Retail banking market investigation: provisional findings report

Appendix 2

Market participants

Contents

Introduction

1. This appendix provides an overview of the main market participants in the UK retail banking sector.[1] The appendix is structured as follows:

   (a) Overview of retail banking.

   (b) Larger established banks with national presence: Barclays, HSBCG, LBG, RBSG and Santander.

   (c) Northern Ireland-focused banks: AIB, BoI and Danske[2].

   (d) Other banks, including new entrants and banks with more limited geographical coverage or which focus on particular product, customer segment and/or distribution channels. These include: Co-op, Clydesdale, TSB, Handelsbanken, Metro Bank, Post Office Money, Tesco Bank, Virgin Money, Aldermore and other small banks.

   (e) Building Societies including Nationwide, Yorkshire, Coventry, Skipton and Leeds.

   (f) Other alternative finance providers.

[1] Where branch numbers are quoted in this appendix they exclude Isle of Man and Channel Islands. Further details of branch numbers are in Appendix 10.2.
[2] Ulster Bank also operates in Northern Ireland and is wholly owned by RBSG.

Overview of retail banking

2. 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, telephony, internet and mobile technology.

3. The term ‘retail banking’ is generally used to distinguish these banking services from investment banking or wholesale banking. Many large UK banks have separate retail banking divisions or business units, with their own management and reporting structures, although there are differences in the way these banks define, organise and describe their retail activities.

Larger UK banks with a national presence

4. The following includes background information, the recent financial results and key performance metrics of the five largest UK retail banks during the period 2012 to 2014.

Barclays plc

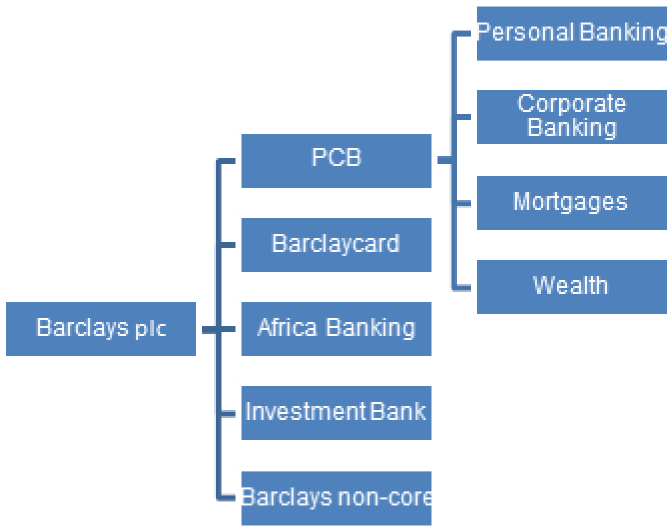
5. Barclays plc is a British multinational banking and financial services company headquartered in London. It is a full-service bank with operations in retail, wholesale and investment banking, as well as wealth management, mortgage lending and credit cards. It has operations in over 50 countries and territories, and has around 48 million customers worldwide.

6. Barclays traces its origins in the UK back to1690. Its first major expansion came in 1896 when a number of UK banks amalgamated under the name of Barclays and Co. Further major expansion occurred between1905 and 1936 with further acquisitions and mergers of a number of English and overseas banks. Since the 1930s there have been a number of further acquisitions and divestments.

7. Today Barclays operates its UK business as a single market brand, ‘Barclays’. It had 1,488 branches in the UK at the end of 2014.

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

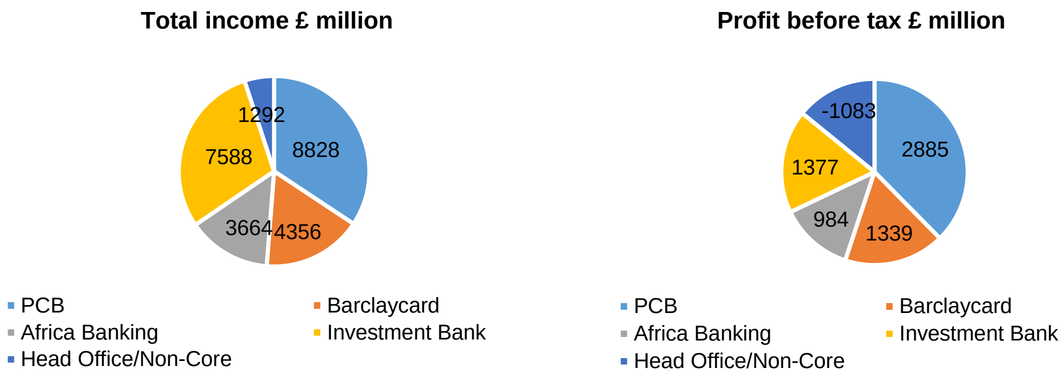
Figure 1: Barclays divisional structure[3]



Source: *Barclays plc 2014 Annual Report*.

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

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.

10. As Figure 2 shows, 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.[4] PCB provides banking services to individuals and businesses in the UK and selected international

[3] 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.
[4] Excluding group level statutory adjustments.

markets, and is subdivided into four main businesses: Personal Banking, Mortgages, Corporate Banking and Wealth.[5]

11. Personal Banking customers, including PCA customers, 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.

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

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). The cost/income ratio reported in Barclays' annual reports (which does not include other net income in the denominator) was 64%, 68% and 62% for 2012, 2013 and 2014 respectively.
†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.

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

[5] Personal Banking and Mortgages businesses constitute Barclays' 'UK retail banking' operations. *Barclays plc 2014 Annual Report*, pp17 & 231.
[6] Based on *Barclays plc 2014 Annual Report*, p232. Comparisons are with 2013 results.

(a) Profit before tax grew 29%, which was driven by growth in personal banking income, lower impairments due to the improving economic environment in the UK, and the continued reduction in operating expenses due to progress on the Transform strategy.[7]

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

(c) Net interest margin (NIM) improved 9 basis points to 3% primarily due to the launch of a revised overdraft proposition. This recognised 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 environment in the UK. This particularly impacted Corporate Banking, 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 2013. This reflected savings in total operating expenses realised from restructuring of the branch network, and technology improvements to increase automation.

HSBC Group (HSBCG)

14. HSBCG is a British multinational banking and financial services company headquartered in London. HSBCG has over 6,100 offices in 73 countries and territories across Middle East and Northern Africa, Asia, Europe, North America and Latin America. It has around 51 million customers.

15. HSBC Bank plc is a wholly owned subsidiary of HSBCG. The business ranges from traditional personal finance and commercial banking, to private banking, consumer finance as well as corporate and investment banking.

16. HSBCG acquired a 14.9% equity interest in Midland Bank in 1987. In 1989 Midland Bank launched First Direct. In 1992, HSBCG acquired full ownership of Midland Bank (including First Direct). Midland Bank was renamed HSBC Bank in 1999 as part of the adoption of the HSBC brand throughout the

[7] 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.

HSBCG. In 2004, Marks and Spencer Bank became a wholly owned subsidiary of HSBC but with its own banking licence and a profit sharing agreement with Mark and Spencer plc. HSBC currently, therefore, trades across three brands: HSBC, First Direct and M&S Bank.

17. At the end of 2014 HSBC had 1,108 branches (including M&S Bank branded branches) in the UK.

18. HSBC Bank plc is structured into four divisions: Retail Banking and Wealth Management (RBWM), Commercial Banking (CMB), Global Banking and Markets (GB&M) and Global Private Banking (GPB).

19. The RBWM division takes deposits and provides transactional banking services to customers in the UK and Europe.[8] Its main types of services include personal banking, HSBC Premier, HSBC Advance and Wealth Solutions & Financial Planning.[9]

20. The CMB division provides a broad range of banking and financial services to business customers ranging from small businesses to large corporates operating both in the UK and internationally.

21. 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.[10]

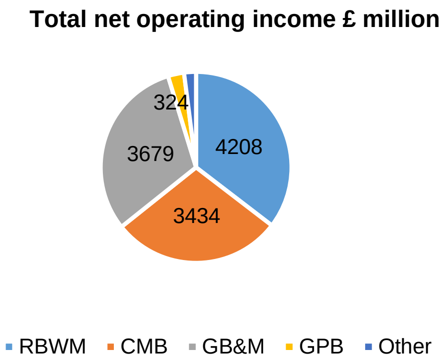
22. The GPB division provides private banking, investment and wealth management services to high net worth individuals.[11]

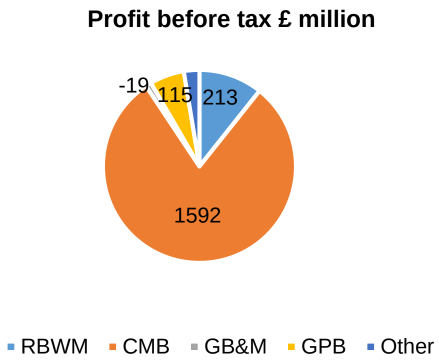
23. Figure 3 shows HSBC's 2014 net operating income[12] and profit before tax by division. As can be seen, RBWM, CMB and GB&M are HSBC's largest divisions by revenue.

---

[8] *HSBC Bank plc 2014 Annual Report*, p5.
[9] HSBC Premier provides a dedicated relationship manager to its mass affluent personal customers. HSBC Advance offers its emerging affluent customers access to range of preferential products, rates and terms. *HSBC Bank plc 2014 Annual Report*, p5.
[10] ibid, p6.
[11] ibid, p7.
[12] 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.

24. 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 and 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.

25. Table 2 summarises the recent financial performance of HSBC's RBWM division. Key points from the 2014 performance included the following:[13]

(a) Reported profit before tax was £213 million, which was £964 million or 82% lower than in 2013. HSBC also estimated 'adjusted profits' by adjusting reported results for effects of significant items, which could distort year-on-year comparisons.[14] On an adjusted basis, RBWM profit before tax was £1.3 billion compared to £1.7 billion in 2013. UK revenue reduced marginally due to spread compression, primarily on mortgages. In addition, fee income fell as a result of higher fees payable under partnership agreements and lower fee income from investment products and overdrafts. These factors were partly offset by improved spreads on savings products and higher current account balances.

(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.

[13] Based on *HSBC Bank plc 2014 Annual Report*, pp19–20 and information provided by HSBC. Comparisons are with 2013 results.
[14] 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.

26. Table 3 summarises the recent financial performance of HSBC's CMB division. Key highlights included the following:[15]

(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 on an adjusted basis was primarily in the UK due to a reduction in loan impairment charges reflecting lower levels of individually assessed provisions, together with increased levels of deposits and effective cost efficiency through the benefits arising from re-engineering of business processes which offset inflationary pressures.

[15] Based on *HSBC Bank plc 2014 Annual Report*, p21 and information provided by HSBC. 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* p16, 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.

Lloyds Banking Group (LBG)

27. Lloyds was originally founded in 1765. It expanded during the nineteenth and twentieth centuries and took over a number of smaller banking companies. In 1995 it merged with the TSB Group plc to form Lloyds TSB Group plc between 1999 and 2013.

28. LBG was formed in January 2009 through the acquisition of HBOS plc (which included the Halifax and Bank of Scotland (BoS) brands) by the then Lloyds TSB Group plc. That year, following the UK Bank rescue package, the UK government took a 43.4% stake in LBG. The European Union decided that the stake taken by the government was to be considered as state aid, and required LBG to divest some of its business. Later that year (November 2009), LBG announced that it would create a new stand-alone retail banking business, made up of a number of Lloyds TSB branches and those of Cheltenham & Gloucester.[16] Lloyds TSB was subsequently renamed Lloyds Bank on 23 September 2013, and TSB was demerged via an initial public offering to the London Stock Exchange in June 2014.

[16] Cheltenham & Gloucester is a former building society which was acquired by Lloyds TSB in 1997.

29. Following the divestment of TSB, there are no Lloyds Bank branches in Scotland, and no BoS branches in England and Wales. LBG has recently opened three Halifax branches in Scotland. As a result, at the end of 2014 LBG had 1,290 Lloyds Bank branches in England and Wales, 665 Halifax branches (of which 16 were in Northern Ireland and 3 in Scotland), and 293 BoS branches in Scotland – totaling 2,248 branches.

30. LBG is predominately UK-focused, and operates through four business divisions: Retail, Commercial Banking, Consumer Finance and Insurance.[17] 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.

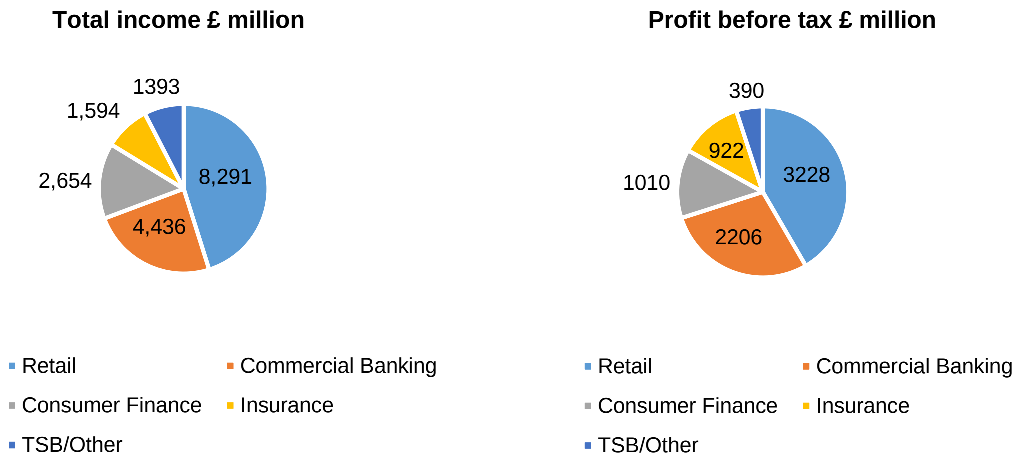
(b) Commercial Banking supports business clients (SMEs through to large corporates) with their banking, financing and risk management requirements. SME Banking is part of Commercial Banking and serves SMEs with an estimated annual turnover of between £1 million and £25 million or borrowing more than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

(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.

31. 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, contributing £8.3 billion (45% of LBG total) of revenue and £3.2 billion (42% of LBG total) of profits.

[17] In addition, it also separately reports financial results for Central Items/Run-offs. 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. 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.

Figure 4: LBG 2014 Total income and profit before tax by division[18]



Source: Based on data presented in *LBG's 2014 Annual Report*, p41.

32. 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).

33. Table 4 summarises the recent financial performance of LBG's Retail division. Key points from the 2014 performance included:[19]

(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.

(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.

---

[18] 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.
[19] Based on *LBG 2014 Annual Report*, p44. Comparisons are with 2013 results.

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, p204-205, 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).

34. Table 5 summarises the recent financial performance of LBG's Commercial Banking division. Key highlights of the 2014 performance included:[20]

(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.

(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

[20] Based on *LBG 2014 Annual Report*, p48. Comparisons are with 2013 results.

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, pp204–205, 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).

Royal Bank of Scotland Group (RBSG)

35. Royal Bank of Scotland traces its origins back to 1707 and its first London branch opened in 1874.

36. RBSG now incorporates Royal Bank of Scotland (RBS), NatWest (acquired in 2000) and Ulster Bank[21] (previously part of NatWest). It provides banking facilities throughout the UK and Ireland.

37. Following the 2007/08 financial crisis the UK government took an 81% shareholding in RBSG. RBSG was required by the European Commission to sell a portion of its business, as the shareholding was regarded as state aid.

38. As a condition of the state aid received by RBSG, the group was required to divest its RBS-branded branches in England and Wales and NatWest branches in Scotland, with the associated retail and SME customers, direct SME customers and a portfolio of mid-corporate customers. On 27 September 2013, RBSG announced that it had agreed a £600 million pre-IPO investment

[21] Ulster Bank operates in the Republic of Ireland and Northern Ireland, through Ulster Bank Ireland Limited and Ulster Bank Limited.

in its Williams & Glyn business with a consortium of investors led by global financial services specialists Corsair Capital and Centerbridge Partners. Williams and Glynn is anticipated to be separated from RBS in 2016 and fully divested by RBS by the end of 2017. Following completion of the operational and legal separation of the business into a stand-alone bank to be branded Williams & Glyn, RBSG would pursue an IPO, and the announced investment would be exchangeable for a significant minority interest in Williams & Glyn at the time of its IPO.

39. At the end of 2014 RBSG had 1,923 branches in the UK (including 74 Ulster Bank branches).

40. Since a group restructure in February 2014, RBSG has 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. In 2014, 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.

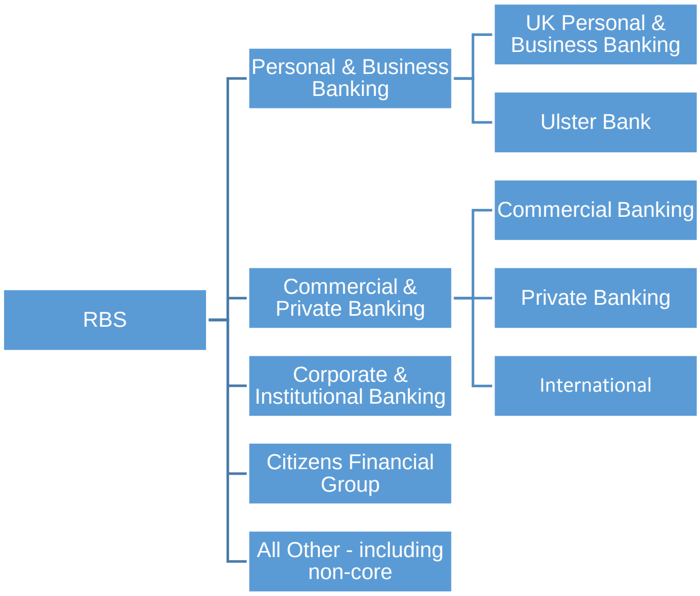
(c) Corporate and Institutional Banking (CIB) – the wholesale banking business. Contains two businesses: Markets and Transaction Services, which both provide a range of banking services to large UK and international corporates and financial institutions.

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

41. In 2014, RBSG implemented a new organisational design for a more UK-centred bank with focused international capabilities.[22] Its divisional structure is shown in Figure 5.

[22] *RBSG 2014 Annual Report*, p3.

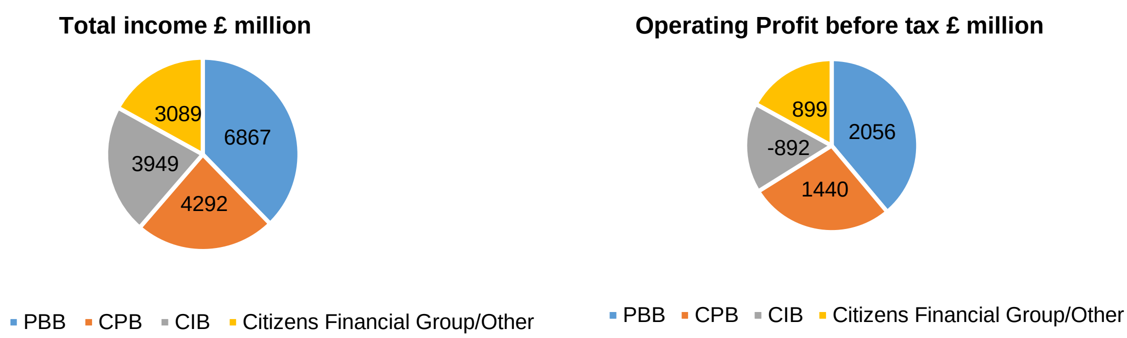
Figure 5: RBS divisions



Source: Based on *RBS 2014 Annual Report*.

42. RBSG 2014 total income and operating profit/loss by division are shown in Figure 6.

Figure 6: RBS total income and profit before tax by division[23]



Source: *RBS 2014 Annual Report*, p443.

43. 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:[24]

[23] Total income and operating profit/loss reported by segment exclude group level statutory adjustments. 'Other' includes RBS Capital Resolution (RCR) and Central Items.
[24] Based on *RBSG 2014 Annual Report*, p131. Comparisons are with 2013 results.

(a) Operating profit of £1.45 billion increased by £631 million, while adjusted operating profit (excluding restructuring and conduct costs) totalled £2.47 billion compared with £1.906 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 litigation and conduct costs. This resulted in an improved cost income ratio of 72% as against 77% reported in 2013.[25]

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

Table 6: 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.

[25] On an adjusted basis, reported cost income ratio in 2014 was 55% compared to 59% in 2013.

44. Financial information on Commercial Banking recent financial performance is shown in Table 7. Key points from the 2014 performance included:[26]

(a) Operating profit increased to £1.29 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 declined by £453 million with fewer individual cases across the portfolio, reduced collectively assessed provisions and higher latent provision releases, reflecting improved credit conditions.[27]

---

[26] *RBS 2014 Annual Report*, p139, information provided to the CMA by RBSG. Comparisons are with 2013 results.

[27] RCR was established to separate and wind down RBSG'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. *RBSG 2014 Annual Report*, p69.

Table 7: 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: *RBSG 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 (Santander)

45. Santander is wholly owned by Banco Santander, SA. Santander manages its affairs autonomously and independently from its Spanish owner, with its own local management team solely responsible for its performance.

46. Santander has been operating in the UK since November 2004 when it acquired Abbey National plc. It acquired Alliance & Leicester plc in 2008. Also during 2008, Santander acquired the deposits and branches of Bradford & Bingley plc from the UK government. In January 2010 Santander combined Abbey National plc with the savings business and branches of Bradford & Bingley, and renamed it Santander UK plc. Santander subsequently merged the Alliance & Leicester business into the renamed business in May 2010. It now operates solely under the Santander brand throughout the UK.

47. At the end of 2014 Santander had 920 branches in the UK.

48. Santander's business is managed and reported on the basis of following divisions: Retail Banking, Commercial Banking and Corporate & Institutional

Banking. Indirect income, expenses and charges which cannot be allocated to those segments are reported under the ‘Corporate Centre’ reporting segment.

49. 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).

50. The PCA business, and a part of the SME business (SMEs with annual turnover of up to around £250,000), is included in Retail Banking. Retail Banking is Santander’s main business, and contributed 82% of its total income and 94% of profit before tax in 2014.

51. Commercial Banking division provides banking services to businesses with a turnover of between around £250,000 and £500 million per year.[28] Its products include loans, bank accounts, deposits, treasury services, invoice discounting, cash transmission and asset finance.

52. 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.[29]

53. Santander’s total income and profit before tax by main division is provided in Figure 7.

Figure 7: Santander UK – total income and profit before tax by division[30]

Source: *Santander UK 2014 Annual Report*, p192.

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

[28] Based on *Santander UK plc 2014 Annual Report*, p245 and information provided to the CMA by Santander.
[29] ibid.
[30] Figure 7 includes Santander’s business divisions but excludes the Corporate Centre.
[31] Based on *Santander UK plc 2014 Annual Report*, p193. Comparisons are with 2013 results.

(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. This reflected reduced banking fees including higher cashback on 123 World products, and reduced overdraft fees. The decrease was partially offset by an increase in credit cards business and continued growth in 123 World product balances.[32]

(c) Impairment losses on loans and advances decreased by £172 million to £187 million in 2014. This was largely due to lower impairment losses as a result of improving economic conditions; rising house prices; prolonged low interest rates; and collection efficiencies introduced both in 2013 and 2014. Provision for other liability charges increased by £169 million to £395 million in 2014, predominantly due to higher Financial Services Compensation Scheme costs, UK Bank Levy, branch de-duplication and conduct charges.

Table 8: Santander Retail Banking financial results, 2012–2014[33]

	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, and 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).

[32] A Santander 123 World customer is someone who holds one or more of the following products: 123 Current Account, 123 Student Current Account, 123 Postgraduate Account, 123 Credit Card, 123 Graduate Current Account, 123 Mini Current Account or 123 Mini (in Trust). See Santander's website.
[33] These results do not cover larger SMEs, which Santander reports under Commercial Banking.

Northern Ireland-focused banks (AIB, BoI and Danske)

AIB Group (UK) Plc (AIB)

55. AIB Group (UK) Plc (AIB) is a subsidiary of Allied Irish Banks plc in the Republic of Ireland, and trades under the name First Trust Bank in Northern Ireland. First Trust Bank offers a full service to business and personal customers, across the range of customer segments, including personal customers, SMEs, and the corporate sector.

56. At the end of 2014 First Trust Bank had 30 branches in Northern Ireland providing services to PCA and BCA customers.

57. For the year ended 31 December 2014, for its operations in the UK, AIB Group (UK) plc reported turnover of €239 million and a loss of €57 million.[34]

Bank of Ireland UK (BOI)

58. Bank of Ireland UK (BoI) is owned by Bank of Ireland of the Republic of Ireland.

59. It provides PCAs and SME banking services in Northern Ireland. It also provides banking services for the Post Office in the UK.

60. At the end of 2014, BoI had 37 branches in Northern Ireland.

61. For the year ended 31 December 2014, BoI reported an operating income of £545 million and an underlying profit before tax of £103 million for its UK operations.[35]

Danske Bank

62. Danske Bank (the trading name of Northern Bank Limited) operates in Northern Ireland and is part of the Danske Bank Group, which is headquartered in Denmark. Danske Bank provides PCAs, loans, mortgages, savings products and wealth planning to personal customers. For business customers, it provides BCAs, financing, trade finance, savings, treasury services and cash management services.

---

[34] *Allied Irish Bank Group Country by Country Reporting – for the year ended 31 December 2014*.
[35] *Bank of Ireland Annual Report – for the year ended 31 December 2014.*

63. At the end of 2014 Danske had 46 branches in Northern Ireland.

64. For the year ended 31 December 2014, for its Northern Ireland operations, Danske Bank Group reported total income of £223.6 million and profit before tax of £117.5 million.[36]

Other banks

65. Descriptions of Metro, Tesco, Virgin Money and TSB are in Appendix 10.2 in our case studies on entry and expansion.

66. Aldermore was established in 2009 and is an SME-focused bank, which provides financial services to SMEs, homeowners and savers. Aldermore specialises in secured lending to SMEs and homeowners in four market segments. These are:

(a) Asset finance: Aldermore offers asset finance loans on single transactions between £5,000 and £1 million in value primarily to fund capital investment in assets including plant and machinery, commercial vehicles, cars, IT equipment and business equipment. As at 30 June 2015 it had net loans of £1.2 billion and an estimated 3% share of the total UK asset finance market.

(b) Invoice finance: Aldermore provides working capital for SMEs by lending against outstanding invoices. At 30 June 2015 it had net loans of around £0.2 billion, which it estimated represented 0.9% of the total UK invoice finance market.

(c) SME commercial mortgages: Aldermore offers SME commercial mortgages of up to a maximum of £2 million on a single property and £5 million on multiple properties. At 30 June 2015 it had net loans of £1.1 billion, an estimated 0.9% of the total UK SME commercial mortgage market.

(d) Residential mortgages: Aldermore offers residential mortgages of up to £1 million and as at 30 June 2015 had net loans of £2.9 billion or 0.6% of the UK residential mortgage market.

67. Aldermore also offers a range of SME and personal savings products including deposit-based easy access, notice accounts and fixed-term bonds

[36] *Danske Bank in Northern Ireland: Financial results – 12 months to end December 2014*.

which it launched in 2012. In November 2013, it launched its Customised Fixed Rate Business Savings Account.

68. It listed on the London Stock Exchange in March 2015. For the year ended 31 December 2014 it reported total operating incomes of £165 million and profit before tax of £56.3 million.[37]

The Co-operative Bank plc (Co-op)

69. The Co-operative Bank plc provides a full range of banking services to retail and SME customers.

70. Up until 2013, the Co-op was wholly owned by the Co-operative Group. However, in 2013 and 2014, the Co-op was the subject of liability management and capital raising exercises to address a capital shortfall. As a result, the Co-operative Group became only a minority shareholder, holding just over a 20% stake in the bank. The remaining approximately 80% was held by strategic investors and other recipients of shares from the liability management exercise.

71. At the end of 2014 the Co-op operated 222 branches in the UK and seven business banking centres.

Clydesdale Bank plc (Clydesdale)

72. Clydesdale Bank plc (Clydesdale) operates under the Clydesdale and the Yorkshire brands in the UK. It is owned by National Australia Bank Limited (NAB), which acquired it from the Midland Bank in 1987. Clydesdale provides PCAs and SME banking services.

73. NAB has announced its intention to pursue a demerger and IPO of Clydesdale. This would be via a demerger of 70–80% of shares to existing NAB shareholders and an IPO of approximately 20–30% of its shares to other institutional investors.

74. At the end of 2014 Clydesdale had 294 retail branches in the UK. Clydesdale also had a further 40 Business & Private Banking Centres (including 23 sites co-located with its retail branches). It does not have any branches in Northern Ireland.

[37] *Aldermore Annual Report and Accounts 2014.* Tax excludes IPO costs of £6 million.

Handelsbanken

75. Handelsbanken is the trading name of Svenska Handelsbanken AB (publ), incorporated in Sweden. It has 201 branches in the UK and provides private and corporate customers with a range of services. Services for personal customers include: PCAs, mortgages, personal loans, savings and wealth management services. Services for corporate customers include: asset and trade finance, cash management, mortgages, loans, invoice discounting and BCAs.

Post Office Money

76. The Post Office provides credit cards, current accounts, insurance products, mortgages and personal loans through the Post Office Money brand which was launched in 2015. Most Post Office Money branded products are provided by Bank of Ireland (UK) plc with Post Office Ltd acting as an appointed representative and credit broker.

77. Personal banking services are offered on behalf of a number of other banks. Although different services are available on behalf of different institutions, these may include: cash withdrawals, paying-in cash and cheques, balance enquiries and cheque encashment. Some post offices also have cash machines, mainly provided by Bank of Ireland. Business banking services are also offered, mainly through Santander UK.

78. The Post Office has around 11,500 branches in the UK.

Other smaller banks

79. Other smaller banks include:

(a) **Paragon Bank**: Paragon bank is a wholly owned subsidiary of The Paragon Group of companies, one of the UK's largest specialist lenders. The Group was established in 1985 and offers buy-to-let mortgages, consumer and SME loans, together with a range of savings accounts available online through Paragon Bank.

(b) **Shawbrook** is a specialist lending and savings bank which offers lending services to SMEs and property investors whose needs cannot be met by the main high street banks. It offers online personal and business savings accounts.

(c) **SecureTrust Bank** was established in 1952 and provides a range of lending and deposit services as well as a fee-based current account to

personal and business customers. It does not have any branches, although customers can pay money in at Barclays' branches.

Building societies (Coventry, Nationwide, Skipton, Leeds and Yorkshire)

80. We provide details here on the five largest building societies in the UK.[38]

Coventry Building Society

81. Coventry Building Society is the third largest building society in the UK. It provides a range of personal accounts, including PCAs, mortgages, insurance, and savings and investments. It has 70 branches and 22 agencies[39] in the UK.

Nationwide Building Society

82. Nationwide is the UK's largest building society as well as one of the largest savings providers and the second largest provider of mortgages in the UK. It offers a range of financial products, including:

    (a) Personal products: PCAs, residential mortgages, personal savings, personal financial planning, insurance products, personal lending, and other general personal banking services.

    (b) Other products: commercial lending.

83. At the end of 2014 Nationwide had 696 branches in the UK serving personal customers. It does not provide BCAs.

84. For the year ended 4 April 2015, Nationwide generated underlying income of £3,152 million and underlying profit of £1,216 million.[40]

Skipton Building Society

85. Skipton Building Society is the fourth largest building society in the UK. It provides savings, mortgages, investments and insurance products but does not provide PCAs. It has over 90 branches in England and Scotland.

---

[38] By assets as at 31 December 2014 (as at 4 April 2015 for Nationwide).
[39] For example, in estate agents.
[40] *Nationwide Building Society Preliminary Results year ending 4 April 2015*.

Leeds Building Society

86. Leeds Building Society is the fifth largest building society in the UK and provides PCAs, savings, mortgages, investments and insurance products. It has over 60 branches, mostly in England.

Yorkshire Building Society

87. The YBS Group includes Yorkshire Building Society and its brands Barnsley Building Society, Chelsea Building Society and Norwich & Peterborough Building Society, and its subsidiary companies including Accord Mortgages. PCAs are only offered under the Norwich and Peterborough Building Society brand. YBS Group provides mortgages, savings accounts, and insurance products. It has 230 branches and 96 associated agencies in the UK.

Other market participants

Crowdfunding

88. Crowdfunding is the raising of funds for a project, venture or initiative by seeking contributions from a wide range and usually large number of contributors. It is typically internet-based and comprises a proposal or project idea, those that wish to provide funds to support it, and is usually facilitated by an intermediary website. Funds are usually raised for specific projects.

89. There are a number of different types of crowdfunding, including equity-based, donation-based, rewards-based, and revenue/profit sharing crowd-funding, depending on the expected type of return on investors. Market participants include Indiegogo (launched 2008) which has funded more than 275,000 campaigns, and Kickstarter (launched 2009) which has funded around 100,000 projects globally.[41]

Peer-to-peer lending

90. This is a variant of crowdfunding where an intermediary matches investors with those looking for loans and usually spreads investments across a large number of borrowers. Funds invested in a peer-to-peer company usually receive a guaranteed percentage return but are not usually protected by the FSCS.[42] Some peer-to-peer lenders offer the option to bid to invest on specific projects at a rate chosen by the investor, whereas others have simpler models

---

[41] Kickstarter website.
[42] Financial Services Compensation Scheme.

offering a fixed rate of return based on the lending period. Market participants include Zopa (launched 2005), Crowdcube (launched 2009), Funding Circle (launched 2010), Rate Setter (also launched 2010) and Thincats (launched 2011)

Invoice trading/finance

91. Firms sell their invoices or receivables to a pool of individual or institutional investors, which is similar to invoice discounting offered by banks. Market participants include Bibby (founded 1982, with around £500 million of lending per year), Market Invoice (launched 2011 with £450 million of invoice finance to date) and Platform Black (launched 2011 with £100 million of invoice finance to date).

Community shares

92. This is a form of share capital that can only be issued by co-operative societies, community benefit societies and charitable community benefit societies. It is used for community purposes such as financing shops, pubs, community buildings, renewable energy initiatives, local food schemes, along with other community-based ventures.[43]

Pension-led funding

93. This allows SME owners/directors to use their accumulated pension funds in order to re-invest in their own businesses. Intellectual property can also be used as collateral.

Debt-based securities

94. Lenders receive a non-collateralised debt obligation typically paid back over an extended period of time. This is similar to purchasing a bond, but with different rights and obligations.

---

[43] Community shares.

Financial performance

Contents

Page

Introduction

1. This appendix provides details on the financial performance of the UK retail banking sector. It includes 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.[1]

Retail banking financial performance

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.

Background

3. 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.

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

[1] The information and data we gathered was from the published annual reports and accounts of Barclays plc, HSBC Bank plc, Lloyds Banking Group plc (LBG plc), Royal Bank of Scotland Group plc (RBSG plc) and Santander UK plc.

Box 1: Examples of description of retail banking activities by UK banks[2]

> **Barclays:** 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**: 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.
>
> **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**: 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.

5. We reviewed selected industry publications, reports by equity analysts and consulting firms to understand key profitability drivers of the retail banks in the UK, as well as emerging trends from their recent financial performance. Key findings from these are discussed below.

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

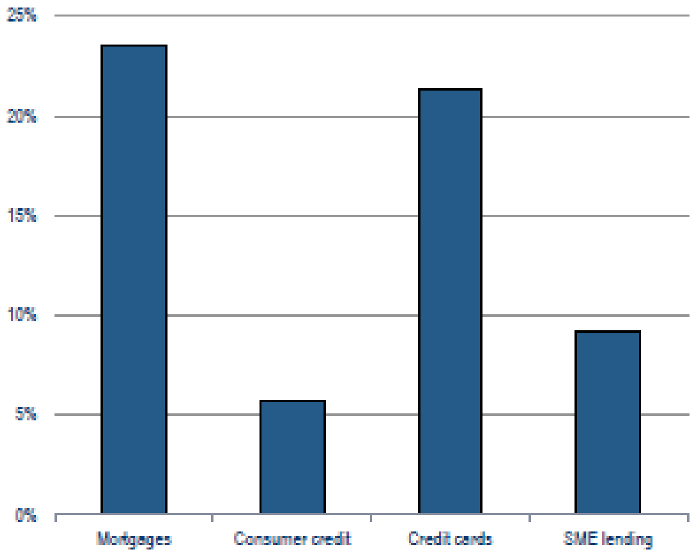
> …despite 2013 profits being slightly lower compared to 2012 profits, we see a good return on equity (ROE) – after adjusting for the many one-off Profit and Loss (P&L) impacts and regulator fines – in the retail and business banking market as a whole, and opportunities for further improvement. We also observe widening

[2] 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.

differences across markets, ranging from rising returns in the UK and Swedish markets to weakening returns in Spain and Italy.[3,4]

7. A 2014 Credit Suisse (CS) report on UK retail banking concluded that based on reported ROE,[5] mortgages were the most profitable lending product, followed by credit cards, with SME lending and consumer credit having lower returns – see Figure 1 below.[6]

Figure 1: Aggregate 'clean' return on equity by product – 2013[7]



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

8. CS concluded that the level of a retail bank's profitability depended on a combination of the following:[8]

(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.

---

[3] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p1.
[4] An earlier report (Oliver Wyman, 2012, *Perspectives on the UK Retail Banking Market*, p3) stated that 'Leaving aside Payment Protection Insurance (PPI) compensation provisions, banks' core returns in UK remain high and stable…'.
[5] 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.
[6] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 10. This report covered 13 UK retail banks.
[7] '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.
[8] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 8. This report covered 13 retail UK banks.

(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.

9. 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).[9]

10. According to a 2014 Deutsche Bank (DB) report, the key drivers of the retail banking profitability in the UK were mortgages and customer deposits, the former of which consumed fairly little capital and delivered fairly stable returns over time.[10] Based on its analysis, DB concluded that UK retail banking was a 'high return, stable industry', which produced an underlying Return on Tangible Equity (ROTE) of 22% over the 14 years 2000-2013.[11] [12] [13] DB stated that since 2009, retail banks' returns had been lower, producing an average underlying ROTE of 17% between 2009 and 2013.[14] 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.[15]

11. KPMG, in an analysis of the 2014 financial results of five UK headquartered banks (Barclays, HSBC, LBG, RBSG and Standard Chartered Bank (SCB)), stated that while these banks were organisationally very different,[16] there were a few general themes emerging from their recent financial performance. These included the following:[17]

(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.

---

[9] ABI (2012), *Investibility of UK Banks*, p16.
[10] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p8.
[11] In general terms, ROTE is computed using profit attributable to shareholders and shareholder equity less intangible assets. ROTE typically is higher than ROE.
[12] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p5.
[13] 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.
[14] ibid, p5.
[15] ibid DB did not state a benchmark cost of tangible equity in its report.
[16] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?*, p17.
[17] ibid, pp11–13.

12. 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.[18] It also stated that tightened regulations were likely to continue to drive up equity requirements and the cost of doing business while limiting revenues.[19] 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.[20] A T Kearney pointed out that retail banks in the UK still struggled due to spread compression, primarily on mortgages.[21]

13. 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.[22]

14. 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.

Key financial metrics – UK retail banks

15. 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.[23,24] 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 financial information, it also has many limitations, including the following:

---

[18] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* cover page.
[19] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p1. See Annex A for A T Kearney summary of the effect of regulation on profitability in Europe's retail banking sector.
[20] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p1.
[21] ibid p4.
[22] ibid p8.
[23] The information and data we gathered was from the published annual reports and accounts of Barclays plc, HSBC Bank plc, LBG plc, RBSG plc and Santander UK plc.
[24] Appendix 2.1 provides a summary of the recent financial performance of the retail banking divisions in scope of our analysis.

(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 financial metrics net of what their management considers exceptional or non-recurring items, while others do not.[25]

16. Due to these limitations, financial data and metrics reported in annual reports and accounts are 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.[26]

Divisional structures

17. 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.[27]

---

[25] These exceptional items can be large (eg PPI remediation), thus increasing the difficulty in comparing financial results across banks.
[26] 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.
[27] 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'

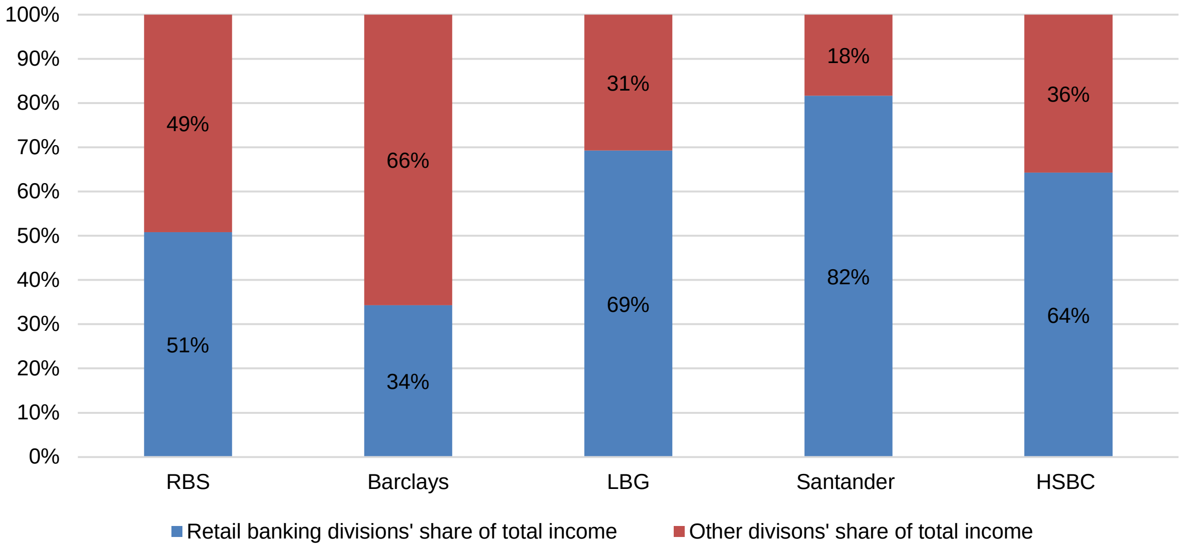
Bank	*Division/segment*	*Activities*	*Geographical focus*	*Comments*
Barclays plc	PCB	• Personal banking including PCAs • Corporate banking (including SME banking services) • Mortgages • Wealth management	UK & selected international markets	New divisions implemented in May 2014; earlier UK retail banking 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	
Lloyds Banking Group plc	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	
Royal Bank of Scotland Group plc	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 of up to around £250,000	UK	New reporting segments introduced in March 2015
	Commercial Banking	• Serves businesses with an annual turnover of between around £250,000 and £500 million	UK	

Source: Banks' 2014 annual reports, CMA analysis.

18. 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 average, derived close to 60% of their total revenues from their retail divisions.[28]

[28] 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



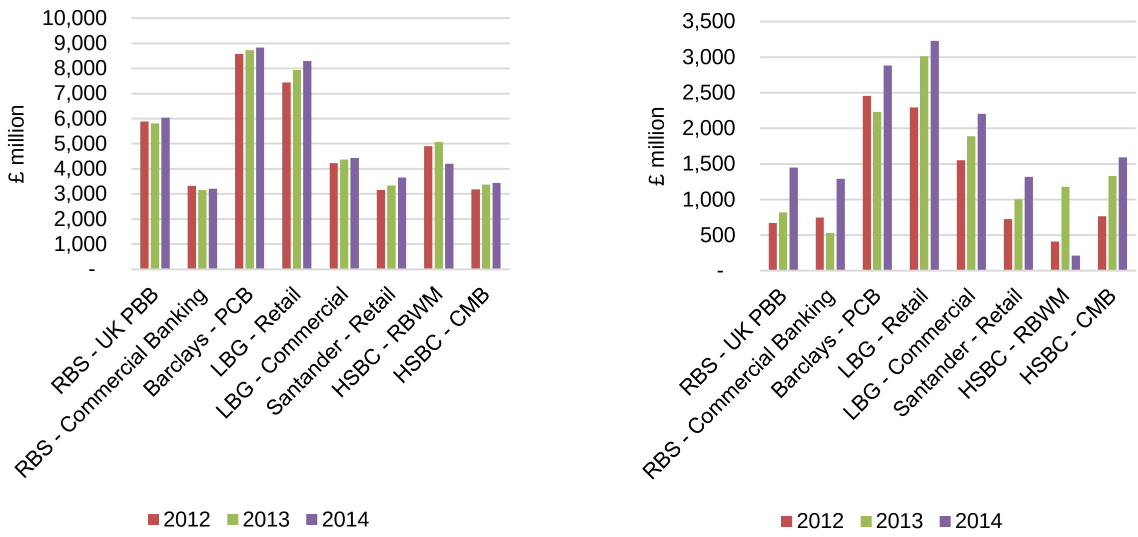
Source: Collated by the CMA based on banks' annual reports.

19. 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.[29] 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.[30]

[29] Based on the banks' 2014 annual reports.
[30] Profit before tax reflects the following in banks' published annual reports and accounts: RBSG plc – Operating profit; Barclays plc – Profit before tax; LBG plc – Underlying profit; Santander UK plc – Profit on continuing operations before tax; HSBC Bank plc – Profit before tax.

Figure 3: Income and profit before tax – retail banking divisions[31]

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

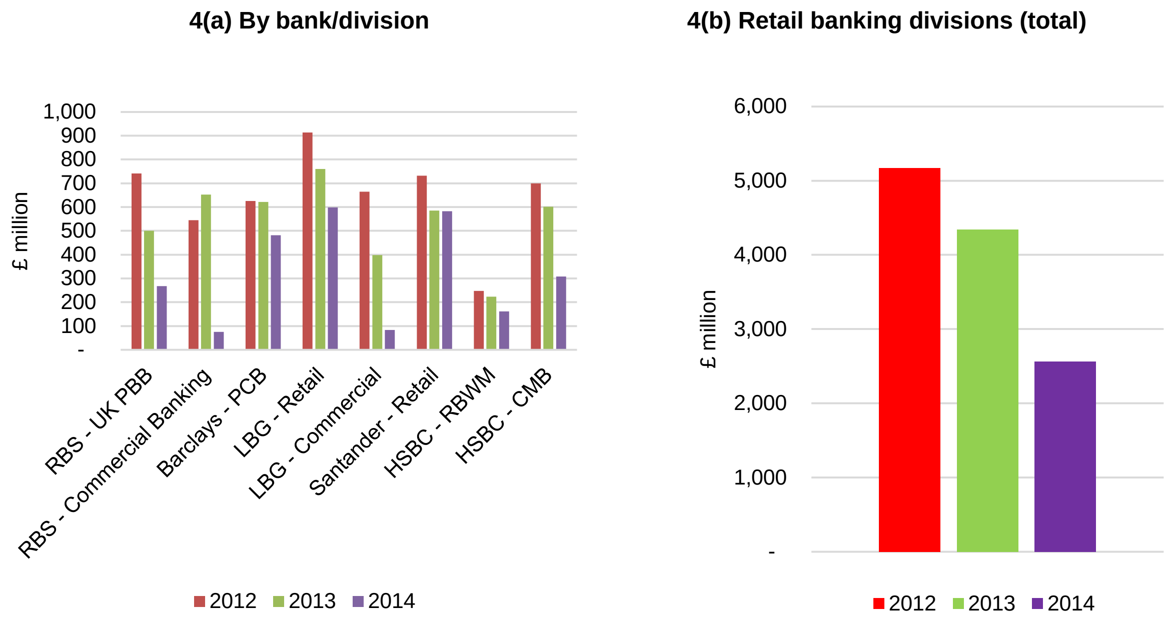


Source: Collated by the CMA based on the banks' annual reports.

20. 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.[32]

[31] 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.
[32] 'Impairments and other provisions' represent the following in banks' published annual reports and accounts: RBSG plc – Impairment losses; Barclays plc – Credit impairment charges and other provisions; LBG plc – 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



Source: Banks' annual reports, CMA analysis.

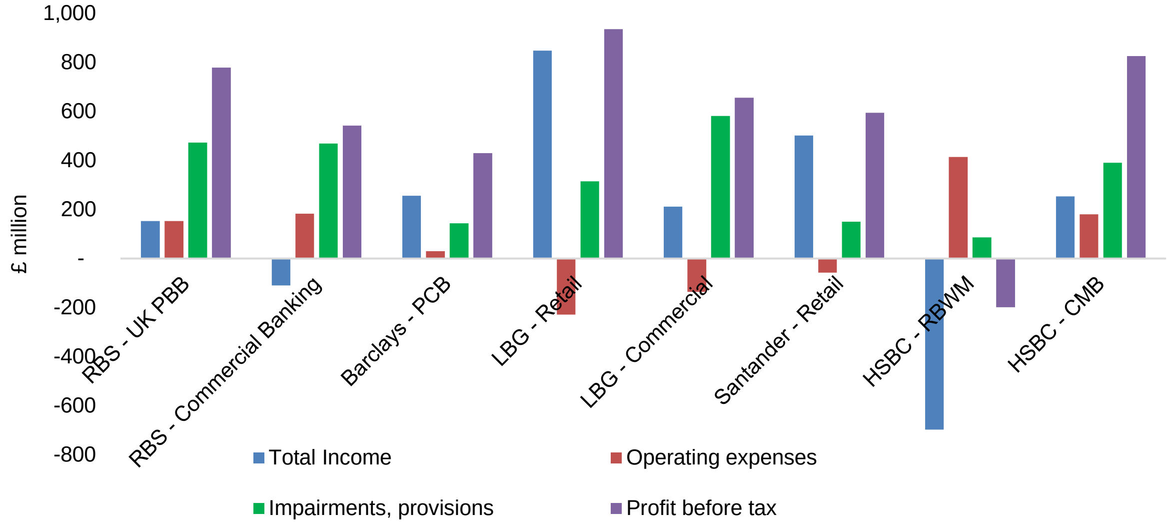
21. Figure 5 shows the components of change in the retail banking divisions' reported profits during 2012 to 2014.

22. 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).

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

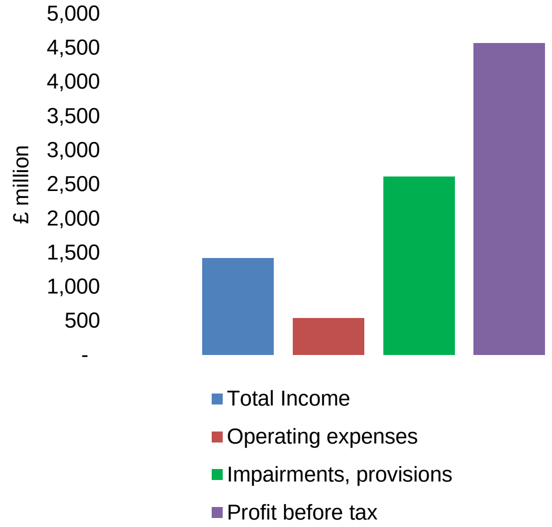
Figure 5: Components of change in profit before tax between 2012 and 2014

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.

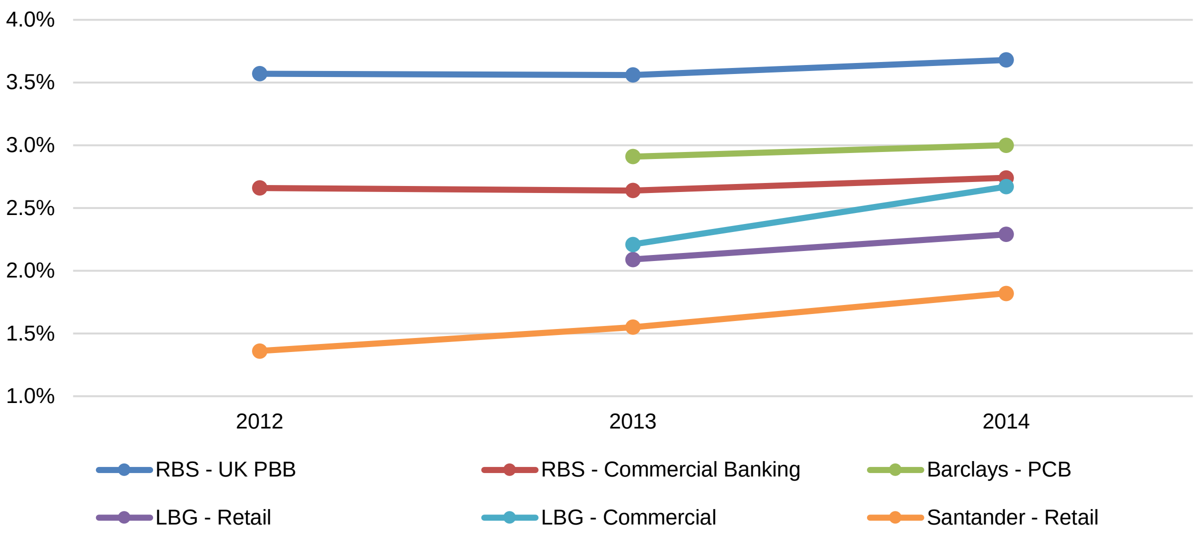
24. We now present summary charts showing financial metrics during the period 2012 to 2014 for the main divisions of the five largest UK retail banks:[33]

[33] 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.

25. As noted, 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[34]

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.

26. 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.

27. 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.[35]

28. KPMG in its analysis of 2014 financial results of the five large UK-headquartered banks (Barclays, HSBC, LBG, RBSG and SCB) reported that the predominantly UK-focused banks achieved an improvement in NIM due to re-pricing deposits and targeting specific customer portfolios.[36] According to

---

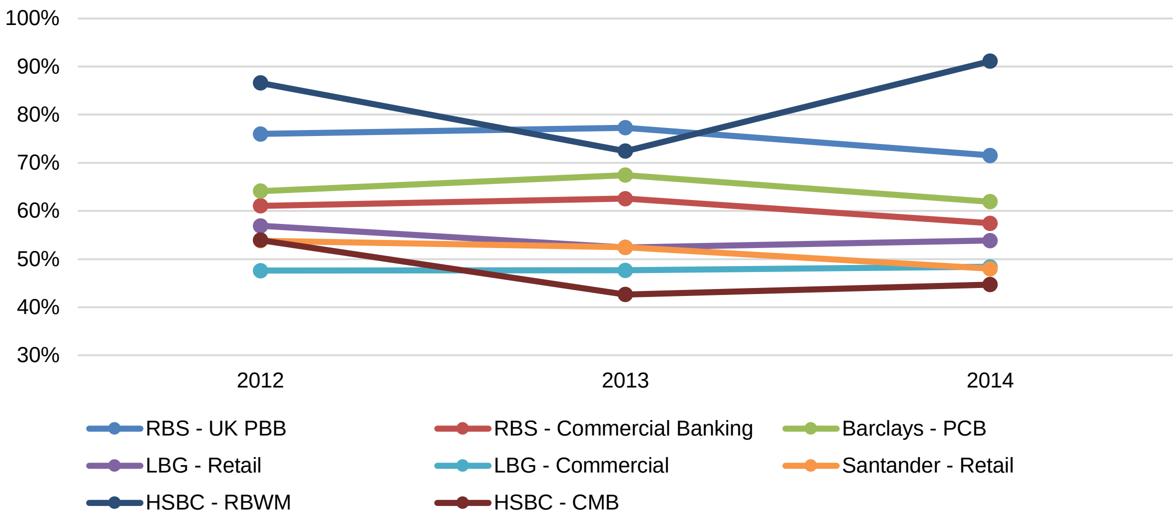
[34] NIM is a key performance metric used in retail banking, and in general terms, refers to the spread earned between lending and borrowing costs. The reported data is based on each bank's definition of NIM.
[35] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014. p 5. This report did not cover 2014 performance.
[36] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?* p11.

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.[37]

29. 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.[38] Similarly, a BoE working paper found that high interest rates were associated with large interest income margins.[39]

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 plc – Total costs; RBSG plc – Operating expenses; Santander UK plc – Total operating expenses.

30. 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 cost income ratios of all retail divisions, declined from about 63% in 2012 to about 60% in 2014.[40]

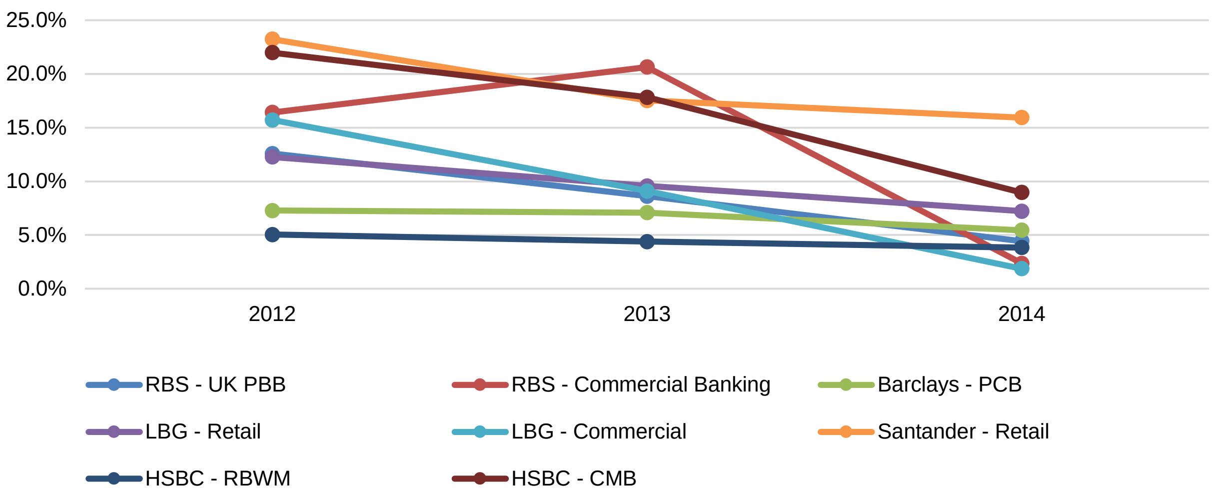
[37] ibid. KPMG reported average NIM in basis points (bps), a unit that is equal to 1/100 of 1%. The reported NIMs in bps were 213.0 for 2014, 209.9 for 2013 and 206.6 for 2012.
[38] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p7.
[39] According to the paper, 'In 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.
[40] Based on 'adjusted' results reported in the annual reports of 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

31. According to a recent KPMG report, the average cost income ratio for the 'Big Five' UK banks (as characterised by KPMG), was 63% in 2014, which was similar to that of 'Challengers' (excluding NAB) at 64%.[41] 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.[42]

32. 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.[43]

Impairments and other provisions

Figure 8: Impairments and other provisions as % of total income[44]



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 plc – Impairment; RBSG plc: Impairment losses; Santander UK plc – Impairment losses on loans and advances, provisions for other liability and charges.

review of compliance with the Consumer Credit Act in the UK. HSBC Bank plc annual reports 2014 (p18), 2013 (p16).

[41] 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*, pp3 & 22.

[42] ibid, p3.

[43] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p12.

[44] [✂] 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.

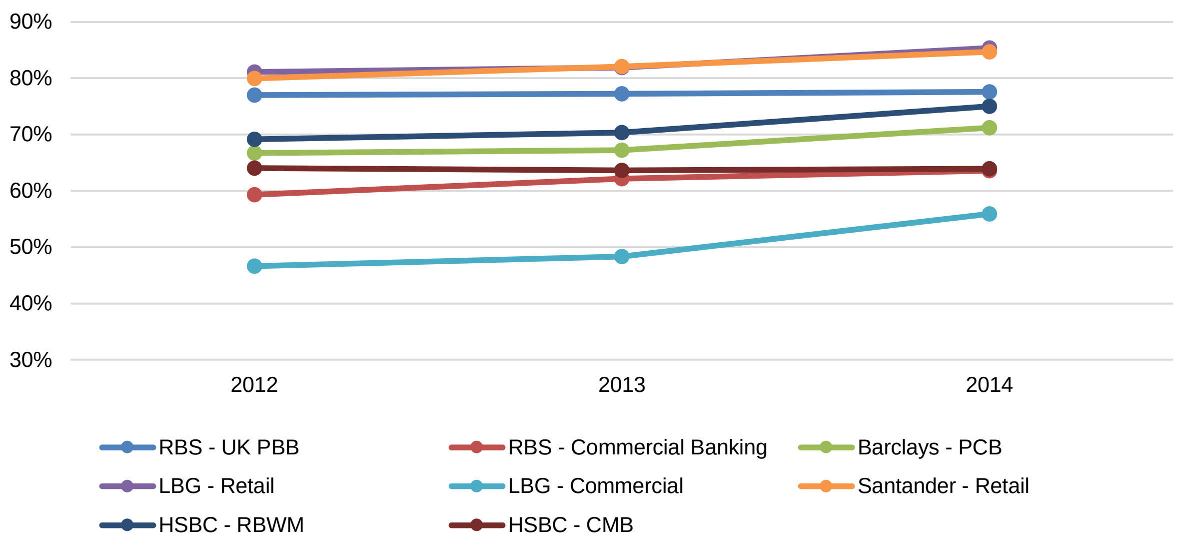
33. As Figure 8 shows, the percentage of impairments and other provisions to total income saw a decline for all banks during 2012 to 2014. For all retail banking divisions taken together, this percentage declined from an average of 14% in 2012 to about 6% in 2014.[45]

34. 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…'[46]

35. 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.

Share of net interest income

Figure 9: Net interest income as % of total income



Source: Banks' annual reports, CMA analysis.

36. 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.

37. 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.[47] According to CS,

[45] 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.
[46] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?*, p13.
[47] Credit Suisse UK Retail Banking Seminar. July 2014. Slide 14.

beyond cyclical trends, 'there has been a more structural shift in the industry's ability to generate peripheral revenues beyond pure interest-related income.'[48]

38. 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.[49] 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.'[50]

Return on equity

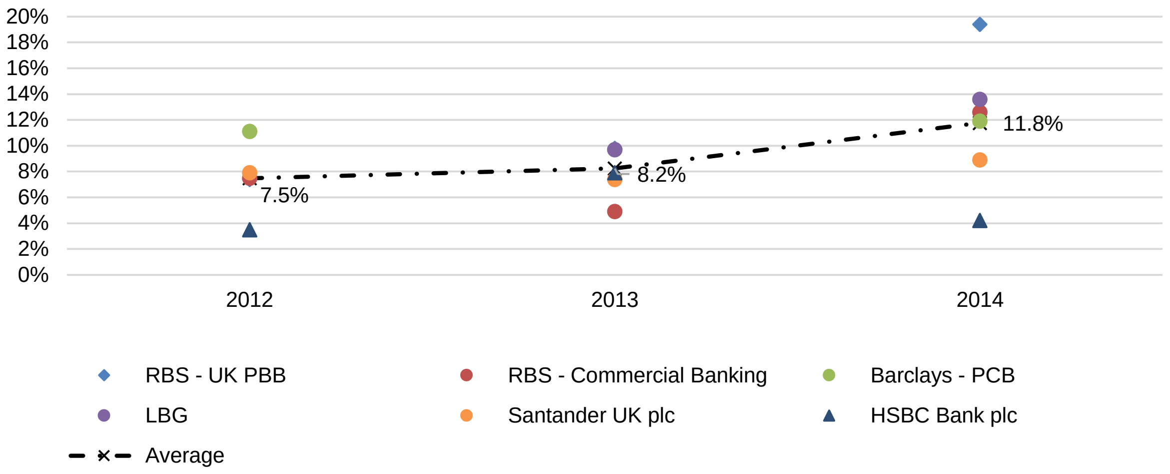
39. ROE is a commonly used performance metric used by many retail banks in the UK. However, the methodology used to calculate the ROE, and the disclosure of ROE at divisional level in the published accounts varies across banks. Some banks report ROE only at the group rather than divisional level. Some 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.[51]

40. 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.[52]

---

[48] ibid.
[49] A T Kearney,*The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p4.
[50] ibid.
[51] We also note that ROE is an accounting based performance measure, and only one of the indicators of the banks' underlying profitability.
[52] 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 plc's 'Underlying return on required equity', LBG plc 2014 annual report, p39. RBS ROE reflects respective division's 'Return on equity', RBSG plc 2014 annual report, pp130, 138. Santander ROE reflects Santander UK plc's 'Return on ordinary shareholders' funds', Santander UK plc 2014 annual report, p355.

Figure 10: Return on equity



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

41. 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.

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

43. 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.[53] [54] 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.[55] Oliver Wyman stated that cost reduction provided the main lever for profit improvement in the near term in many markets.[56]

44. 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

[53] 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.
[54] 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. Annex B provides ROE from 2004 to 2011 as calculated by Oliver Wyman for UK retail and small business banking. 2011.
[55] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p5.
[56] ibid, p4.

the below-the-line items of which a significant portion had become a more recurrent feature of UK retail banking.[57]

45. 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.[58]

46. 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.[59,60]

47. 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%.[61] 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.[62]

   (c) Methodology: for example, Oliver Wyman reported ROEs 'normalised' with capital calculated as a percentage of risk-weighted assets,

---

[57] 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.
[58] 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.
[59] EY (2015), European Banking Barometer.
[60] 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.
[61] Our analysis (Figure 10) showed that UK retail banks' average reported ROE during 2012 to 2014 was about 9%.
[62] Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery*, p23.

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.

48. 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 continued to recover from the financial crisis and gained from lower impairments.

Conclusion on retail banking financial performance

49. 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;

(c) declining cost income ratio and impairments;

(d) improving profits and returns; and

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

Annex A: Impact of regulation on profitability

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

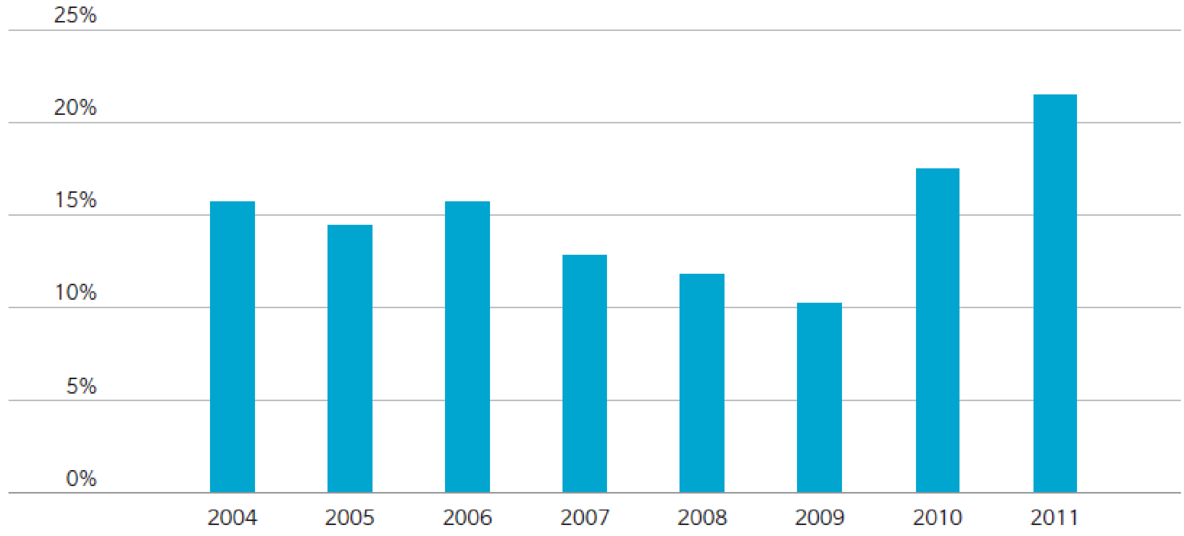
Not exhaustive

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

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

Annex B: 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).