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Professor Alasdair Smith
Reference Group Chair
Retail banking market investigation
Competition and Markets Authority
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Dear Professor Smith

Virgin Money response to Competition and Markets Authority's Retail banking market investigation *Invitation to comment on additional remedy suggestions*

We welcome the opportunity to respond to the Competition and Markets Authority's (CMA) Retail banking market investigation *Invitation to comment on additional remedy suggestions*.

We have reviewed the alternative and additional remedies in the *Invitation to comment* that have been proposed by respondents to the CMA's consultation on its *Provisional findings report* and *Notice of possible remedies.* We note that some of these remedies address specific issues faced by overdraft users, including those who use unarranged overdrafts, while others are broader in scope, focusing on ways to make it easier for people to compare PCA products and to prompt PCA customers to consider switching.

We comment on these alternative and additional remedies below. We also set out our views on the remedies we believe should be considered further to address the challenges faced by overdraft users and more generally to encourage the emergence of a PCA market that delivers better outcomes for PCA customers.

Alternative remedies to address challenges faced by overdraft users

We agree with the CMA that the PCA market is not working well for many overdraft users. We recognise that free-if-in-credit (FIIC) banking is popular with many customers. However, we think it is 'unfair' (in the sense meant by the regulatory term 'treating customers fairly') that free banking for some customers (including those who are more affluent and more financially literate) is subsidised by often-high overdraft charges paid by other customers (including those who are less affluent and less financially literate).

We therefore welcome the CMA's openness to alternative and additional remedies, including approaches that it was not previously minded to pursue, alongside those that it has already proposed, to address challenges faced by overdraft users.

According to the analysis contained in the CMA's *Provisional findings report*, overdraft users include customers who are less affluent and less financially literate. The *Provisional findings report* states that PCA overdraft users are less likely to switch accounts than other customers, despite often having the most to gain from switching. It also notes the difficulty of comparing overdraft charges across banks, and that overdraft users face additional barriers to switching due to uncertainty surrounding the acceptance and timing of an overdraft approval.

As recognised in paragraph 4 of the *Invitation to comment*, a particular concern expressed by some respondents to the CMA's consultation on its *Provisional findings report* and *Notice of possible remedies* related to customers using unarranged overdrafts. Some of these customers are likely to have modest incomes and few savings, and may well find it difficult to avoid unarranged overdraft charges, even if they are notified of them.

We suggested in our supplementary response to the CMA's consultation on its *Provisional findings report* and *Notice of possible remedies* that the CMA should carry out further analysis on the extent and scale of cross-subsidies between different groups of PCA customers and introduce remedies that restrict any charges that are found to be excessive, unfair and/or regressive.

We think that it would be helpful in this regard for the CMA to estimate the contribution made by each individual source of the £8.7 billon income that UK banks made from PCAs in 2014 – including, for example, the amount that came from overdraft customers and, within that, from customers with unarranged overdrafts.

Measures to control outcomes for PCA customers

We note in paragraph 7 of the *Invitation to comment* that the CMA may now consider measures to control outcomes, which it previously stated (in paragraphs 175 and 176 of the *Notice of possible remedies*) that it was not minded to pursue.

We believe the CMA should seriously consider measures to control outcomes as potentially the most effective and straightforward way to achieve better outcomes for PCA customers who use overdrafts, and that this should not be restricted to the specific suggestions made by Which? and by the Financial Services Consumer Panel.

We believe that consideration should also be given to measures which would restrict 'non-prominent fees' (a term used by the PRA in observing factors which weaken competition and can facilitate the pass-through of costs to retail banking consumers[1]) which might be deemed to be 'unfair', such as complex or opaque charges for additional account features.

We think that measures to control outcomes on non-prominent fees on PCAs would be consistent with regulatory action in other markets, such as controls on mobile phone roaming charges and caps on debit and credit interchange fees.

We also believe such an approach would complement and reinforce other measures to increase the transparency and comparability of PCAs. We note, in particular, the work being done to develop a set of standardised terms and definitions for services linked to payment accounts that are subject to a fee (as part of the implementation of the Payment Accounts Directive). We support this initiative, as we believe it could help consumers to make more informed choices between current accounts offered by different providers.

Free-if-in-credit banking versus transparent headline pricing

We think that markets work better for consumers if competition is focused on headline prices rather than on non-prominent fees and charges for ancillary products and services. We observe in this regard the comments on FIIC banking made by John Fingleton, former Chief Executive of the OFT, in evidence to the Parliamentary Commission on Banking Standards:

> *our view at OFT was that explicit, transparent pricing should be on the things where the banks make all their money; forgone interest and overdraft charges were the least transparent and least visible to the customer…Our preferred solution would have been to try to stem all of the alternative sources of revenue and channel competition into up-front charges.*[2]

As we said in our responses to the CMA's consultation on its *Provisional findings report* and *Notice of possible remedies*, we believe that FIIC banking contributes to low levels of consumer engagement and switching, as the absence of clear and transparent headline prices and charges makes it hard for customers to understand the true cost of their PCA banking, or the costs of PCAs of other banks.

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[1] The PRA uses this term in *CP37/15 The Implementation of ring-fencing*, in considering how banks might pass on the costs of ring-fencing. It states that 'Behavioural biases can lead to failure by customers to take into account the cost of non-prominent fees (eg overdraft charges) and add-on products (eg payment protection insurance)'.
[2] Oral evidence session with Parliamentary Commission on Banking Standards, 10 January 2013

We think that controls on non-prominent fees, whether through the options we suggest or alternative remedies, could encourage a market-driven move away from FIIC banking and towards simpler and clearer headline pricing and charges.

We note the partial move away from FIIC banking that has already resulted from changes such as the introduction by Santander of its 123 account and the introduction of reward accounts by some other providers. Reward accounts clearly offer benefits, relative to standard PCAs, for many customers.

However, even with reward accounts, it is not easy or straightforward for consumers to compare products. Account features such as limits on the amount of deposits qualifying for higher interest rates make comparison of the benefits of different reward accounts difficult. Because of this, consumers who have switched to reward accounts may be reluctant to consider switching subsequently to an alternative reward account.

So, while reward accounts may increase PCA switching in the short to medium term, they may not lead to a long-term increase in PCA switching, after the PCA market has reached a new equilibrium.

As we have argued in previous submissions to the CMA, we think an alternative mechanism that could help to encourage a move away from FIIC banking to more transparent PCA pricing, and drive a more sustainable increase in switching, would be to require banks to pay credit interest on PCAs at or above a minimum level, irrespective of the amount of deposits. We think this would encourage the development of PCAs similar to reward accounts, but with pricing that is clearer and easier for consumers to understand.

Other alternative remedies

In relation to the other alternative remedies that have been suggested:

- We think that the colour coding suggested by Tesco (detailed in Paragraph 9(a) of the *Invitation to comment*) is not practical and might actually add to complexity. In foods, the colour coding can apply to measures such as sugar content or fat content. However, for PCAs, the colour coding would have to take account of different patterns of use by consumers, and how these can change over time. For example, a PCA that is green for one consumer might be red for another if their patterns of behaviour are different, and the appropriate colour for a consumer could change over time if their behaviour changes.

- We support the proposal relating to standardised monthly bills suggested by TSB (detailed in Paragraph 9(b) of the *Invitation to comment*). However, as we said in our response to the CMA's consultation on its *Provisional findings report* and *Notice of possible remedies*, we do not believe that prompts will in themselves lead to a significant improvement in switching and competition.

We welcome the CMA's willingness to remain open-minded about possible remedies and encourage the CMA to consider possible control measures that would lead to better outcomes for consumers, including overdraft users, and that would offer an appropriate degree of protection for consumers who are less affluent and less financially literate. We believe that such measures would have the additional benefit of encouraging a market-driven move away from the FIIC banking model: we think that greater focus on headline prices would increase switching and would encourage competition and innovation.

We would be happy to meet you to discuss further possible remedies and our views on them.

Yours sincerely

Dave Dyer
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Virgin Money