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Which? response to the CMA's Retail Banking Market Investigation provisional findings and possible remedies

Summary

The CMA's provisional findings confirm the concerns that Which? outlined in its previous submission to this inquiry: that retail banking is not sufficiently competitive, and that this is not delivering good outcomes for consumers.

The CMA has a duty to decide whether it should take action, and/or recommend that others take action, to remedy, mitigate or prevent the detrimental effects on customers that result from the competition problems it identifies. In addition, the CMA must seek as comprehensive a solution as is reasonable and practicable to any detrimental effects on customers that result from those competition problems. The CMA is charged not simply with promoting competition, but also with protecting customers from the harmful effects that competition problems can have. This dual role in competition and consumer policy should run through much of what the CMA does, but the CMA's proposed package of remedies does not provide a means of sufficiently addressing the consumer harm that has been identified.

The CMA has provisionally found that a combination of low customer engagement, barriers to searching and switching, and incumbency advantages in the provision of personal current accounts (PCAs) is leading to adverse effects on competition. The CMA's analysis identifies overdraft users and non-engaged customers, who are less financially sophisticated and/or less confident in using the internet, as those who are likely to be particularly affected by competition problems.

The 10 possible remedies identified by the CMA all relate to switching. Given that the overall picture painted by the CMA's inquiry remains that customers in credit have low incentives to switch, and customers who are heavy users of overdrafts are very unlikely, or are unable, to switch, it follows that remedies that focus only on the switching process cannot reasonably be expected to address the detriment these customers face.

While the proposed remedies are mostly desirable and the package is likely to bring some customer benefits, focusing only on switching is insufficient. These remedies alone are unlikely to transform the market from either a competition or customer perspective. Effective switching processes should be treated as a hygiene factor, and expecting these switching related remedies to address overdraft charging problems, for example, is unrealistic.

The CMA needs to take a broader view of remedies and carefully examine how it could lessen consumer harm, including through consumer empowerment and protection mechanisms.

This response proposes a package of additional remedies that focus on generating a shift in the way customers are treated. This includes measures that directly address the harm associated with overdraft charges, within a broader set of measures aimed at prompting and supporting culture change that would result in banks treating their customers in a fairer and more honest way.

While we recognise that the CMA is operating to a tight deadline, the CMA should seek to deliver these additional remedies, alongside the proposed switching remedies.

Comments on the CMA's analysis and possible remedies

The CMA's analysis shows that outcomes are particularly poor for heavy overdraft users, and indicates that around 9% of customers have paid more than £20 per month in overdraft charges. Furthermore, around 2% have paid more than £60 per month, which indicates that some heavy overdraft users will have been paying hundreds of pounds per year in overdraft charges.

Which? has identified overdraft charging as a key area in which some current practices do not look fair or appropriate. It appears that banks are using unarranged overdraft charges as a means of extracting significant funds from a group of customers that has revealed itself as unlikely to switch.

The CMA found that 14% of PCA revenue comes from unarranged overdraft charges, and yet there appears to be little justification for applying any unarranged overdraft charges at all. The limited risk management and cost issues that these charges relate to in the context of modern payment systems do not justify the significant negative effects that come from allowing banks to target a group of customers that face significant barriers to switching with much higher charges.

The CMA found that overdraft users were less likely to switch, and this was particularly so of heavy users. Expecting switching remedies to address the identified harm is therefore unrealistic.

The 10 possible remedies identified by the CMA all relate to switching. Many of them, notably remedies 3, 7, 8, 9, 10, 11 and 12, look to provide for sensible housekeeping or updating and improving the current switching service. Having effective, trouble-free switching arrangements is important going forward, in order to try to generate more competitive pressure to develop and bring forward new customer offerings. However, these changes are unlikely to have a big impact on problems with overdraft charging and are therefore unlikely to provide an effective means of addressing the consumer harm that the CMA has identified.

Remedy 1, to prompt customers to review their PCA provider at times when they may have a higher propensity to consider a change, might appear promising, but there is likely to be a range of practical problems to overcome, particularly in relation to third party access to customers, which could limit the impact it has on improving switching rates.

We question whether Bacs is well placed to promote the benefits of changing provider, as suggested in remedy 2, or indeed whether a general advertising campaign would be effective in increasing public awareness of the potential savings or rewards that could be obtained by switching current account provider and of the benefits of using the Current Account Switch Service to do so in terms of security and convenience. As such, remedies 1 and 2 are unlikely to have a major impact on customer awareness of potential benefits from switching, given practical difficulties.

Remedy 3 proposes to facilitate price comparisons by making transaction data more easily available and usable. However, for it to be effective, more clarity is needed over what the 'deal' is in relation to overdrafts, in particular unauthorised overdraft use.

Remedy 5, which requires the collection and dissemination of data on PCA service quality in a form that would enable valid comparisons between them, appears promising. However, the notice of possible remedies says very little about what this could or should include, and as set out in our additional package of remedies, it should be developed and broadened further and in a way that puts customer views central to defining and measuring service quality.

Which? has no comments on remedy 4, proposing a PCW for SMEs, or remedy 6, to standardise and simplify BCA opening procedures.

Additional remedies

This section of the response proposes additional remedies that focus on generating a shift in the way customers are treated. Which? is confident that these remedies are consistent with the CMA's analysis of the detriment faced by consumers in the retail banking market. If taken forward as a package, these remedies should help to provide an effective means of addressing the consumer detriment that the CMA has identified.

A. Measures to support culture change and more effective customer engagement

Long-standing competition problems in the retail banking sector have left a situation where customers are often not treated in an appropriately fair and honest way. There needs to be a culture shift in banking that focusses banks on the needs of consumers.

The CMA should require banks to put mechanisms in place to prompt and support a culture shift in banking that focuses on the needs of the consumer. This remedy should not involve regulatory micro management, but should instead involve incentivising each bank to develop a culture based on effective engagement with its customers: understanding what their customers consider to be fair treatment and taking that knowledge fully into account when designing policies and practices.

For example, this remedy could involve:

- Each bank being required to establish an independent customer challenge group to hold it to account on its engagement with its customers;
- The challenge group publicly reporting to an independent body on the quality of the bank's engagement with customers and whether customers' views have been fully taken into account;
- Developing reputational, financial and/or procedural incentives based on the challenge group's report;
- Holding the bank to account for enabling the challenge group to undertake its work drawing on the appropriate information and skills, and being able to demonstrate its independence; and
- Holding each challenge group to account for discharging its role effectively and independently.

The development of this remedy could be informed by experience with customer engagement efforts, including through the use of customer challenge groups, in other regulated sectors.

B. The same charges for arranged and unarranged overdrafts

Within its package of remedies, the CMA should tackle the issue of high overdraft charges, and one remedy proposed by Which? is to consider stopping banks from differentiating their charging structures for arranged and unarranged overdrafts.

The CMA identified that 14% of PCA revenue came from unarranged overdraft charges in 2014. The CMA's transaction analysis found that 51% of overdraft users (around 22% of all users) went into an unarranged overdraft at some point in 2014. The CMA found that regular use of unarranged overdrafts was not rare, and that 10% of unarranged overdraft users used it for nine months of the year or more.

Table 7.1 of the CMA's full provisional findings report summarises PCA provider overdraft charges, and shows the marked difference that is typically seen between arranged and unarranged overdraft charges when an arranged overdraft limit is exceeded. This evidence shows how the monthly charges for using an unarranged overdraft can be as much as 15 times higher than those for an arranged overdraft.

Unarranged overdraft charges cover two situations:

- When a payment is made that takes the balance over the arranged limit, and this results in an over-limit fee and/or a 'paid item' fee; and
- When a payment that would have taken the balance over the arranged limit is not made, and this results in an unpaid item fee.

Which? proposes that the CMA considers whether unarranged overdraft charges that arise in these situations should be not be higher than for arranged overdrafts.

Changing unarranged overdraft charges would clearly impact on the way in which banks raise revenues from PCA customers. However, this should not have a major impact on the free-if-in-credit model. Some degree of revenue rebalancing through other charges should be expected, but at the same time, and in line with the CMA's analysis, the current level of revenue from unarranged charges, given the low likelihood of users of unarranged overdrafts switching, is subject to particularly limited competitive pressure.

At present, a customer may exceed an arranged limit in one of three ways:

i) A payment request is lodged that would take the customer over their pre-arranged limit, and the bank chooses to accept it;
ii) A payment request is lodged that would take the customer over their pre-arranged limit, and the payment is accepted (e.g. by a retailer) without bank authorisation;
iii) The application of bank charges or interest cause the balance to exceed the pre-arranged limit without any payment request being made.

If the bank is aware that accepting the payment request would take a customer over a pre-arranged limit then Which? questions whether any additional charge should be levied. The bank is explicitly authorising the customer to extend their overdraft, whether the customer is aware of that or not. In some scenarios, for example if a customer has £1 of available funds and tries to transfer £10 out of their account using faster payments, or tries to withdraw £10 from an ATM, the payment is simply not be allowed to take place. But for other payment transactions, the bank may, at its discretion, authorise the payment and then charge a paid item fee. If a bank decides to offer additional flexibility in terms of access to funds, it should do so on the same terms as would apply to an arranged overdraft.

It seems likely that the historic rationale behind the high charges for going over an agreed limit was to manage liability and incentive issues associated with payments that took place without payment-specific authorisation. For example, banks used to issue cheque guarantee cards and so in principle a consumer could continue borrowing by writing cheques of a value that the bank had guaranteed to pay. In this context, a high over-limit fee can be understood as part of the deal associated with providing the flexibility of being able to write guaranteed cheques. It provides an incentive on the customer not to use this flexibility over and above a pre-agreed level. But times have changed. We no long have cheque guarantee cards and while there are still some unauthorised, but guaranteed, payments – such as some contactless payments – banks have much more flexibility over how customer risks are managed. The value of contactless payments for example, is limited, and banks can and do limit access. The risk management issues that remain appear to be much more limited and can be managed in much more flexible ways given modern payment authorisation technology.

The only other reason for a user exceeding their limit would from the PCA provider levying interest and/or charges. Which? does not believe that this provides an appropriate justification for applying additional charges.

Which? also proposes that unpaid item charges should cease. Unpaid item charges appear to be a relic from legacy payment methods and are no longer justified. Table 7.1 of the provisional findings report shows that most PCA providers have an unpaid item charge, and for those that do, the level ranges between £6 and £28.

Unpaid item charges are the only charges that PCA customers directly face for the use of payment systems (except for when CHAPS is used for large transfers such as with a house purchase). In the context of modern payment systems, there is no logic in charging for unpaid items. If faster payments is used and an item remains unpaid, no charge is levied: the payment simply fails to go through and a failure message will be received. Similarly, credit and debit cards can be declined with a message sent describing payment as unsuccessful, but which gives rise to no charge. The same applies to attempts to withdraw money at an ATM. Unpaid item charges only arise when older, legacy payment systems are used.

The application of unpaid item charges targets charges for payment system usage only on those who may be least well placed to pay, and who are unlikely to respond by switching.

C. Greater clarity on what the 'deal' is about authorising payments

The CMA has recognised the existing lack of clarity faced by customers. The CMA refers to the FCA's recent conclusion that despite the introduction of transparency initiatives, the terms set by PCA providers for overdrafts can be so complex and opaque that even the most astute customer could struggle to understand what they are paying for, and that there was widespread confusion about what happens when customers exceed their arranged overdraft.

However, the CMA has proposed nothing, beyond the switching remedies, to address the problem that customers cannot understand what the current service is that they are paying for.

Customers should have better information about what the 'deal' is with unauthorised overdrafts. In its package of remedies, the CMA should consider requiring banks to provide greater clarity to customers about unauthorised overdraft use and when they will and will not authorise payments that cause a pre-arranged limit to be exceeded. As set out in remedy B, banks should set the terms on which they are willing to offer overdrafts, and if they decide to pay an item that results in an overdraft being exceeded, they should treat this as a temporary increase in the overdraft limit. Otherwise they should not authorise the payment.

D. Greater clarity on buffer zones

The CMA should consider how the use of buffer zones and other flexibility mechanisms can be used to help customers avoid exceeding their limits. For example, these measures could help manage situations where payments made without authorisation can result in an account holder unknowingly exceeding an arranged limit. This would assist banks with managing risks concerning limit breaches and payment authorisation failures. However, the use of such mechanisms should not be used as a means of charging higher prices to a set of customers identified as inactive.

E. Supporting customers in financial difficulties

The Lending Code includes a commitment to help customers if they are in financial difficulties, including by considering suspending interest and charges if these would cause the debt to increase or lead to the repayment term becoming too extended.

In the FCA's credit cards market study interim report, the regulator recognised that while firms are already required to monitor for signs that consumers may be struggling to repay, they could also identify and potentially address problematic debt sooner, before interest and avoidable charges accumulate. The FCA has said it wants to explore how to rebalance the incentives for firms in the credit card market to ensure that lower cost alternative credit is offered as a matter of course to those who appear to be building up problem debt after a standard period such as 12 months.

Similar remedies should be considered in the context of PCA overdrafts. In line with the change in culture described in remedy A, banks should be required to take an honest and fair, proactive and staged approach to how they support customers facing financial difficulties.

One key part of addressing financial difficulties can be to stop overdraft charges making those difficulties worse. The CMA should therefore consider remedies that tackle the impact that high overdraft charges have on customers in financial difficulty.

The CMA's analysis identifies heavy overdraft users as being able to make significant gains from switching PCAs. However, heavy overdraft usage itself indicates that a customer is likely to be using their overdraft as a high cost source of credit. High cumulative overdraft charges can exacerbate financial difficulties and, regardless of whether or not the customer switches PCAs, addressing that financial difficulty may require a reduction in the extent to which the overdraft is used. Where necessary, this could involve replacing some or all of a customer’s overdraft with a cheaper source of credit that can be paid down more rapidly and at lower cost.

However, the amount of income banks currently earn from unarranged overdraft charges may act as a significant disincentive to taking appropriate action in this area. Addressing unarranged overdraft charging issues, as set out in our proposed remedies above, should therefore also be seen as a key part of encouraging better practice towards customers in, or approaching, financial difficulty.

F. Service quality metrics

The CMA should develop remedy 5 in way that puts customer views at the centre of measuring service quality.

Banks should be required to engage with consumers to develop metrics and publish data on the quality of services that capture what is important to customers. This work should be subject to challenge by the challenge groups proposed in remedy A.

The regulator could pull out key common metrics and data that it would mandate in order to enable comparisons between banks (e.g. league tables), which would better inform customers about available options. This regulated common set of data could include service quality measures related to key problem areas including the treatment of customers in financial difficulty (remedy E), as well as the extent of unarranged overdraft charges and the clarity over what the ‘deal’ is concerning unarranged overdrafts (remedies B and C, above).

Banks’ engagement with their customers should also identify other quality measures that would spur greater responsiveness by each bank to its particular customers’ priorities.

In addition, as part of this process, banks should ensure that they have in place compensation arrangements that are in line with consumer expectations.

Importantly, by developing remedy 5 in this way, the development and use of service quality comparisons could be used to promote culture change, and not simply as a tool to facilitate switching.

G. Better tools for customer control

The CMA should consider how banks can use additional prompts and control mechanisms to assist customers to manage their accounts.

There are both direct and indirect costs to the customer for using a PCA. These costs are heavily dependent on how well the customer uses and controls their account, and recent evidence highlights the effectiveness of using certain tools that improve customer control.

For example, experience with text alerts shows that prompt and control options can have a major impact on the efficiency of account management. The FCA found that signing up to text alerts or mobile banking apps reduced unarranged overdraft charges incurred by 5-8%, and signing up to both resulted in a reduction of 24%. HSBC reports that 72% of First Direct customers who were sent text alerts were able to avoid fees, as were 50% of those using its high street HSBC network.

Attention should also be given to those who are not assisted by text alerts and mobile apps, particularly given the CMA's assessment that one of the groups most likely to be particularly affected by competition problems is non-engaged customers, who tend to be less financially sophisticated and/or less confident in using the internet.

This remedy would work alongside remedy F, as would remedy D, as the availability of these tools and mechanisms could be considered as metrics of quality of service. In this case, banks could be held to account for how effectively they put their customers in control of managing their accounts, both through the usage of existing tools, but also by examining whether banks are developing, testing and deploying other options that may be effective for different types of customers.

Which?
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