RETAIL BANKING MARKET INVESTIGATION

Summary of hearing with HSBC plc on 14 July 2015

Introduction

1. HSBC provided an update on its retail banking strategy as referenced in its announcements dated 9 June. HSBC noted that it was in a unique position among UK banks as a business which was heavily focused on two 'home' markets, Hong Kong and the UK. HSBC emphasised the importance of the UK market to its Group and its aim to be the 'bank of choice' in the UK.

2. HSBC highlighted in particular its planned investment of more than $1billion globally in digital technology, which it said was increasingly important to customers and therefore an increasingly important aspect of competition. HSBC also noted that it saw the upcoming requirement to create a ring-fenced retail bank in the UK as an opportunity to create an even more focused and effective competitor. HSBC said that to this end, it proposed to include the entirety of its retail business, including all its corporate and private banking business, in the ring-fenced bank. It was also planning to rebrand the ring-fenced bank and to move it to a new head office in Birmingham.

3. HSBC set out its view that the personal current account (PCA) and small and medium-sized enterprises (SME) banking markets in the UK were extremely competitive. Standing still was not an option as market share could easily be eroded.

4. HSBC highlighted its efforts to improve customer satisfaction. For PCAs, this had included simplifying overdraft fee structures and the use of text alerts, empowering customers to exit overdraft positions before charges were incurred. This had significantly reduced the number of complaints received.

5. For SMEs, improved customer service had included increased relationship management (RM) activity. HSBC considered that RMs played an important role both in retention and acquisition of customers. HSBC said it was also planning to relaunch its business banking mobile app. HSBC noted the success of these measures to date and the importance of continuing to focus on customer service.

6. In SME banking, HSBC had launched an £8 billion fund for SME lending, up 25% from last year, and had taken a series of actions including waiving

arrangement fees and security fees for business loans, and doubling the time of free banking from 6 months to 12 months.

7. HSBC said it had also had to take action to retain and acquire PCA customers. HSBC re-launched its Advance proposition, which included an offer worth £120, linked to HSBC's cash ISA. More recently, HSBC had started to offer further switching incentives in relation to Advance. Taking all these benefits into account, HSBC said it was effectively paying £240 to acquire each customer, which it felt was what the competition dynamic in the market demanded: previous incentives had had less effect than desired. HSBC also highlighted Apple Pay as a major new entrant into payments provision, heralding a shift towards further vertical disaggregation in the industry. HSBC said it was one of the launch partners of Apple Pay, with its Apple Pay services scheduled to be launched at the end of July.

8. HSBC said it considered that the above actions illustrated the vibrant competitive market both for PCA and SME banking, with (for example) regulatory intervention (eg credit data), Customer Account Switch Service (CASS), and new entry and expansion and competition between existing players, all combining to reinforce and drive ever increasing competition in the market.

Profitability

9. HSBC said that it looked at profitability from a contribution perspective and tended to look at revenues and direct costs. HSBC explained that the difficulty with the allocation of fixed costs and capital costs meant that it was challenging to conduct any profitability analysis on a fully allocated cost basis

10. HSBC said it was important to look at profitability over the cycle and there were differences between PCAs and business current accounts (BCAs) following the decline in interest rates. [✂].

11. HSBC said that its impairment numbers were at a historic low and for BCAs it was an unusual point in time. Low impairment numbers had a positive impact on both PCA and BCA businesses but more so on BCA. It said cost savings had improved overall profitability, a further round of cost cutting was underway looking to save $4.5 to $5 billion across the Group globally by 2017, [✂]. HSBC said that keeping control of costs was key to ensuring that there were funds for investment.

12. HSBC said that in evaluating how well it was doing in the UK it looked at the holistic picture which included large corporates, all mid-market enterprises, corporate real estate businesses, financial sponsors etc.

13. [✄]

14. HSBC stressed that banking was a cyclical business and based on the past five years knee jerk directional changes to approach could have been made because of impairments but this was not its approach. HSBC said that it was a relationship bank and did not make knee jerk decisions and this continuity was important for customers.

Customer acquisition

15. [✄] HSBC said it was [✄] and hence it was competing for new business.

16. In terms of its SME business, HSBC said that in one year [✄]. HSBC said it must keep bringing customers in and be aggressive to win its share of the market. It was looking to acquire SMEs across a range of sizes – small businesses grew into large businesses – and the key to acquiring and recruiting new customers was providing high quality service not pushing new products.

17. The key, HSBC said, was understanding customers' needs and that was why it invested so much in its relationship model so as to understand the needs of customers.

18. HSBC said that there had been a fundamental shift in attitude and there were no longer any targets for selling specific products. Building relationships and providing a high quality service was key to customer acquisition and retention. HSBC noted that quick, simple, fast and convenient account opening was also key.

19. HSBC said that financing a new business had changed radically in the past 35 years with businesses able to arrange financing from different providers for different requirements. HSBC said overdrafts were less prevalent and often a credit card was used as a substitute. Many people no longer required cheque books, with digital and online banking on the increase.

20. HSBC also noted that start-up businesses varied in size and, therefore, requirements.

21. In terms of PCAs, HSBC said that [✄], it was about contribution and that contribution had changed for a variety of internal and external reasons. [✄].

22. HSBC said that changes to its overdraft charges had a significant positive impact on complaints. HSBC said changing its overdraft charges was the right thing for it to do for its customers.

23. HSBC said that it placed equal importance on acquiring and retaining customers. In terms of new propositions HSBC had targeted its ‘Premier’ accounts at more affluent customers and ‘Advance’ accounts at the mid-market emerging affluent. HSBC stressed that it had not targeted this segment at the expense of others, it had also launched student accounts which it saw as a key area of business in creating a deep and lasting relationship overtime. HSBC said that it was one of the first banks to meet the Government requirement in terms of a consistent offering for basic bank accounts. HSBC was clear that it wanted to cater for all customer segments.

Switching

24. HSBC said that there were two ages at which switching spiked, [✂]. There was a very significant switching churn at the age [✂], with about [✂] of customers switching around that age. The second spike was at [✂].

25. HSBC said that it was previously losing a lot of customers because the 24 and 31 age group were switching from HSBC because of high overdraft charges and poor market propositions for mortgages and personal loans. HSBC said that it had now addressed these issues. The change in the overdraft charges were the biggest hit on HSBC’s profit and loss but it was still the right thing to do. Since 2014 HSBC said that it had focussed much more on acquisition of PCA relationships. HSBC said that its share of new business went from [✂]% in the 2000s to around [✂]% in 2011. HSBC said that the launches of its Premier, Advanced and student accounts as well as its refocussed efforts on creating relationships with customers had lead its share of flow to rise to [✂]%.

Branches

26. HSBC said it had two performance indicators for both BCAs and PCAs and had a balanced scorecards – KPIs with financial and non-financial metrics and this was consistent with other banks.

27. HSBC said that many BCA customers did not use branches in the way they used to, but some segments, (for example, professionals such as lawyers and heavy cash users) were still reliant on branches.

28. HSBC said that branches were costly and it was not now clear that the expenditure gave it a competitive advantage. HSBC was working with the Post Office and would soon start to use their network for BCA customers, and was already using it for PCA customers.

29. In terms of its SME business, HSBC indicated that RMs were an important element of its operation, but that they did not need a branch network in order to operate.– RMs were based in separate commercial centres away from branches, and functioned best by being local to customers and visiting customers on their sites. If RMs got it right with SMEs, HSBC said it would do very well.

30. [✄] and that retention and acquisition of customers was key to growing the business.

31. HSBC made clear that branch closures had to be signed off at a high level but the closures were in direct response to the reduction in customers' use of branches.

32. HSBC currently had 1,054 branches, but said that it had recently announced more branch closures. HSBC said that currently branches were a relevant and important part of its business model but it was not dependent on its branch network to grow its business.

33. HSBC cited Handelsbanken as a new entrant that successfully relied more on RMs and an agency branch network rather than having its own extensive branch network.

34. HSBC said that other new entrants had chosen to compete with a branch network, for example, Metro. Atom on the other hand had been very explicitly non-branch.

35. HSBC said [✄]. To measure its branch performance, HSBC said it [✄].

Competition for business

36. HSBC said that there was competition at every single level of business. It did not have the luxury of targeting particular segments or competitors. Competition was coming from an array of incumbent banks, new entrants, challengers, online etc.

37. HSBC said [✄] and this reflected the range of attractive products available in the market and the intensity of competition for customers. HSBC said that it was working hard to improve its service offering and products.

38. HSBC said Metro had been the first bank to be approved in a century but now it was easier to enter the market and more competitors were doing so. HSBC said that challenger banks were increasing customer expectation in the market even before they were bringing in larger volumes of customers.

HSBC said that Metro had been in an enviable position with the speed at which it was able to implement its IT systems. [✂] gave new banks a distinct advantage.

Appraising investment

39. HSBC said that prioritisation of investment decisions was made on the basis of what was right for the whole business. HSBC indicated that some investments were more successful than others but clearly investment returns were measured. Customer outcomes were a key measure. More customers preferred to do things online, so digital was a key area of investment.

40. [✂]

41. HSBC said that its UK arm was around 25% of HSBC globally and the UK was one of those priority markets for growth. The proposed ring-fencing of the UK business was a great opportunity to grow the business.

Data and innovation

42. HSBC did not agree with the suggestion put forward to it that digital banking was detrimental to some consumers. Younger people were more digitally engaged and would engage more with the bank through indirect channels while their parents maybe would come to branches about once a month. A third of young customers who used mobile phones would check their bank account every day.

43. HSBC indicated that the percentage of customers vulnerable to exclusion, because they did not have access online or were not comfortable with it, was a reducing problem. HSBC said it was tackling the risk of vulnerability or exclusion of some people by promoting the use of the Post Office. 99% of the UK population was within three miles of a Post Office.

44. HSBC said that the use of digital banking was where the market was moving very fast, 95% of SMEs used internet banking at some stage and 79% used it every week.

45. HSBC said that not all banks had confirmed they would use Apple Pay but HSBC and others wanted to be in the first wave, [✂]. The experience in the United States suggested that Apple Pay would be a success in the UK from usage and adoption perspective.

Small and medium-sized enterprises

46. HSBC said that the Charterhouse research figures indicated that 91% of its SME customers had said they were happy, while 9% were unhappy. However it was important to recognise that 9% represents a significant number of customers.

47. HSBC said that speed of setting up accounts, providing credit cards etc was key to recruiting new start businesses and if this could all be done via the internet so much the better. In its experience, if the account could not be set up within 24 hours some customers were genuinely disappointed.

48. HSBC said that it had used a multi-channel business account 'opening tool' to facilitate the opening of business accounts. [✄].

49. HSBC said that for the largest SMEs, switching main bank relationship can sometimes be event driven, in that these customers would consider switching if, for instance, their main bank refused them a loan.

50. HSBC said that it was improving in the acquisition of customers. Over the last 6 months it had [✄] new SME customers a month with £6.5 million to £25 million turnovers. The RM model was key to acquisition for larger SME customers.

51. In general, HSBC said that challenger banks might not be always looking to go into the BCA market as they may have different priorities but where they were competing very effectively was in relation to loans. HSBC said it must compete with them more effectively on that front.

52. In relation to services such as Paypal, HSBC said that some companies saw those as a substitute for BCAs.

53. In deciding what product was best for a customer, overdraft, loan, etc, the key was to listen to the customer and assess their needs.

54. HSBC said that giving more power and flexibility to RMs was very important. HSBC said its RMs would have tablets on which to prepare loan applications on the spot as they would have access to customer information while away from their office base.

55. In terms of success, HSBC said that by the end of Q3 it would have stemmed the loss of SME customers and the next step was to gain customers.

56. HSBC said that currently about [✄]% of its SME customers were not paying fees, either because they were in the first year of the account benefitting from

free banking or, in the vast majority of accounts, because they were community banking accounts.

57. HSBC said that more comparison of loan pricing across the market would improve competition and be of benefit to customers.

58. The headline in attracting new customers was the prospect of free banking, whether it was 6 months, a year or more. Once free banking comes to an end and charges start to apply, customers may look to move banks.

59. HSBC said that focussed UK advertising campaigns were important but so too was word of mouth, and the HSBC brand was well regarded. HSBC said it also hosted industry focused dinners to let customers know they were in that market. Small business industry websites were also targeted. Different techniques were used for different customer segments.

60. HSBC said that competition for RMs was intense and in order to retain their best most experienced RMs, it had recently changed the career and pay structure.

Profitability of business loans

61. HSBC said that profitably of loans was good if you had a really good liability book. If you got the balance right and the economy was strong loans were profitable. HSBC said that profitability was poor during the economic decline when it had to write-off [✂] of loans. Profitability needed to be looked at over a cycle.

62. HSBC said that many of the new entrants into the banking market had focused on lending, had a very good operating model and were achieving average return on equity of around 18% per annum.

63. HSBC said it approved [✂]% of business loan applications and where it did not do so the decision was based purely on credit risk data on which it judged it just could not lend. HSBC stressed that a key factor was not that banks were not lending but more that businesses were not borrowing.

64. HSBC's view was that it had a really good relationship with the British Business Bank and that there were some really good ideas coming from it.

65. Overall HSBC said [✂]. However, HSBC had operated in the UK for a considerable length of time, and it was still committed to this market. The ring-fencing of HSBC's UK business was a real opportunity for growth and profitability.

Searching and switching

66. HSBC believed there was a dynamic switching market, where switching levels were high when looking at flow numbers of market share. It said the CMA's framework for assessment should also include customers that had actively decided to access information and assess offers but decided not to switch because they were either satisfied or felt that HSBC provided a more competitive offer. Switching numbers alone did not tell the full story of how competitive the market was or how engaged customers were.

67. In terms of its SME business, HSBC said that [✂]% of customers in the market, and [✂]% of HSBC customers, had considered switching in the past two years, which HSBC believed to be high numbers. A low percentage of customers actually switched due to good levels of service and product range. HSBC said that although customers may not have moved their current accounts, they still searched the market for other products and often engaged in soft switching such as multi-banking.

68. HSBC was a net loser of [✂] PCA customers through switching. It pointed out the importance of internal switching; [✂] customers had switched internally into different propositions. This element of customer engagement was not was necessarily captured by CASS information.

69. HSBC said that technological developments increased customer engagement. On the supply side, the digitalisation of banking meant customers were less dependent on the branch network. The CMA GfK Survey stated that 66% of customers used online banking, and a third of mobile banking users engaged with their bank daily. This coupled with multi-banking enabled customers to make direct comparisons with other banks on a daily basis. Developments across other industries meant customers were now more demanding.

70. HSBC said that [✂] were currently looking at other products. HSBC were able to inform customers who were 'relationship managed' of its products and prices, however it was harder for HSBC to communicate with 'portfolio managed' customers who needed to go online to compare products. [✂]

71. HSBC recognised more could be done to share information with SMEs. Although the majority of its customers had no issues with accessing information, HSBC felt there was an issue with the assessment of this information.

72. In respect of the Business Data Initiative (BDI), HSBC observed that the ambition for BDI was greater than Midata as it covered SME services across a number of industries. [✂].

73. HSBC said the ability to share transactional data already existed through packages such as Quick Books and Zero Cloud, though the BDI would provide a more common platform to exchange data.

74. With regards to the effect of Midata on PCAs, HSBC said that [✂] of its customers had used it to get information on their own accounts. Once more price comparison websites started to use it, Midata would have increased awareness and visibility, though HSBC believed transparency already existed and there were already a number of other ways to compare PCA options.

75. HSBC said customer behaviour in this market, in respect of their credit balances, should not be read forward into a normalised interest rate environment. PCA balances had risen and customers had a high-liquidity preference.

76. HSBC had responded to the challenge of new accounts in the personal current account market by improving its service. It had also made significant changes to pricing of liquidity and short-term financing, which it believed made it the most competitive and transparent overdraft offering in the market.

77. HSBC said that banks were using different strategies to compete, which HSBC felt was a sign of a healthy market. HSBC said it had decided [✂] but had instead focussed on relationship based offerings such as Advance and Save Together, and its ISA campaign. HSBC said its balance sheet was different from its competitors. Though it preferred [✂], the competitive dynamics have meant that they recently launched an account that paid £120 for switching in, and it was further rewarding savers by paying an additional £120 to customers who used its cash ISA.

78. HSBC agreed that PCA customers who were frequently overdrawn were less likely to switch, however this was down to perception rather than barriers as, in most cases, customers would get the same or a higher overdraft limit when switching. HSBC felt there was a broader problem with financial education and exclusion, as opposed to problems with switching overdraft facilities.

79. HSBC said that [✂]% of its PCA revenue last year came from interest and fees from overdrafts, though this was now reducing due to reductions in charges. HSBC also said that as interest rates started to normalise, the percentage of revenue from overdrafts would reduce. For its SME business, overdrafts were also more and more being substituted by customers for other credit products.

80. HSBC said that, whilst the reduction in overdraft charges had a customer satisfaction component, it had also been driven by competition. HSBC said

that the different overdraft propositions adopted by the banks was evidence of a competitive market.

81. HSBC told us that CASS should not be used as shorthand for switching as multi-banking was far larger than CASS. HSBC believed that only 20% of switches occurred through CASS. CASS (for PCAs and BCAs collectively) was currently tracked at 69% for customer awareness and 62% for confidence, which was close to target. HSBC had encouraged CASS through its Premier and Advance campaigns, and it had contributed marketing spend that promoted switching through CASS. Although HSBC was a net loser through CASS, it had advanced competitiveness and CASS generally was a positive success story for the market.

82. HSBC said it believed that there were no significant issues for BCA customers with overdraft switching as, in the last five years, [✄]% of SMEs with an overdraft had switched. In the same period [✄]% of small SMEs with an overdraft had switched, whilst only [✄]% without an overdraft had switched.

83. HSBC said that medium-sized SMEs often perceived there was a complexity to switching, which made switching unreliable. CASS had made switching easier for SMEs with 83% of SME customers having found it an easy process. The promotion of CASS however had tended to focus awareness on PCAs, though this was changing.

84. HSBC said a KYC (Know Your Customer) utility would make it easier for SME customers to open accounts with multiple banks, and switch banks, as this standardisation meant customers would not need to go through the process multiple times; though each individual bank reserved its own final judgment. HSBC had discussed with BDI the need for data to be used for that commonality of KYC.

85. HSBC indicated that it did not support account number portability as there was no evidence that customers wanted it and, it believed, there was no customer need for it; the costs of delivery outweighed any customer benefit.

86. HBSC told us that overwhelming evidence suggested customers supported free-if-in-credit banking and that customers would not benefit from any change. It believed capping overdrafts could reduce competition by reducing overdraft availability.

87. HSBC said that its surveys suggested that transactional fees would reduce customer satisfaction and that customers would not consider a PCA with a fee regardless of the benefits. [✄]. Account fees also reduced multi-banking as was demonstrated in the Irish market which, in turn, reduced switching.

88. With regards to fee paying accounts, HSBC cautioned against comparing the PCA and BCA markets as the customers behaved differently. Its SME customers were charged £[✂] per annum after they came out of their initial year of free banking, and the average charges overall were [✂]. On the whole, SMEs tended to believe that this represented value for money, however they would close their account if they believed it was not cost effective.

89. HSBC said that the majority of start-up businesses initially looked to open a PCA before they moved to a BCA. According to its survey, 60% opened a BCA with a different bank from the one they had a PCA with. HSBC said it attributed this to a failure in service and false perception that it was not interested in small to medium sized businesses. Whilst it was not a trigger point, HSBC observed that customers who had a PCA and BCA account with the same bank would often close both accounts if they were dissatisfied with one of them.

Concentration and market power

90. Whilst HSBC said it had a very good franchise in Scotland, positioned at the very top end of SME and large corporate, it said that it did not have a large footprint in Scotland due to customer loyalty to three Scottish banks. Whilst Scotland was a small market, HSBC had expanded its PCA business and had six or seven branches there. There were big oil and gas businesses in Aberdeen, which was also one of its largest originators of mortgages.

91. HSBC said that both mechanisms in the CMA's updated issues statement for concentration giving rise to market power, boiled down to differentiation. One was a concern that big banks may be able to 'over-differentiate' their products, and the other was that they could differentiate very well between their customers and that impacted on their ability to price discriminate and therefore compete for active customers. As regards, the first mechanism, whilst HSBC accepted that if differentiation and non-price factors were sought after by customers it would affect its prices, HSBC said it did not accept that the work that went into competing on non-price factors amounted to unnecessary differentiation that sought to confuse or erode price sensitivity and could thereby harm consumers.

92. As regards the second mechanism, HSBC said there was evidence that suggested there was an ability to discriminate between active and inactive customers, which thereby undermines that mechanism. Indeed, there was evidence that big banks compete hard for new and switching customers in both markets. HSBC added that this was entirely consistent with a well-functioning market. It said there was always a balance between giving

switchers and more active customers an incentive to switch, and the extent to which that was then transmitted to the rest of the customer base.

93. HSBC observed that any correlation between concentration and market outcomes in the UK does not necessarily imply causation. It said that falling concentration had not driven the improvements in customer outcomes; this had been driven by increased customer engagement and rivalry, which had also provided entry and expansion opportunities.

94. With regards to the CMA's preliminary work on PCA pricing, HSBC emphasised the importance of including the value of non-PCA benefits like discounts.

95. [✄] It also highlighted that the larger banks had led the way with new innovations, which contradicted the theory of a concentrated market.

96. HSBC said that the merger between Lloyds and HBOS had not impacted negatively on competition. It said Lloyds had successfully implemented a new strategy which had increased competition in the market, and this had played a part in HSBC's drop in market share.

97. The current acquisitions and sales of banks in the UK could potentially bring additional expertise and knowledge to the market. Santander's acquisition of Abbey was seen as an example of a revitalisation of that business, which increased competiveness in the market, and this was due the determination of the management team rather than concentration or ownership.

98. HSBC said it expected the same outcome from Sabadell's acquisition of TSB, should Sabadell have the determination, as well as the right strategy and IT systems. It said TSB were already competitive from a mortgage perspective, but the potential new drive in efficiencies, streamlining of processes, and aim to grow market share would serve to increase competition in the PCA market. HSBC were aware that Sabadell, like Lloyds, would target the SME market rather than the large corporate market, which was too capital intensive.

99. HSBC also felt that Clydesdale would benefit from a new more committed management team.

100. HSBC said it planned to have its ring-fenced bank operational from 1 January 2018, and this signalled its commitment to the UK. The ring-fenced bank was estimated to cost £1.5 billon and would be independent with a mandate for the UK. As its competitors had not expressed the perimeters for their own ring-fenced banks, it was unclear the effect this would have on competition, however HSBC predicted that the ring-fenced banks would be well capitalised with optimised liquidity.

101. Ring-fencing would increase competition, as smaller banks and building societies which offered products outside of the ring-fenced banks, and which were not encumbered with duplicative costs, would be able to exploit these advantages between now and 2019. HSBC said it would be dedicating a significant amount of its resources to implementing the plans to create the ring-fenced bank, [✂].

102. HSBC said that the models for each bank's ring-fencing would be slightly different. HSBC had decided on a broader model as it believed, ultimately, the other models would not survive due to customer dissatisfaction; it also wanted to maintain the connectivity between its UK management team.

Barriers to entry and expansion

103. HSBC said that capital requirements had historically been viewed as a barrier to entry but this had changed dramatically. The removal of add-ons in Tier 2 for capital had encouraged entry. HSBC said that whilst the debate surrounding advanced internal ratings based versus standardised based capital had been a talking point amongst smaller banks, the risk-weighting for SMEs was fairly generous under the standardised capital model when compared to the advanced internal rating basis.

104. HSBC indicated that the industry debate had moved towards 4.1% leverage ratio which meant businesses with very low risk weights and had moved towards a standardised methodology. The leverage ratio meant, over time, HSBC would have to have more capital, so its historical advantage in mortgages was no longer there. The IRB model disadvantaged HSBC in the PCA market because of the risk weight consumption on overdrafts; it required higher capital requirement than new entrants, as the IRB model consumed more capital for overdrafts.

105. HSBC said it probably had the lowest cost of funds of any bank in the UK though this was not a function of its back book of customers. It had attracted [✂] of liabilities in the last twelve months; there was no pricing differential between its back book and front book on deposits. It attracted deposits through its prudential strength. HSBC said that new entrants typically attracted one-year, two-year and five-year deposits at relatively high prices, though it was also the case in the wider market; as the liquidity risk was high, new entrants attracted these deposits for funding reasons and to mitigate liquidity risk.

106. Since the financial crisis, HSBC said that [✂].

107. HSBC said that Bank in a Box (BiaB) enabled challenger banks to implement changes quicker than large banks. Though new entrants needed to customise BiaB which impacted customers, HSBC cited OakNorth as an example of a new entrant which used BiaB to put out a large scale, low cost operation very quickly. New entrants had a huge advantage creating their own systems using BiaB over banks with legacy IT, such as HSBC.

108. HSBC said the case of Santander proved that, within a four to five year period, a bank could grow to become a very large player.

109. HSBC said there was trend of customers not using branches as much, and its own SME survey suggested over half of its customers would consider a non-traditional bank without branches, though there were legacy customers that still required a branch. As HSBC already had a branch network its strategy was to maximise it as part of a multi-channel offering.

110. HSBC said it did not think a branch network was necessary to become a large player in the market, and they were not a barrier to entry or expansion; it cited First Direct as an example, which had 1.2 million customers. Unless out of design, new entrants were no longer considered niche, and now offered a full range of banking products.

111. HSBC said that First Direct [✄].

112. HSBC said that the business case for launching a non-branch bank was a lot stronger than it was five years ago particularly given changes in customer behaviour. HSBC believed Atom Bank would grow in the coming years, and it highlighted the £5 billion worth of assets Handelsbanken, Aldermore and Shawbrook had attracted between them, despite having no branches. HSBC said it viewed them as dangerous competitors, and that market share should not be considered when looking at business flow. It said there was aggregated competition in the market so, even if a bank was not large in size, it still competed if they were large enough to set customer expectations.

113. HSBC said that digital-only offerings had set a high level of customer expectation, to which the large banks had responded and will continue to respond. Market share was being lost to challenger banks, particularly in the SME market. HSBC envisaged higher switches to new entrants in the next two to three years and the disruptive nature of some 'non-bank' competitors concerned HSBC more than the traditional banks.

114. HSBC said that a barrier for non-branch banks and new entrants, related to the large banks' competitive reaction to the changing market. HSBC also believed that a lot of the new entrants would end up merging. Whilst economies of scale gave larger banks an advantage with some fixed costs

such as compliance costs, HSBC did not rely on this and would pass on its value to its customers.

115. HSBC said the UK was benign attractive market and liquidity and capital were plentiful, however an economic downturn would hinder expansion plans, though many new entrants had built a foundation to withstand this. HSBC also pointed out that alternative finance providers had provided £1.5 billion of general purpose business lending to the market this year, which was [✄]% higher than HSBC had provided.

116. HSBC said that digital-only banks did not have large balance sheet risks therefore did not have prudential constraints on expansion, though there was still a reputational risk constraint from losses. It said growth rates from new entrants were high as they started from a smaller position, however the sign of a competitive and functioning market was how others reacted to this; HSBC said it had reacted by a number of ways including relaunching its Advance offering.