Prin-Gov

Adrian McCarthy
Principal
PrinGov Limited

Competition & Markets Authority
retailbanking@cma.gsi.gov.uk

20 November 2015

Dear Sir or Madam,

The following are my comments on the CMA's Provisional Findings Report for PCA's (22 October 2015).

My comments are restricted to the PCA / Overdrafts market (excluding NI), and are not made about the BCA market or the SME Lending Market.

Competition

1. Your Provisional Findings Report is clear that the current lack of competition derives from the lack of customer engagement and confidence in switching. As the Treasury Committee suggested at its hearing on 4 November 2015, you appear to believe that 'it is the customers' fault', and that the remedies lie with customers.
2. It may be said that you have landed on the 'demand side' (customers) rather than the 'supply side' (banks) of competition in your search for Possible Remedies to create markets that operate better.
3. It may be analogous to suggest that customers caused the financial crisis by agreeing to the risky lending practices of the banks.
4. The difficulty with your provisional approach is that the challenges of the demand side (i.e. around customer engagement) may be considerably more intractable and expensive to remedy overall, than the supply side market structural side (bank) reforms that you should be minded to consider.
5. In a 'chicken and egg' discussion about customers and banks (i.e. which is the cause of the adverse effects on competition (AEC) you have found), you have decided that <u>customers</u> have failed to engage with an inadequately competitive PCA market to order

to make it more competitive versus a position that sees the banks (or Government through legislation / regulations) creating a more competitive landscape which customers can respond to dynamically through greater product and services innovation.

6. Of course, customers acting in concert to prompt a more competitive market may be considerably more uncertain to achieve the desired outcome of a competitive PCA market than would be structural changes in the 4 banks that provide 70% of PCA accounts.

Supply Side (Banks' Side)

7. The impact of the financial crisis has dulled and diminished competitive forces for the following reasons.
    a. The absolute existential need for banks to re-build their capital, profitability and balance sheets (usually by methodically and ruthlessly simplifying their business models and reducing costs).
    b. The reduction in the risk appetites of banks (and in particular of their boards) caused by relentless high profile regulatory censure, fines and remediation costs.
8. Over the period since the financial crisis a narrow band of PCA competitive behaviour has emerged (or example the Santander 123 account and the Nationwide Flex-plus account) focused on relatively low cost (for the banks) rewards and higher perceived added value for customers.
9. The marketing for these offers has been predicated on a low interest environment (also restricting bank pricing flexibility), and – it could be argued – did not put customers at the heart of what the banks were doing. The banks have been pursuing 'share of wallet' by funnelling their customers into a small number of highly marketed products, rather than innovating new approaches that fundamentally address customers' PCA needs.
10. It is not to say that banks have not wished to innovate, it is rather than they could not because the resources of the large banks have been tied up with remediation and other mandatory legal and regulatory requirements (including burgeoning conduct risk processes).
11. Para 16 of the Provisional Findings Report states the following. "The four largest banks (LBG, HSBCG, RBSG and Barclays) in Great Britain accounted for approximately 70% of

active PCA's" (i.e. almost 48 million PCA's). In other words, just 4 Executive Committees (including 4 CEO's) decide on the prevailing competitive environment for PCA customers in Great Britain.

12. In addition, all substantive customer/product/services-based change (a pre-requisite for a changing PCA competitive landscape) must now be delivered through Digital/IT, and the immense BAU / Legacy complexity and patchwork of systems-based change required severely restricts competitive responsiveness (and is likely to for a long time to come).
13. I have not read about a large UK bank board considering whether it would be best for it to break itself up to serve its customers better (and deliver improved value to shareholders). Surely within the current post-financial crisis period that should be a question they consider with some regularity.

Demand Side (Customers' Side)

14. Customers are clearly of the view that banks (and bankers) are 'as bad as each other', and for that reason there is little value in them (i.e. customers) committing their own personal resources to (*and taking the risk of*) switching bank accounts.
15. Historic conservatism amongst bank customers has been reinforced by the financial crisis, and by what appear to be never-ending headlines and television news items about banking scandals and bankers' bonuses.
16. Trust in UK banks has been largely destroyed, and customers now answer questions about their level of trust at a functional pragmatic level (i.e. with the benefit of the knowledge of the 100,000 euro guarantee and that a Government would not allow a large bank to fail repeating Northern Rock style headlines).

Bank Break-up Too Expensive.

17. Your conclusion that breaking up the larger retail banks would be too expensive (based on what has happened with TSB and Williams & Glyn's) does not take into account the following important factors.
    a. Lengthy timescales required for meaningful change. The larger banks are facing huge costs over the next 10-20 years installing new cores banking systems and effecting radical Digital/Mobile business model change and strategies (sometimes recently called the Uber-isation of banking).

b. The aggregated cost <u>to all consumers</u> of break-up of the larger banks <u>not</u> happening, may be greater than the cost <u>to the banks</u> of breaking up. You do not appear to have considered this in your provisional findings.

c. Greater competition tends to add shareholder value for those companies that thrive within an environment of greater competition, and for that reason there can be a 'win-win' outcome for both customers and shareholders of banks (and of course employees and society as a whole).

d. Ring-fencing has emerged as a mechanism to protect retail banks (and their personal / SME customers) within the ring-fence from fatal drains on fungible capital from operations outside of the ring-fence. The process of ring-fencing will be expensive but it will be mandatory to protect consumers and prevent a repeat of Government bails-out.

   i. *A similar approach could be used to ring-fence banks within a banking group for the purposes of greater competition (let's call it 'RF2' to distinguish it from the current ring-fencing requirements (which let's call 'Vickers' or 'RF1')).*

   ii. *These 'RF2' banks could be <u>competitively autonomous</u> within a 'Vickers ring-fenced bank' (RF1), and also within a large banking group, i.e. within a federated structure to improve competition.*

   iii. *This may achieve a far wider landscape of mid-size banks competing with each other and/or within different PCA customer segments.*

   iv. *This may also encourage the evolution of dynamic and digital/mobile banking business models.*

e. Banks and PCA's exist globally. It likely that new dynamic digital/mobile banking business models and strategies will be 'tried and tested' elsewhere in the World and imported into the UK (and/or passported from the EU). For that reason it will be better that the CMA creates an improved Supply Side market, rather than seeking to rely on Behavioural Economics inspired nudges, mechanisms and triggers as Possible Remedies to prompt greater competition between the existing banks.

18. For these reasons (i.e. at the same time as ring-fencing and transformation to Digital/Mobile business models), <u>now is the perfect opportunity</u> for the larger banks to

be broken up to increase competition (albeit possibly under the 'RF2' suggestion above). (Note: There could be many RF2's within a 'Vickers' RF1.)

19. The CMA might consider – as a Possible Remedy - what the maximum number of customers for a UK 'RF2' Bank should be to create the maximum competition. Would it be 4 million customers or 8 million customers (or some other number)? The CMA might wish to invite responses on this idea.

Behavioural Triggers.

20. Your Possible Remedies focus on Behavioural Triggers (perhaps through advice you have received from the Behavioural Insights Team led by David Halpern) aiming to bring switching 'opportunities' to the attention of customers when adverse events happen (IT outages / changes in terms and conditions etc.).
21. The events you suggest may simply reinforce customers' view of banks generally, and for that reason – at best –have a neutral effect on switching (i.e. the 'all as bad as each other' inertia argument).

Customer-Centricity

22. At present Banks have <u>no</u> <u>duty</u> to bring to the attention of their customers the fact that better deals exist for them even within their own products and services. Banks do not currently do this where it means that they will lose money, and so they <u>rely</u> on considerable customer inertia within their business models.
23. Customers have strong perceptions that it has usually taken them a long time to build up the patchwork that is their own personal 'web' of payments, whether it be through their debit card details for on-line subscriptions, direct debits to utilities, a credit card attached to Paypal, payments for the Dartford Bridge or Central London Congestion Charge, etc.
24. Many customers have no record of their own personal financial 'web'. For that reason, switching current accounts holds out the prospect of a customer navigating forgotten passwords, automated call-centres, webchat and automated internet processes (many caused by banks automating to reduce costs), and this is a daunting prospect. Clearly the CASS switching service has added little, if anything, to levels of confidence in switching.

25. Customers also increasingly worry about their credit scores, because those scores are becoming fundamental for renting, mortgaging and obtaining further credit, i.e. enabling key aspects of their basic needs and more complex personal aspirations.

The Digital/Mobile Future

26. The Digital/Mobile Future of PCA's may be increasingly dominated by the likes of Apple, Google and PayPal in the medium-to-long term (or even by bank-owned Digital/Mobile Divisions (that in due course may themselves 'consume' / 'overrun' their 'traditional' parent).
27. Digital-savvy cash-rich tech-originated businesses that will be confident in their own abilities to create new mega-trends of 'ways of doing things' that customers have not yet even considered, are highly likely to provide the real future competition (subject to regulatory hurdles being surmounted). In that context the CMA's Possible Remedies may quickly seem outmoded and irrelevant.
28. The Treasury Committee on 4 November – quite rightly – expressed concerns about a lack of customer Digital/Mobile knowledge and literacy. In the future there will be a patchwork of Digital and Non-Digital preferences amongst customers, but the trend-line is clear towards Digital/Mobile. (By way of example, look at London Transport no longer accepting cash on its buses.)

Business Model Adjustment

29. Of course, however the competitive landscape may change, banks will need to be profitable to continue to serve their customers. Banks should not do that within a strongly implicit background of the larger banks being 'too big to fail' because that will be anti-competitive for the entire PCA sector.
30. The Supply side status quo Provisional Findings of the CMA (i.e. to leave the banks as they are) will perpetuate for too long the recovery phase of banks following the financial crisis.
31. In general, banks do not know at the moment if their PCA offerings are profitable (as was discussed at the Treasury Committee on 4 November 2015). This is of course anti-competitive because the financial judgements of banks around future current account offerings will be financial 'shots in the dark' and for that reason opaque from the customers' points of view.

32. It may stifle competition if new PCA product and services features are 'grafted' on to the existing uncertain cost foundations because transparency may decrease and comparison can become more difficult (bringing associated complexity and lack of clarity in Price Comparison Websites).

Free If In Credit (FIIC) PCA's

33. The arguments over FIIC PCA's being a 'con' have been well-articulated by the Treasury Committee, and for that reason I do not raise them here. But, a word of caution: if the FIIC model disappears (flawed as it is) there may be many customers who are 'disenfranchised' because they may be 'exited' by their banks (either actively or constructively).
34. The outcomes of the Retail Distribution Review (RDR) have shown that good consumer protection intentions and principles can give rise to unintended and undesirable consequences with adverse effects on the availability of services and on competition.

Complaints

35. The level of complaints against banks (including PCA's) is at very high levels; the numbers are published by the FCA twice each year, and they are continuing to increase. At http://www.fca.org.uk/firms/systems-reporting/complaints-data/aggregate-complaints-data the following report from the FCA can be found for 2015 H1: *'Current accounts' saw the largest numerical increase in complaints, rising by 120,450 or 31.2% to 506,326, which also made it the most complained about product category after PPI.'*
36. Whilst customers do not feel confident about switching, they do feel confident about complaining in what has become a post-PPI compensation culture, prompted by poor levels of service caused by cost cutting and the general loss of individual banking relationships.
37. Trust between customer and banks may never return (and may seem largely irrelevant to customers in the Digital/Mobile age of PCA banking (because of in part - for example - the rise of call centres, webchat and automation, and the decline of branches).

Overdrafts

38. Many PCA customers struggle with their overdrafts. Credit is an important tool for customers. Many customers become 'overdraft prisoners', 'credit card prisoners', and of

course, ‘mortgage-prisoners’; many of them then become largely at the mercy of banks’ overdraft charging models.

39. What used to be known as ‘the never-never’ can put PCA customers into a ‘twilight zone’ of overdraft and credit card debt from which it can become very difficult to emerge. Banks earn their highest fees from those who are financially less skilled and disciplined.
40. There are varying degrees of competition in a customer switching their PCA overdraft to another bank (depending on the size of the overdraft and their personal circumstances). But many customers are too embarrassed to air their ‘negative’ financial position either over the telephone or within an open plan environment in a local bank branch, and they fear the impact that a refusal of their switching application will have on their credit scores.
41. For this reason, the cross-subsidisation of one set of customers by another is anti-competitive. It might be possible to argue otherwise if there were multiple differentiated PCA-charging business models (including for overdrafts) within the UK market, but there are not.

Conclusion

42. In short:
    a. Structural change to create more medium-sized banks serving UK customers will create better competition than the triggers for customers being proposed as Possible Remedies;
    b. The cost of this change may easily merge with the huge investment in changes facing UK banks as they move inexorably towards Digital / Mobile business models over the next 10-20 years; and
    c. *A new <u>competitive ring-fence approach</u> might facilitate the creation of more medium-sized banks (whilst at one level keeping them prudentially within ‘Vickers’ ring-fencing, and at another level keeping them within large banking groups but with business model autonomy within a ‘federation’).*
    d. *These ‘Strata’ would then protect retail customers from another banking crisis <u>and</u> create a dynamic competitive environment for them.*

Prin-Gov

Yours faithfully

- Sent by Email –

Adrian McCarthy
Principal
PrinGov Limited