Retail banking market investigation: provisional findings report

Appendix 4

Previous approaches to market definition in retail banking

Background

1. This appendix summarises the approaches to market definition taken by the OFT, the CC and the CMA in previous investigations into retail banking industries. The Appendix is split into two sections, each dealing with PCAs and SME banking markets respectively.

Previous findings in the provision of personal current accounts

2. In the past there have been several instances in which the OFT and the CC have looked into the provision of PCAs. This includes the CC's 2007 investigation into personal current account banking services in Northern Ireland,[1] the OFT's 2008 market study into PCAs in the UK,[2] the OFT's 2008 report to the Secretary of the State on the anticipated acquisition by Lloyds TSB of HBOS,[3] the OFT's 2013 review of the PCA market[4] and the CMA's 2014 PCA market study update.[5]

3. The CC's 2007 market investigation into PCA banking services in Northern Ireland listed the following as the main characteristics of a PCA:

   (a) provision of a facility to deposit and store money, with quick and easy access;

   (b) provision of a facility to receive payments by cheque or electronic transfer;

   (c) provision of a facility to make instant and/or regular payments without using cash, eg through cheques, switch payments, bank transfers, standing orders and direct debits; and

   (d) provision of the means for short-term borrowing through an overdraft.

4. It then looked at whether other products could substitute for these four functions of a PCA. In particular, the CC looked at whether financial products that did not provide all four functions, such as BBAs, instant access savings accounts and credit union accounts, could act as substitutes for a PCA. The

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[1] CC (2007), *Personal current account banking services in Northern Ireland market investigation*.
[2] OFT (2008), *Personal current accounts in the UK*.
[3] OFT (2008), *Report to the Secretary of the State for business enterprise and regulatory reform on anticipated acquisition by Lloyds TSB of HBOS plc.*
[4] OFT (2013), *Review of the personal current account market*.
[5] CMA (2014), *Personal current accounts – market study update*.

CC saw no evidence of any competitive reaction to the introduction of other personal financial products. Nor did it see any evidence in internal pricing papers provided by the banks that any other products were monitored or considered in the banks' decision-making processes on PCAs. Despite recognising that some customers may have turned to alternative products, such as BBAs, the CC noted that there was indication that enough considered doing so to require any of the banks to alter their behaviour, and therefore there was no evidence of a competitive constraint being exerted on PCAs.[6]

5. For these reasons, the CC found that other personal financial products could not readily be substituted for a PCA except for a small minority of customers with straightforward financial affairs, and that there are enough such customers to constrain PCA pricing.[7]

6. Supply-side substitution analysis showed that, given significant barriers to entry and expansion and the low switching rates, it was unlikely that potential entrants, such as building societies, credit unions and suppliers of other personal finance products, could quickly, easily and profitably switch to providing PCAs in the event of price increase. Given the above, the CC did not consider that other financial products exerted effective competitive constraint on PCAs. The CC also did not believe that there was a broader market including all financial products.[8]

7. The CC concluded that the relevant product market should include all PCAs, including packaged accounts, but should not be drawn more widely to include BBAs, instant access savings accounts, credit union accounts, offset/current account mortgages or other personal financial products.[9]

8. With regard to the relevant geographic market, the CC considered that there was a lack of close demand- or supply-side substitutability between Northern Ireland and Great Britain, and considered that the relevant geographic market should consist of Northern Ireland only. It also saw no need to define the market at a local level, given that banks in Northern Ireland did not operate their policies on a local basis, chain of substitution between overlapping local markets, and the fact that customers may access branches from several locations.[10]

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[6] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraphs 3.5–3.12.
[7] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraph 3.13.
[8] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraphs 3.14–3.26.
[9] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraphs 3.2–3.30.
[10] CC (2007), *Personal current account banking services in Northern Ireland market investigation,* paragraphs 3.31– 3.37.

9. The OFT's 2008 market study into personal current accounts in the UK relied on the CC's findings and did not provide a formal market definition. However, it included basic bank accounts in its assessment together with other PCAs. It looked at Great Britain and Northern Ireland separately.[11]

10. Similarly, the OFT's 2008 report to the Secretary of the State on the anticipated acquisition by Lloyds TSB of HBOS also relied on the product market definition established by the CC. In relation to the relevant geographic market, the OFT focused on Great Britain only as Lloyds did not operate in Northern Ireland. The OFT noted that the merging parties' market shares were not consistent throughout Great Britain, with HBOS's market share being three times bigger in Scotland than in England and Wales, and considered that the merger could lead to significant changes in the relative market shares between Scotland, and England and Wales. On the basis of the limited evidence available, the OFT considered that the possibility that Scotland should be considered as a separate geographic market could not be excluded. With respect to the local markets, the OFT noted the importance of branch network and considered that there was local competition to attract and retain customers, even if not on every parameter of price, quality, range and service specifications. It therefore was unable to exclude the possibility that a merger that significantly increases local market concentration in the supply of PCAs through branch access could raise substantial competition concerns at the local level.[12]

11. In its 2013 PCA market review, the OFT described PCAs as services providing the facility to hold deposits, receive and make payments using cheques, debit cards, direct debits, standing orders, and continuous payment authorities, as well as to use ATMs and transfer money. Additionally, many PCAs have overdraft facilities. It identified six main PCA types: standard, packaged, premium, student, basic and youth accounts.[13]

12. Similarly, in its 2014 PCA market study update, the OFT considered that PCAs provided the following services:

    (a) allowing payments such as wages and benefits to be received;

    (b) allowing payments to be made to others (both spontaneous, like debit card payments, and planned, such as standing orders and direct debits);

[11] OFT (2008), *Personal current accounts in the UK*, paragraphs 2.1–2.13 & 3.4.
[12] OFT (2008), *Report to the Secretary of the State for business enterprise and regulatory reform on anticipated acquisition by Lloyds TSB of HBOS plc*, paragraphs 90–100.
[13] OFT (2013), *Review of the personal current account market*, paragraphs 3.4–3.15.

(c) holding balances for consumers; and

(d) offering a line of credit through overdrafts.

13. However, the OFT did not engage in its own market definition exercise, and adopted the approach taken in its 2013 PCA market review.

14. Finally, the OFT also considered whether the developments in the area of payment services, such as PayPal and Google Wallet, represented challenges to PCA providers. It recognised that alternative service providers, such as PayPal, were developing payment services that may allow customers essentially to 'bypass' their PCA providers for certain transactions and could potentially represent a threat for PCA providers in the following ways:

(a) banks may lose the interchange income associated with the transactions;

(b) banks might get less data on their customers' purchasing behaviour; and

(c) their relationship with their customers might become weaker.

However, the OFT stressed that none of these products could be used to substitute for a PCA; for example, customers still required a PCA to get their wages or benefits paid in or to access an overdraft. It also expressed its uncertainty about the future developments in the market, noting that on the one hand, new entry in the market for PCAs might become more likely as alternative payment services providers might find it easier to provide PCAs once they created a base in payment services. On the other hand, new entry might become less likely if PCAs became less attractive for providers due to the decrease in opportunities to build relationships with customers and collect data on their purchasing behaviour.[14]

Previous findings in the provision of SME banking services

15. In the past there have been several instances in which the OFT and the CC have looked into the provision of SME banking services. This includes the CC's 2002 market investigation into the supply of banking services by clearing banks to SMEs,[15] the OFT's 2008 report to the Secretary of the State on the anticipated acquisition by Lloyds TSB of HBOS[16] and the CMA's 2014 market study into SME banking.[17]

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[14] CMA (2014), *Personal current accounts – market study update*, paragraphs 2, 2.64–2.65 & 6.10–6.11.
[15] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises*.
[16] OFT (2008), *Report to the Secretary of the State for business enterprise and regulatory reform on anticipated acquisition by Lloyds TSB of HBOS plc*.
[17] CMA and FCA market study (2014), *Banking services to small and medium-sized enterprises*.

16. In its 2002 market investigation, the CC identified four separate product markets within the banking services provided to SMEs:

(a) liquidity management services: business current accounts, together with short-term bank deposit accounts and overdraft facilities provided in conjunction with current accounts;[18]

(b) general purpose business loans;

(c) other types of business loans: invoice discounting and factoring, hire purchases, leasing and other asset finance; and

(d) other business deposit accounts.

17. In its assessment, the CC considered the degree of substitutability between the above products. The CC found that from a demand-side perspective, short-term deposit accounts as well as short-term borrowing facilities (overdrafts) were used for different purposes by businesses than other (longer term) deposit accounts and business loans. The CC argued that BCAs together with short-term deposit accounts and overdrafts provided an integrated liquidity management service for SMEs for their everyday use. BCAs without an overdraft facility could also be regarded within the liquidity management services, as suppliers of such accounts imposed some competitive pressure, albeit not for those SMEs who wanted overdraft facilities.[19]

18. It also looked at the usage of PCAs by SMEs for business purposes. The CC acknowledged that possibly as much as 20% of SME could have used a PCA, however these were likely to be only the smallest SMEs, namely sole traders and possibly partnerships. There were also restrictions on the use by SMEs of personal accounts. The two categories of accounts were differentiated by their charging structures and the facilities available, users of BCAs having access to business loans and relationship mangers, unavailable to PCA users. Due to these differences, the two types of account were likely to appeal to different customer types, business using a PCA having no access to a range of other services, such as business loans. There was also little evidence of movement from BCAs to PCAs. For these reasons, the CC saw little scope for ready substitutability or price pressure between PCAs and BCAs, since in most cases business users could not switch to PCAs given the nature of their

[18] This excludes PCAs used by SMEs.
[19] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises*, paragraphs 2.31–2.40 & 2.46–2.47.

businesses and their banking requirements. Therefore, the CC considered that PCAs and BCAs were in distinct product markets.[20]

19. The CC also considered that loans should be split into two product markets, namely, general purpose business loans and other types of loans and gave the following reasons: different types of loans were used to address different business needs, had different characteristics and charging structures, moreover, general purpose business loans did not necessarily require a collateral, while asset finance and hire purchase were used for the purchase of specific assets, which they were then tied to. This had further implications for differences in terms and conditions across the various types of loans and led differences on the supply-side.[21]

20. With regard to relevant geographic markets, the CC did not find it necessary to define local markets. Despite recognising the importance of access to local branches and relationship managers, it noted that there were no major price differences between local regions in England and Wales, the role of local relationship managers was limited, the coverage of the main charges and services was national, adjacent areas competed with each other, there was no evidence of suppliers exploiting the lower degree of choice available to their SME customers, and four of the larger clearing banks were present in both England and Wales.

21. The CC considered that there were likely to be very few localities in Scotland where SMEs were likely to use branches or relationship managers in England and Wales, or vice versa, nor it was considered to be possible in Northern Ireland because of the sea barrier. In addition, it noted that there was a preference for Scottish and Northern Irish banks in Scotland and Northern Ireland respectively, and observed considerable differences between banks' market shares in these regions, ie the vast majority of services being supplied by Scottish- or Northern Irish-based banks.

22. The CC therefore regarded England and Wales, Scotland and Northern Ireland as three separate geographic markets for liquidity management services and for general purpose business loans. The markets for other types of loans and other deposit accounts, where the local element was found to be less important, were found to be UK-wide.[22]

[20] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises,* paragraphs 2.17–2.27.
[21] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises*, paragraphs 2.42–2.45.
[22] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises*, paragraphs 2.31–2.61.

23. In its report on the Lloyds/HBOS merger, the OFT used the market definition established by the CC; however, due to lack of data and time available, it considered the provision of banking services to SMEs as a whole, which at the time was not disputed by any of the parties. In terms of relevant geographic markets, the OFT viewed England and Wales, Scotland and Northern Ireland as separate markets, but, for completeness, it also considered the impact of the merger on Great Britain[23] as a whole.[24]

24. Finally, CMA's 2014 market study into SME banking services also did not conduct their own assessment of relevant markets. The relevant product and geographic market definitions were based on CC's 2002 market investigation, with focus on liquidity management services (predominantly BCAs) and business loans.[25]

[23] UK-wide assessment was not necessary as Lloyds did not operate in Northern Ireland.
[24] OFT (2008), *Report to the Secretary of the State for business enterprise and regulatory reform on anticipated acquisition by Lloyds TSB of HBOS plc*, paragraphs 142–148.
[25] CMA and FCA (2014), *Banking services to small and medium-sized enterprises*, paragraphs 4.8–4.11.

Alternative payment providers

Background

1. This appendix provides further information on the services offered by non-traditional, digital market participants in the payments sector such as PayPal, Amazon, Google and Apple (alternative payment providers).

Relevant services

2. Table 1 below provides a summary of the relevant services offered by each of PayPal, Amazon, Google and Apple. The final column also includes, for purposes of comparison, the relevant services also offered by a UK retail bank. A brief overview of each product dimension is provided in the sections that follow.

Table 1: Summary of relevant services offered by digital payment providers (and a UK retail bank for comparison)

Product dimension	*PayPal*	*Amazon Payments*	*Google Wallet*	*Apple Pay*	*Barclays*
Digital wallet					
Linked to debit/credit cards	Yes	Yes	Yes	Yes	No
Linked to bank accounts	Yes	Yes	Yes	No	No
Payments services					
Online purchases	Yes	Yes	Yes	Yes	Yes
High street purchases	At participating retailers using smartphone or all retailers using PayPal Access card	No	At participating retailers using smartphone or all retailers using Google Wallet debit card†	At participating retailers using iPhone 6	Yes
Direct debits and standing orders*	No	No	No	No	Yes
ATM cash withdrawal	Yes, using PayPal Access card	No	Yes, using Google Wallet debit card†	No	Yes
Transfers between individuals	Yes	No	Yes	No	Yes – between bank accounts and on smartphones using Pingit and/or Paym
Receiving salaries or other similar payments into the account*	No	No	No	No	Yes
Balance holding	Yes	Yes	Yes	No	Yes
Credit available					
Personal credit	Credit limit available subject to credit check	No	No	No	Yes – through credit cards or personal loans
Business credit	Cash advance against future PayPal sales income (by invitation only based on PayPal transaction history)	Term loans to Amazon Market Place merchants (currently offered by invitation only)			Yes – through SME lending products.

Source: CMA analysis.
*We have not seen evidence of PayPal, Amazon Payments, Google Wallet and Apple Pay providing these services, however there are no legal restrictions that prevent them from doing so.
†Operations using Google Wallet debit card are currently available in the USA only.

Digital wallet

3. A digital wallet is a service that facilitates the storage of payment (and possibly other) credentials and enables users to make payments, either online or via a mobile device. It can take a number of forms, encompassing different technologies, channels and providers. Digital wallets are generally split into two broad categories:

   (a) Online digital wallets allow customers to store the payment details of one or more cards online for use in repeat purchases. The main advantage for users of online digital wallets is that they do not have to input their bank details each time they make a transaction on the internet, potentially providing benefits in terms of convenience and security. They first

appeared in the late 1990s, with PayPal and eBay, and are now common on websites such as Amazon. PayPal now provides a variety of services including online payment services, mobile payment services, account services, deferred payment systems, money (including cheques) transfer services into PayPal accounts and in-store payment systems.

(b) Mobile digital wallets allow customers to make in-store payments with their mobile device. There are different models of payment with a mobile device, including cloud-based technology, QR code scanning and the use of Near Field Communication (NFC)[1] technology to transmit credentials to point-of-sale devices. The majority of mobile digital wallets currently available worldwide are provided by technology companies. In contrast, card providers, such as Visa and MasterCard, are yet to offer mobile based wallets that can be used in stores, and the services offered by banks are more limited in their scope with money transfers between individuals being the core service of these applications. In July 2015, Apple introduced Apple Pay to the UK market. Apple Pay allows iPhone 6 owners to use their smartphone (or an Apple Watch) to make payments at NFC-equipped terminals. As of June 2015, 19 high street stores and all of the major UK banks had signed up to Apple Pay.[2]

4. It may also be useful to distinguish those wallets that currently only allow for the aggregation of debit and credit cards and those that can also be linked to bank accounts. For instance, Apple Pay does not currently have a functionality to link directly a bank account, and are only linked to a debit or credit card.

5. Although online digital wallets are relatively established, adoption remains relatively low, and credit and debit cards still account for significantly larger proportions of online payments. Mobile digital wallets are less established but the UK's low level of adoption is in line with several other European and North American countries. It appears that concerns about security and their ability to provide a more convenient payment experience than, for example, credit or debit cards are a key drivers of the limited adoption of digital wallets to date.

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[1] NFC technology enables two-way interaction through radio communication between electronic devices, allowing for contactless payment with a single touch, or at distances of less than four centimetres. The technology can also be used for accessing digital content and connecting electronic devices, though for making contactless payments it can be built into mobile phones, debit or credit cards, or stickers amongst other things. See: Near Field Communication Forum.

[2] Deloitte innovation report, Section 4.

Payment services

6. While digital wallets can be used fairly extensively to make purchases online, the purchase of goods in bricks-and-mortar shops (using a smartphone or other smart device) is currently limited to selected participating retailers/devices.[3] Notable exceptions are PayPal and Google customers who have applied for and been issued with a PayPal Access Card[4] and Google Wallet debit card,[5] respectively. These allow the users to make ATM cash withdrawals and payments at all retailers that accept MasterCard.

7. At present, payment services do not seem to be replacing established payment providers or platforms, such as Visa or MasterCard, but rather act as an additional intermediary to facilitate the transaction. Deloitte's report on innovation in retail banking[6] provides an overview of different models of payment systems adopted by alternative payment providers.

Balance holding

8. PayPal, Amazon and Google allow users to hold balances in their digital wallets (in contrast to Apple Pay, which only allows users to link their debit/credit cards). While this balance holding feature resembles a current account, it is technically an e-money account[7] rather than a bank deposit.

9. Electronic money issuers are subject to the Electronic Money Regulations,[8] which allow them to provide customers with an electronic balance, accept funds from other accounts on behalf of customers, and make payments from their customers to third parties. Although e-money balances are not protected by the Financial Services Compensation Scheme, the regulations require issuers to safeguard customers' funds either by storing them at an authorised credit institution or investing them in safe assets such as government bonds.

Transfer of funds

10. Users of PayPal and Google Wallet accounts are able to transfer money freely to other individuals and on their smartphones, similar to the Pingit service offered by Barclays and Pay Your Contacts service by RBSG. This service is not currently offered by Apple Pay, and only business account

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[3] The use of Apple Pay in physical locations is currently limited to iPhone 6 users.
[4] Note that the PayPal Access card is technically an e-money, rather than debit, card.
[5] Not available in the UK.
[6] Deloitte innovation report, pp24–27.
[7] With the exception of PayPal, which is an authorised credit institution licensed under Luxembourg law.
[8] Electronic Money Regulations (2011).

holders can receive money through Amazon Payments (subject to a transaction fee).

11. Paym is a service developed by the UK Payments Council that allows registered users to transfer money (via the existing LINK and Faster Payments Service (FPS) infrastructure and their bank's smartphone app) using only the registered recipient's mobile phone number. The service is supported by the following participating banks: Barclays, Clydesdale, LBG, Danske, HSBCG, Nationwide, RBSG, Santander and TSB.[9]

12. For the customer to be able to receive salary or similar payments into the e-money account or set up DDs and SOs, the e-money provider needs to have access to a bank account number, most commonly in IBAN[10] format, which allows the accounts to be identified in the transaction system. Access to a bank account number can be obtained indirectly via a sponsor bank. However, although there are no legal restrictions for e-money providers to access a bank account number, we have not seen evidence that it is commonly done in practice. In fact, only a few providers and none of the established ones seem to currently have access to a bank account number.

Credit

13. PayPal is currently the only payment service to offer personal credit (subject to status) in the form of a revolving credit line with a rate of 19.99% APR.[11]

14. PayPal also offers business credit in the form of a cash advance against future PayPal sales income. Eligibility is assessed based on PayPal transaction history and no external credit check is required. However, the service is currently only available by invitation to existing PayPal business users.

15. In July 2015, Amazon has reportedly started rolling out its Amazon Lending service to the UK,[12] through which fixed term loans are offered to Amazon Marketplace merchants based on their Marketplace sales history. While the loan principal is sent to the businesses' bank accounts, the repayments are collected from their Marketplace accounts. The loans are currently only available by invitation to existing Marketplace sellers.

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[9] See Paym.co.uk
[10] International Bank Account Number (IBAN) is an internationally agreed system providing a means to identify bank accounts across national borders. IBAN is the preferred system in pan-European transaction services.
[11] PayPal Credit, Special Financing Options.
[12] See, for example: Reuters (June 2015), Exclusive: Amazon looks to offer loans to sellers in China, seven other countries.

Main findings

16. We have conducted a review of the publically available literature on the competitive threat posed by new digital entrants.[13] An overview of the key themes identified in the literature (listed in Annex A) is provided below and Annex B contains a more detailed summary of the relevant analyses. We have also examined the evidence from banks and whether it indicated that digital wallet providers could act as a competitive constraint to banks.

Competitive position of digital entrants

17. Digital new entrants are expected to utilise their expertise in IT and online transactions to challenge in the payment services market and threaten the interchange fee revenue source of retail banks.

18. New entrants such as PayPal and Google are not expected to establish themselves as fully-fledged deposit holding institutions. Instead, those with an existing online presence would be seeking to use payment services as a means to increase the breadth of their service offering and increase the loyalty of existing customers. In fact, Google’s digital wallet service is being offered in partnership with the card issuers.

19. Nevertheless, there remain additional risks to banks’ deposit-related revenue, with mobile wallets having the potential to diminish the relationship between customers and card issuer, thereby reducing brand attachment and increasing the potential for account switching. Widespread use of digital wallet applications will also impact banks’ plans to leverage transaction data in the case of digital wallet solutions in which merchant-level transaction data is no longer transmitted to card issuers.

Advantages of existing banks

20. It is suggested that traditional banks enjoy a competitive advantage from their already large customer base, track record in security and data protection, and customer trust. Furthermore, research suggests a physical branch presence, while declining in importance, is still an important factor for customers. Nevertheless, consumer research also suggests a growing willingness of customers to consider alternative providers of banking services, particularly where these are established brands providing other online services (such as PayPal, Google and Amazon).

[13] It should be noted that the material surveyed was mainly comprised of market reports/think-pieces by management consultancies, and the corresponding caveats apply.

21. The regulation of payment services providers, which are technically e-money issuers, may bestow a competitive advantage on traditional banks. Consumers may perceive a difference in the security of balances held in accounts between traditional banks and e-money institutions (because the latter is not covered by the Financial Services Compensation Scheme). However, e-money regulations do require balances held in customers' accounts to be separately stored in a safe asset or authorised credit institution, and are protected from the claims of other creditors should an alternative provider find itself in financial distress. In practice, therefore, customers are unlikely to incur substantial losses.

22. Access to Bank of England settlement accounts (which are only available to authorised credit institutions) has also been cited as a potential barrier in denying e-money issuers access to risk-free accounts and requiring them to deposit balances with banks.[14] However, it is noted that the e-money issuers also have the option of investing the balances in a safe asset such as a government bond.

23. Similarly, the status of e-money issuers means they are unable to directly access certain payment systems. As such, payment service providers must rely on access to Bacs and FPS systems indirectly through an indirect access provider. Section 10 and Appendix 10.1 set out in more detail some of the issues that have been identified in respect of indirect access to payment systems and the involvement of the PSR. While the ability of established banks to cross-subsidise the provision of current accounts has been cited as a factor limiting competition for new entrants, the business strategy pursued by alternative providers, which already have large operations in related markets, is also thought to involve the subsidisation of entry by other product offerings.

Impact on banks' revenue

24. Some analysts have derived forecasts of significant revenue loss, reduction in market share and margin compression by 2020 (although the evidence base and forecast methodology around this estimate is not clear). The main services likely to be affected by growth of alternative payment providers are PCAs, BCAs and merchant acquiring. We focus on PCAs and BCAs as merchant acquiring is outside our ToR.

25. Our analysis of PCA revenues (see Section 5 and Appendix 5.2 for more details) shows that the value of funds and overdraft charges still represent the

[14] See Section 10 and Appendix 10.1 for more information on barriers to entry and expansion.

largest sources of income from PCAs. Therefore, assuming that alternative providers do not challenge the deposit holding activities of banks, there is an implied upper bound to the revenues at risk (ie interchange fee income) which represented around 10% of aggregate 2014 PCA income in the UK, though it may be lower in future due to implementation of the Regulation on Interchange Fees.[15]

26. In regard to BCA revenue (see Section 6 and Appendix 6.2 for more details), our analysis suggests interchange fee revenue accounted for only 1% of 2014 revenue. Increasing use of digital wallets that link directly to bank accounts (such as PayPal) might also affect transactions revenue (16% of 2014 revenue excluding monthly fees) in the case of some SMEs.

27. Some more qualitative assessments of the competitive threat have concluded that the ability of banks to easily replicate the tech solutions offered by new entrants (citing the commoditisation of mobile banking as an example) means that while new entry will drive banks to innovate their service offering, significant impact on revenue is unlikely.

Evidence from banks

28. A number of banks said that the emergence of alternative digital providers would increasingly act as a competitive constraint on the behaviour of established banks.

29. For example, RBSG references the threat posed by players ‘cherry-picking’ specific parts of the traditional retail banking value chain, for example, digital wallets. It argues that firms such as Apple and Google possess a globally recognised brand and existing customer base, and can leverage the financial and consumer data that they already hold to employ a targeted marketing strategy at potential customers.[16]

30. Similarly, LBG cites the disruptive impact of alternative payment providers such as PayPal, Amazon and Google. In response, LBG has developed a strategy to continually improve its digital proposition, including mobile prompts and guidance, extension of payment options, contactless cards and channel migration. Danske welcomes the establishment of the PSR, alternative payment systems such as PayPal and the implementation of the EU Payments Accounts Directive as positive developments in the competitiveness of the retail banking sector.[17]

[15] The Regulation on Interchange Fees is discussed further in Section 3 and Appendix 3.1.
[16] RBSG’s response to the IS, pp19–21.
[17] Danske’s response to the IS, pp6–7.

31. Nevertheless, there appears to be limited evidence in banks' own documents that they view digital payments providers to be an immediate competitive threat. In particular, committee and strategy papers regarding the development of mobile banking apps and participation in the Paym scheme appear to be focused on the extent to which rival banks are offering similar services, with no reference to impact of new entrants or alternative providers.

32. Exceptions to this observation are Barclays and RBSG, the only two established banks that have developed their own mobile payments facility (independently of Paym).

33. For example, [✂].

34. Barclays conservatively estimates that PayPal has approximately 1.2 million business customers in the UK, which it estimates to be greater than its own customer base, and notes that it takes into account the activities of PayPal when considering its BCA and PCA strategy. Payments associated with PayPal accounts in terms of volumes remain small and, as Barclays very roughly estimates, amounts to [✂]% and [✂]% of total payments made in relation to BCAs and PCAs (including savings accounts) respectively. However, Barclays considers that PayPal has already achieved material scale. Finally, despite its claims about large interchange fee losses to PayPal, Barclays has not made any specific estimates of such losses.

35. In its board papers, Barclays cites the disruptive entry of new 'niche technology-based players' as a concern to its retail banking business [✂]. Nevertheless, Barclays' PCA division appears to consider that most niche competitors have only low to medium likelihood of achieving the required scale and, while the specific threat from PayPal and Apple is acknowledged, such providers will still rely on merchant acquirers such as Barclaycard[18] to process their debit/credit card transactions.

Summary

36. The initial review of the literature suggests that competition from alternative payment providers occurs in the payment services area of the retail banking offering. Industry analysts do not consider it likely that entrants will seek to compete with the deposit holding activities of banks, or with lending facilities such as overdrafts and business loans. As such, alternative payments systems do not represent a full substitute to the products within our ToR:

[18] Barclaycard is currently the Merchant Acquirer for an alternative payments provided.

PCAs and SME banking (BCAs, business loans and business deposit accounts).

37. This is also supported by the findings in Deloitte's report on innovation,[19] which suggests that the development of digital wallets to date indicates that digital wallets do not represent a substitute for the PCAs or BCAs as a whole, because they require customers to have an underlying payment vehicle, which is often a current account. However, the report argues that notwithstanding that uptake remains relatively low, digital wallets, to some extent, do replicate individual aspects of full current account functionality, notably the facility to hold deposits and make payments, and the development of mobile banking applications and Paym functions has to some extent been driven by the rise of digital wallets.

38. The report also states, that in addition to providing competition to banks in the market for the provision of payment acceptance services, digital wallets appear to be allowing non-banks to provide lending services to SMEs that are traditionally provided by banks. For example, PayPal, through its Working Capital service, which was launched in 2013, provides cash in advance to businesses based on PayPal payments history. Since 2013, it has internationally provided more than $500 million in capital, and as at 31 December 2014, the outstanding balance of merchant loans was approximately $99 million.[20] Amazon Lending has been in operation in the USA since 2011, and has lent approximately $1 billion of capital to tens of thousands of small US traders.[21] It was launched in the UK on 1 July 2015.

39. Hence, while the potential of digital wallets to gain a share in the current account market may improve if they become accepted as standard forms of payment, it is too early to assess the extent to which they could develop to offer a competitive constraint on full PCA or BCA functionality.

40. The growth of alternative payments providers may affect some sources of PCA and BCA revenue. This includes banks' interchange fee income, which is shared when alternative payments providers are used. Use of alternative payment systems, such as PayPal, which link directly with users' bank accounts may also affect BCA transactions revenue. Less readily tangible losses could also arise from a weakening of the customer relationship and inability to leverage transaction-level data if banks are ultimately disintermediated from their customers. However, we have not seen evidence

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[19] See Deloitte innovation report, Sections 4 and 8.
[20] Deloitte innovation report, p74.
[21] Deloitte innovation report, p74.

that the growth of alternative payments providers has yet led to a material loss of income or other effects in PCA and SME banking markets.

41. While existing players in online markets have a large customer base and strong brand on which to launch digital payment services, existing banks have advantages in the form of access to payment networks and customer attitudes to security and trust. Banks have also already demonstrated an ability to replicate innovations made in mobile payments (eg the Pingit and Pay Your Contacts apps offered by Barclays and RBS, respectively). Therefore, while the threat of entry and expansion by digital providers may have prompted technological improvements in the service offerings of banks, it is not clear that material changes to revenue will result.

Annex A: References

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Annex B: Overview of the recent literature on the emergence of alternative market entrants

Theme: Nature of competitive threat

Key message: Given their comparative advantage in IT and retail, alternative new entrants are most likely to challenge in the area of payment services rather than as fully-fledged credit institutions.

Source	*Evidence*
Positive Money (2014)	The payments and current accounts markets should be wide open for new entrants from experienced technology firms, given the IT intensive nature of the industry (ie they are essentially a technology service whereby databases store customers' account balances, a protocol allows payments to be validated, and a networks allow information about payments to be transferred between payment terminals, payment systems and banks).
Accenture (2012)	While the traditional card operations of established players in service areas such as debit, credit and prepaid payments are currently profitable and enjoy an apparently loyal customer base, the emergence of new payment options and experiences could rapidly erode banks' revenues in this area. Alternative online payment providers are primarily looking to invest to extend their existing brands' operation and loyalty of existing users. This makes them a particularly dangerous threat due to their existing capacity and product offerings, which allow them to aggressive target market share while relying on the ability to switch to a focus in profitability once they have achieved a critical mass of users and transactions, ie they can effectively 'buy' market share by 'giving away' the services that banks currently regard as revenue generators.
Grant Thornton (2014)	Banks are facing unexpected competitors in the retail payments market, and the facilitating approach adopted by regulators towards market entry for alternative payment services providers is expected to increase the competitive pressure.
Experian (2014)	The strategy of new entrants is not to become a bank (and take on the associated regulation and capital requirements), but to take a dominant share of the payments industry income.
Deloitte (2014)	Large alternative providers such as Google and Apple are not expected to pursue a strategy involving the setup of banking subsidiaries with a large balance sheet. This is primarily because this would necessitate a large capital base, which would fundamentally change their investor proposition. Furthermore, the intensity of regulatory scrutiny to which they would be subject to under such a strategy would limit their ability to innovate in their core business.
Ernst & Young (2014)	The business models of alternative payment providers are thought to be based on the derivation of revenues from customer transaction level-data, which can be used to cross-subsidise the payment services element of the product. Some financial services providers believe that 'the large, online, digital payment platforms are looking to drive revenue out of the data and are even willing to give away the payment revenue to make money on the promotion.'

Key message: As well as a loss of interchange fee income, new entry in this area this could fundamentally change the relationship between customers and banks and result in a loss on the ability to leverage customer transaction data.

Experian (2014)	The predicted rapid adoption of mobile wallet services could replace the traditional money transmission account. While leveraging existing bank payments infrastructure, these new entrants may replace the bank as the core relationship owner with customers, relegating established banks to a role of back-end service provider. Banks could become a back-end service provider.
Deutsche Bank (2013)	The primary risk to banks is a loss of share in payments (disintermediation) and a loss of brand value with customers as ‘bank cards disappear into e-wallets and are not seen again, with phones deciding which card to use in which store’. This brand diminution may manifest itself as a market share risk if mobile wallets enable customers to switch bank accounts without any required change in their gateway of interaction (ie smartphone SIM).
Ernst & Young (2013)	Established banks are concerned that new entrants and digital payments systems will disintermediate them from their customers and reduce the information they are able to collect on consumer purchasing patterns. In the absence of this transactional level purchasing data, the potential of banks to provide sales promotion services to retailers will be lost. The underlying risk is then that banks become relegated to that of utility providers of a financial service commodity.

Key message: There may also be knock on impacts on deposit holding related income.

Ernst & Young (2013)	The relative cost to digital wallet providers of using card versus automated clearing house payment networks is expected to result in them incentivising consumers to fund purchases from their wallet balances rather than through debit/credit cards. This will not only have a direct impact on banks’ interchange fee revenues but may also increase the incidence and size of balances held in digital wallets versus bank accounts, reducing both NCI revenue as well as banks’ pool of available low-cost deposit funding.
Deloitte (2014)	There is a secondary risk to banks that the balances alternative payment providers hold will reduce the ‘float’ earned by banks on current account deposits.

Key message: However, the nature and magnitude of the competitive threat will vary by product offered.

Accenture (2012)	‘The competitive dynamics vary between different offerings, even from the same provider. For example, Google Checkout is an alternative service that competes with banks, whereas Google Wallet is a collaborative initiative with the “traditional” financial services sector.’

Theme: Barriers to entry

Key message: Scale of customer base and operations, expertise in security and data protection and a trusted position amongst consumers as custodians of deposits and personal data provide banks with a competitive advantage over new entrants.

Accenture (2014a)	Banks enjoy the incumbency advantage of a relatively ‘sticky’ customer base and value experience in the field of payments, security compliance and finance, which are difficult to replicate. Crucially, consumers already

	trust banks' brands to guard their financial security, and are not yet ready to invest the same degree of trust in new online entrants. This is supported by evidence from a 2013 Accenture survey of 23,000 consumers across 23 countries, which found that 41% of customers trusted their bank most with their personal data (compared to 23% for Google and 12% and 8% for Apple and Amazon respectively).
Accenture (2014b)	More than 80% of customers considered it important that their bank has a long track record of financial performance (although this factor is less important for younger customer).
Grant Thornton (2014)	Survey evidence suggests the maintenance of a branch network is still important for customers. Findings from an online survey suggest that 48% of customers retain a preference to contact their bank via a branch for simple transactions. Furthermore, access via a branch remains customers' primary method of buying more complex products.
Deutsche Bank (2012)	Traditional financial institutions have considerable experience of security and data protection, which offers them a strategic competitive advantage in the mobile payment solution segment.
Deutsche Bank (2013)	Banks continue to enjoy customer confidence as a safe place for their deposits. Providers of payment services from other sectors, such as PayPal and Google, would need to achieve similar levels of customer confidence in challenge for market share. Overall, banks are expected to retain much of their market share due to the scale in storage and transfer of customer funds that they already enjoy along with their expertise in cyber security and the associated customer trust that this brings. They are also likely to be able to match emergent providers in innovation in transactions offering (eg mobile, contactless).

Key message: Regulation of e-money issuers may also act to limit the extent to which alternative payment providers can compete.

Positive Money (2014)	Significant and unnecessary barriers to entry exist in the form of the Bank of England only providing settlement accounts to entities that are authorised credit institutions. This prevents e-money issuers from depositing their customers' balances in a risk-free Bank of England account. Instead, they must either store the funds in a safe asset or at an authorised credit institution, thereby allowing the established banks to set fees that form the cost base for e-money issuers. Furthermore, access to the CHAPS, BACS, Faster Payments, and cheque and credit clearing networks is exclusive to Bank of England settlement account holders. This lack of access to the wider payment networks limits the nature of transactions e-money issuers can carry out (specifically, they cannot process a payment between a customer and a holder of an account at a different e-money issuer or bank). This thereby bestows a competitive advantage on the established payment providers. The lack of coverage of the Financial Services Compensation Scheme to e-money deposits also increases the perceived risk of holding balances with new entrants compared to established banks.

Positive Money (2014)	E-money issuers are prohibited from paying interest on customers' balances. This is likely to act as a disincentive to customers storing significant balances with alternative providers compared to established banks. Established banks, in providing other products, are able to subsidise their current accounts. In contrast, e-money issuers, in only offering payment services, have no opportunity to cross-subsidise – and must therefore earn revenues through transaction fees.

Key message: However, the importance of branch networks appears to be diminishing and alternative providers, with a growing track record in securely processing transactions, already enjoy large and willing customer bases.

Bain (2014)	The importance of classic barriers to entry enjoyed by banks, such as the personal relationships between branch managers and customers, scale economies in branch networks and a reputation for security are diminishing.
Accenture (2014b)	Evidence from the Accenture 2014 North America Consumer Digital Banking Survey suggests that 39% of 18- to 34-year-olds and 29% of 35- to 55-year-olds would consider switching to a bank with no branch locations.
Accenture (2014a)	There is also evidence of a willingness to consider alternative providers. A survey of 3,846 bank customers in North America found 46% of 18- to 34-year-olds and 34% of 35- to 54-year-olds consider themselves 'likely' or 'very likely' to bank with PayPal if it began offering banking services. Similar (but slightly lower percentages) were found for Google, Amazon and Apple.
	While many new entrants lack the scale to pose an immediate threat to banks, this could change quickly. For example, Square, the point-of-sale payment processing venture, has accumulated more than 4 million users since 2009.
Deutsche Bank (2013)	Many of the alternative market participants that already have a relatively loyal and regular clientele (numbering in the thousands of millions) representing all age cohorts are expanding rapidly and increasingly offering web-based financial solutions.
Grant Thornton (2013)	According to customer research, brands such as Google and Apple are perceived as 'user-friendly, convenient and reliable services'. Once new competitors manage to overcome trust issues and regulatory barriers, they will use technological innovation to satisfy new customer's demands and change what 'good looks like'.

Key message: And the legacy structure in which established banks are organised may inhibit their ability to respond quickly to the emerging threat posed by alternative providers.

Accenture (2012)	The payment capabilities of established banks are often spread across various product lines, which are themselves being run with discrete strategies. This fragmentation of the at-risk services across P&Ls may slow down banks' response to the rapid changes taking place in the market. For example, an increase in revenue from digital payment services may appear as a loss in interchange fee revenue for a different P&L silo. This lack of visibility may hinder the ability of banks to make pricing and investment judgments around payment services offerings, and discrete areas of the same bank may find themselves competing with each other for the same transactions. 'The likeliest winners from such internal conflicts are the internet-based "online payment provider" entrants and other non-bank players such as mobile operators.'

Theme: Expected impact on market share

Key message: In the absence of mitigating action by banks there is a significant threat to established banks' market shares.

Accenture (2014)	Accenture estimates that in the absence of pre-emptive action by banks, competition from digital players could erode as much as one-third of traditional retail bank revenues by 2020. This estimate was produced using scenario analysis of digital disruption across a number of revenue sources (including consumer and SME lending, payments service, current accounts). Market share erosion and margin compression was modelled using disruption case-studies.
Accenture (2014a)	The competitive threat posed by new entrants is most prominent in the area payments services, which have traditionally been a significant source of revenue for banks. While in Europe alternative payment providers currently hold a limited market share (1.5% in 2012), Accenture estimates that this is expected to rise to nearly 15% by 2020.
Accenture (2012)	The payments service market is not forecast to expand significantly. Therefore, the growing number of retail payment services providers will be competing for the same volume of transactions.

Key message: However, evidence from the UK implies an upper bound on the segment of the value chain at risk, and while new entry is expected to force innovation by banks, the risk to overall market share is limited.

CMA (2014)	Interchange fees were the joint lowest source of total revenues for PCAs in 2013 (12%), accounting for approximately £1 billion in total PCA revenue, compared to £3.2 billion for net credit interest, £3 billion for overdraft revenues and £1 billion for account fees.
Deutsche Bank (2013)	While a stable interchange fee revenue contributed to the long-term viability of the banks' business, retaining deposits is more relevant. Deposits account for 60% of European banks' funding, and financing through deposits will be of increased importance due to the more stringent liquidity requirements placed on banks by Basel III.
Deutsche Bank (2013)	Banks are expected to retain market shares in key elements of the value chain. A 'killer app' is unlikely to emerge that banks are not able to copy and release themselves, and the speed in which mobile payments have already become commoditised is a case in point. 'Combined with the very significant upside to returns when interest rates rise, we think that retail banking remains a generally attractive investment prospect.'

Relevant geographic markets

Background

1. In this appendix we set out our analysis with respect to defining relevant geographic markets for PCAs and SME banking services.

2. We have identified the following relevant product markets:

   (a) PCAs;

   (b) BCAs;

   (c) business loans; and

   (d) business deposit accounts.[1]

3. Below we separately consider relevant geographic markets for PCAs and SME banking products. Previous approaches to defining geographic markets are summarised in Appendix 4.1.

4. Our guidelines state that geographic markets may be based on the location of suppliers and defined as an area covering a set of firms or outlets which compete closely because enough customers consider them to be substitutes.[2] Our ToR are limited to UK sterling bank accounts and we did not receive any evidence that the markets were wider than the UK. Below we consider whether geographic markets for PCAs and SME banking products are: (a) local; (b) regional (in the sense of each region within devolved nations) or national (ie whether England, NI, Scotland and Wales are separate markets); or UK-wide.

Relevant geographic markets for PCAs

Whether relevant geographic markets are local

5. Although the local aspect, mainly through the usage of local branches for customer acquisition and retention, remains important,[3] pricing, product

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[1] See Section 4.
[2] *CC3*, paragraph 145.
[3] For instance, GfK PCA consumer survey reported that local branch convenience was the third most important reason for PCA customers in choosing a bank. However, the reliance on local branches has been diminishing over the years – although the importance of local branches remains high, the usage of internet and mobile banking has been growing significantly. This is also in line with the expected growth of online-only banks, such as

offering, service levels and marketing activities are determined for each brand at a UK-wide level, regulatory requirements[4] do not differ materially across the UK and customers' needs and behaviour are broadly similar across different areas.

6. The majority of the banks told us that they did not think that consumer needs differed across geographic areas and noted that they applied harmonised policy and provided consistent offering across the geographic markets in which they were present. For instance, Barclays noted that, despite a few regional differences, the banks provided a consistent offering in terms of price and service levels across the UK. Barclays stated that it favoured a UK-wide market definition. It also noted that alternative service providers, such as Apple Pay, had launched their products at a UK-level, rather than focusing on different regions.[5]

7. Similarly, RBSG submitted that the market should be viewed, at its narrowest, as two separate markets for GB and NI. It stated that, with the partial exception of Ulster,[6] it generally applied a harmonised policy across the UK, did not make any distinction in product development and design across regions, and did not segment its customers by region. Despite different RBSG brand presence in different regions,[7] there were no differences in terms of pricing, products, [✂] across the UK. RBSG also noted that other banks, such as Santander, Nationwide and Handelsbanken, had all recently increased their Scottish customer base and that the new entrants into the Scottish market did not consider it necessary to adopt or retain Scotland-specific branding.[8]

8. TSB noted that there was some variation between different markets, especially in the sense which banks were the incumbents and which banks were the challengers, but did not think that in general the market and consumer behaviour differed between Scotland and England and Wales. It also noted that many of the banks were regionalised in the way they were constructed through mergers over time.

9. Similarly, Clydesdale argued that the fact that (a) it offered the same products and terms and conditions across GB; (b) there was no differentiation between different regions of the UK in terms of barriers to entry and expansion; and (c)

First Direct, Smile and the expected entry by Atom. For more information on the importance of branches, see Section 10 and Appendix 10.1.
[4] For more information on regulatory requirements, see Section 3 and Appendix 3.1.
[5] See Barclays' response to the UIS, pp4–5; and Summary of hearing with Barclays on 9 June 2015, paragraph 55.
[6] [✂]
[7] NatWest in England and Wales, RBS in Scotland and Ulster in NI.
[8] See RBSG's response to the UIS, p7.

the way in which customers utilised digital tools to engage with and access retail banking services, all supported the view that Scotland formed a part of the same market as England and Wales. Clydesdale also stated that it believed that some banks might have made participation choices because of the size of the market and the availability of customers within certain regions. However, the market dynamics and the way that people competed were the same in both Scotland and England and Wales and any regional differences were due to historical reasons, eg customers may often have chosen their banks based on where the branches were located.[9]

10. LBG also noted that pricing was national and thought that the CMA's geographic market definition[10] was satisfactory. LBG agreed that it did not consider Scotland to be a separate market from England and Wales. In particular, it noted that there was strong competition across GB, with key parameters of competition and strategy, such as product characteristics and pricing, and certain elements of products, such as telephone and digital banking, being set and provided on a GB-wide basis. The impact of digital banking has further eroded any differences between the UK nations. In addition, historical differences in brands between Scotland and the rest of GB were being eroded, with the Lloyds TSB Scotland business being divested to TSB, Halifax expanding into Scotland, and the creation of Williams & Glyn.

11. Santander considered that the correct geographic market was UK-wide but recognised that there may be regional variations with regard to relative strength of competitors.[11]

12. Similarly, HSBCG considered that there were differences between England and Wales versus Scotland, but did not provide a definite view whether these should be viewed as different markets or not. It noted that its operations in Scotland were smaller, but its PCA business had expanded. In addition, First Direct operated on a national level and also had a large number of Scottish customers.

13. In our UIS, we said that we did not intend to define the market at a local level but we would consider the local dimensions of competition, such as importance of local branches to customer acquisition for new entrants as part of our competitive assessment.[12] We have not received any evidence or

[9] See Clydesdale's response to the UIS, p3.
[10] In the UIS, we considered that Scotland, NI and England and Wales formed three separate geographic markets. We did not exclude the possibility that Scotland and England and Wales could be part of the same relevant geographic market.
[11] Santander's response to the UIS, p5 and summary of hearing with Santander on 7 July 2015, paragraph 102.
[12] See Section 10 and Appendix 10.1.

submissions[13] from parties indicating that we needed to consider separate local, ie sub-national markets. On the contrary, the majority of the banks agreed that the market for PCAs was at least GB (meaning that NI was a separate geographic market) or even UK-wide. Accordingly, we maintain the view that we should define national rather than local banking markets. However, we consider the aspects relevant to local competition as part of our competitive assessment.

Whether relevant geographic markets are regional or UK-wide

14. We now turn to the assessment of which separate national markets we should identify. In our UIS we said that we were considering either three national geographic markets, namely England and Wales, Scotland and NI, or two national geographic markets, combining England, Wales and Scotland into a single GB-wide market with a separate market for NI.

15. As seen above, no party suggested that geographic markets should be narrower than England, Wales, Scotland and NI. The Welsh government considered Wales was a separate market from England, but no other party expressed this view. RBSG, Clydesdale, LBG and TSB suggested that markets should be GB-wide and Barclays, Santander, Danske, AIB and BoI expressed a preference for a UK-wide market.

16. As already mentioned, each bank brand sets the main competitive variables, including product offering, pricing, service levels and marketing activities on a UK-wide basis. However, the fact that each bank has a UK-wide offering does not necessarily mean the market is UK-wide if customers tend to use different banks in different parts of the UK, as banks in those areas would only compete with each other. We have looked at the extent to which this is the case for the devolved nations and the English regions by looking at differences between regions/devolved nations' individual bank market shares.

17. The Welsh government told us it considered that there was a separate Welsh geographic market. The Welsh government said that it considered devolution had changed the economic and political landscape considerably since the CC's conclusions from 2002 and that Wales should be regarded as a distinct geographic market to England to enable the competition issues to be explored via specific analysis and data. Pricing, product offering, service levels, marketing activities and regulatory requirements do not differ in England and Wales. Our analysis has shown that market shares in Wales were broadly similar to market shares for the whole of GB, as was also the case for the

[13] Parties' responses to the UIS also did not suggest that we should consider separately competition in each of a large number of local markets.

English regions (see Table 1 below). Hence, we consider there is a single geographic market covering England and Wales.

18. We found some differences in market shares between Scotland and the rest of GB. In England and Wales, LBG (through the Lloyds and Halifax brands), Barclays, RBSG (through the NatWest brand), HSBC and Santander were the five biggest banking groups in 2014. In Scotland, most PCAs in 2014 were supplied by RBSG (through the RBS brand), LBG (through the BoS and Halifax brands), TSB, Clydesdale and Santander. In addition, the NatWest and RBS brands of RBSG have almost identical product offerings across both brands, and apply similar criteria and charging structures, as is also the case for the Lloyds and BoS brands of LBG.[14] Hence, our analysis has shown that there is some, although limited, difference between Scotland and the rest of GB. However, as mentioned before, the majority of banks view GB as a single market. In addition, the competition in both Scotland and England and Wales occurs, to a large extent, between the same banks as the vast majority of PCAs in both regions are provided by the same banking groups, each offering similar products in all three nations subject to the same regulatory requirements and similar customer characteristics. Accordingly, we do not consider that there is enough difference between Scotland and England and Wales to consider the two as separate geographic markets.

19. However, the situation is different in NI, where 63% of main PCAs were supplied in 2014 by Ulster, Danske, BoI, and AIB, whereas GB-based brands, such as Lloyds, Barclays and HSBCG had only 4% of the market combined. While Ulster is owned by RBSG, its product offering and management is currently separate from NatWest and RBS.[15] Of the larger GB-based brands, only Santander, Halifax and Nationwide also have a relatively large market share in NI.

20. We have also looked at geographical differences between regions/devolved nations quantitatively. For each area, we have calculated how different market shares in that area are from those in the country as a whole – this is measured by the sum across all banks of the absolute difference between each bank's area market share and its country-wide market share. We then calculate a score between 0 and 100 to indicate the extent of difference between market shares in the area and country-wide market shares.[16] If area

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[14] Although the similarities seem somewhat less in the case of the LBG brands than the RBSG brands. Halifax has a different product offering and is marketed as a 'challenger' brand in both England/Wales and Scotland. Its market shares across both markets do not vary as much as for other brands.
[15] [✂]
[16] The score is calculated as the sum of the absolute differences between each bank's market shares in the area and its market shares in the country as a whole (GB or UK) divided by the maximum possible value for this sum. The maximum possible value for this sum is $(200 - 2S_j)\%$ where S_j is share of country total represented by

market shares are the same as country-wide market shares, an area is assigned a score of 0, and if the banks in the area are entirely different from those in the rest of the country, the area is assigned a score of 100.

21. Table 1 shows that bank shares in the regions of England and Wales are similar to country-wide bank shares. There is more difference in Scotland, but the score is nevertheless less than half the maximum. The difference is significantly larger in NI, being around two-thirds of the maximum.

Table 1: Differences between regional/national and UK/GB PCA market shares: score* (where score of 0 indicates no difference and 100 indicates maximum difference)

Region/devolved nation	*Difference from*	
	UK	*GB*
East Midlands	6.0	5.1
East of England	11.2	10.6
London	16.0	15.4
North East	16.6	15.6
North West	13.4	12.9
NI	67.2	
Scotland	40.9	39.9
South East	9.0	7.7
South West	10.1	8.9
Wales	11.1	10.0
West Midlands	10.8	9.5
Yorkshire and the Humber	19.0	18.6

Source: Responses to PCA aggregate data request.
*The scores range from 0 (when market shares are identical) to 100 (when the suppliers in the relevant area are entirely different from the suppliers in the rest of the country). The scores have been calculated using the following formula:

$$\sum_{i=1}^{N} \frac{|S_{L_i} - S_{C_i}|}{200-2*S_j},$$

Where i represents an individual bank and N is the total number of banks, S_L – market share in the area, S_c – market share in the whole country (GB or UK) and S_j is share of area j in the whole market (GB or UK).
Note: Market shares were calculated at brand level except that shares of: *(a)* RBS and NatWest brands of RBSG; and *(b)* Lloyds and BoS brands of LBG were combined as these brands have similar strategies and product offerings.

22. In our UIS, we stated that our current view was that NI remained a separate geographic market from the rest of the UK. The majority of the parties agreed with this approach, although several banks, including AIB, Danske, BoI, Santander and Barclays suggested that there was a single UK-wide market. Danske, for instance, pointed to a number of PCA and BCA providers predominantly based in GB that had increased their presence in NI (Santander, Halifax and HSBC), and to banks which had previously focused on NI either expanding their activities in GB (BoI) or being more closely integrated into UK parents (Ulster).[17]

customers in area j. To illustrate that $(200 - 2S_j)$% is the maximum score – suppose customers in the area account for 10% of the total in the country; the maximum score occurs when banks in a particular area are completely different from those in the rest of the country – if so, they would have 100% market share in that area and 10% in the country as a whole, while all other banks would have 90% market share in the country as a whole and 0% in the area. The sum of the differences between market shares in the area and market shares in the country as a whole is {(100-10) + (90-0) = 180}%.

[17] Danske's response to the UIS, pp1–2 and response to IS, p5.

23. AIB noted that market factors and the structure of the sector in NI comprised certain regional characteristics (similarly to other regions in the UK), but remained of the view that NI should be part of the UK market for PCAs, as the customer needs were the same across the marketplace. It also referred to new UK providers, such as Santander, Halifax, Tesco and Marks & Spencer, which were entering the market in NI. However, it noted that certain changes in GB, such as divestment of TSB, did not have an effect on NI.[18]

24. BoI noted that the core issues that are being investigated had many common features across the UK as a whole and favoured a UK-wide market.[19]

25. However, banks' market shares in NI remain quite different to those in GB (see paragraph 21). Although we have seen evidence that some GB-based banks, in particular Santander and LBG (through its Halifax brand), have been able to increase their market share in NI, we have not seen the reverse, namely Irish banks trying to expand their presence in GB, which is currently very small. We take this as evidence that competition in NI is to a large extent between different banks than competition in GB, and therefore we consider there is at least the potential for competitive conditions to differ between the two territories.

26. For these reasons, our provisional view is that the competitive situation in NI is different from the rest of the UK, and we therefore regard NI and GB as separate geographic markets for the purpose of our analysis. We recognise that some aspects of the two geographical markets are similar, and we do not consider that the distinction between NI and GB affects our competitive analysis, which remains relevant for both geographic markets.

27. This is also consistent with the previous findings – in the CC's 2007 Market Investigation into PCA banking services in NI, NI was found to constitute a separate relevant geographic market, due to the lack of close demand- or supply-side substitution between NI and GB.[20]

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[18] AIB responses to IS and Summary of hearing with AIB on 16 July 2015, paragraphs 56–60.
[19] BoI's response to the IS, p2.
[20] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraphs 3.31–3.37. See Appendix 4.1 for more information on previous approaches to market definition.

Relevant geographic market(s) for SME banking

Whether relevant geographic markets are local

28. As for PCAs, the local aspect, mainly through the usage of local branches for customer acquisition and retention, remains important.[21] However, as mentioned earlier in paragraphs 5 to 12, our analysis has shown that banking brands' policies are largely centralised, with pricing, product offering, service levels and marketing activities being determined at a UK-wide level. Regulatory requirements and customers' needs also do not differ materially across the UK.

29. In our UIS, we said that we did not intend to define the markets for SME banking products at a local level but that we would consider the local dimensions of competition, such as the importance of local branches to customer acquisition for new entrants, as part of our competitive assessment.[22]

30. We have not received any evidence or submissions[23] from parties indicating that we needed to consider separate local, ie sub-national, markets. Banks agreed that the geographic markets for SME banking were at least GB-wide. Accordingly, as in the case of PCAs, we maintain the view that we should define national rather than local banking markets. However, we consider the aspects relevant to local competition as part of our competitive assessment.

31. This is also in line with previous findings in the CC's 2002 SME market inquiry. Despite recognising the importance of closeness to a bank and access to a relationship manager, the CC found it unnecessary to define relevant geographic markets as local, as: *(a)* there were no major price differences between regions; *(b)* the neighbouring areas were competing with each other and the suppliers in more concentrated areas did not tend to exploit the lower degree of choice available to their consumers; and *(c)* the largest clearing banks were represented in almost all parts of local markets. In any case, there were no significant differences in the market features between regions, and therefore joint analysis of different regions was possible.[24]

[21] For instance, Charterhouse BBS reported that local branch convenience was the second most important reason for SMEs in choosing whom to bank with. For more information on the importance of branches, see Section 10 and Appendix 10.1.
[22] This issue is discussed in Section 10 and Appendix 10.1.
[23] Parties' responses to the UIS also did not suggest that we should consider separately competition in each of a large number of local markets.
[24] CC (2002), *The Supply of banking services by clearing banks to small and medium-sized enterprises*, paragraphs 2.52–2.54. See Appendix 4.1 for more information on previous approaches to market definition.

Whether relevant geographic markets are regional or UK-wide

32. In our UIS we noted that the previous inquiries had tended to focus on three separate geographical areas: England and Wales, Scotland and NI. We indicated that we did not see a reason to depart from this approach, except that some more recent market changes might suggest a wider geographic market combining Scotland and England and Wales into a single GB-wide market. We noted that we considered that NI remained a separate market from the rest of the UK.

33. As indicated above, banks generally agreed with this approach, with only a few banks, including Danske, AIB, BoI, Santander and Barclays suggesting that the markets for SME banking products should be viewed as UK-wide.

34. As already noted, each bank brand sets the main competitive variables, including product offering, pricing, service levels and marketing activities for SME banking products on a UK-wide basis. However, the fact that each bank has a UK-wide offering does not necessarily mean the market is UK-wide if customers tend to use different banks in different parts of the UK, as banks in those areas would only compete with each other. We have looked at the extent to which this is the case for the devolved nations and the English regions by looking at differences between regions'/devolved nations' individual bank market shares.

35. As already indicated, the Welsh government believes that the economic and political landscape has changed considerably since 1999 and that Wales is a distinct geographic market to England. In the Welsh roundtable discussion, the Welsh government reiterated that it was essential to include separate data and analysis from a Welsh perspective, to properly understand the issues facing businesses in Wales. It expressed a concern that Wales is a location, which is seen as remote from many of the centralised decision-making panels that determine which businesses get supported.[25]

36. However, as seen in Table 2 below, there are limited differences between bank shares within the regions of England and Wales, the whole of GB, and the UK. Additionally, other parameters, including pricing, product offering, marketing activities and regulatory requirements, do not differentiate between the two nations. Accordingly, for the purposes or our analysis, we consider that there is a single geographic market covering both England and Wales.

37. Bank shares in Scotland and NI continue to differ more from the rest of the UK. In Scotland, the largest share of BCAs were held by LBG (through the

[25] Summary of roundtable discussion in Wales on 29 June 2015.

BoS brand), RBSG (through the RBS brand) and Clydesdale. However, this was relatively similar to England and Wales, where LBG, RBSG (through NatWest), HSBCG and Barclays held the largest share. While LBG and RBSG operate via different brands in Scotland compared to England and Wales, the NatWest and RBS brands of RBSG have almost identical product offerings across both brands, and apply similar criteria and charging structures, as is also the case for the Lloyds and BoS brands of LBG.[26] Hence, although there is some difference between Scotland and the rest of GB, the competition in both markets, by and large, takes place between the same market players. Thus, on balance we do not consider that there is enough difference between Scotland and England and Wales to regard the two as separate geographic markets.

38. By contrast, in NI, the largest share was held by different banks (including Ulster, which has a distinctive different offering from the rest of RBSG).[27] In 2014, 86% of the market for BCAs was shared between Ulster, Danske, BoI and AIB, whereas the big GB-based banks, ie HSBCG, Barclays, and Lloyds/BoS collectively had less than 4% of the market for BCAs. Of the larger GB-based brands, only Santander was able to acquire a larger market share of slightly less than [✂] [5–10]%.

39. We have also looked at geographic differences in BCA shares between regions/devolved nations quantitatively – the analysis is similar to that for PCAs. Table 2 shows that BCA bank shares in the regions of England and Wales are similar to country-wide bank shares. There is more difference in Scotland, but the score is nevertheless less than half the maximum. The difference is very large for NI at nearly 90% of the maximum.

[26] The similarities seem somewhat less in the case of the LBG brands than the RBSG brands.
[27] [✂]

Table 2: Differences between regional/national and UK/GB BCA market shares: score* (where score of 0 indicates no difference and 100 indicates maximum difference)

Region/devolved nation	*Difference from*	
	UK	*GB*
East Midlands	5.6	4.7
East of England	12.1	11.5
London	13.8	12.5
North East	14.7	13.1
North West	13.5	12.5
NI	86.8	
Scotland	41.2	39.5
South East	7.5	4.8
South West	11.8	10.4
Wales	14.7	12.9
West Midlands	10.8	8.9
Yorkshire and the Humber	14.4	13.6

Source: Responses to SME aggregate data request.
* The scores range from 0 (when market shares are identical) to 100 (when the suppliers in the relevant area are entirely different from the suppliers in the rest of the country). The scores have been calculated using the following formula:

$$\sum_{i=1}^{N} \frac{|S_{L_i} - S_{C_i}|}{200-2*S_j},$$

Where i represents an individual bank and N is the total number of banks, S_L – market share in the area, S_c – market share in the whole country (GB or UK) and S_j is share of area j in the whole market (GB or UK).
Note: Market shares were calculated at brand level except that shares of (a) RBS and NatWest brands of RBSG; and (a) Lloyds and BoS brands of LBG were combined as these brands have similar strategies and product offerings.

40. We have stated in our UIS that our view was to regard NI as a separate geographic market from the rest of the UK, and only few banks, including AIB, Danske, BoI, Santander and Barclays argued for an all-inclusive UK-wide market, whereas the majority of the banks agreed with our proposed approach. As in the case of PCAs, competition in NI is to a large extent between different banks than competition in GB, and therefore we consider there is at least the potential for competitive conditions to differ between the two territories.

41. The analysis discussed above relates to market for BCAs only. We do not have sufficient data to carry out a similar analysis for business loans and business deposit accounts. We acknowledge there is more uncertainty, in particular about whether NI is a separate market from GB, for business loans and business deposit accounts than for BCAs as the range of providers is wider for business loans and business deposit accounts that for BCAs. However, we expect analysis for these markets to show broadly similar results to that for BCAs, as SMEs tend to take out these products with their BCA supplier.[28]

42. Accordingly, our provisional view is that the competitive situation in NI remains different from the rest of the UK and, for the purposes of our analysis, we therefore consider that GB and NI are separate relevant geographic markets

[28] For more details see Section 8. For instance, Charterhouse BBS indicated that of those SMEs that have an instant access savings account, around 95% hold it with their main bank, and of those that are using a term deposit account, around 82% hold it with their main bank. Similarly, of those SMEs that have a business loan, 93% hold it with their main bank.

for SME banking products. We recognise that some aspects of the two geographical markets are similar, and we do not consider that the distinction between NI and GB affects our competitive analysis, which remains relevant for both geographic markets.

Conclusions

43. Our provisional view is to consider that GB and NI are separate relevant geographic markets for PCAs and SME banking products. Some aspects of the two geographic markets are similar and are considered together in the provisional findings report.