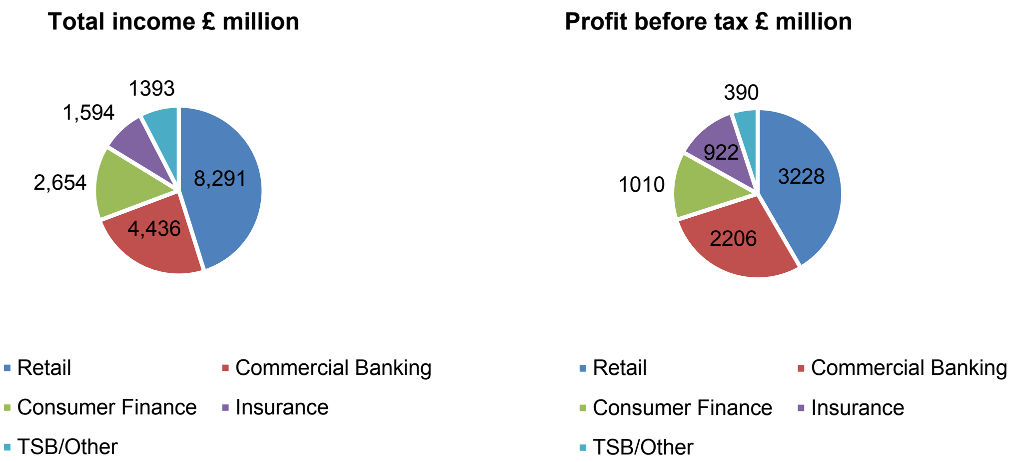
  *(b)* Commercial Banking supports business clients (SMEs through to large corporates) with their banking, financing and risk management requirements. SME Banking is part of Commercial Banking and serves SMEs with an estimated annual turnover of between £1 million and £25 million or borrowing more than £50,000 and clients with more complex and broader needs (eg multiple products).

[104] In addition, it also separately reports financial results for Central Items/Run-offs and TSB. LBG describes these divisions as follows: Central Items: includes assets held outside the main operating divisions, including exposures relating to Group Corporate Treasury which holds the Group's liquidity portfolio and Group Operations; Run-offs: includes assets that are outside of the Group's risk appetite, and were previously classified as non-core; and TSB is a stand-alone multi-channel retail banking business. It serves retail and small business customers; providing a full range of retail banking products. LBG 2014 Annual report, p109.

*(c)* The Consumer Finance division is divided into the following business units: Asset Finance, Consumer and Commercial Cards, and European Online. Asset Finance is subdivided into LBG's Black Horse (motor finance loans) and Lex Autolease (vehicle leasing and fleet management services) brands.

16. Figure 4 provides a breakdown of LBG's total income and profit before tax in 2014 by main business divisions. Retail was the largest division, contributed £8.3 billion (45% of LBG total) of revenue and £3.2 billion (42% of LBG total) of profits.

**Figure 4: LBG 2014 Total income and profit before tax by division**[105]




Source: Based on data presented in LBG's 2014 annual report, p41.

17. LBG's PCA business sits within its Retail division, while LBG's SME client base is split between RBB, which serves smaller customers with more straightforward needs (and is in the Retail division), and the SME Banking business unit, which serves larger customers with more complex needs (and is in the Commercial Banking division).

18. Table 4 summarises the recent financial performance of LBG's Retail division. Key points from the 2014 performance included:[106]

*(a)* Underlying profit increased 7% to £3.2 billion.

*(b)* Net interest income increased 9%. Margin increased 20 basis points to 2.29%, driven by improved deposit mix and margin, more than offsetting reduced lending rates.

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[105] LBG's results are presented in its accounts on an underlying basis excluding items that in its management's view would distort the comparison of performance between periods. LBG 2014 annual report, p41.
[106] Based on LBG 2014 annual report, p44. Comparisons are with 2013 results.

*(c)* Other income was down 16%, with lower protection income partly due to the decision to close the face-to-face advised protection role in branches, and lower wealth income due to regulatory changes.

*(d)* Total costs increased 7% to £4.5 billion, reflecting higher indirect overheads previously absorbed in the TSB segment and costs associated with ongoing investment in the business.

*(e)* Impairment reduced 21% to £599 million, with unsecured charges decreasing consistent with lower impaired loan and arrear balances. Secured coverage strengthened to 37%, resulting in a 13% increase to the impairment charge.

**Table 4: LBG Retail financial results, 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 6,037 | 6,500 | 7,079 | 9% | 8% |
| Other income | 1,406 | 1,435 | 1,212 | | |
| **Total income** | **7,443** | **7,935** | **8,291** | **4%** | **7%** |
| **Total costs** | **–4,236** | **–4,160** | **–4,464** | **7%** | **–2%** |
| Impairment | –914 | –760 | –599 | –21% | –17% |
| **Underlying profit** | **2,293** | **3,015** | **3,228** | **7%** | **31%** |
| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
| Net interest margin | [✂] | 2.1% | 2.3% | 0.2% | [✂] |
| Cost income ratio* | 56.9% | 52.4% | 53.8% | 1.4% | –4.5% |
| Impairment and other provisions % to total income† | 12.3% | 9.6% | 7.2% | –2.4% | –2.7% |
| Net interest income % to total income‡ | 81.1% | 81.9% | 85.4% | 3.5% | 0.8% |

Source: LBG 2014 annual report, p45, CMA analysis.
*Total costs/total income.
†Impairment/total income.
‡Net interest income/total income.
Note: Retail is responsible for providing PCAs, savings accounts, personal loans and mortgages. It also distributes insurance, protection and credit cards, as well as serving RBB customers (ie SMEs with an estimated annual turnover of less than £1 million and borrowing less than £50,000; start-ups; and customers with straightforward banking needs).

19. Table 5 summarises the recent financial performance of LBG's Commercial Banking division. Key highlights of the 2014 performance included:[107]

*(a)* Underlying profit of £2.2 billion, was 17% higher than in 2013, driven by income growth in SME, mid-markets and financial institutions and lower impairments.

*(b)* Income increased by 1% to £4.4 billion as a result of increased net interest income in all client segments offset by declining performance in other income reflecting challenging market conditions and lower income from Lloyds Development Capital.

107 Based on LBG 2014 annual report, p48. Comparisons are with 2013 results.

(c) Net interest margin increased by 46 basis points to 2.67% as a result of pricing of new lending, customer repricing in deposits and a reduction in funding costs helped by the increase in Global Transaction Banking Deposits.

(d) Other income decreased by 13% driven by lower client income in Debt Capital Markets and Financial Markets due to the continued low interest rate and low volatility environment in 2014 and a lower level of revaluation gains in Lloyds Development Capital.

**Table 5: LBG Commercial Banking financial results, 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 1,971 | 2,113 | 2,480 | 17 | 7 |
| Other income | 2,254 | 2,259 | 1,956 | | |
| **Total income** | **4,225** | **4,372** | **4,436** | **1** | **3** |
| **Total costs** | **–2,011** | **–2,084** | **–2,147** | **3** | **4** |
| Impairment | –664 | –398 | –83 | –79 | –40 |
| **Underlying profit** | **1,550** | **1,890** | **2,206** | **17** | **22** |
| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
| Net interest margin | [✂] | 2.2% | 2.7% | 0.5% | [✂] |
| Cost income ratio* | 47.6% | 47.7% | 48.4% | 0.7% | 0.1% |
| Impairment and other provisions % to total income† | 15.7% | 9.1% | 1.9% | –7.2% | –6.6% |
| Net interest income % to total income‡ | 46.7% | 48.3% | 55.9% | 7.6% | 1.7% |

Source: LBG 2014 annual report, p47. CMA analysis.
*Total costs/total income.
†Impairment/total income.
‡Net interest income/total income.
Note: Commercial Banking supports business clients (SMEs through to large corporates) with their banking, financing and risk management requirements. SME Banking sits in Commercial Banking and serves SMEs with an estimated annual turnover between £1 million and £25 million or borrowing greater than £50,000 and clients with more complex and broader needs (eg multiple products).

## RBS

20. Since a group restructure in February 2014, RBS has had the following divisions:

(a) Personal and Business Banking (PBB) – provides a range of banking products to personal and private banking customers and smaller businesses with an annual turnover of £2 million or less. It includes UK PBB and Ulster Bank. In 2014, PBB contributed 38% of RBS's total income and 59% of its statutory operating profit before tax.

(b) Commercial and Private Banking (CPB) – serves all of RBS's commercial and corporate customers other than the smaller business customers (£2 million or less turnover) and the very largest corporates, which are served by Corporate and Institutional Banking. Commercial and Private

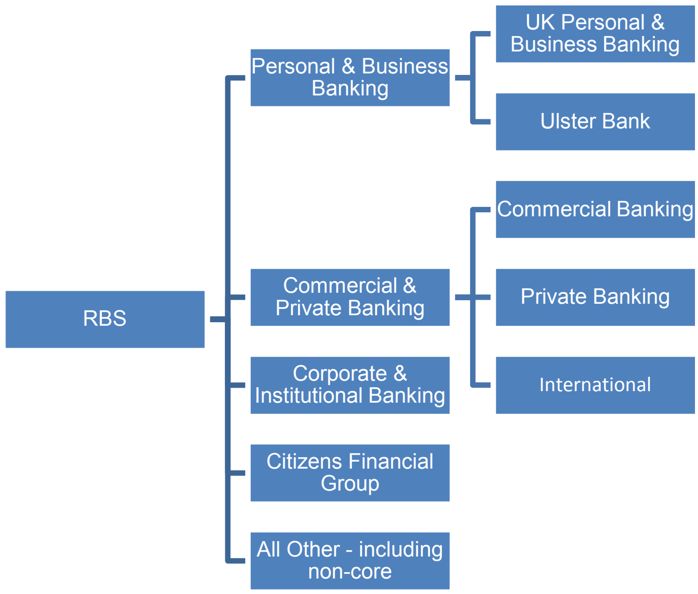
Banking contributed 23% (as per RBS's accounts) of RBS's total income, and 41% of its statutory operating profit before tax.

*(c)* Corporate and Institutional Banking (CIB) is the wholesale banking business, containing two businesses: Markets, and Transaction Services, which provide a range of banking services to large UK and international corporates and financial institutions.

*(d)* Citizens Financial Group is engaged in retail and corporate banking activities in the United States.

21. In 2014, RBS implemented a new organisational design for a more UK-centred bank with focused international capabilities.[108] Its divisional structure is shown in Figure 5.

**Figure 5: RBS divisions**

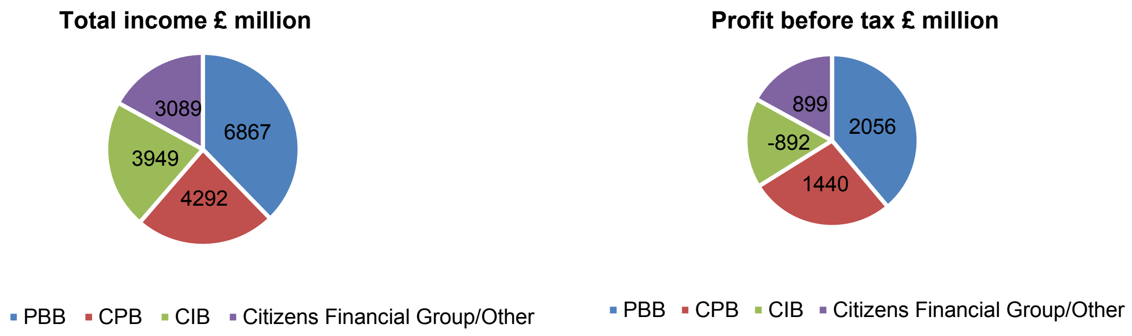



Source: Based on RBS 2014 annual report.

22. RBS's 2014 total income and operating profit/loss by division are shown in Figure 6.

[108] RBS 2014 annual report, p3.

**Figure 6: RBS total income and profit before tax by division**[109]




Source: RBS 2014 annual report, p444.

23. The UK PBB's recent financial results (which include PCAs, and SMEs up to £2 million) are shown in Table 6. Key points from the 2014 performance included:[110]

*(a)* Operating profit of £1.5 billion up £ 631 million, while adjusted operating profit (excluding restructuring and conduct costs) totalled £2.5 billion compared with £1.9 billion in 2013.

*(b)* Increase in net interest income of £193 million or 4%, which was driven by improvement in NIM of 12 basis points, and volume growth.

*(c)* Decrease in operating expenses of £174 million or 4%, reflecting lower restructuring and litigations and conduct costs. This resulted in an improved cost income ratio of 72% as against 77% reported in 2013.[111]

*(d)* Net impairment charge was down 47% to £268 million driven by further decrease in new default charges together with release of provisions and recoveries on previously written off debt.

[109] Total income and operating profit/loss reported by segment exclude group level statutory adjustments.
[110] Based on RBS 2014 annual report, p131. Comparisons are with 2013 results.
[111] On an adjusted basis, reported cost income ratio in 2014 was 55% compared to 59% in 2013.

**Table 6: RBS UK PBB financial results, 2012–2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 4,532 | 4,490 | 4,683 | 4 | –1 |
| Net fees and commissions | 1,349 | 1,309 | 1,287 | | |
| Other non-interest income | 3 | 14 | 67 | | |
| **Total income** | **5,884** | **5,813** | **6,037** | **4** | **–1** |
| Direct expenses | | | | | |
| - staff costs | –998 | –928 | –892 | | |
| - other costs | –284 | –524 | –380 | | |
| Indirect expenses | –1861 | –1954 | –2027 | | |
| Restructuring costs | | | | | |
| - direct | –140 | –118 | –10 | | |
| - indirect | –104 | –109 | –92 | | |
| Litigation and conduct costs | –1,085 | –860 | –918 | | |
| **Operating expenses** | **–4,472** | **–4,493** | **–4,319** | **–4** | **-** |
| Profit before impairment losses | 1,412 | 1,320 | 1,718 | 30 | –7 |
| Impairment losses | –741 | –501 | –268 | | |
| **Operating profit** | **671** | **819** | **1,450** | **77** | **22** |
| Operating expenses – adjusted | –3,143 | –3,406 | –3,299 | | |
| Operating profit – adjusted | 2,000 | 1,906 | 2,470 | | |

| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest margin | 3.57% | 3.56% | 3.68% | 0.12% | –0.01% |
| Cost income ratio* | 76% | 77% | 72% | –5% | 1% |
| Impairment and other provisions % to total income† | 12.6% | 8.6% | 4.4% | –4.2% | –4.0% |
| Net interest income % to total income‡ | 77.0% | 77.2% | 77.6% | 0.3% | 0.2% |

Source: RBS 2014 annual report, pp130–131, CMA analysis.
*Operating expenses/total income.
†Impairment losses/total income.
‡Net interest income/total income.
Note: Adjusted operating expenses and adjusted operating profit exclude restructuring costs and litigation and conduct costs.

24. Financial information on Commercial Banking recent financial performance is shown in Table 7. Key points from the 2014 performance included:[112]

*(a)* Operating profit increased to £1.3 billion compared to £530 million in 2013. This was driven by lower net impairment losses, lower operating expenses and higher income. Adjusted operating profit increased by £663 million to £1,495 million.

*(b)* Net interest income increased by £79 million or 4%, largely reflecting repricing activity on deposits partly offset by the impact of reduced asset margins. The NIM improved to 2.74% from 2.64% achieved in 2013.

*(c)* Operating expenses were down £131 million or 7% reflecting lower litigation and conduct costs, and lower underlying direct costs.

*(d)* Net impairment losses declined £576 million to £76 million as 2013 included the impact of the creation of RBS Capital Resolution (RCR) on 1 January 2014. Excluding RCR charges, underlying impairments

[112] RBS 2014 annual report, p139, information provided to the CMA by RBS. Comparisons are with 2013 results.

declined by £453 million with fewer individual cases across the portfolio, reduced collectively assessed provisions and higher latent provision releases, reflecting improved credit conditions.[113]

**Table 7: RBS Commercial Banking financial results, 2012–2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 1,969 | 1,962 | 2,041 | 4 | - |
| Net fees and commissions | 981 | 944 | 885 | | |
| Other non-interest income | 370 | 251 | 284 | | |
| **Total income** | **3,320** | **3,157** | **3,210** | **2** | **–5** |
| Direct expenses | | | | | |
| - staff costs | –533 | –513 | –508 | | |
| - other costs | –261 | –269 | –249 | | |
| Indirect expenses | –780 | –891 | –882 | | |
| Restructuring costs | | | | | |
| - direct | –71 | –18 | –40 | | |
| - indirect | –39 | –37 | –53 | | |
| Litigation and conduct costs | –343 | –247 | –112 | | |
| **Operating expenses** | **–2,027** | **–1,975** | **–1,844** | **–7** | **–3** |
| Profit before impairment losses | 1,293 | 1,182 | 1,366 | 16 | –9 |
| Impairment losses | –545 | –652 | –76 | | |
| **Operating profit** | **748** | **530** | **1290** | **143** | **–29** |
| Operating expenses – adjusted | –1,574 | –1,673 | –1,639 | | |
| Operating profit – adjusted | 1,201 | 832 | 1495 | | |

| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest margin | 2.66% | 2.64% | 2.74% | 0.10% | –0.02% |
| Cost income ratio* | 61% | 63% | 57% | –5% | 2% |
| Impairment and other provisions % to total income† | 16.4% | 20.7% | 2.4% | –18.3% | 4.2% |
| Net interest income % to total income‡ | 59.3% | 62.1% | 63.6% | 1.4% | 2.8% |

Source: RBS 2014 annual report, pp137–138, CMA analysis.
*Operating expenses/total income.
†Impairment losses/ total income.
‡Net interest income/total income.
Note: Adjusted operating expenses and adjusted operating profit exclude restructuring costs and litigation and conduct costs.

## Santander UK plc

25. Santander UK plc's business is managed and reported on the basis of following divisions: Retail Banking, Commercial Banking and Corporate & Institutional Banking. The indirect income, expenses and charges are reported under the 'Corporate Centre' reporting segment.

26. Retail Banking's main products are residential mortgage loans, savings and current accounts, credit cards, personal loans and insurance policies as well as Santander Consumer Finance, predominantly a vehicle finance business.

27. The PCA business, and a part of the SME business (SMEs with annual turnover of up to £250,000), is included in Retail Banking. Retail Banking is

[113] RCR was established to separate and wind down RBS's high capital intensive assets. Targets were set to remove 55–75% of these assets from the balance sheet by the end of 2015 and 85% by the end of 2016. RBS 2014 annual report, p69.

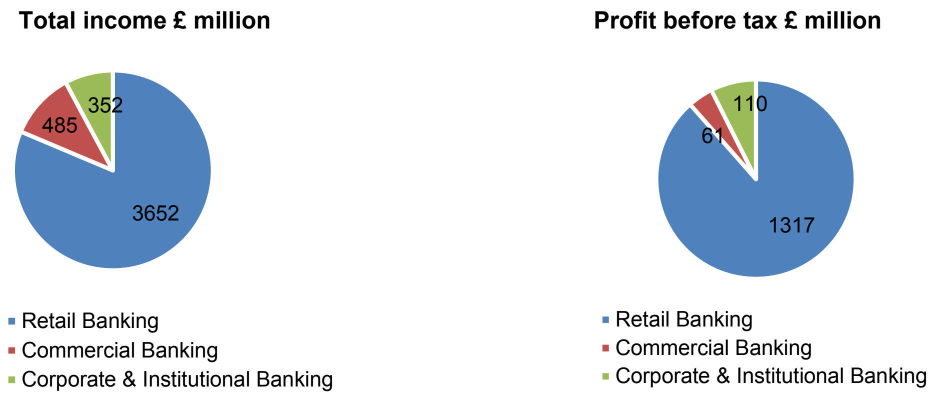
Santander's main business, and contributed 82% of its total income and 94% of profit before tax in 2014.

28. Commercial Banking division provides banking services to businesses with a turnover of between £250,000 and £500 million per year. This means that the rest of the SME business of our reference product, is included in Commercial Banking. Its products include loans, bank accounts, deposits, treasury services, invoice discounting, cash transmission and asset finance.

29. Corporate and Institutional Banking is a financial markets business, which provides services to large corporates, with an annual turnover above £500 million, and financial institutions. This division does not provide services that are relevant to our investigation.

30. Santander's total income and profit before tax by main divisions is provided in Figure 7.

**Figure 7: Santander UK – total income and profit before tax by division**




Source: Santander UK 2014 annual report, p192.

31. Table 8 summarises the recent financial performance of Santander's retail banking division. Key points from the 2014 performance included:[114]

*(a)* Net interest income increased by £354 million to £3.1 billion in 2014, largely driven by increased lending and reduction in cost of funding.

*(b)* Non-interest income decreased by £39 million to £560 million in 2014, reflecting banking fees, higher cashback on 1|2|3 World products, and reduced overdraft fees, partially offset by an increase in credit cards business and continued growth in 1|2|3 World product balances.[115]

[114] Based on Santander UK plc 2014 annual report, p193. Comparisons are with 2013 results.
[115] A Santander 1|2|3 World customer is someone who holds one or more of the following products: 1|2|3 Current Account, 1|2|3 Student Current Account, 1|2|3 Postgraduate Account, 1|2|3 Credit Card, 1|2|3 Graduate Current Account, 1|2|3 Mini Current Account or 1|2|3 Mini (in Trust). See Santander's website.

(c) Impairment losses on loans and advances decreased by £172 million to £187 million in 2014, which was largely due to lower impairment losses as a result of improving economic conditions and prolonged low interest rates. Provision for other liability charges increased by £169 million to £395 million in 2014 predominantly due to higher Financial Services Compensation Scheme, UK Bank Levy, branch de-duplication and conduct charges.

**Table 8: Santander Retail Banking financial results 2012-2014**

| | *2012 £m* | *2013 £m* | *2014 £m* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest income | 2,519 | 2,738 | 3,092 | 13% | 9% |
| Other income | 632 | 599 | 560 | | |
| **Total income** | **3,151** | **3,337** | **3,652** | **9%** | **6%** |
| **Total operating expenses** | **–1,696** | **–1,750** | **–1,753** | **-** | **3%** |
| Impairment losses on loans and advances | –420 | –359 | –187 | –48% | –15% |
| Provisions for other liability and charges | –312 | –226 | –395 | | |
| **Profit on continuing operations before tax** | **723** | **1,002** | **1,317** | **31%** | **39%** |

| | *2012* | *2013* | *2014* | *Change 2014 vs 2013* | *Change 2013 vs 2012* |
|---|---|---|---|---|---|
| Net interest margin | 1.4% | 1.6% | 1.8% | 0.3% | 0.2% |
| Cost income ratio* | 53.8% | 52.4% | 48.0% | –4.4% | –1.4% |
| Impairment and other provisions % to total income† | 23.2% | 17.5% | 15.9% | –1.6% | –5.7% |
| Net interest income % to total income‡ | 79.9% | 82.0% | 84.7% | 2.6% | 2.1% |

Source: Santander 2014 published accounts, p193, CMA analysis.
*Total operating expenses/total income.
†Impairment losses on loans and advances and provisions on loans and advances/total income.
‡Net interest income/total income.
Note: Retail Banking services personal banking customers and SMEs with straightforward banking needs. Retail Banking's main products are residential mortgage loans, savings and current accounts, credit cards, personal loans and insurance policies as well as Santander Consumer Finance, predominantly a vehicle finance business.

# Appendix 2: Impact of regulation on profitability

**Tighter regulation is impacting overall profitability in Europe's retail banking sector**

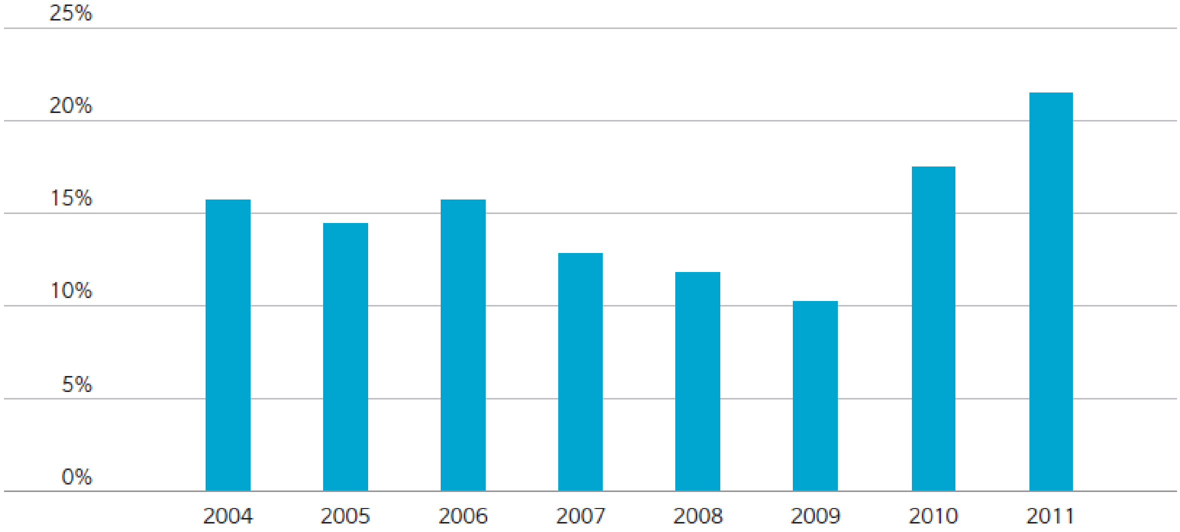
Not exhaustive

| Category | Main regulatory measures | Impact on returns |
|---|---|---|
| **Capital and liquidity requirements** | • Increase minimum common equity capital ratio<br>• Introduce conservation buffer in 2016 (increasing in 2019)<br>• Introduce mandatory leverage ratio in 2018<br>• Introduce liquidity coverage ratio in 2015 (increasing in 2019)<br>• Introduce the net stable funding ratio in 2018 | • Increased equity requirements<br>• Decreased exposure to more risky products<br>• Possible forced divestment from capital-intensive businesses<br>• Increased cost of funding |
| **Consumer protection requirements** | • Implement policies to guarantee fair client treatment (consumer protection legislation)<br>• Implement know-your-customer guidelines and anti-money laundering standards<br>• Review deposit guarantee schemes by the European Union<br>• Implement the EU's Consumer Credit Directive<br>• Implement the Markets in Financial Instruments Directive II (MiFID II)<br>• Implement Payment Services Directive and regulations on interchange fees | • Limited revenue generation potential<br>• Increased costs to adjust IT systems and operations to guarantee compliance |
| **Operational requirements** | • Implement proposals on operational continuity in resolution<br>• Implement proposals for separating retail and corporate investment bank activities | • Increased costs of doing business and restructuring costs<br>• Possible forced business divestment |

Source*:* A T Kearney, The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model, p11.

# Appendix 3: ROE, 2004 to 2011: UK retail and small business banking

**Figure 1: Average UK retail banking returns*,†**




Source*:* Oliver Wyman (2012), *Perspectives on the UK Retail Banking Market,* p3.
*Market ROE weighted across banks by asset size. ROEs normalised with capital calculated as 11% of risk-weighted assets and tax rate of 30%. Institutions included: A&L, Barclays, B&B, Co-operative Bank (pre-Verde), HBOS, HSBC, LBG, Nationwide, Northern Rock, Northern Rock Asset Management, RBS, Santander, Tesco, YBS. Note that different banks report on different bases, therefore inclusion and definition of small business banking dependent upon institution specific reporting structures.
†Excludes exceptional items and charges (eg PPI charges).