LLOYDS BANKING GROUP

LLOYDS BANKING GROUP PLC

CMA RETAIL BANKING MARKET INVESTIGATION

Response to the Provisional Findings and Remedies Notice

20 NOVEMBER 2015

CONTENTS

This submission comprises the following sections:

A. Executive Summary

1. Throughout the investigation, Lloyds Banking Group ("**LBG**") has encouraged the CMA to identify the real issues and facts in the reference markets and to expose some of the myths that have distracted regulators and decision-makers from improving outcomes for customers. LBG explained in its letter to the CMA at the start of the investigation just over twelve months ago that these markets could and should work better for customers and that a further cycle of future inquiries can be avoided. The best way to do this is to diagnose the issues properly, to learn from previous mistakes and to trial and then implement remedies that will actually make real and permanent changes that will benefit customers.

2. LBG has some of the most compelling propositions in these markets and is constantly investing to improve them. **LBG wants to see these changes delivered so that new and existing customers can easily compare its propositions with other providers** and choose to switch their accounts to LBG.

3. The CMA has made good progress in its Provisional Findings in identifying many of the key issues and facts. The overall package of remedies it has proposed is a good starting point.

Problems identified by the CMA are fundamental to how customers engage and solving them will deliver more effective competition

4. In its Provisional Findings, the CMA has found three main problems in the reference markets. LBG supports these findings. The three main problems are:

   (a) **SME customers**, **particularly smaller businesses**, have lower levels of engagement than PCA customers, have no useful tools to compare accounts and rarely shop or switch their current account;

   (b) PCA customers find it difficult to **compare current accounts** and do not have the right tools to do so. Awareness of the switching service needs to be higher and **many customers believe switching is more difficult than it actually is**; and

   (c) PCA customers with **overdrafts have most to gain from switching** but think it will be difficult to switch and often cannot get reassurance that a new provider will offer them the same level of overdraft before switching.

5. These problems are consistent with those identified in LBG's initial letter, and with the evidence it has shared with the CMA. **They are not trivial, they are fundamental to how customers engage and to how providers compete.** They have a significant impact on providers in the sector, and not everyone will support addressing them. Fixing them will transform how customers can engage with the market and shop around for current accounts. This will increase the pressure on providers to innovate and improve the price and quality of products and service. Implementing effective remedies will involve significant cost, effective coordination by a number of regulators and HMT, and the adoption of advanced and world-leading technology and innovation.

6. Given the limited time available LBG has focussed its response on these main issues, remedies and the most important errors in the Provisional Findings. The CMA should not assume that LBG agrees with all of the CMA's other findings and analysis simply because they are not raised in this response.

The CMA can make quick progress, and go further than its proposed remedies

7. The CMA's list of remedies is a good starting point. Some of these remedies will have clear and immediate benefits to customers and implementation work should begin immediately. **They can deliver, within 12 months, much better and more powerful comparison tools** that will allow personal and, for the first time, business customers to understand what their account costs and how much they could save by changing provider, as well as greater awareness and confidence in the Current Account Switching Service ("**CASS**"). These changes will have a bigger impact on SMEs where engagement and awareness of CASS is lower, and can be further enhanced by the outcomes from the NESTA small business innovation challenge.

8. The CMA can deliver these by changing the current governance for delivering open data in banking and giving clear outputs and prioritising delivery of an open API standard for business and personal current accounts, building on the start made with midata. More effective CASS marketing should be delivered by changing the current governance and approach. The CMA could make the FCA or PSR responsible for oversight to ensure delivery.

9. In addition to the CMA's list of potential remedies, **additional behavioural remedies should be considered**. At present the CMA's behavioural remedies are aimed at encouraging customers to consider alternative accounts and to stimulate switching to alternative providers. The CMA's evidence shows that many customers could reduce their costs of banking, regardless of switching provider, if they behaved differently with their existing account. Some remedies to encourage this customers to engage more with how they use their accounts, such as opt-in balance alerts, have already been trialled by LBG. Initial results are promising, and suggest that rapid behaviour change is possible, which can save some customers up to 25% of overdraft fees. The impacts of these types of behavioural remedies are similar to that reported by the FCA and when combined with additional interventions around customer communications and statements, the cumulative effects could be even bigger. The CMA can help the industry to deliver these changes by working with the Information Commissioner's Office to address any concerns about data protection that prevent providers automatically opting in many customers.

10. **This package of changes will deliver real benefits within a year** but also create momentum towards more customer engagement, and the right environment for the programme of trialling that is required for the other proposed remedies. Trials are critical to ensuring that behavioural remedies are effective, but the process is not as quick and will require a detailed, transparent and iterative programme to identify what works – there is no shortcut to this if we are serious about making real and lasting improvements for customers. **LBG has run a series of customer trials during the first twelve months of the inquiry that demonstrate that there is more that can be done to help overdraft customers reduce fees and to drive higher engagement.** The FCA has a critical role to play in the continued development, implementation and review of these behavioural remedies, which is consistent with the CMA's statutory timetable, and consistent with similar remedies recently imposed in other markets.

The CMA has demonstrated that myths about competition do not stand up to scrutiny

11. LBG also wanted this investigation to address some of the myths about how competition works in the reference markets. Examples include that: all banks are the same; customers tend to be dissatisfied; innovation is low; entry is difficult and expansion is slow; significant cross-subsidies exist; scale gives established banks a significant competitive advantage; and free-if-in-credit ("**FIIC**") pricing is a significant problem. As

the Provisional Findings have demonstrated, **none of these views stand up to scrutiny** and, more importantly, they are distracting from what really needs to happen.

12. There are findings in the Provisional Findings report that are not supported by the evidence, or which have been presented in such a way that they may continue to perpetuate these views or leave open the debate on whether they are significant problems.

The CMA's analysis of price and quality is not robust

13. The CMA's analysis starts from a reasonable view that in a competitive market over time providers with better propositions, in terms of **price and quality**, should grow and those with worse proposition should lose market share. This is generally true, but there are problems using this framework in the reference markets.

14. First, pricing and quality in the reference markets are **difficult to measure**, and the CMA's approach so far is not robust, and so cannot be used to make the assessment of market outcomes that the CMA wants to. Even if the CMA overcomes these problems and is able to measure price and quality more robustly, there are good reasons why the CMA would not necessarily find this relationship between price and quality in current accounts over the last five years. This is because of the problems identified by the CMA in terms of levels of engagement, the lack of tools for customers to compare prices, and the fact that CASS was only launched two years ago and customer awareness and confidence is still building.

15. That simply reinforces the need to address these problems through the remedies the CMA has identified. But the absence of such a relationship historically over the last five years given all of these factors cannot be used to find evidence of unilateral market power over existing customers or that size and concentration lead to higher prices. The CMA has found **no evidence of excess profits** in aggregate or at a provider level and the problems with engagement affect providers of all sizes.

16. The CMA should focus on looking forward and the competitive dynamics in the market as engagement improves and providers with new, different and lower cost business models are entering and expanding. **Entrants have the potential to challenge the established providers with lower prices, which reflect their lower costs and innovative service** - they can genuinely serve at lower cost because of lower cost IT systems, no legacy costs, no basic bank account obligations and by focussing on different distribution strategies such as only serving metropolitan areas, more affluent customers, and/or digital.

17. The established providers are already responding to this emerging pressure from lower-cost competitors. **All of the largest four providers have launched new products at lower prices and the pace of change and product innovation is accelerating.** At the same time, they are investing in digital to compete on the same basis with these new entrants, which is improving quality. To accelerate this natural competitive process, these entrants (and the established providers that are quickest to adapt their business models) need more engagement and switching, which is what the CMA's remedies focus on.

18. There is a lot of work to do if the CMA wants to procure a reliable analysis of price and quality:

    (a) an objective measure of quality is needed. **Customer satisfaction is not the same as quality** and cannot be used to look at a price/quality relationship – high and low quality products can have the same level of satisfaction and there is no reason a lower priced product should have lower satisfaction;

(b) around 40% of current account revenues are generated by **credit balances and interchange which is not even included** in the CMA's 'prices' and is not spread evenly across providers and products, which the CMA's model assumes. The level and relative cost of each product depends on its share of balances and account usage across the market and should be included in the assessment;

(c) the CMA compares a simple 'average' across brands and customer segments. This does not make economic sense because of the different ways in which providers target different customer segments. One would not average the fares and quality of first class and economy air travel or compare the price and quality of an online-only supermarket with a multi-channel supermarket. **The CMA needs to look at the target customer segment for each product individually** before it can draw conclusions on relative prices;

(d) there are flaws in the **data and assumptions** used to calculate the prices and quality metrics, and in the interpretation of the results. There is no statistically significant relationship between price and market share in PCAs. This analysis cannot support the CMA's findings on pricing and quality, and simply does not give an accurate description of LBG's position in the market.

19. Resolving these issues will be time consuming and even if, once solved, the analysis provided more robust evidence that providers with lower prices and better quality do not gain market share, this would not require different or additional remedies. LBG remains willing to work with the CMA to develop more robust analysis but would **prefer that effort is focussed on designing and implementing effective remedies**.

20. However, if the CMA chooses to do this, it should explain this and step back from its existing **provisional findings on price and quality in PCAs and BCAs as they are incorrect and present a misleading view of the absolute level of price and the relative price of all current account providers.**

Further work is required on gains from switching and FIIC pricing

21. The analysis of possible **gains from switching** gives a misleading impression of the size of gains available to PCA customers (which, in some cases, are higher than the entire revenues of the market). The average gains from switching of £70 per customer would suggest that the industry could lose £4.2bn (or half of revenues) if all customers switched. As the CMA found no excess profits, this is not credible. LBG agrees that some customer segments, particularly overdraft customers, can gain from switching, but the CMA should understand and accept that higher levels of switching would lead to price changes in both markets – for example, Santander, as the most switched to brand in the personal market, has recently increased the monthly fee on its 123 product from £2 to £5.

22. The CMA needs to **complete its work on FIIC**. The CMA is right to conclude that FIIC does not explain why few customers switch and there is no case to change the model as it is popular with customers and encourages multi-banking. There are also many non-FIIC products already available that charge monthly fees and/or offer credit interest, such as Santander 123 and Club Lloyds. But, given the strong views expressed in response to this aspect of the Provisional Findings, the CMA needs to do more to lay these other concerns to rest. One of these concerns is that lower income groups pay more under FIIC, but in reality the costs of a PCA rise with income and the distributional outcomes for FIIC accounts are not problematic. The CMA is in a unique position to investigate the distributional outcomes of FIIC, and look at whether alternative pricing structures would resolve this or any other concern.

Next steps

23. In this response LBG sets out its key concerns with specific elements of the Provisional Findings and provides additional thoughts on potential remedies. In the very short time available to comment LBG has focussed on the most important points. LBG will submit a further response on the CMA's pricing analysis when all of the relevant data and analysis are available.

24. **LBG will continue to engage constructively** in the next phase of the inquiry and to help the CMA design and implement a set of remedies that will work and deliver real and lasting change for personal and business customers and address the problems that have been identified.

B. Response to Provisional Findings

1. THE CMA'S PROVISIONAL ANALYSIS OF PRICES AND QUALITY IS WRONG

1.1 The CMA assesses prices and quality for both PCA and BCA for each brand. The CMA uses satisfaction rather than quality, which is not the same. Its analysis misses 40% of PCA revenues by excluding credit balances and interchange, which are not shared evenly between providers as the CMA's model assumes. The analysis is based on averages across channels (for example branch, digital and telephony), products (packaged, reward, standard and basic) and customer segments (more affluent and less affluent customers).

1.2 The CMA uses this framework to draw the following conclusions:

(a) that larger, more established PCA providers tend to offer the highest average prices (but not for SME services);

(b) two smaller BCA providers offer considerably higher levels of satisfaction than other providers, although the relationship between satisfaction and prices for the remainder of providers is flat;

(c) PCA and BCA providers with above average prices and below average quality are losing market share only slowly to providers offering below average prices and above average quality;

(d) PCA customers on average could make financial gains of £70 per year if they switched, and heavy overdraft users would save on average £260 per year by switching; and

(e) longer established banks in these markets (including LBG) hold market power over their existing customers.

1.3 The CMA's analysis starts from a reasonable view that in a competitive market over time providers with better propositions, in terms of price and quality, should grow and those with worse propositions should lose market share. This is generally true, but there are good reasons why the CMA would not necessarily find this relationship between price and quality in current accounts over the last five years. This is because of the problems identified by the CMA in terms of levels of engagement, the lack of tools for customers to compare prices, and the fact that CASS was only launched two years ago, and customer awareness and confidence is still building. This simply reinforces the need to address these problems through the remedies the CMA has identified.

1.4 However, before getting to this assessment, pricing and quality in the reference markets is difficult to measure, and the CMA's approach so far is not robust. The result is that the CMA's price analysis does not reflect actual pricing in the reference market. Santander, which is the most switched-to brand in the market, is found to have the 12th highest prices for primary accounts holders. Lloyds Bank is found to be the most expensive brand in the most valuable customer segment despite paying the highest rate of credit interest and offering a £100 fee-free overdraft to customers in this segment through Club Lloyds. Bank of Scotland is found to have an average price that is two or three times higher than actual average revenue per customer.

1.5 The CMA also makes comparisons between price and customer satisfaction, in the absence of a reliable quality metric. Such a comparison is meaningless. Customer satisfaction is not the same as quality. Satisfaction is a measure of how well a product or service meets expectations about quality, given the price a customer pays. Satisfaction could be high even if quality is low, or vice versa. Satisfaction can also be clouded by non-quality factors – TSB and Lloyds Bank digital services have different NPS scores even though they are objectively identical. The CMA cannot use satisfaction to compare quality.

1.6 The CMA's existing analysis cannot be used to make the assessment of price and quality that the CMA wants to report. And there is a lot of work to do if the CMA wants to get to a reliable analysis of price and quality. LBG suggested earlier in the process that the CMA should use disaggregated data on the individual transactions of customers, rather than the aggregated monthly data the CMA has used. Using transaction-level data would address many of the issues with the CMA's price analysis, by avoiding the problems of missing data and the need for so many assumptions. Although the CMA decided not to use transaction-level data, LBG offered in June 2015 to help to verify the accuracy of the CMA's model against more accurate data on its own customers. LBG has only just been given access to the CMA's model, and so has not had time to do this verification exercise. LBG will separately submit the results of this work when it is completed to help the CMA correct the problems with its own analysis and interpretation of the results. Some of the flaws in the data, assumptions and modelling could have been addressed if the CMA had published its framework and detailed calculations in working papers prior to the publication of the Provisional Findings.

1.7 Resolving these issues will be time consuming and even if, once solved, the analysis were to provide more robust evidence that providers with lower prices and better quality do not gain market share, this would not require different remedies. LBG remains willing to work with the CMA to develop more robust analysis, but would prefer that effort is focussed on designing and implementing effective remedies.

1.8 These conclusions on price and satisfaction formed the centrepiece of the CMA’s presentation to journalists and have been extensively repeated by commentators. It is important that if the CMA chooses not to resolve the issues with its analysis, it should explain this and step back from its existing provisional findings on price and quality in PCAs and BCAs as they are incorrect and present a misleading view of the absolute and relative level of prices of all current account providers.

1.9 The analysis of possible gains from switching gives a misleading impression of the size of gains available to PCA customers (in some cases, higher than the entire revenues of the market). The average gains from switching of £70 per customer would suggest that the industry could lose £4.2bn (or half of revenues) if all customers switched. As the CMA found no evidence of excess profits, more switching to lower priced profits would, over time, lead to some re-pricing by all providers. Recently announced price increases announced by Santander on its popular 123 account provide evidence of this already occurring. LBG agrees that some customer segments, particularly overdraft customers, can gain from switching, but higher levels of switching would inevitably lead to some price changes in the current account markets. The CMA should be very clear that the CMA’s analysis cannot be interpreted as the "gains available if everyone switched".

1.10 The CMA's needs to compete its work on FIIC. The CMA is right to conclude that FIIC does not explain why few customers switch and there is no case to change the model as it is popular with customers and encourages multi-banking. There are also many non-FIIC products already available that charge monthly fees and/or offer credit interest, such as Santander 123 and Club Lloyds. But given the strong views expressed in response to this aspect of the Provisional Findings, the CMA needs to do more to lay these other concerns to rest. One of these concerns is that lower income groups pay more under FIIC, but in reality the costs of a PCA rise with income and the distributional outcomes for FIIC accounts are not problematic. The CMA is in a unique position to investigate the distributional outcomes of FIIC, and look at whether alternative pricing structures would resolve this or any other concerns.

1.11 LBG asked the CMA to consider market shares by value rather than volume. The CMA has not disclosed the full details of its calculations of market share by revenue. The CMA's finding that volume and value based market shares are the same is counter-intuitive. LBG would expect those providers who only target higher income customers and/or do not offer national, branch service to have higher value than volume shares given the drivers of revenue under the current pricing model. LBG is unable to verify the robustness of the CMA's analysis of market shares by value and would like the CMA to release more data. It remains important for the CMA's inquiry to settle whether volume based market shares are the right way to measure concentration, expansion and the relationship between price, quality and market share.

1.12 Throughout the investigation, LBG has encouraged the CMA to identify the real issues and facts in the reference markets and to expose some of the myths that have distracted regulators and decision-makers from improving outcomes for customers. Examples include: that all banks are the same, that customers tend to be dissatisfied, that innovation is low, entry and expansion is difficult and slow, that significant cross subsidies exist, that scale gives established banks a significant competitive advantage and that FIIC pricing is a significant problem. As the Provisional Findings have demonstrated, none of these views stands up to scrutiny and, more importantly, they are distracting from what really needs to happen.

2. LBG'S CONCERNS WITH THE CMA'S PRICE AND QUALITY ANALYSIS

2.1 The CMA has tried to condense pricing and quality for each brand to simple 'averages'. This does not make sense in any market and so the relationship the CMA expects to find in a "well-functioning market" would not, in fact, be found in any market.

2.2 In any market there are typically products and services aimed at different segments of the market with pricing and quality tailored to these different segments. Some providers will focus on particular segments (for example, more affluent or price conscious customers). Some providers will focus on all segments but differentiate their offers either by brand or by proposition. Some providers will only offer certain channels (such as online only). Examples would include: low cost airlines versus full service airlines offering different classes of travel; and supermarkets, like Aldi and Lidl, that target more price conscious customers against Waitrose and Marks & Spencer that target more affluent customers. Further examples include Tesco that has in the past offered "Value" ranges, standard ranges and "Finest" ranges to target different segments within the same brand; Ocado only offers online delivery versus Tesco, Waitrose and Sainsbury's that offer online and bricks and mortar sales channels.

2.3 Price and quality (of the product and service) will naturally vary by segment, for both PCA and BCA. Customer satisfaction will reflect customers' expectations about price and quality in each segment. Averaging prices and quality by brand across segments makes no sense. But this is exactly what the CMA has done in this inquiry. It has averaged across all of these dimensions. Comparing the average price and quality of Easyjet with British Airways is meaningless. The relevant comparison might be between the price/quality of Easyjet with the 'economy class' option of British Airways. Comparing the average quality of Tesco with Ocado does not make sense. The relevant comparison is between the online offer of Tesco and Ocado. A proper analysis of price and quality in PCA and BCA and the relationship to market share would look at each segment separately and compare within each segment.

2.4 This is also important when looking at the relationship between price, quality and changes in market share. You would not expect a cheaper online supermarket to gain market share from a supermarket whose customers want to shop in a physical store. But this is what the CMA has done in averaging price and quality. LBG serves all segments and channels across all three of its brands. Average quality is meaningless in this regard. LBG segments quality and seeks to match the service it offers to the price of the product where it can. More affluent, valuable customers are offered superior service [✂]. This differentiation will be lost in average quality measures that cover the quality experienced by basic, standard, reward and packaged account customers with different income levels.

2.5 These examples are clear, and yet the CMA makes these inappropriate price/quality comparisons across customer segments for both PCA and BCA.[1] Figure 5.17 of the Provisional Findings compares First Direct, which only offers digital/telephony products to high-value customers, with other providers that serve low value accounts across extensive branch networks, including 9 million basic bank accounts. It compares Metro Bank, that is focused on new branches in affluent, metropolitan areas of London and the south-east, with providers that serve nationally including in less affluent and less densely populated rural areas.

2.6 The CMA's price analysis tries to answer the wrong question, which is "what is the average price for each product across the same group of customers?" But providers do not always serve the same group of customers. Club Lloyds and Bank of Scotland Vantage will have different customer profiles from the average profiles across all customers, that reflects targeting through pricing/eligibility of these products, and so will hold higher balances than for other providers. Santander's 123 customers will have very high balances which will be rare for other providers because of the high interest rate (relative to instant access savings accounts) on balances of up to £20,000. This can be seen from the Bank Of England data on their share of PCA deposits versus their volume based share. First Direct will have very few low balance or activity customers because it charges £10/month if customers do not meet income based eligibility criteria and automatically closes accounts that have not been used after two years.

2.7 A simple test of the robustness of the CMA's model is to look at the average revenue for these products and compare this with the average price in the CMA's analysis. The Table below shows this analysis for Lloyds Bank and Bank of Scotland. The CMA model average price for Classic account is broadly in line with average receipts. However, the CMA model price for Classic with Vantage and Club Lloyds is [£5 to £10] higher than average receipts per primary account. This is because customers hold higher balances on average for these products to benefit from credit interest. This is not picked up in the CMA model, which therefore gives the wrong impression of the competitiveness of these products.

[1] See Figure 5.17 of the Provisional Findings.

Table 1 Comparison of CMA's price model and average receipts

Brand	Product	CMA model		Average receipts*	
		Average price	£1751+ 2DD	Per account	Per primary account
BoS	Classic		8.19	[£2 to £5]	[£5 to £10]
	Classic with Vantage		4.73	[<£0]	[<£0]
	Average	**6.51**	**5.63**	**[£0 to £2]**	**[£2 to £5]**
Lloyds	Classic		8.19	[£3 to £5]	[£5 to £10]
	Club Lloyds		4.21	[<£0]	[<£0]
	Average	**7.74**	**6.96**	**[£2 to £5]**	**[£5 to £10]**

Source: CMA Provisional Findings, Appendix 5.4, Table 6 and 7. LBG PCA Aggregate Data Request.

Notes: Average prices are for the product listed. *Average receipts excludes interchange fees and value of funds and so is directly comparable with 'price'.

2.8 To properly assess relevant price and quality differences across providers, the question the CMA should answer is "what is the price paid for each product for <u>each product's own customer segment</u>?" The CMA would be able to identify what relative price each product offered for its target segment. The CMA has the data to do this, and could use the actual customers for each product to model its target segment. Only then can the CMA reach a view on the relative competitiveness of each provider within each segment, and ultimately across the market as a whole.

Data, assumptions and calculations used to estimate prices paid by customers are not robust

2.9 The CMA's analysis of prices is based on incomplete data and requires many assumptions to reach its estimates. The model that is used was built quickly and was not putback to providers in working papers.

2.10 The CMA could have avoided these problems by using disaggregated transaction-level data, or at least verifying some results by accepting LBG's offer to use the transaction-level data of LBG's own customers. This means that the price estimates cannot be relied on, as the examples show below.

2.11 LBG will report back to the CMA on its work to verify the accuracy of the CMA's estimates, but has not had sufficient time with the model to do this yet. The CMA still has the opportunity to undertake an analysis of prices using disaggregated transaction level data.

2.12 This analysis could then correct for the missing data and assumptions, as illustrated in the Table below.

Table 2 Illustration of impact of alternative data and assumption on 'average' prices

What the CMA should have done		CMA's approach		Potential impact on reliability of estimates
Framework	Assess prices in different customer segments	Average across all customer segments	✘	Prices vary by **±£10** between segments
	Assess quality in different customer segments	Average across all customer segments	✘	Satisfaction varies by **±10%** between segments
Data and assumptions	Include latest prices	Omits key recent price changes	✘	Santander 123 price increase **increases** Santander price by £3 per month
	Use disaggregated transaction level-data to determine customer volumes	Aggregated data omits key customer volumes	✘	Omission of paid/unpaid item fees **increases** Nationwide cost by **£1.30** relative to Lloyds
		Requires many assumptions to estimate prices	✘	Assumption about £10 unplanned excess **reduces** Lloyds by **£2.72.**
	Treats all customer benefits on same basis	Only includes additional benefits for Nationwide	✘	Exclusion of travel insurance **increases** Nationwide average price by **£3.06**
	Use most likely comparator across brand to calculate price for each customer	Use existing mix of products within brand to calculate price for each customers	✘	Using most likely comparator **reduces** prices for some brands by **[✂]** on average
Calculations	Exclude control accounts for existing overdraft customers	Includes Control accounts as alternative product	✘	Reduces gains from switching – value to be verified

Analysis should include latest prices

2.13 There have been some significant and important price changes during the course of the inquiry. Some larger more established banks have reduced prices through new product launches (Barclays Blue and RBS Rewards), and Santander has significantly increased the price of the Santander 123 account. This will increase prices by £3 per month for its 4 million current account customers.

2.14 In the CMA's model, Santander's average price increases by only [✂].[2] This demonstrates some of the flaws in the model and the model understates the number of customers that would choose the 123 product. This is because the CMA's model does not account for the changes in behaviour that such customers make when they switch to Santander, such as increasing balances and consolidating utility payments.

2 Using the most likely comparator method.

Data omits key customer volumes

2.15 The CMA's method for calculating prices is based on incomplete data of the drivers of pricing. This is because the CMA uses data aggregated each month (or only for the final quarter of 2014) for each customer, rather than disaggregated transaction-level data. This means that many determinants of price for each customer are omitted from the calculation or significant assumptions are needed. Missing items include:

(a) overdraft balances, which will determine interest and fees paid in products where these fees depend on the level of balances or the interest and fee-free amounts, such as First Direct and Halifax Reward;

(b) daily balances, which will determine interest paid in products with tiered interest such as Club Lloyds and Santander 123;

(c) the value of cash back earned on retailer spending and direct debits;

(d) monthly credit turnover which determines eligibility for products and certain rewards, such as Halifax £5 per month;

(e) the number of direct debits separate from standing orders, which is likely to overstate the eligibility of some customers for products; and

(f) the occurrence of paid and unpaid item fees (i.e. fees paid if a customer makes a payment that takes them over an unplanned limit, or if providers refuse a payment because of insufficient funds in an account).

2.16 These omissions can have a significant impact. Some of the lowest priced products in the CMA's analysis have the highest fees for paid and unpaid items. These charges therefore hit unplanned overdraft users, but are not included in the CMA's analysis, and so will bias the CMA's results. Nationwide charges £15, Metro £10 and Tesco charges £5 for *paid* items, which other providers, including LBG, do not charge for. Nationwide also has the highest fees in the market for *unpaid* items at £15. Halifax Current and Reward accounts do not charge for unpaid items.

2.17 The omission of paid and unpaid items means that some providers will appear to have lower prices in the CMA's analysis, particularly for customer segments that use unplanned overdrafts. This could have a significant effect on prices for some providers – based on simple assumptions, and could increase the price for some Nationwide products by over £1.30 relative to LBG products.[3]

2.18 Other omissions will affect some products, but not others – such as the use of different balance tiers or unplanned fee buffers. Without further analysis that includes these omitted charges, it is not possible to conclude on the relative levels of prices for each customer segment.

Results are sensitive to the CMA's price assumptions

2.19 Even where prices are included in the CMA's analysis, it still has to make significant assumptions to calculate prices, which would have been avoided if transaction level data had been used. The results of the CMA's analysis can be very sensitive to these assumptions. The assumption that customers using an unplanned overdraft are £100 in

---

[3] Assumes average of 8% of customers would face paid item charges (this is proportion of customers using unplanned overdraft in LBG tranche 3 data) and average of 3% of customers face unpaid item charges (this is average number of unpaid item fees for Lloyds Classic account in 2014). This would imply average price of Nationwide FlexAccount price would be £1.65 higher and Lloyds/BoS overdrafts would be £0.30 higher.

excess of their planned limit increases the average cost for Lloyds Bank by over 50% (+£2.72) compared with an assumption of a £10 excess (with little or no effect on the majority of other products and providers). These shortcomings could have been avoided by using disaggregated customer transaction data (midata files) in the analysis instead of the aggregated monthly data.

Additional benefits are not treated on like-for-like basis

2.20 The CMA values some benefits offered by products but not others. In particular, the value of Nationwide's travel insurance for its FlexAccount is included, but the value of benefits for other products, such as Club Lloyds Lifestyle Benefits, is not.[4] There is no justification for this. Many Nationwide customers may not place any value on this benefit (if they hold insurance elsewhere or do not travel abroad). This clearly biases the results in favour of some products. The CMA's analysis of Nationwide's average price shows that the value of the travel insurance benefit is £3.06 per month on average, which is twice as much as Nationwide customers pay for their PCA on average, and more than the average cost of many of the other PCA products in the CMA's analysis. This result distorts the CMA's analysis in favour of some products. All products should be compared on the same basis, which means either including or excluding all additional benefits.

Weighting of products for brands is wrong

2.21 The CMA's method assumes customers select products on the basis of the mix of existing products available for each credit turnover segment, rather than on the most likely comparator for each customer profile. For example, the model assumes that the 'price' of a Lloyds account for a Santander 123 customer with credit turnover of over £1,751+ is weighted towards a Lloyds Classic account, rather than Club Lloyds.[5] This is a strong assumption to make and does not reflect the prices such customers would actually pay were they to shop around and compare providers. In reality, [40-50]% of switchers to Lloyds Bank across all segments move to Club Lloyds with balances that are [55-65]% higher on average.

2.22 The correct approach is to use the most likely comparison product for each brand for each customer. This will better represent the price that customers would be offered if they compared providers or switched to that brand. The effect of using the most likely comparison product for each customer is to reduce the average price of some products by up to £[✂]. Lloyds Bank's average price is reduced by £[✂].

2.23 The CMA's assumption leads to some counterintuitive results where brands that have high volumes of switching customers and are targeted at particular segments appear to have high prices in those segments. Lloyds, which has a product (Club Lloyds) targeted at high value customers (CTO>£1,500 + 2DD) with high credit interest and an interest-and-fee free overdraft, is the highest priced brand in this segment. The most switched-to brand in the market, Santander, is 12th highest priced in this segment, despite its 123 product. By using the most likely comparator, and also adjusting for the impact of paid/unpaid items, unplanned excess, and additional benefits, the price results are more in line with what should be expected. As shown in the Table below, Lloyds Bank is then [✂] lowest price in this segment and Santander is [✂] lowest.

---

4 Club Lloyds benefits include 6 cinema tickets, magazine subscriptions or gourmet society membership.

5 This is the implied weighting from Table 6 in Appendix 5 of the Provisional Findings.

Table 3 Rank of Santander and Lloyds Bank prices using CMA model and alternative assumptions

Brand	Proposition	CMA Model	Most likely comparator
Santander	Most switched to product – 3% interest for balances > £3,000 and cashback	12th	[✂]
Lloyds Bank	Highest interest rate of 4% for balances up to £5,000 and £100 fee-free overdraft	18th	[✂]

Source: Frontier Economics analysis of CMA model. See Table 4 below for assumptions and Annex section 1.

Price calculations are not transparent

2.24 The CMA's calculations of prices are not transparent. The model was built quickly and had to incorporate accurately a significant volume of data and pricing dimensions. Providers have not been permitted to review the underlying model and the accuracy of its calculations. LBG is aware of some concerns that can be identified, such as the inclusion of control accounts as alternative products for customers (which should not be an option as they would imply reductions in overdraft usage) and the selective categorisation of switching incentives that ignores temporary introductory offers and fee-free overdrafts.

2.25 LBG offered to verify the CMA's models in June and has only just been given access. It had not previously seen any working papers on the CMA model. It is well-established that firms are entitled to access the workings and underlying formulae of such models in these types of investigation.[6]

Combined impact of errors in approach

2.26 The combined effect of the issues with data, assumptions and calculations is significant. The Table below illustrates the effect of some of these issues identified above. Although these effects can be illustrated for 'average' prices, the correct basis for considering relative prices must be for individual customer segments. The Table shows that the prices of some providers fall significantly as some of the bias in the CMA's methodology towards particular products with additional benefits and the assumption of existing mix is changed. The average price for Lloyds Bank falls by £[✂] and [✂] falls by £[✂], whilst [✂] prices increase by £[✂]. The range of average prices across the industry also changes from over £[✂] to £[✂]. Some of these effects are large, which only indicates the potential for calculation problems and the sensitivity of particular assumptions.

6 *R (Eisai Ltd) v National Institute for Health and Clinical Excellence* [2008] EWCA Civ 438 and *HCA International Limited v CMA* [2014] CAT 11.

Table 4 Illustration of impact of alternative data and assumption on 'average' prices

Brand	Average price using (CMA's method)*	Excluding additional benefits**	Average price using most likely compar-ator†	Impact of £10 unplanned excess assump-tion††	Impact of paid and unpaid item charges‡	Alternative estimate	Difference in prices
Barclays	£3.89		[✂]	[✂]	+£0.24	[✂]	[✂]
BoI/PO	£1.64		[✂]	[✂]	+£0.45	[✂]	[✂]
Clydesdale	£3.20		[✂]	[✂]	+£0.45	[✂]	[✂]
Co-op	£5.50		[✂]	[✂]		[✂]	[✂]
HSBC	£2.86		[✂]	[✂]		[✂]	[✂]
First Direct	£3.99		[✂]	[✂]		[✂]	[✂]
M&S	-£0.95		[✂]	[✂]		[✂]	[✂]
Lloyds	£7.74		[✂]	[✂]	+£0.30	[✂]	[✂]
Halifax	£3.25		[✂]	[✂]		[✂]	[✂]
BoS	£6.51		[✂]	[✂]	+£0.30	[✂]	[✂]
Metro	£1.15		[✂]	[✂]	+£1.10	[✂]	[✂]
Nationwide	-£1.38	+£3.06	[✂]	[✂]	+£1.65	[✂]	[✂]
RBSG	£4.44		[✂]	[✂]	+£0.18	[✂]	[✂]
Santander	£4.09		[✂]	[✂]	+£1.10	[✂]	[✂]
Tesco	£0.88		[✂]	[✂]	+£0.55	[✂]	[✂]
TSB	£7.25		[✂]	[✂]	+£0.30	[✂]	[✂]

Notes: See Annex section 1.

*CMA Provisional Findings Appendix 5.4, Table 7. **Excludes travel insurance benefit. † Analysis of CMA data by Frontier Economics. Overdraft charge. †† From original CMA analysis in Disclosure Room and Appendix 5.4, paragraph 42 of the Provisional Findings. ‡ Based on Table 7.1 (some other products not included in Table 7.1 may have lower fees) of the Provisional Findings. Assumes 8% propensity to incur a paid item charge and 3% propensity to incur an unpaid item charge - see paragraph 2.17 and footnote 3 below.

2.27 The problems with data, assumptions and calculations mean that the analysis of price, and its relationship with quality, market share or tenure, cannot be used as evidence without validating the accuracy of the price estimates. Ideally, the CMA would be able to compare the estimates from the model with actual data on the prices paid by customers.

2.28 As explained above, LBG has suggested throughout this investigation that the CMA should use disaggregated transaction data to assess prices (which would avoid most of the data and assumption problems). LBG requested access in June 2015 to the CMA's model to compare its aggregated data with analysis using disaggregated daily data of customers' account usage. LBG was only granted access to this model on 9 November 2015 and has not yet completed this comparison. LBG will submit this analysis once it has been completed to assist the CMA in understanding the robustness of its model.

Quality assessment is meaningless

2.29 The CMA has attempted to assess the quality of service delivered to PCA and BCA customers by using measures of satisfaction and willingness to recommend, together with metrics of actual service quality. The CMA correctly recognises that each metric "*represents only an imperfect proxy for the particular dimension of quality we are seeking to capture. We are also unable to capture all aspects of banks' service offering. Additionally, there are specific limitations to the proxy measures*".[7] The implication of this is that the CMA should be cautious about drawing any conclusions from these quality metrics. However, despite this recognition, the CMA's analysis gives prominence to results that are incorrect and so may continue to perpetuate myths about quality of service in the reference markets.

Satisfaction cannot be used to measure quality

2.30 Customer reported satisfaction is useful for assessing whether a product or service is delivering to expectation, which is why LBG uses these metrics. However, satisfaction is not a measure of quality, which is what the CMA has used it for.

2.31 In most markets for the same customer segments, there should be a relationship between price and quality. However, there is no reason why there should be a relationship between price and satisfaction. Satisfaction can be exactly the same for both high and low quality products, at different prices, if those products meet expectations. The top two ranked restaurants in London on Trip Advisor with equal 5-star satisfaction ratings are a pizzeria in Homerton with an average price of £15 and a Michelin star restaurant in Mayfair with average price of £80.[8] By confusing quality with satisfaction, the CMA's evidence becomes meaningless.

Which? satisfaction scores should not be used

2.32 The CMA has used PCA satisfaction metrics taken from Which?. These metrics are not robust, have no simple interpretation, and should not be used in the CMA's analysis. The metrics are based on an unrepresentative sample, which the CMA says it has not been able to verify. The CMA is also unclear what these metrics actually represent – with the ratings described by the CMA as 'proportion satisfied'.[9] This in incorrect. LBG's understanding is that the Which? ratings are a composite score that is arbitrarily weighted – customers saying 'very satisfied' have a weighting of 16, and customers saying 'fairly' satisfied' have a weighting of 8. This is a subjective approach that exaggerates the differences between providers and should not be used by the CMA when it has its own satisfaction data available.

CMA's analysis of other factors is limited

2.33 The CMA conducts a limited analysis of other factors that determine the quality of service. This analysis is not sufficient to reach a conclusion on the quality of different providers.

---

7 Appendix 5.5, paragraph 6 of the Provisional Findings.

8 As at 19 November 2015.

9 Appendix 5.5, Figure 6 of the Provisional Findings.

2.34 Its analysis of the quality of branches is limited to opening hours. The CMA recognises "*the trade-off between having a smaller number of heavily-used branches open for long hours and a larger number of more lightly-used branches open for shorter hours…[such that] the former group would tend to come out better from a comparison limited to opening hours only*".[10]

2.35 There are many drivers of quality of service, including digital banking, reliability, branch refurbishment, queuing times, self-service facilities, as well as customer service and customer experience. The level of quality for any customer will depend on their channel, their experience of other products and services (i.e. not PCA or BCA), and their customer segment, with some providers offering different levels of service for different segments. Creating a bottom-up measure of quality of service is not practical given these different drivers.

Interpretation of results is incorrect: Price and market share

2.36 The CMA concludes from its price/market share analysis that providers "*with the highest market shares tend to have the highest average prices*".[11] This conclusion appears to be based on a visual inspection of this relationship, shown in Figure 5.8 of the Provisional Findings.

2.37 This is not an acceptable method for evaluating relationships between variables. Such relationships can be tested statistically. The relationship between price and share in the CMA's analysis <u>does not pass these statistical tests</u>.[12] Moreover, the relationship between price and share is weaker when some reasonable changes are made to the analysis, such as excluding Nationwide travel insurance and adopting the £10 overdraft excess assumption. The relationship is also weaker for different customer segments. Further analysis of the relationship is presented in Annex section 1 below.

2.38 The correct interpretation of this evidence is that there is no relationship between the CMA's average price measure and share. The CMA cannot conclude that there is a "tendency" for larger banks to have higher prices based on this relationship in the absence of evidence.

Interpretation of results is incorrect: PCA Price and quality

2.39 The CMA says that "*we would expect customers to be unambiguously better off by switching from the 'high-price low-quality' providers to 'low-price high-quality' brands*", where quality is measured by 'satisfaction'.[13] This statement is entirely wrong because satisfaction is not the same as quality. Customers may not be better off if they switch to a product with higher levels of satisfaction if this product is lower quality. The CMA should retract this analysis as it is incorrect.

2.40 Moreover, the CMA has given undue prominence to Figure 5.17 of the Provisional Findings which remains un-redacted, and was specifically included in a briefing to journalists prior to its publication. This Figure is used to show that there are brands that have above average prices and below average quality, including Lloyds and Bank of Scotland. This result arises because the CMA confuses quality with satisfaction and uses the wrong framework for these comparisons, which blend across customer segments ranging from low value basic bank account customers to packaged account customers that receive a

10 Appendix 5.5, Paragraph 48 of the Provisional Findings.

11 Paragraph 5.68 of the Provisional Findings.

12 That is the t-statistic on the coefficient between price and market share does not exceed critical values for 5%, 10% or even 15% confidence level.

13 Paragraph 5.102 of the Provisional Findings.

range of different benefits. The true test is to compare the prices and quality (not satisfaction) for customers in the same customer segments and same channels – for example, looking at LBG customers that have a credit turnover of over £1,000 and do not use branches compared with First Direct.

2.41 LBG does not recognise the CMA's characterisation of Lloyds and Bank of Scotland as having high prices and low quality as suggested in Figure 5.17 of the Provisional Findings and in the CMA's pricing analysis, which is not consistent with other evidence. The evidence shows that LBG is one of the most competitive banks in the market:

(a) LBG's products include some of the most competitive pricing in the market for some customer segments. Halifax offers a £5 reward for customers who pay in £750 each month. Club Lloyds offers the highest credit interest in the market for customers that pay in over £1,500 per month and hold 2 direct debits. Based on the method set out in Table 4, Lloyds Bank has the [✂] lowest average price for customers with credit turnover above £1,500 and 2 direct debits, and Halifax is in the lowest priced [✂] providers for customers with credit turnover between £750 and £1,500.

(b) Halifax is the second most switched to brand in the market in the latest CASS switching statistics, and has been the leading destination in recent periods.[14] The number of customers switching to Halifax is three times that of Nationwide. LBG overall is the only one of the largest four banks that has a net gain of switchers.

(c) LBG has the highest customer satisfaction of the largest five banks.[15]

(d) LBG's apps are the highest rated in the UK across all providers. LBG has invested more than £750m in digital since 2011, and will invest a further £1bn by 2017.

(e) LBG's branches have the highest proportion of weekend opening of the largest four banks (the top three for weekend opening all have smaller networks and do not serve the low footfall locations that LBG serves). LBG is publicly committed to ensure that over 90 per cent of Lloyds and Bank of Scotland customers will continue to have a branch within five miles of their home, while the Halifax branch network will be maintained.

(f) SME lending outperformed the market with year-on-year net growth in advances of 5% (Q3 2015) in contrast to flat growth for the industry, and this continues a trend in higher lending growth for more than four years.

2.42 The robustness of the CMA's price and quality findings is further undermined by Santander appearing to have above average prices and average quality despite Santander's 123 PCA being the most popular new current account in the market. This suggests that the CMA's analytical framework for price and quality does not appropriately capture what customers want and the trade-offs and calculations customers make.

2.43 It is not even clear to LBG why the CMA has selected and interpreted the data it presents in the Provisional Findings (and which it used in media briefings). Despite LBG's concerns with the use of averages and using satisfaction rather than quality, and with multiple errors in the pricing data, even the CMA's own data does not support its finding.

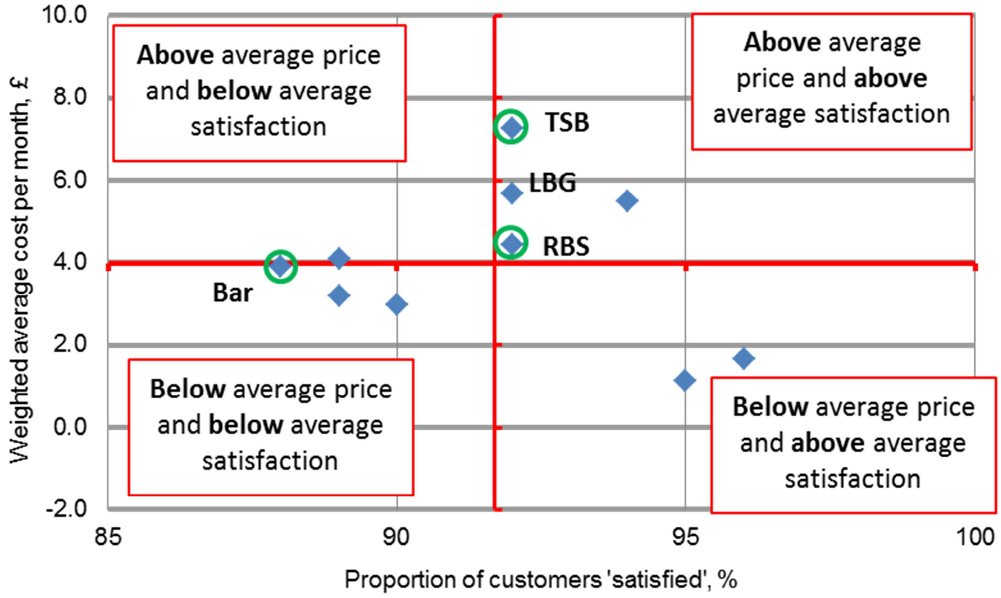
---

14 See CASS switching dashboard for 2015 Q1. Halifax was the leading destination and had the largest net gain in 2014 Q3.

15 Appendix 5.5, Annex 1, Table 1 of the Provisional Findings.

2.44 If the CMA had chosen to work with the same flawed pricing data, but compared this to its own satisfaction data, rather than the flawed and unverified Which? data, it would have produced a chart that is something like the one shown below. This alternative chart shows that there are no providers with above average prices and below average satisfaction, in contrast with the CMA's finding. And it would have been easy to add that some players with higher pricing have launched significantly different propositions in recent months, as shown below.

Figure 1 Comparison of customer satisfaction (using CMA's survey) and price by provider



Source: Price data is taken from Appendix 5.4, Table 7, of the Provisional Findings, and excludes Nationwide travel insurance. Customer satisfaction from Appendix 5.5, Annex A, Table 1 of the Provisional Findings.

O indicates new product launch.

2.45 The Figure above is not an accurate or insightful description of market outcomes because it suffers from all of the problems discussed above. However, LBG would like to understand why the CMA decided to use one flawed set of "quality" data (which it admits has not been verified) rather than the "quality" data that it commissioned itself, and specifically for these purposes. This choice by the CMA appears completely arbitrary but has had significant consequences for how commentators including the media and consumer groups perceive market outcomes. The CMA should undertake and complete the correct analysis, as described above, but even if the CMA decides not to do so it must, based on the evidence it has presented, provide a more accurate description of the results, beyond noting that "they must be treated with caution", and it must withdraw the conclusion that LBG tends to have higher prices and lower quality.

Interpretation of results is incorrect: SME price and quality

2.46 The CMA finds that two banking groups, Handelsbanken and Co-op, appear to deliver considerably higher levels of customer satisfaction than other providers.[16] This analysis has the same flaw as for PCA quality as it averages across multiple customer segments, where there are significant differences in competitive rankings for different segments of

16 Paragraph 6.93 of the Provisional Findings.

customers. The CMA should look at customer satisfaction in each of these different segments, before it can draw a conclusion on relative levels of satisfaction.

Interpretation of results: Gains from switching

2.47 Throughout this investigation, LBG has emphasised the need for enhancements to be made to customer engagement (see LBG's response to the CMA's Notice of Possible Remedies ("**Remedies Notice**") in Part C of this response below). The corollary of the need to enhance engagement is that some customers will be able to gain by comparing different products in the market and switching providers.

2.48 However, the CMA's analysis of the gains from switching is misleading. It raises the prospect of significant gains for large numbers of people which cannot be achieved.

(a) First, in a market with revenues of £7.4 billion, any analysis that shows "*total gains to customers if everyone switched to the cheapest products and maintained their current transaction patterns*" of £10.3 billion is not credible.[17] LBG agrees that some customer segments, particularly overdraft customers, can gain from switching but the CMA should understand and accept that higher levels of switching would lead to price changes in both markets, given the CMA found that there are no excess profits – for example Santander, as the most switched to brand in the personal market, has recently increased the monthly fee on its 123 product from £2 to £5. The CMA should be very clear that the CMA's analysis cannot be interpreted as the "gains available if everyone switched".

(b) Second, there are some important limitations to the CMA's analysis. Throughout the investigation, LBG has highlighted the problem of using aggregated customer data to analyse gains from switching (see comments above). The inclusion of additional benefits such as Nationwide's travel insurance, and the exclusion of other equally valuable benefits such as Club Lloyds lifestyle benefits, means that results are biased towards some providers. LBG has re-estimated the gains from switching excluding for the value of benefits, and this reduces averages gains by 10%.[18]

(c) Finally, the CMA's press release highlighted gains from switching of £70 on average and £260 for high overdraft customers. This interpretation of the evidence demonstrates the flaw of averaging. The distribution of gains in the market is non-normal and fat-tailed – 64% of the gains from switching are concentrated in just 20% of customers.[19] However, for half of customers, gains would be less than £[✂] per year on average.[20]

2.49 There are two important implications that follow from the distribution of gains. For most customers, the gains from switching are very small. First, this explains why switching rates and expansion of market shares measured on a volume basis are not high. Second, for those customers for whom potential gains from switching are large, this is where the CMA should target its remedies. As LBG highlighted previously to the CMA, remedies should be focussed in particular on high overdraft users.

---

17 Paragraph 5.41 and Annex 5, paragraph 33 and table 4 of the Provisional Findings.

18 Frontier Economics analysis of CMA model in CMA Disclosure Room.

19 Frontier Economics analysis of CMA model in CMA Disclosure Room.

20 Frontier Economics analysis of CMA model in CMA Disclosure Room. Excludes gains from Nationwide travel insurance.

3. THERE IS NO EVIDENCE TO SUPPORT A FINDING OF MARKET POWER OVER EXISTING CUSTOMERS

3.1 Based on the evidence of prices, gains and quality, the CMA finds that providers "*with larger market shares are able on average to charge higher prices and/or provide lower quality*".[21] This is used to support the finding that "*incumbent banks [including LBG] in these markets hold market power over their existing customers*".[22] LBG believes that the evidence does not support these findings.

3.2 The CMA's price/share relationship appears to be the main evidence used to support this finding, but the price/share relationship for PCAs is not robust. The correlation between price and market share that the CMA finds is not statistically significant.

3.3 Furthermore, there is no evidence of excess profitability, there is a high level of innovation which benefits existing customers, customer satisfaction of existing customers is very high, and the pricing for many of LBG's existing customers is competitive. All this evidence is inconsistent with providers having market power over existing customers. Customer engagement can be enhanced for some customers, but it does not follow that providers possess market power over all existing customers.

3.4 The CMA also considers whether the evidence of recent mergers and divestments supports the existence of any market power. In doing so, it concludes that it "*did not find strong evidence of a reduction in competition following LBG's acquisition of HBOS*". In fact, there is *no evidence* of a reduction in competition following LBG's acquisition of HBOS, as set out in paragraph 2.41 above.

3.5 There is no evidence for the CMA to reach a finding that there is a tendency for large providers to offer higher prices, and consequently that providers have market power over existing customers. The findings for PCAs in this regard should be consistent with the findings in relation to SME banking where the CMA has concluded that it does "*not find clear evidence of a relationship between market share and either pricing or quality outcomes*".[23]

4. NO HOLISTIC ASSESSMENT OF FREE IF IN CREDIT

4.1 One of the eight issues LBG raised at the start of the investigation was the need for an objective assessment of the FIIC pricing model in the context of alternatives, including whether any other pricing structure can result in better customer outcomes.

4.2 The CMA has made some progress in such an assessment and has found that the UK does not have lower switching rates than countries that do not have FIIC PCAs.[24] However, the CMA needs to go further. Criticism of the CMA's findings in relation to FIIC has been high profile.[25]

4.3 There are a number of criticisms of FIIC that go beyond the CMA's assessment, and which need to be looked at individually in the CMA's final report in the context of potential alternatives. These criticisms are that FIIC is highly misleading and gives rise to a perception of low gains from switching, problems with comparability, and that it requires providers to cross-subsidise from other areas.

---

21 CMA Provisional Findings, para 11.58.

22 CMA Provisional Findings, para 11.55.

23 Paragraph 6.100 of the Provisional Findings.

24 Paragraph 7.49 of the Provisional Findings.

25 See Financial Times, "MPs slam UK competition watchdog over free banking", 4 November 2015.

4.4 The source of the FIIC concerns is the difficulty in understanding the costs of a PCA and comparing products. To date, there has been a lack of effective tools to help customers calculate the cost of their product, including forgone interest, and to compare with alternatives, including products that pay credit interest. This is why LBG has:

(a) called for such tools throughout this investigation;

(b) been actively assisting the development of midata 2; and

(c) been calling for remedies to enhance engagement. LBG believes that ideas from other providers that could achieve this, such as 'traffic light' comparisons using personalised customer data from midata 2, should be included in trials of potential remedies.

4.5 Any concerns can only be expressed relative to some other (as yet unspecified by any regulator or commentator) pricing model that could replace FIIC. This alternative model may include higher credit interest rates, lower overdraft fees and the introduction of monthly fees or transaction charges. A monthly fee that replaced these sources of revenue would be between £10 to £15 per month for standard PCAs.[26]

4.6 This outcome would not be welcomed by customers, and could not be achieved through regulation without harming competition or a significant risk of unintended consequences. Even if such an alternative pricing model could be introduced, this would not address the criticisms of FIIC.

4.7 Changing the pricing model is not the solution to any concerns – BCAs do not use FIIC and yet the problems with customer engagement are more serious. The underlying concerns with FIIC should be addressed through the CMA's package of possible remedies to enhance engagement and comparison. To resist the criticism of FIIC, the CMA should conduct a holistic assessment that considers what the alternative pricing models could be, and assesses whether these alternatives would resolve the concerns that have been raised.

5. THE BANK SURCHARGE DOES NOT DISADVANTAGE NEW ENTRANTS OR SMALLER PROVIDERS

5.1 The CMA has said that it will consider further the implications of a new bank corporation tax surcharge after a number of building societies and smaller banks have expressed concerns about the impact the tax will have on new entry and on their ability to expand. Furthermore, the CMA is reported as being "*institutionally sympathetic to these arguments*". [27]

5.2 The UK Government considers that banks and building societies should make an additional contribution to reflect their "unique risks" to the UK economy.[28] The existing bank levy was introduced in 2011 as a tax on certain bank liabilities with an additional aim to "*encourage the banks to make greater use of more stable sources of funding, such as long-term debt and equity*".[29] This made sense at the time, prior to ring-fencing of retail banks and reforms in capital regulation, because the risks and costs of failure were linked to these liabilities. HM Treasury's plans for banking taxation now seek "take account of the very significant improvements in banking sector regulation and underlying profitability

---

26 This is based on replacing Lloyds Bank revenues from the value of funds and overdraft fees with a fixed monthly fee payable by primary accounts (i.e. credit turnover of £500+ with 2 DDs).

27 See The Daily Telegraph (Business), "Competition watchdog was lazy in report say MPs", 5 November 2015.

28 HMT, Summer Budget 2015, Paragraph 1.200.

29 IFS, "Taxes and Benefits: The Parties' Plans", April 2015.

since the bank levy was first introduced".[30] Shifting to a profit-basis means that "*banks' contributions will be increasingly aligned with profit and capital accumulation, reducing the risk of tax constraining lending or influencing banks' decisions on the location of internationally mobile activities*".[31]

5.3 In shifting to a corporation tax surcharge, smaller banks will, for the first time, have to make an additional tax contribution and investors in these banks will therefore be worse off than under the current bank levy. However, the question for the CMA is not whether the corporation tax surcharge increases costs for small providers or what impact the surcharge will have on investment and lending decisions by all providers. The question for the CMA is only whether it restricts or distorts competition by, for example, having a disproportionate impact on smaller, less well established providers and/or new entrants versus larger, established providers.

5.4 Corporation tax applies almost universally across the economy, including for smaller businesses. This tax is not considered to be distortionary from a competition perspective in any sector, including banking. There is therefore no reason why an increase in this tax should introduce a competitive distortion in banking. Moreover, evidence suggests that smaller banks benefit from lower costs of provision through newer, simpler IT systems, more modern (or lower cost digital only) distribution networks, and the absence of legacy costs. This is reflected empirically in smaller recent new entrants typically earning significantly higher equity returns in both retail and SME banking than larger, more established retail and business banks.[32] This suggests there is no evidence the increase in taxation will impact their ability to invest, grow, and compete relative to larger providers.

---

30 HMT, Summer Budget 2015, Paragraph 1.201.

31 HMT, Summer Budget 2015, Paragraph 1.203.

32 KPMG find that "average cost:income ratio of the largest five banks was 63% in 2014, which was similar to that of all the 'Challengers' (excluding NAB) at 64%. The 'Smaller Challengers', however, had a much lower cost income ratio of 53% in 2014… 'Challenger' banks had on average a higher ROE than the largest five banks in 2014.", CMA Provisional Findings, paragraph 2.72.

C. Response to Remedies Notice

1. INTRODUCTION AND SUMMARY

1.1 LBG sets out below its response to the CMA's Remedies Notice. Responses to the CMA's detailed questions on each remedy will be provided separately.

1.2 Overall, LBG is broadly in agreement with the CMA's proposed remedy package, and as LBG has itself been calling for these types of changes throughout the investigation (and indeed for a number of years before that), LBG is keen to help the CMA progress quickly. For this reason, this response focuses largely on suggested next steps, while also summarising relevant lessons and insights that can be applied from other retail banking product market studies and other industries.

1.3 LBG considers that remedies can be broadly split into the following two groups:

(a) **remedies where the immediate next step should be to move quickly to implementation.** This group largely relates to those remedies that seek to make operational changes or require functional builds that third party providers can undertake or which already exist in some form. Delivering these remedies quickly will also contribute towards the success of other proposed remedies intended to influence customer behaviour; and

(b) **remedies where trials are a necessary next step before any form of rollout**. This group largely relates to those remedies that seek directly to influence customer behaviour. Changing customer behaviour is difficult and requires significant trialling to test what works in practice, and results are not always as expected. This takes time to do properly, and the CMA will need to account for this in remedy design.

1.4 This is summarised in Table 5.

Table 5 CMA remedies grouped by suggested next steps

CMA remedy	PCA	SME	Trial / test	Implement
1. Prompts to customers to review PCA or BCA	✓	✓	✓	n/a
2. Increase awareness of switching and CASS	✓	✓	✓	n/a
3. Transaction data more easily available and usable	✓	✓	n/a	✓
4. A PCW for SMEs	n/a	✓	n/a	✓
5. Service quality comparisons	✓	✓	n/a	✓
6. Standardise and simplify BCA opening procedures	n/a	✓	n/a	✓
7. Overdraft eligibility checker	✓	n/a	✓	n/a
8. Extension to CASS redirection period	✓	✓	n/a	✓
9. Retain and provide ex-customer transaction data	✓	✓	n/a	✓
10. Transfer CPAs through CASS	✓	✓	n/a	✓
11. Support the partial switching service	✓	✓	✓	n/a
12. Changes to CASS governance	✓	✓	n/a	✓
13. Data sharing with credit reference agencies	n/a	✓	n/a	✓
14. Commercial open data and data sharing proposals	n/a	✓	n/a	✓
15. Loans price and eligibility indicator	n/a	✓	✓	n/a

1.5 Where remedies can quickly move to implementation, there are some important next steps:

(a) World class application programming interface ("**API**") functionality is a necessary and critical input to all of the CMA's remedies around building new comparison tools and functionality in both business and personal current accounts. The current API governance is not working effectively and is unlikely to deliver quickly enough. As the governance is essentially the same as that used for midata in personal current accounts, it needs to change. Unlocking the benefits of the CMA's proposed comparison remedies will require the CMA to set out and design new governance arrangements for APIs for current accounts to prioritise their development within 12 months.

(b) The remedies to enhance CASS are well intentioned, but based on experience of how CASS is currently governed, for these ideas to be properly converted into genuine change, new governance is required. The nature of Bacs governance and the core expertise of Bacs mean it is not the organisation best placed to take forward the CMA's proposals. Instead, control for delivering these could be given to the FCA or the PSR. There is also scope for more rapid and innovative thinking around how to improve CASS marketing through, for example, the use of regional trials of different "creative" elements at the core of any marketing campaign as well as testing innovation such as the effectiveness of CASS switcher prize funds to build awareness, confidence and engagement.

1.6 Where customer trials are necessary in advance of any form of rollout, there are a range of relevant insights from recent LBG and wider regulatory work that will be important for the CMA's remedy design work. These lessons also have timing and process implications: finding the right answers to deliver change will require time and resources. However, as outlined below, this would all still be consistent with, and fit within, the CMA's existing statutory responsibilities and timetable. For the customer engagement remedies that would benefit from ongoing refinement, LBG suggests that the FCA is well placed to oversee the customer testing required.

Other introductory remarks

1.7 LBG will discuss remedy design with the CMA in more detail in due course. At this early stage in the remedy design process, LBG notes the following:

(a) LBG is keen that the remedies, once designed, cover all providers in the market. This will be important to ensure no provider benefits or is disadvantaged by the remedies that are introduced.

(b) It is important that the remedy package provides a holistic and stable approach to regulation in these markets.

(c) A number of remedies envisage creating new services, for example, Remedy 4 is designed to set new comparison tools and services for SMEs. The CMA should create an environment where service providers can create effective and engaging services utilising API functionality. The NESTA small business innovation challenge will support the creation of a healthy, dynamic and competitive range of comparison tools and services that can be sustainable and evolve over time, minimising or removing the need for future regulatory intervention.[33] The CMA

[33] LBG has been engaging with the banking industry and innovation charity NESTA to establish a prize fund (the SME Innovation Challenge Prize) to incentivise and stimulate innovation in the development of comparison services for SMEs to achieve a step change in the number of businesses that are engaged in the switching process The Prize Fund is currently approaching the end of its design phase and the CMA was provided with an update in relation to

should limit this remedy to providing a backstop for the creation of the services if the market has not delivered the services within a set time.

(d) As previously described, larger SME businesses tend to have more complex needs, and are more likely to have dedicated advisors or internal experts. They are more likely to negotiate bespoke offers, and tend to make sophisticated decisions around their banking needs. In general terms, this suggests the CMA remedies directed at the SME market should focus on smaller businesses.

1.8 Whilst customer behaviour takes time to change, LBG considers that the CMA's proposed remedies package, appropriately designed, has the potential to do this. Allowing the remedies sufficient time to embed and work as a package will maximise the chances of the package succeeding.

1.9 Finally, the CMA has specified a number of aims for the remedies package. There will be more than one way to achieve these aims, and part of the remedy design process should be to think through how best to deliver the necessary changes. Mandated industry-wide solutions may be one option, but these types of interventions carry a risk in that they can limit the ability of competition to deliver similar solutions: the CMA should be mindful not to undermine the competitive process by introducing remedies that crowd out provider-led innovation. In particular, there is a danger that mandated remedies may limit the scope for new entrants and existing providers to differentiate themselves, and prevent or distort emerging market solutions building upon new and emerging tools.

1.10 One example is account opening procedures. All providers have a strong incentive to invest in making it simpler and easier to open a business or personal current account for new and switching customers. LBG has previously shared data with the CMA on how many customers drop out of account opening and switching processes when they are required to come into a branch. LBG is investing in and trialling new ways to make it simpler and easier for customers to do this, some of which were shared with the CMA at the LBG site visit.

1.11 For LBG, this is as an important way to differentiate and gain competitive advantage. LBG is investing significantly in its customer transformation programme to make opening an account even simpler and LBG has even more radical and innovative solutions under development than the prototypes shown to the CMA. LBG would not want any remedies, through unintended consequences, to undermine LBG's ability to gain competitive advantage and drive more switching to LBG through these innovations, and other similar advances.

1.12 As a general principle, LBG rules nothing in or out at this stage. Caution is required and in all cases the CMA should assess the incentives for new entrants/existing providers to introduce solutions, and the likelihood that they will do so. LBG understands that on balance, there may be good reasons to introduce industry-wide solutions in some cases. Equally, the correct approach may be to conclude that certain remedies are best left to providers. If necessary, the NESTA prize challenge approach is one way to actively create the incentives to deliver market solutions, and indeed this approach is already underway in relation to incentivising SME switching.

1.13 LBG has concerns about the process the CMA has outlined between publication of the Provisional Findings and the Provisional Decision on Remedies. LBG has explained to the CMA its concerns that the current planned roundtables will be an ineffective forum to

the prize fund on 30 July 2015 and more recently on 18 November 2015. Extensive stakeholder engagement has been undertaken including with SMEs, new specialist and smaller financial providers, financial technology companies, comparison businesses and business groups. The SME Prize Fund is in a position to be launched in Q1 2016, and thus will quickly start to deliver benefits to the SME market.

make progress, and that the planned private hearings are too short. The CMA has rejected alternative proposals that, based on LBG's experience, would help the CMA to deliver an effective set of remedies with wide support from new entrants, smaller providers and consumer and business groups. LBG would welcome the opportunity for more engagement directly with the Inquiry Team and Panel on remedy design and implementation beyond the planned roundtables and short private hearing.

Remedies the CMA is minded not to consider further

1.14 LBG agrees with the CMA's decision not to pursue certain remedies, as the evidence does not support the pursuit of these remedies:

(a) **measures to control outcomes**, e.g. price control on unauthorised overdraft charges, have high potential to create unintended consequences. The experience of the price controls imposed following the Competition Commissions 2002 SME banking investigation suggest that such measures are unlikely to deliver lasting customer benefits;

(b) **measures that would address perceived distortions arising from the widespread use of free-if-in-credit accounts** would not improve competition in the PCA market, and they would be likely to be ineffective and deeply unpopular with customers; and

(c) **structural remedies,** i.e. divestments, which would be costly, complex, take a long time to deliver, and not address the underlying concerns in the PCA and SME banking markets. As such, they would be wholly disproportionate.

2. GOVERNANCE IS THE SINGLE BIGGEST FACTOR TO CONSIDER WHERE REMEDIES CAN BE QUICKLY IMPLEMENTED

Improvements to the ability of customers to compare accounts

Key considerations

2.1 The CMA has set out a number of remedies to help customers compare accounts across the PCA, BCA and SME lending markets: remedies 3, 4, 5, 6, 9, 13, and 14. LBG supports these remedies. LBG's detailed views on these remedies will be provided separately.

2.2 Whilst it is understandable that these remedies have been described separately for each market, in practice the functionality being described will sit together as part of a single package, given the similarities between the technical requirements underpinning the new tools.

2.3 Importantly, world class API functionality is a key input that will unlock wider innovation in the market, and lead to a range of commercial solutions to make it easier for customers to compare providers and products, and to make use of their own data.

2.4 The CMA's proposed changes sit within a wider landscape of changes currently taking place. LBG's thinking has been shaped by two key initiatives: midata 2 and the NESTA SME innovation challenge prize fund.[34] Both of these are highly relevant for the CMA's

[34] The Government's midata programme has the potential to facilitate powerful, easy to use comparison tools, but the current functionality is limited, and it is only available for PCA customers. LBG (together with Runpath Ltd.) has developed an enhanced "midata 2" tool which allows comparison websites, for the first time, to offer meaningful comparison services for BCA customers, in addition to PCA customers. midata 2 will also be usable on any device: desktop, tablet, and smart-phone. It also allows quality and range of services comparisons. LBG considers that midata 2 can play a material role in enhancing both PCA and BCA customer engagement.

comparison remedies. LBG has previously written to the CMA in detail on these points, and believes these two initiatives can provide a starting point for the CMA's remedy design.

2.5 Specifically, a prize challenge approach could be used directly in the development of comparison tools, linked to a PCW for SMEs (Remedy 4). Prize initiatives could also be used to deliver remedies such as changes to BCA account opening processes (Remedy 6), or making transaction data more easily available. Challenge prizes could also be used to complement provision of service quality data for comparison purposes (Remedy 5), and commercial open data sharing proposals (Remedy 14). Overall, there are potentially a wide range of applications. The CMA should consider carefully how such challenge prizes can help to deliver the remedies proposed.

2.6 In addition to these changes, the CMA's proposed comparison remedies should be developed alongside the changes which are already underway as part of the Small Business Enterprise and Employment Act and the API open data initiative. This will avoid over-complication and/or duplication of analysis. It will also ensure the CMA's package can build on the work already underway.

2.7 These remedies do not require immediate further trialling to understand customer behaviour. Rather, these remedies can be implemented (subject to further design discussions); the key challenge will be to ensure delivery.

2.8 HM Treasury has been instrumental in driving the work on APIs forward. However, the breadth of the current open data initiative, and different and often conflicting views of providers mean that HMT is not best placed to manage the delivery of world class API standards quickly that will lead to a brilliant customer experience. With this in mind, the CMA should work with HMT to set the output and timelines, with appropriate prioritisation to deliver for the immediate use cases. The management of their delivery would naturally sit with the FCA or PSR.

2.9 The CMA should specify that the FCA or PSR should oversee development of APIs including midata 2, given their wider oversight of the relevant parts of the reference markets and comparison services, and relevant expertise in this area.

Other practical considerations for comparison remedies

2.10 There is a thriving and innovative comparison market. Rather than fully specifying the various comparison remedies, the CMA should instead focus on setting up the relevant rules and procedures that will govern the direction of travel. The actual commercial solutions should then be left to the market to discover, through the usual competitive processes that will discover how best to get customers to engage with these new services. PCW penetration and usage has been significant and is still growing rapidly in other retail financial products, and there is no reason to believe this cannot be achieved in the reference markets.

2.11 Remedies that deliver new functionality should be PCW provider agnostic. This will ensure customer choice, and that all providers have the ability and incentive to deliver continual improvements to the services in response to customer demands. This will allow the PCW market to deliver competitive outcomes. LBG is also keen to ensure that any PCW solutions are focussed on all the important aspects of the services available, and include quality metrics as well as the cost to customers. In return for access, PCWs should guarantee full market coverage and search result rankings not based on referral fees paid by providers.

2.12 For the aspects of the relevant remedies directed towards SME customers, the size of SME should be a consideration in determining the scope of the proposed changes and the success criteria used for these remedies. Beyond a certain size of business, the level of bespoke terms and use of relationship managers will limit the relevance and accuracy that comparison services of this nature can offer. This suggests that such services should be targeted at smaller SMEs, and the CMA should not expect significant take-up from larger SMEs.

2.13 Remedy 4 seeks to create a new price comparison service. Rather than a single supplier, LBG is keen that any solutions are competitive and supplier agnostic, to allow all suppliers and third parties to innovate and explore possible solutions. The CMA could also usefully consider a challenge prize approach, with a stated aim of delivering a healthy, dynamic and competitive set of comparison tools and services.

CASS enhancements

Key considerations

2.14 Remedies 8, 10, and 12 all relate to forms of CASS enhancement. LBG supports these remedies. LBG's detailed views on these remedies will be provided separately. These remedies require no further testing and can be implemented quickly by the CMA.

2.15 The remedies to enhance CASS are well intentioned, but it will require strong leadership and oversight to deliver the changes as envisaged. Based on experience of how CASS has been governed to date, LBG is not confident that the current Bacs governance processes are the right vehicle to deliver this.

2.16 First, the CMA's remedies seek to improve customer engagement with CASS. This will require specialist understanding of customer behaviour, and the ability to design and communicate changes to customers. Bacs as an organisation is set up primarily to operate payments infrastructure. LBG is not confident that Bacs has the right core competencies and level of experience to deliver these remedies.

2.17 Second, the Bacs board is made up in large part of directors from member banks. There are good reasons for this operating structure, which is fit for purpose for delivering Bacs' objectives. However, it is unlikely to be fit for purpose for delivering the CMA's proposed remedies. Rather than a large group making decisions by committee, the remedies should be overseen by a strong independent body with experience delivering behavioural changes.

2.18 Both these factors suggest that rather than specifying detailed changes to CASS, the CMA should instead focus on setting up the correct oversight and governance. It can then set the overall objectives, provide a level of resources (funded from providers), and specify the nature of the control and oversight required. Given its expertise in this area, LBG believes responsibility for delivering CASS improvements should be given to the FCA.

2.19 In addition, the CMA should think creatively about how its CASS enhancement aims can be achieved. Rather than defaulting to existing processes, or simply increasing the relevant CASS budgets, the CMA should consider what will work best in practice. For example, this could involve testing social media messages aimed at different customer segments, built to support existing (or newly designed) regional or national broadcasting campaigns. LBG is keen that any additional resources allocated to these remedies are used efficiently, which will require both the correct governance, and detailed customer understanding.

Other practical considerations for CASS enhancement remedies

2.20 Remedy 10 seeks to add the transfer of continuous payment authority ("**CPA**") agreements to CASS redirections. It is clear that this would be a valuable addition to

CASS, which would be popular with customers. The extent to which this will alleviate switching concerns, and increase customer engagement with CASS is a valid question which should be explored. As CPAs are controlled by the card schemes and merchants and service providers who use CPAs with their customers, rather than Bacs, practical implementation of this remedy will require the CMA to make the card schemes deliver this and create the right incentives for merchants to adopt the solution. LBG supports this remedy, in principle, and agrees that it has potential to address the CMAs concerns if it can be practically implemented.

3. THERE ARE A NUMBER OF RELEVANT INSIGHTS FOR REMEDIES SEEKING TO DIRECTLY ENHANCE CUSTOMER ENGAGEMENT

3.1 Remedies 1, 2, 7 and 15 all seek directly to deliver behavioural change, either by getting customers to engage more or in different ways with existing products and services, or by introducing new functionality. LBG supports these remedies in principle, and considers that they will address the areas of concern noted by the CMA. LBG's detailed views on these remedies will be provided separately.

3.2 LBG also considers that the implementation of these remedies should involve trials as a necessary next step before any form of rollout, as these remedies will require customer testing to establish what works in practice. Different messages will resonate with different customers, and the content, format, frequency and other elements also influence the impact of messages for each of these customer groups and/or contexts. It is not possible to predict in advance what the best (most impactful) messages will be. The CMA's immediate focus should therefore be to set up a robust testing programme, and think through the best governance arrangements for this.

3.3 The need to conduct trials is supported by LBG's experience in the reference markets. Previous remedies proposed by regulators with little or no customer trialling have not had the intended impact, even where in theory the changes were well-intentioned and appeared sensible.[35] Recent regulatory work in similar markets has shown that this approach is already being used in practice, and with positive results. For example, recent FCA work on overdraft messaging[36], insurance redress,[37] and savings rate changes[38] have all used various forms of customer trial to deliver insights.

3.4 Remedy 11 seeks to further support the CASS partial switch service. LBG supports the intent behind this remedy: helping customers to try a new account before committing to a switch is likely to improve switching, and be positive with customers. LBG considers that any operational complexities involved in creating the capability the CMA envisages can be overcome.

3.5 The CMA should be mindful that one issue with a partial switch it that it is often difficult for front-line staff and customers alike to understand the possible consequences of partial switching. Holding two accounts concurrently with payments in/out of each can create implications contingent on customer choices, which can be difficult to explain succinctly. For example, some accounts (e.g. Club Lloyds) have eligibility criteria that depend on account activity and accounts will have different authorised and unauthorised overdraft thresholds and charging structures. Holding multiple accounts means it can be difficult to predict and control outcomes.

---

35 FCA Occasional Paper 10: Message Received, March 2015

36 ibid

37 FCA Occasional Paper 2: Redress letters, April 2013

38 FCA Occasional Paper 7: Savings rate renewal letters, Jan 2015

3.6 To overcome this potential issue, LBG notes that customers already have the ability to open a new account and trigger the seven day switch at a later date. Some customers already take advantage of this. This remedy should seek ways to market this ability more effectively. The issues above can be overcome if customers are able to open a new account with a switch date set in (say) two weeks' time. The day before the switch, and importantly, once customers have their new debit card, pin number, online and mobile access and have had a chance to experience the new account, they can be contacted to confirm they would still like the switch to take place. This would be much more cost effective and simple and would allow customers to effectively try before they switch.

3.7 This would alleviate the current issues with partial switching, and would build on existing functionality. This could be quickly set up, and a single variant tested quickly to assess whether this would be valued by customers, and whether it could have a significant impact.

Insights from LBG trials

3.8 LBG has been at the forefront of recent changes and thinking in relation to customer engagement, and previously through the development of CASS. More recently, LBG has undertaken customer experiments with a large sample of PCA and BCA customers. LBG's recent experience provides a number of important practical implications for the CMA's own planned trials, and LBG has provided the CMA with a comprehensive set of insights from this work.[39] Of particular note:

(a) **Push Messages.** The emergence of context-specific push messages may have greater impact than traditional text messages, emails or letters. These prompt mobile app users directly on a behavioural trigger (e.g. approaching an overdraft limit) with a digital link through to an action. Because of their ease of use, they are increasingly replacing text messages, online banners and website interstitials as part of the customer engagement profile. **The CMA needs to consider the potential for these in trials.**

(b) **Tools.** LBG tested several tools to help PCA and BCA customers manage their accounts better. For example, providing customers that go into unplanned overdraft with prompts around available planned limits, text alerts for those approaching or who are over overdraft limits and annual account summaries with specific calls to action depending on the customer's transaction history. Several of these tools were effective in changing customer behaviour for the better with their current provider. Remedy 1 focuses on prompts to switch, whereas these trials show there are significant potential customer benefits also to be had by changing behaviour with *existing providers*. **LBG strongly suggests the CMA add this type of prompt to Remedy 1**.

(c) **Overdraft eligibility checker.** Remedy 7 proposes an overdraft eligibility checker tool to reduce customer uncertainty before switching with an overdraft. LBG supports this concept and has already tested a version. While this particular version did not have the desired impact of increasing account opening, lessons were learned from this and improvements are being explored in the next iteration. **These insights are directly relevant for the design of Remedy 7**.

(d) **Trigger prompts.** The CMA is proposing introducing a range of trigger prompts. LBG tested one such prompt targeted at customers making complaints as a way to prompt switching by the most dissatisfied. This particular complaint letter response insert was not as effective as hoped and alternative variants and channels need to

39 Email from Steve Smith, Monday 16 November 2015.

be explored. **A key lesson here is that implementing remedies without prior testing risks introducing ineffective remedies.**

3.9 As well as these specific points, the work also provides a range of general insights that will be relevant for the CMA as it enters the remedy design phase.

(a) **Good design and set up**. The CMA will need to think carefully about how to design the trial in terms of customer randomisation (control and treatment), data collection, adjusting for trends and other specific effects that could bias the results. In particular, small changes (in wording, format, presentation etc) in customer communication can make a big difference and appropriate variants will need to be determined in advance of trial launch. LBG's experience was that design and set up took three months prior to putting trials into the field.

(b) **Targeting**. Treatments need to be targeted at specific customer groups (e.g. those with the most to gain) and clearly linked to previous data analysis/hypotheses defining the group of interest. Trials can be used to test these hypotheses and to make targeting better, by analysing results for specific customer groups, even within the sample included in the trial. LBG's work showed in several instances that certain sub-segments within the overall sample were more responsive to prompts than other sub-segments, or the average response for the overall sample.

(c) **Reference to an appropriate baseline**. Some results at face value may appear to be small in magnitude, but all results should be read in the context of the levels of engagement today, and/or typical response rates to similar financial services interventions. The CMA should be realistic about the extent to which it will be possible to find silver bullets leading to a step change in customer engagement, given providers are constantly trying to improve this as a normal part of the competitive process e.g. through the switching incentives currently available.

(d) **Multilateral in nature**. Trials should be 'multilateral' i.e. they should involve multiple providers. This does not mean every provider must participate in every trial. Where sample sizes are smaller (e.g. SME), multilateral trials will have greater power by increasing the size of control and treatment groups. Multilateral trials will require greater central coordination and project management.

(e) **Replication of results**. Trials can refute or support hypotheses about customer behaviour, but they can never prove them. The more repetitions supporting a hypothesis, the stronger the confidence that can be applied to the result. It takes time to change behaviours, and even where a significant result is found, customers should be monitored over a period of time to check whether the new behaviour persists, as this is the ultimate success criterion.

A programme of effective trials is consistent with the CMA's statutory responsibilities, framework and timetable

3.10 As illustrated above, well-designed trials take time. Careful design of a behavioural experiment requires a number of steps, including development of testable hypotheses, sample selection and size, communication design, establishing proper control and randomisation process, ease of customer action, data collection processes and so on. The absence of any of these steps risks unreliable results. LBG's experience with its own engagement trials reflects this.

3.11 Poor design leads to trials which yield poor evidence and risks ineffective remedies. Post-trial remedies will require iterative testing and refinement. Indeed, in LBG's view any interventions should be under constant review, and evolve over time as customer behaviour changes, and as more is learned about what works.

3.12 This suggests that the CMA will not have final form behavioural remedies in place by spring 2016, or even necessarily by the time the investigation ends. To be clear: remedies can be in place from the appropriate point in the CMA's investigation, with the intention being to launch a set of remedies following research, with these remedies being regularly tested and iterated as evidence is collected on their effectiveness. Over time, the remedies would evolve to become increasingly more effective.

3.13 An implication of the approach suggested above is that the trials to be conducted in early 2016 should not be set up to necessarily find the set of final completed remedies. Rather, these trials should be used for evidence gathering with the following three aims:

(a) to narrow down some forms of the alternative remedies to something that is more likely to succeed over a 2-3 year period; i.e. the 2016 trials should test very specific aspects of possible remedies, rather than complete versions;

(b) to understand more about the different alternatives that can be considered over a 2-3 year iterative period; and

(c) to understand more about the specific instructions to give to other organisations on what targets to set and how to proceed.

3.14 The CMA should consider now which body might review and control the trials and remedies over the relevant lifetime of the remedies. The FCA has significant experience in designing, implementing and analysing behavioural experiments of this nature in financial services and would be well placed to oversee this programme of work.

Other practical considerations for remedies directly aimed at behavioural change

3.15 There is a large universe of dimensions and triggers to vary and test relating to customer communications. When the CMA reaches the design phase, as well as triggers and variants there are a number of other issues to consider and test for their relative impact:

(a) differences between push and pull messaging;

(b) whether messaging should come from providers or third parties;

(c) the role of prompts directed at (rival) providers, rather than customers;

(d) the optimal degree of personalisation in messaging; and

(e) targeting and use of behavioural insights as a framework to design, test and vary content.

3.16 The focus of targeting should be those customers who are most likely to gain or least able to access information. This will require a detailed understanding of which customers have most to gain, and where any switching gains are concentrated. LBG comments on this in more detail in its response to the CMA's Provisional Findings set out above.

3.17 It will be important to ensure that all of the communications remedies receive input from relevant professionals and sector experts. Creative designers are likely to be better at designing variants for testing than either regulators or providers.

3.18 Finally, Remedy 15 seeks to develop a loans price and eligibility indicator for SME customers. This may be perceived as an interim step while fuller comparison services are being developed, as envisaged by Remedy 4. It follows that as Remedy 4 relates to a more comprehensive set of comparison tools, it may make more sense to pursue Remedy 15 as part of Remedy 4, subject to the speed with which progress can be made on

Remedy 4. However, at this stage LBG agrees it is right to consider Remedy 15 independently.

Additional remedies not currently covered by the CMA's list

3.19 LBG broadly supports the CMA's list of proposed remedies. However, for design purposes the ideas set out should be treated as starting points only, as there may be variants of what the CMA describes, or new remedies that could also address the CMA's concerns in the reference markets.

3.20 Providers have experience trying to engage customers, and it follows that providers may themselves have ideas about how the remedies might work in practice. For example, Tesco Bank has proposed a traffic light system for comparison purposes, which if developed and personalised using customer's transaction usage and comparison functionality proposed could be popular with customers, and successful at generating behavioural change. The forthcoming roundtable hearings and subsequent discussions are an opportunity to discuss this.

3.21 The Tesco traffic light proposal could have an impact, and this should be tested. However, the thinking behind this is based on traditional methods of communication, and it is not clear what data would be used to create the comparison. A further build would be to incorporate the traffic light idea with midata 2. Providers could create personalised traffic light messages for customers based on their own transaction data, and messages could be sent proactively to customers from their existing provider, linked either to annual or regular messaging, or to new trigger points to be determined as part of Remedy 1. Trials could then determine the best way to deliver this messaging.

3.22 This is one example of how remedies could be combined to create new and exciting functionality which could be quickly implemented and tested. There will be many other examples of how ideas like this could be generated building from the list of remedies currently set out, and the CMA should seek to encourage and facilitate this thinking. This will maximise the chance of delivering the best remedies package.

3.23 In addition to the CMA's list of potential remedies, further behavioural remedies should be considered. At present the CMA's behavioural remedies are aimed at encouraging customers to consider alternative accounts and to stimulate consideration of switching to alternative products. However, the CMA's evidence shows that many customers could reduce their costs of banking, regardless of switching, if they behaved differently with their existing account.

3.24 Some remedies to encourage this type of engagement with product usage, such as opt-in balance alerts, have already been tested by LBG, as described above. Initial results are promising, and suggested that rapid behaviour change is possible, which can save some customers up to 25% of overdraft fees. The impacts of this type of behavioural remedy are similar to that reported previously by the FCA and, when combined with additional interventions around customer communications and statements, the cumulative effects could be even bigger. This should form a central part of the CMA's thinking in relation to the design of its behavioural remedies.

ANNEX

This annex includes the following sections:

1. A summary of LBG's review of the CMA's analysis of prices from the CMA Disclosure Room.

2. A summary of LBG's review of the relationship between price and market share from the CMA Disclosure Room.

3. A summary of LBG's review of the gains from switching from the CMA Disclosure Room.

4. An assessment of FIIC against different criteria.

1. PRICE ANALYSIS FROM DISCLOSURE ROOM

1.1 The following three Tables report the prices for each brand for different eligibility segments using the CMA's method, using the most likely comparator approach, and using the alternative assumption for the value in excess of an unplanned limit at £10.

1.2 It shows the importance of considering each customer segment individually:

(a) There is a wide range in prices between customer segments for individual providers. Using the CMA's method (Table 6), the price for [✄] ranges from -£[✄] to £[✄]; [✄] ranges from £[✄] to -£[✄]. The weight placed on each of these customer segments in the CMA's analysis will drive relative 'average' prices. The correct approach should be to look at prices for each products specific customer segment.

(b) Some providers have relatively lower prices in some customer segments than others, which highlights how providers compete differently. Using the most likely comparator method (

(c) Table 7), which better reflects how providers compete for particular customers, Halifax's price is under £[✄] for the target segment of its Reward product where credit turnover is between £750 to £1,500 (+2DD), but is over £[✄] for other segments; First Direct's price is under £[✄] for its target segment where credit turnover is above £1,000 (+2DD), but up to £[✄] for other segments.

1.3 The sensitivity of the results to the assumption of the value of an overdraft in excess of the unplanned limit of £100 compared with £10 is shown in Table 8. There are some very significant differences in the results for some providers. It is not possible to determine which version of the results is correct until verification on disaggregated transaction level data is undertaken.

Table 6 Prices for each customer segment using CMA product weighting (five-year monthly average, including switching incentives) for standard/reward products only

£ per month (negative figure indicates payment to account-holder)

Group	*Brand*	***Customer segment***											
		£0 to £500 DDs: <2	£501 to £750 DDs: <2	£751 to £1,000 DDs: <2	£1,001 to £1,500 DDs: <2	£1,501 to £1,750 DDs: <2	£1,751+ DDs: <2	£0 to £500 DDs: 2+	£501 to £750 DDs: 2+	£751 to £1,000 DDs: 2+	£1,001 to £1,500 DDs: 2+	£1,501 to £1,750 DDs: 2+	£1,751+ DDs: 2+
Barclays	Barclays	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	3.49
BoI/PO	Post Office	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	2.43
Clydesdale	Clydesdale & Yorkshire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	3.48
Co-op	The Co-operative Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	5.19
HSBCG	HSBC	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	3.16
	First Direct	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	1.87
	M&S Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	-0.22
LBG	Lloyds Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	6.96
	Halifax	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	3.03
	Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	5.63
Metro	Metro Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	1.61
Nationwide	Nationwide	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	-0.89
RBSG	Royal Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	5.96
	NatWest	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	4.47
Santander	Santander	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	4.19
Tesco	Tesco Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	-0.26
TSB	TSB	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	6.68
Nationwide (without insurance benefit)		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	2.66

Source: CMA model. Provisional Findings Appendix 5.4, Table 6.

Table 7 Prices for different customer segments based on most likely comparator products (five-year monthly average, including switching incentives) for standard/reward products only

£ per month (negative figure indicates payment to account-holder)

Group	***Brand***	***Customer segment*** £0 to £500 DDs: <2	£501 to £750 DDs: <2	£751 to £1,000 DDs: <2	£1,001 to £1,500 DDs: <2	£1,501 to £1,750 DDs: <2	£1,751+ DDs: <2	£0 to £500 DDs: 2+	£501 to £750 DDs: 2+	£751 to £1,000 DDs: 2+	£1,001 to £1,500 DDs: 2+	£1,501 to £1,750 DDs: 2+	£1,751+ DDs: 2+
Barclays	Barclays	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
BoI/PO	Post Office	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Clydesdale	Clydesdale & Yorkshire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Co-op	The Co-operative Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
HSBCG	HSBC	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	First Direct	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	M&S Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LBG	Lloyds Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Halifax	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Metro	Metro Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nationwide	Nationwide	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RBSG	Royal Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	NatWest	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Santander	Santander	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Tesco	Tesco Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
TSB	TSB	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nationwide (without insurance benefit)		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Frontier Economics analysis of CMA model. For each customer, the most likely comparator product is used to calculate the price for that brand in that customer segment. These brand/segment prices are averaged across customer segments using CMA method.

Table 8 Prices for different customer segments based on most likely comparator products with £10 unplanned excess assumption (five-year monthly average, including switching incentives) for standard/reward products only

£ per month (negative figure indicates payment to account-holder)

Group	***Brand***	***Customer segment*** £0 to £500 DDs: <2	£501 to £750 DDs: <2	£751 to £1,000 DDs: <2	£1,001 to £1,500 DDs: <2	£1,501 to £1,750 DDs: <2	£1,751+ DDs: <2	£0 to £500 DDs: 2+	£501 to £750 DDs: 2+	£751 to £1,000 DDs: 2+	£1,001 to £1,500 DDs: 2+	£1,501 to £1,750 DDs: 2+	£1,751+ DDs: 2+
Barclays	Barclays	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
BoI/PO	Post Office	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Clydesdale	Clydesdale & Yorkshire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Co-op	The Co-operative Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
HSBCG	HSBC	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	First Direct	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	M&S Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LBG	Lloyds Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Halifax	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Metro	Metro Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nationwide	Nationwide	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RBSG	Royal Bank of Scotland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
	NatWest	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Santander	Santander	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Tesco	Tesco Bank	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
TSB	TSB	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nationwide (without insurance benefit)		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

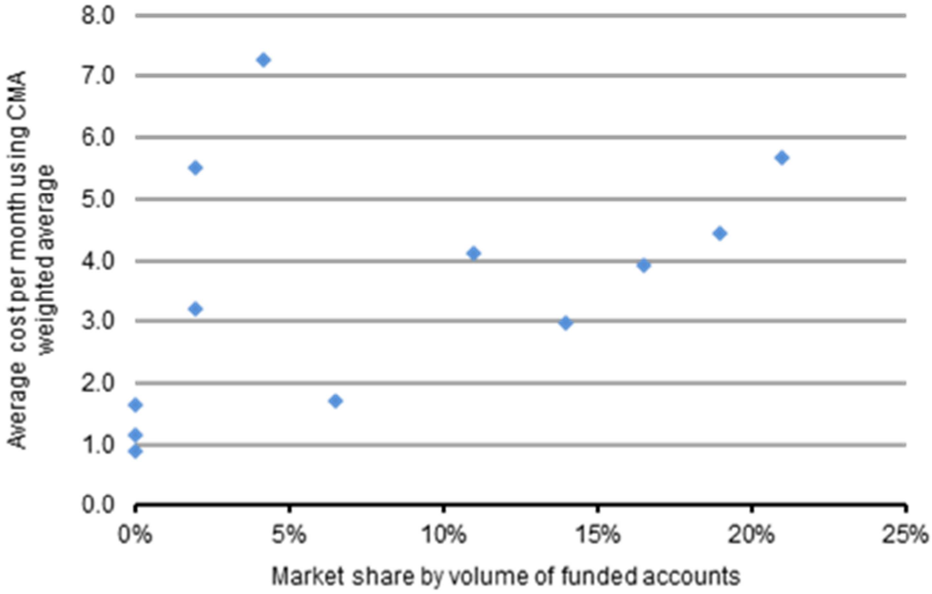
Source: Frontier Economics analysis of CMA model. Calculated as

Table 7, using the output from the CMA model under alternative assumption that value in excess of unplanned overdraft is £10.

2. RELATIONSHIP BETWEEN PRICE AND MARKET SHARE

2.1 LBG has reviewed the CMA's analysis of the price/share relationship in the Disclosure Room. The CMA uses a positive relationship between price and share to find there is a tendency for large providers to have higher prices. This relationship is produced in [the non-confidential version of] Figure 2 below. It is not clear from looking at this chart that there is a relationship between price and market share.

[Non-confidential version of] Figure 2 Average five-year prices vs market share – weighted average of all segments



Source: Prices from Provisional Findings, Appendix 5.4, Table 7. Nationwide average price excludes travel insurance benefit. Market shares from CMA's PCA Market Study Update, Figure 2.3. TSB share is reported in paragraph 2.21. Metro, Tesco and Post Office are not shown individually in Figure 2.3, but have a combined share of <2.5%. They are each represented with 0% share in the chart.

2.2 Whether there is a positive relationship cannot simply be assessed by looking at this chart. The relationship can be calculated and whether there is a positive relationship can be tested statistically. The Table below shows whether the relationship between prices and share is statistically significant at different confidence levels. The Table below shows three specifications for average prices based on the CMA's analysis: a) The CMA's original specification; b) the effect of excluding Nationwide travel insurance (in the same way that other benefits that come with products such as Barclays Blue or Club Lloyds); and c) the effect of the alternative assumption that the excess above an unplanned limit is £10 rather than £100. The relationship between market share and price is not statistically significant under the standard 5% and 10% confidence levels. Specification C, which adjusts for Nationwide travel insurance and the altemative overdraft assumption has a p-value of 45%. There is no evidence in these specifications of a relationship between price and share.

Table 9 Statistical significance of relationship between prices and market share for different specifications

Specification	Nationwide travel insurance	Unplanned excess assumption	Pricing rule	Segment	P-value on slope coefficient	Significant at 5% level	Significant at 10% level
A.	Included	£100	Existing mix	All	18%	No	No
B.	Excluded	£100	Existing mix	All	15%	No	No
C.	Excluded	£10	Existing mix	All	45%	No	No

Source: Frontier Economics analysis in CMA Disclosure Room.

2.3 As explained in paragraph 2.21 *et seq*. of LBG's response to Provisional Findings (at Part B of this response), the CMA's weighting of products should not be used as it makes an unrealistic assumption for brands with multiple products about the product that customers would be offered based on their characteristics. LBG believes the correct approach is to use the most likely comparison product for each brand for each customer. This will better represent the price that customers would be offered if they compared providers or switched to that brand.

2.4 The Figure and Table below show the relationship between average prices on the price of the most likely comparator for each customer based on their characteristics. Nationwide travel insurance is excluded. The alternative assumption of a £10 unplanned excess is shown in the Figure. There is clearly no relationship between price and market share in this figure, which is reflected in a p-value of 30% under the £100 assumption and 79% under the £10 assumption. This analysis shows that there is no relationship between average price and market share.

Figure 3 Five-year prices vs market share using most likely comparator and £10 unplanned excess assumption

[✂]

Source: Frontier Economics analysis of CMA model. Nationwide average price excludes travel insurance benefit. Market shares from GfK Financial Research Survey.

Table 10 Statistical significance of relationship between prices and market share for different specifications

Specification	Nationwide travel insurance	Unplanned excess assumption	Pricing rule	Segment	P-value on slope coefficient	Significant at 5% level	Significant at 10% level
D.	Excluded	£100	Likely comparator	All	30%	No	No
E.	Excluded	£10	Likely comparator	All	79%	No	No

Source: Frontier Economics analysis in CMA Disclosure Room.

2.5 These Figures show the lack of a statistically significant relationship between 'average' prices and market share. However, for the reasons set out in section 2 of the main submission, it does not make sense to look at 'average' prices. Instead, all analysis of prices and other competitive dimensions should individually assess each customer segment. The Figures and Table below show the relationship between prices and market share for two different customer segments using different approaches (market shares are for the whole market and not these customers segments). These continue to show the absence of any relationship.

Figure 4 Five-year prices vs market share using most likely comparator for largest segment (credit turnover of £1,751+ and 2DD)

[✂]

Source: Frontier Economics analysis of CMA model. Nationwide average price excludes travel insurance benefit. Uses £100 unplanned excess assumption. Market shares from GfK Financial Research Survey.

Figure 5 Five-year prices vs market share using most likely comparator for largest segment (credit turnover of £750 - £1,000 and 2DD)

[✂]

Source: Frontier Economics analysis of CMA model. Nationwide average price excludes travel insurance benefit. Uses £100 unplanned excess assumption. Market shares from GfK Financial Research Survey.

Table 11 Statistical significance of relationship between prices and market share for different specifications

Specification	Nationwide travel insurance	Unplanned excess assumption	Pricing rule	Segment	P-value on slope coefficient	Significant at 5% level	Significant at 10% level
F.	Excluded	£100	Likely comparator	£1751+ 2DD	27%	No	No
G.	Excluded	£100	Likely comparator	£750 - £1000 2DD	21%	No	No
H.	Excluded	£100	Existing mix	£1751+ 2DD	15%	No	No
I.	Excluded	£100	Existing mix	£750 - £1000 2DD	11%	No	No
J.	Excluded	£10	Likely comparator	£1751+ 2DD	61%	No	No
K.	Excluded	£10	Likely comparator	£750 - £1000 2DD	50%	No	No
L.	Excluded	£10	Existing mix	£1751+ 2DD	38%	No	No
M.	Excluded	£10	Existing mix	£750 - £1000 2DD	36%	No	No

Source: Frontier Economics analysis in CMA Disclosure Room.

2.6 The analysis above shows that there is no statistically significant relationship between prices and market share. There is no evidence to conclude that there is a 'tendency' for larger providers to have higher prices.

3. GAINS FROM SWITCHING FROM DISCLOSURE ROOM

3.1 The Tables below show the distribution of gains (monthly values excluding switching incentives) with and without the value of Nationwide travel insurance for different customer segments. This shows that:

(a) Overall gains are small for most customers. Half of customers would gain by less than £[✂] from switching to the lowest cost product per year (Median gain of £[✂] per month in Table 12), excluding the value of Nationwide travel insurance. [✂] would gain by less than £60 per year, excluding Nationwide travel insurance ([✂]% gain less than £5 per month overall in Table 12).

(b) The segments with the least to gain are non-overdraft users with low credit balances - [✂]% of this segment would gain less than £60 per year. Around [✂]% of customers with credit turnover less than £500 would gain by less than £60 per year.

(c) Heavy overdraft users (14+ days) have the most to gain from switching to the lowest cost product. Only [✂]% of these customers would gain by less than £5 per month from switching. Half would gain by at least £[✂] per year from switching to the lowest cost product.

(d) Non-overdraft users with high credit balances (>£5,000 average balance) are the segment with the second highest potential gains. Half would gain by at least £[✂] per year.

Table 12 Distribution of gains from switching **excluding** value of Nationwide travel insurance (monthly prices ex switching incentives)

	Proportion of Customers				
	Gains < £1/ month	**Gains < £2/ month**	**Gains < £5/ month**	**Mean**	**Median**
Overdraft Users:					
1 to 7 Overdraft Days	[✂]	[✂]	[✂]	[✂]	[✂]
8 to 14 Overdraft Days	[✂]	[✂]	[✂]	[✂]	[✂]
14+ Overdraft Days	[✂]	[✂]	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]	[✂]	[✂]
Non-overdraft Users:	[✂]	[✂]	[✂]	[✂]	[✂]
Credit £0 to £500	[✂]	[✂]	[✂]	[✂]	[✂]
Credit £500 to £2000	[✂]	[✂]	[✂]	[✂]	[✂]
Credit £2000 to £5000	[✂]	[✂]	[✂]	[✂]	[✂]
Credit £5000+	[✂]	[✂]	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]	[✂]	[✂]
Eligibility segment:	[✂]	[✂]	[✂]	[✂]	[✂]
£0 to £500 DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£501 to £750 DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£751 to £1,000 DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£1,001 to £1,500 DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£1,501 to £1,750 DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£1,751+ DDs: <2	[✂]	[✂]	[✂]	[✂]	[✂]
£0 to £500 DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
£501 to £750 DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
£751 to £1,000 DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
£1,001 to £1,500 DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
£1,501 to £1,750 DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
£1,751+ DDs: 2+	[✂]	[✂]	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]	[✂]	[✂]
% of all customers	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Frontier analysis of Runpath data in CMA Disclosure Room. Notes: These Tables use monthly data on standard and reward accounts. Only the lowest cost alternative product is considered in calculating switching benefits. Uses assumption of £100 unplanned excess.

3.2 The Table below shows the distribution of switching gains. As LBG has highlighted throughout the investigation, value in the PCA market has a non-normal distribution with fat tails. This is also the case for gains from switching. Around two-thirds (64%) of switching gains (including the value of Nationwide travel insurance) is concentrated in just 20% of customers. Nearly three-quarters (74%) is concentrated in only 30% of customers. This means that for the majority of customers the gains from switching are small.

Table 13 Concentration of switching benefits across the market including Nationwide travel insurance (monthly prices ex switching incentives)

% of customers:	10%	20%	30%
		Share of Switching Gains:	
All Customers	49%	64%	74%
£0 to £500 DDs: <2	50%	64%	93%
£501 to £750 DDs: <2	50%	64%	71%
£751 to £1,000 DDs: <2	42%	57%	67%
£1,001 to £1,500 DDs: <2	46%	61%	71%
£1,501 to £1,750 DDs: <2	47%	60%	69%
£1,751+ DDs: <2	43%	59%	69%
£0 to £500 DDs: 2+	50%	65%	72%
£501 to £750 DDs: 2+	48%	66%	75%
£751 to £1,000 DDs: 2+	43%	57%	67%
£1,001 to £1,500 DDs: 2+	40%	56%	66%
£1,501 to £1,750 DDs: 2+	44%	61%	70%
£1,751+ DDs: 2+	52%	67%	76%
15+ od	34%	52%	66%
8 to 14 od	43%	59%	69%
1 to 7 od	56%	65%	73%
£0 to £500	28%	37%	54%
£500 to £2000	26%	54%	54%
£2000 to £5000	27%	46%	55%
£5000 or more	39%	58%	73%

Notes: This Table uses monthly data on standard and reward accounts. Only the lowest cost alternative product is considered in calculating switching benefits. Analysis is done with original prices including Nationwide travel insurance. Source: Runpath data.

3.3 The Table below shows the impact of including Nationwide travel insurance, which increases the average gain per month from £7.10 to £9.30 using the lowest cost product and from £5.60 to £6.20 using the average of the five lowest cost products.

Table 14 Replication of Table 3 in PF Appendix 5.4 including and excluding Nationwide travel insurance (5 year monthly average including switch incentives)

	Overdraft users-average days in OD			All OD users	Non-od users - average balance				All non-OD users	All
	1 to 7	8 to 14	15+		£0 to 500	£500 to 2000	£2000 to 5000	£5000+		
Standard/Reward PCAs compared to:										
Excluding Nationwide travel insurance										
Lowest cost	5.2	12.3	24.6	13.2	2.4	3.3	4.8	12.5	4.8	7.1
Average of five lowest cost	4.1	10.3	21.1	11.1	1.8	2.2	3.9	2.0	2.4	5.6
Including Nationwide travel insurance										
Lowest cost	6.5	13.1	24.6	14.1	3.2	4.1	5.6	13.5	6.5	9.3
Average of five lowest cost	4.7	11.0	21.7	11.8	2.0	2.7	4.3	2.2	2.8	6.2
Share of all standard/reward account holders	20%	8%	15%	43%	14%	18%	12%	13%	57%	100%

Notes: This Table uses 5 year data on standard and reward accounts. Both the lowest cost alternative product and average of five lowest cost alternative products are considered in calculating switching benefit concentration. Source: Frontier analysis of data in CMA Disclosure Room.

4. ASSESSMENT OF FIIC AGAINST DIFFERENT CRITERIA

4.1 There are a number of criticisms of FIIC that go beyond the CMA's assessment, and which need to be looked at individually in the CMA's final report. These criticisms are that:

(a) FIIC is highly misleading;

(b) FIIC gives rise to a perception of low gains from switching;

(c) FIIC leads to a lack of transparency and comparability; and

(d) FIIC requires banks to cross-subsidise from other areas.

4.2 LBG believes that such criticisms can only be made in comparison with other pricing models that could replace FIIC. The alternatives would need to include the payment of credit interest to replace 'forgone' interest as a cost to customers or replacement of overdraft fees. The economics of PCAs mean that it would not be possible to introduce credit interest for all customers without the introduction of a monthly fee or transaction based pricing (although not necessarily for higher value customers when these fees may be waived, e.g. Club Lloyds).

4.3 A monthly fee that replaced the income from forgone interest would be between £5 and £10 for a standard PCA, depending on how many customers closed existing secondary accounts. Replacing overdraft fee income would add a further £3 to £5 to this monthly fee. Moving away completely from a FIIC model to a simple monthly fee with credit and debit interest, would mean a monthly fee for £10 to £15 per month, which would leave many customer worse off.[40]

4.4 LBG believes that such an outcome could not be achieved through regulation, without harming competition, and that this outcome would not be welcomed by customers. Even if an alternative pricing model could be introduced, this would not address these criticisms without introducing new trade-offs.

FIIC is not misleading: customers can already receive credit interest

4.5 Under FIIC, one of the 'costs' to customers is forgone interest. Some customers may not be aware that they are 'paying' for their account in this way, which leads to criticism that the pricing model is misleading.

4.6 This criticism may reflect a lack of understanding of the range of products that customers can already choose from. The CMA should publish the facts about FIIC. There are many products in the market that have already moved away from FIIC, which the CMA should be clear on. The CMA should be clear on how many primary account customers already pay monthly fees or receive credit interest. This can show how important FIIC remains in the market, and what the trend is over time.

4.7 Of those customer that do not pay fees or receive credit interest, the CMA should set out for what proportion the cost of forgone interest or overdraft fees significant. This can be segmented by eligibility criteria to show which customer income segments are paying the highest charges under FIIC. The impact of removing overdraft fees for basic bank account customers should be included in this analysis.

4.8 For those customers that are still on FIIC products and do incur high fees, there is a need to enhance engagement with the alternative products already available in the market. LBG believes the way to do this is to improve comparability and give customers the tools to compare products across the market, which include interest paying products. The cost of 'forgone' interest is clear from the potential gains of moving to products like Halifax Reward or BoS Vantage.

FIIC is not the reason for low gains from switching

4.9 Under alternative pricing models, customers would not pay through 'forgone interest' and may potentially have a better understanding of the cost of their account. However, FIIC and forgone interest are not the reason for low gains from switching.

4.10 The cost of a PCA is low for many customers because they do not hold high balances or use their overdrafts. Over [50-60]% of LBG's primary accounts hold less than £1,000 on average, for which the value of funds generated by the provider is around £24 per year.[41] For the 57% of non-packaged customers that don't have overdrafts and so are therefore unlikely to pay any charges under FIIC (some products already charge a monthly fee), the gains from switching to products that already pay credit interest is less than £33 per

---

40 This is based on replacing Lloyds Bank revenues from the value of funds and overdraft fees with a fixed monthly fee payable by primary accounts (i.e. credit turnover of £500+ with 2 DDs).

41 Based on MQ PCA Aggregate data request, tab B.3. Estimated using the CMA's standardised value of funds of 2.42%.

year.[42] Over half of customers would gain less than £[✂] per year from switching to the lowest cost product.[43]

4.11 Under different pricing models, the gains from switching for these customers would be unlikely to be much greater than under FIIC. For customers with low levels of account usage, the value of receiving credit interest would be small and would be offset by paying a monthly fee or transaction charges.

4.12 There are some customers with high balances that could gain from credit interest, more than they might pay in monthly fees or transaction charges under an alternative pricing model. However, these customers can already gain from switching to high credit interest products, like Club Lloyds. Intervention to make all products pay credit interest would actually reduce the gains from switching for these customers, and damage the competitiveness of these existing products. The solution to this concern is to make these high balance customers more aware of the products that are already available and how much they would gain from switching today.

FIIC is not the reason for a lack of comparability

4.13 PCAs combine different services and accordingly under any pricing structure, the cost of the PCA will depend on the mix of the services a customer uses. It is therefore difficult to compare costs between products without a comparison tool such as midata. Replacing FIIC would not improve comparability.

4.14 Products with monthly fees are no easier to compare than FIIC. Although a monthly fee may be a simpler focal point for prices, customers would still need to understand their average balances and overdraft usage, as well as credit interest rates and overdraft fees, to compare products. (Customers need this information to compare products which have monthly fees and credit interest that are already in the market). Introducing transaction fees may make products even more difficult to compare as customers would need to understand the number and type of transactions they make.

4.15 FIIC accounts can also help comparability compared with a pricing model with a monthly fee. This is because more customers will hold products with different providers under FIIC and can 'try before you buy'. Customers that multi-bank have greater awareness of price and quality of different providers, and can more easily switch between them. Customers are unlikely to multi-bank if they have to pay monthly fees with different providers.

FIIC is not the source of 'cross-subsidy' or differential margins

4.16 LBG believes there is no cross-subsidy in PCAs in the true economic sense that some customers groups or products make a negative contribution after direct costs (other than basic bank account customers). However, 'cross-subsidy' is sometimes used to refer to differential margins, where some customer groups or products generate a higher margin than other groups. Such differential margins are a normal feature of competitive markets where there are large fixed and common costs and are a result of competition. The CMA should be clear on these issues in its Final Report to address this specific criticism.

4.17 This criticism against FIIC is that, because some customers do not pay for their PCA, their use of services is subsidised by other customers, and overdraft customers in particular. However, this view does not reflect the economics of PCAs as non-overdraft customers make a significant contribution to revenue from the value of funds or 'forgone interest'. Both customers with balances and overdraft customers therefore make a contribution. It is customers with a high volume of low value transactions, particularly in branches, with

42 Appendix 5, Table 3, Provisional Findings.

43 See Table 12 above.

low balances and overdraft usage that are therefore most likely to make a lower contribution than other customer groups.

4.18 Other pricing models do not address concerns about differential margins between customer groups. If interest is paid on credit balances, then non-overdraft customers will make a smaller contribution, and overdraft customers would make a greater contribution overall. Monthly fees could be introduced to rebalance the contribution from different customer groups, but would mean customers with low account usage make a greater contribution than customers with high levels of account usage, either in terms of balances or transactions. Transaction based charges could be used to reflect account usage, but at the cost of increased complexity of charging structures.

4.19 If the concern here is actually that overdraft charges are too high, it is not clear that FIIC is the reason for the current levels of overdraft pricing. Rather it is the level of engagement of overdraft customers and their awareness and ability to switch to alternatives. These are dealt with specifically by the CMA's proposed remedies, which should be targeted at customers with high overdraft usage.

The solution to these concerns is enhanced engagement

4.20 LBG believes that the source of the concerns about FIIC is the difficulty in understanding the costs of a PCA and comparing products. To date, there has been a lack of effective tools to help customers calculate the cost of their product, including forgone interest, and to compare with alternatives, including products that pay credit interest. This is why LBG has called for such tools throughout this investigation and for remedies that are shown to enhance engagement. LBG believes that ideas from other providers that could achieve this, such as 'traffic light' comparisons, should be included in trials of potential remedies.