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Dear Professor Smith,

<u>Competition & Markets Authority (CMA) *Retail banking market investigation: Provisional findings report*</u>

We welcome the opportunity to respond to the CMA's Retail banking market investigation *Provisional findings report* and *Notice of possible remedies.*

As you know, Virgin Money is a growing challenger bank which is looking to expand its presence in the UK retail banking market, including in personal current accounts (PCAs). We have also recently announced our intention to enter the SME market, but have largely restricted our comments in this submission to the CMA's analysis and proposed remedies with regard to the PCA market.

We believe that free-if-in-credit (FIIC) banking contributes to low levels of consumer engagement and switching

We concur with the CMA's provisional finding in relation to the PCA market – namely that "a combination of low customer engagement, barriers to searching and switching and incumbency advantages in the provision of PCAs in both GB and NI is leading to adverse effects on competition (AECs)".

We agree that the low level of customer engagement means that the discipline imposed by customers on banks, through switching and the threat of switching, is not as strong as it would be if customers were more engaged.

We think that a root cause of the low level of customer engagement and of switching is the FIIC banking model. We note the CMA's comment that "FIIC reduces to some extent awareness of the costs (direct and indirect) that customers are incurring" and its recognition that "it is possible that FIIC has some impact on the lack of customer engagement". Given this, we are surprised by the CMA's statement that, "we have not found that the FIIC model is contributing to low switching rates".

We believe that the prevalence of FIIC banking, together with the fact that the four large incumbent banks are widely perceived to look very similar to each other, contributes to both weak customer engagement and low switching. The complexity and opacity of pricing under the FIIC model makes it very hard for customers to assess the true cost of their PCA banking, for charges made and for interest foregone, and even harder to assess the cost of PCAs of other banks. Our view is that this has a negative impact on customers' incentives and ability to search and switch PCAs, and is an important reason for the limited increase in switching following the introduction of the current account switching service (CASS).

We think that a market will work best for customers where firms compete on headline prices, which customers can easily understand, and service quality. We find it difficult to think of examples of a market which works well for consumers in the absence of headline prices and/or where competition takes place primarily over non-prominent fees and add-on products. Indeed, we would argue that such pricing structures are more likely to result in consumer detriment.

We are concerned that FIIC leads to significant cross-subsidies, which may be regressive

We note that the CMA's own analysis shows that the FIIC model continues to lead to significant cross-subsidies between different groups of PCA customers. The CMA has estimated that 54% of PCA customers did not incur charges for usage of their PCA in the last quarter of 2014, whilst 46% incurred charges, the most common being overdraft charges. Also, the CMA has found that, on average, PCA customers could save £70 a year by switching to the cheapest product, and that overdraft users could save £140 to £260 a year. This supports our view that the PCA market is not delivering good outcomes for many customers.

Although, as the CMA says, free banking meets the requirements of many customers, it seems unfair that customers who enjoy genuinely free banking should be cross-subsidised by users of overdrafts. This is because, as the CMA recognises, this group is likely to include customers who are less affluent, less educated, less likely to switch, and vulnerable to price discrimination.

We were therefore disappointed that the CMA did not focus on cross-subsidies in its *Provisional findings report*. We think that the CMA should do further analysis on the extent and scale of cross-subsidies within the PCA market, and consider whether these cross-subsidies are excessive, unfair and/or regressive.

We believe that well targeted interventions by the CMA could encourage a market-driven move away from FIIC

We think that a move away from the FIIC banking model would act as a significant prompt for customers to assess the alternatives and to consider switching. However, we recognise that a move away from FIIC banking is not easy. As the CMA has recognised, FIIC banking is popular with many customers. Also, any firm that unilaterally moved away from FIIC could lose significant market share, whilst any coordinated move away from FIIC could lead to charges of collusion.

However, we note some encouraging trends in the market, such as the introduction of reward accounts, particularly the Santander 123 account, which may lead to a broader move away from FIIC banking in a way that could deliver better value and greater transparency for customers.

We think that the CMA should encourage this move by limiting 'hidden' charges which may be considered excessive, unfair and/or regressive. Such remedies would be consistent with interventions to limit and then ban mobile roaming charges and to limit debit and credit card interchange fees. If the CMA is unable to restrict such charges because of limitations on its powers, or unable to do so because of the limitations of its financial analysis, we suggest that it should give further consideration to measures to control outcomes such as requiring banks to pay credit interest on PCAs at or above a minimum level. We think that this would lead to PCAs similar to reward accounts, with pricing that would be easier for consumers to understand than on reward accounts which offer attractive headline rates, but for only up to limited amounts.

We think it is necessary to resolve the issue as to whether PCAs are profitable (on a standalone basis) or are loss-leaders

We note the CMA's finding that PCAs are profitable in their own right and its conclusion that selling additional products to PCA customers is not a fundamental driver of PCA competition. We are surprised by these statements. The finding that most PCAs are profitable is based on information supplied by banks, and it contradicts previous comments by Lord Turner, who thought that PCAs were a loss-leader for the large incumbent banks. The conclusion that the prospect of cross-selling other products does not drive competition in PCAs is contrary to our understanding and experience. Additionally, the absence of monoline providers of PCAs suggests a reliance on cross-selling.

We therefore consider it important that the CMA should seek to determine, on its own reasonable assumptions:

- whether banks make excess profits and returns from PCAs;
- whether PCAs make returns which are below banks' hurdle rates but which are augmented by profits arising from cross-selling other products to PCA customers; or
- whether PCAs are loss-leaders.

We realise that this exercise would require the CMA to carry out the financial analysis which it found difficult because of uncertainties relating to the allocation of shared costs, equity capital and revenues. If banks are unable or unwilling to provide the CMA with their own analysis of PCA profitability, we suggest that the CMA should carry out its own analysis, using the information in Appendix 5.3, and put this analysis to the banks for their review and comment.

We believe new technologies could help build customer engagement

We think that customer engagement is likely to be improved by encouraging the move to online banking, where customers can be in greater control of their PCA in a way and at a time that is convenient for them. Whilst the primary appeal of these services may be to customers who are, in general, more affluent and financially literate, the FCA observed, in its recent paper *Regulatory barriers to innovation in digital and mobile solutions*, that, "Mobile solutions for financial services could be a tool to help reduce financial exclusion in the UK".

To this end, we strongly support the initiatives already launched by the FCA on smarter consumer communications and on regulatory barriers to innovation in digital and mobile solutions.

We believe that the CMA's proposed remedies are sensible, but that they do not go far enough

We believe that the provisional remedies put forward by the CMA are practical and sensible. For example:

- we support Remedy 6, that business current accounts (BCAs) opening procedures should be standardised and simplified. Indeed, we think that this Remedy 6 could be generalised to standardising processes, such as those required for customer due diligence, including Know Your Customer (KYC) and Know Your Business (KYB), where banks should not compete by requiring lower standards. This would enable customers to complete forms online rather than face-to-face in a branch, if they wish to do so, as part of a general move towards online banking.

- we support Remedy 11 and agree that some customers may be more willing to switch under the partial switch service, with an equivalent guarantee, than the full switch service. However, we think that Account Number Portability (ANP) should be included among the list of possible remedies, and that the combination of a move away from FIIC banking and the introduction of ANP would lead to real change in the PCA market.

However, we do not think that the CMA's package of remedies, focusing on prompts, comparison tools and an improved CASS, goes far enough or that it is sufficient to make a big enough difference to switching, competition or innovation.

This is because, while the remedies should reduce customer detriment, we do not think that they will, in themselves, lead to a significant increase in customer engagement, because of problems arising from the complexity and opacity of FIIC pricing. Also, prompts at trigger points do not seem likely to change the switching behaviour of those PCA customers, including overdraft users, who are less financially literate and less likely to switch. Additionally, as discussed at the Treasury Committee hearing with the CMA, many consumers may become increasingly concerned about security risks in comparison tools.

Conclusion

We do not think that the possible remedies put forward by the CMA will, if implemented, lead to real change in the PCA market any more than other measures over recent years, such as requirements for annual statements, the publication of complaints statistics or the introduction of CASS, have done.

We believe that the following measures would lead to real change in the PCA market and to good outcomes for consumers:

- measures which, by limiting excessive, unfair or regressive cross-subsidies under the FIIC banking model, would lead to a market-driven move away from this model;
- the introduction of Account Number Portability alongside an improved CASS – a dual-track approach along these lines would make sense given that it will take time to implement ANP and, in any case, as I have argued previously, a transitioned move to ANP would make sense in terms of managing costs and risks.

We shall, of course, be happy to meet you to discuss further any or all of these matters.

Yours sincerely,

Jayne-Anne Gadhia
Chief Executive Officer
Virgin Money