LLOYDS BANKING GROUP PLC

CMA RETAIL BANKING MARKET INVESTIGATION

Response to 'Invitation to comment on additional remedy suggestions' and 'Questions for banks on remedy 1'

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1. SUMMARY

1.1 LBG sets out below its response to the 'Invitation to comment on additional remedy suggestions' ("**Additional Remedies**") of 18 December 2015 and 'Questions for banks on remedy 1' of 17 December 2015 ("**Remedy 1 questions**").

Remedies relating to overdrafts

The CMA's initial remedy proposals are mutually reinforcing and will help unplanned overdraft customers by changing customer behaviour and increasing competitive pressure on providers

1.2 In its Provisional Findings, the CMA found two main problems in the PCA market. **LBG agrees with these findings**, which are consistent with those identified by LBG throughout the CMA's investigation:

(a) many PCA customers find it **difficult to compare current accounts**, relative to other retail financial products, and do not have the right tools to do so. Awareness of the switching service needs to be higher and many **customers believe that switching is more difficult than it actually is**; and

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

1.3 These problems are not trivial, they are **fundamental to how customers engage** and to how providers compete.

1.4 The CMA identified in its Notice of Possible Remedies a set of remedies that would, following customer trials, help customers, particularly overdraft customers, in two different ways:

(a) by **changing customers' behaviour**, to reduce how much they pay in overdraft fees and other costs. In this connection, text alerts and mobile banking have been shown to reduce unplanned overdraft fees by 24%.[1] In a trial, LBG achieved an uplift of [40-50%] in customers increasing their planned limit, and so reducing unplanned fees, when they received a text alert to tell them about the option to do so; and

(b) by **making it easier for overdraft customers to compare costs, shop around and switch**. The CMA's original list of remedies can deliver, within 12 months, much better and more powerful comparison tools ("midata 2") that will allow customers to better 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**"). There are also remedies

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[1] FCA Occasional Paper No.10.

designed to give customers greater certainty that they will get the overdraft they want before they switch, and targeted prompts to encourage customers who use overdrafts regularly to shop around.

1.5 These two approaches are not independent, but **mutually reinforcing**. They work with the competitive process to provide a greater incentive for providers to compete more aggressively on the level and structure of overdraft charges, and also continue to give existing and new PCA providers room to innovate and differentiate themselves.

1.6 They will transform how customers can engage with their product, including by reducing overdraft usage and costs, and by facilitating more effective shopping around for PCAs. As overdraft customers engage more, this will **increase the pressure on providers to innovate and improve their overdraft price and quality of service** in the same way they have with credit interest and rewards.

1.7 Implementing these remedies effectively will involve significant cost, effective coordination by a number of regulators and HMT, and **the adoption of advanced and world-leading technology and innovation.**

Additional Remedies on overdrafts would stifle competition and innovation and require detailed, invasive and ongoing regulation

1.8 LBG understands the concerns expressed by some customer groups and other respondents; that it may take some time for the CMA's original remedies to be trialled and implemented. Many of the remedies aimed at driving more engagement, and crucially remedies that will make it easier to compare costs, can be implemented in 12 months. This means that **there is no justification for more invasive or prescriptive regulation** of the structure and/or level of overdraft charges (even for a transitory period).

1.9 **Customers value the service provided by overdrafts** (both planned and unplanned). Overdrafts are used by around 23 million customers, with 12 million exceeding their planned limit annually. An unplanned overdraft allows customers to borrow for a short period and avoid the financial cost and other consequences of missing payments on household bills. It also means customers can make payments for essential services (such as needing to purchase petrol late at night) without the need to rely on being able to contact their bank.

1.10 Overdraft pricing forms part of a package of services provided by a PCA. Providers **innovate, differentiate themselves and compete on what charges they levy** as well as on the level of those charges. Halifax introduced simple daily fees of £1 and other providers have copied this model. Many providers cap the level of fees each month, and providers compete on the level of paid and returned item fees – for example, some providers, including Halifax, do not charge any paid or returned item fees.

1.11 Providers have **developed innovative tools to help customers manage their overdraft** and understand its costs. The growth of mobile banking means more and more customers are using text alerts, and managing their overdraft in real-time from their mobile. Lloyds Bank was one of the first brands to launch an overdraft calculator. LBG has trialled an overdraft eligibility checker to give customers more certainty over whether they would get an overdraft if they switched. LBG has also introduced innovative free services allowing customers to understand and improve their credit score.

1.12 **Technology is giving customers much greater control over their accounts and is fundamentally changing how customers use overdrafts**. It is making it much simpler for customers to pay only when they really need to borrow. There is scope for much more innovation. Push messaging on smartphones will allow providers to **alert customers in real time** if they are about to go into an unplanned overdraft and allow them to avoid or manage the costs of doing this. Innovation is strong – Halifax for example has recently launched "Balance Extra" a simple tool that warns customers earlier in a month if they are likely to go overdrawn that month based on their typical spending.

1.13 LBG therefore has significant concerns both in principle and in practice about all of the proposed additional remedies that would directly regulate overdraft pricing. These remedies are the **wrong way to tackle problems of customer engagement** in the PCA market **and would be disproportionate.** As the CMA itself recognises, price controls "can be complex to implement and monitor" and there is "a risk that such controls create market distortions".[2] In the PCA market, the suggested controls would have a range of adverse effects:

(a) **shift competition and innovation away** from those customers who stand to benefit most from increased engagement, just as the tools to help these customers are beginning to emerge;

(b) **undermine the CMA's other remedies** by removing the incentives for many customers to manage their account usage or engage in the market, compare providers and switch;

(c) **reduce differentiation** in a market where customers can currently choose between different tariffs for unplanned overdrafts and credit balances - customers would have **less choice** as pricing becomes undifferentiated, reducing competitive pressure from customer switching;

(d) **harm entry and expansion,** reducing existing and emerging competitive pressure. The OFT reported in its 2007 review of the SME price undertakings that all three of the main "challenger" banks, as well as other smaller banks, said that they had been hindered by the price regulation;[3]

(e) **lead to a rebalancing of prices,** as competition responds to the restrictions in a market with no excess profits. Which? recognises and accepts this would mean increases in prices for other services, such as planned overdrafts. Such rebalancing would mean that some customers are better off, and some would be worse off under these remedies. Any rebalancing is best left to the market and competitive process rather than regulators who will have to justify any distributional consequences of forcing through pricing changes;

(f) **increase costs of providing overdrafts,** as customers have less incentive to manage the level of their planned limit or to stay within that limit, which would make it more costly to assess credit risk; and

(g) **reduce the availability of unplanned overdrafts** if the incremental costs of providing an unplanned overdraft are not covered by the regulated level of prices.

1.14 Given the diverse charging structures already in place and as they form part of a package of services, any form of intervention would likely require detailed, invasive and ongoing regulation to monitor and enforce. Experience from other products, such as credit card default fees, suggests that price caps can create focal points and raise prices. **Direct**

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2 Competition Commission (2013), Guidelines for market investigations: Their role, procedures, assessment and remedies, paragraph 378.

3 OFT (2007), *SME Banking: Review of the undertakings given by banks following the 2002 Competition Commission report*, paragraphs 5.69 and 5.70.

price regulation and/or controls on the structure of charges will dampen competition and innovation (by preventing further new pricing models). Detailed rules and invasive regulation will also create barriers to entry and make it harder for new entrants. **Such remedies should therefore not be pursued.**

1.15 LBG has similar concerns about the proposal to move from customers "opting out" to customers "opting in". This would be a significant shift for [over 20] million overdraft customers with a **substantial risk of unintended consequences.** LBG has previously researched why customers value the ability to make unplanned payments. Mostly this was because many customers understand the costs and consequences of missed and late payments to avoid embarrassment or to prevent ongoing issues with service providers, and this is why customers do not "opt-out". If there is a change requiring customers to "opt-in", many customers may fail to do so without understanding the potential impacts, given their familiarity with the current default.

1.16 Any of the proposed **remedies are open to individual providers to offer** as part of their PCA pricing. Providers are free not to charge returned item fees (and some already do not). Providers can charge the same price for planned and unplanned overdrafts. Providers can cap the total level of charges that customers pay for using overdrafts (and some providers already do this) or they can offer interest and fee free overdrafts up to certain limits (as some already do). Providers can offer free overdrafts (and some do). Providers can choose the level of charges for "opt-out" accounts and can invest to deliver more sophisticated opt-out products that allow customers to choose which payments are made or refused to avoid overdraft charges.

1.17 Eligible **customers can now also open fee-free basic bank accounts**, following HM Treasury's new requirements.[4] This means eligible customers can choose not to have an overdraft and will not incur any fees for returned items.

1.18 **The CMA's original set of remedies when trialled and implemented will accelerate these trends and increase the pressure on all providers to innovate and improve their offering for customers.**

1.19 The time period for this consultation has been relatively short. If the CMA decides to pursue any of the proposed price regulation proposals, then a full analysis of their impacts would be required and further input from providers would be necessary.

Remedies relating to prompting, comparison and switching

1.20 LBG remains a **strong supporter** of the CMA's original list of remedies to prompt customers, aid comparison and make switching easier. These remedies should be targeted at heavy unplanned overdraft users as they are one of the groups with the most to gain from enhanced engagement. This means that as remedies are developed and trialled, ideas that help **this group of customers are prioritised** and that outcomes for this group will be key indicators of overall effectiveness.

Ideas to prompt and engage customers can be trialled, although experience suggests some may not be effective

[4] LBG's new basic bank account products were introduced on 18 January 2016.

1.21 Some of the remedies suggested by other providers to help to improve engagement have the **potential to improve outcomes** for the group of unplanned overdraft users, as well as other groups, and could be **included within a programme of trials**. In particular:

(a) the suggestion for 'traffic lights' from Tesco Bank could be combined with midata 2 to provide simple personalised summaries for customers rather than profiles;

(b) the idea of a monthly statement, although the form of such statements suggested by TSB may be too complex by including forgone interest. Monthly statements are also likely to be ignored by many customers as they would not be targeted - TSB, and other providers could trial such statements to test their effectiveness;

(c) the suggestions from First Trust Bank about the requirements in the NI Order, including notifying customers before deducting overdraft charges and interest. LBG already implements these requirements for customers outside Northern Ireland. For other providers, this would be more targeted than a monthly statement, but its effectiveness would depend on how it is designed and how options for changing behaviour are presented; and

(d) clearer terms and conditions for overdrafts, as suggested by Which? – the most effective way to do this would need to be trialled, and other ways of communicating information could also be tested, such as LBG's use of videos to explain important terms and features in a way customers find easier to understand and remember.

1.22 Any of these ideas, and others that are suggested, may be effective at enhancing engagement for unplanned users or other priority groups, either **individually or collectively with other remedies**. Care will be needed in designing how the communication is presented, the channels that are used and how personalised information can be included. The **effectiveness of any idea or approach can only be determined through a programme of trialling**. It is not possible to second guess the effectiveness of these or other remedies.

Remedy 1 will require prescriptive regulation following an effective trial programme

1.23 The prompts developed for Remedy 1 should be the outcome of such a trial programme. The CMA will then be able to specify which prompts are most effective at enhancing engagement. The CMA will need to specify clearly how these prompts should be implemented so that each provider can do so to the same standard. It will be necessary for prescriptive regulation to ensure that all providers meet these specifications, and LBG expects that implementation should be reviewed in future. **It is not clear why other incentives, such as a customer challenge group or ranking of outcome metrics, would then be required.** If such channels could help to motivate providers, then the market is better able to do this, through consumer organisations and the media.

Quick adoption of APIs is needed for 'credit passports' and not a centralised resource

1.24 LBG agrees that making information on transaction history more portable will help customers to be offered credit on the same terms by new providers that could make real-time overdraft decisions and confirm offers prior to switching. The solution to this problem is not data sharing with a centralised resource, which would then control access to valuable data – credit reference agencies currently charge customers up to £15 per month for access to their credit rating which Martin Lewis describes as "not meaning very much".[5] **The better solution to this problem is to adopt APIs** for the sharing of PCA transaction data which would allow the new provider to access the required data. If a central resource is required for this solution, then this should be a shared resource with no charging. Credit reference agencies could provide this, but this should be on the condition that they are part of the midata programme to give free access to customers' own data.

1.25 This is why it is important for the CMA to set out and design new governance arrangements for APIs for current accounts to prioritise their development within 12 months. This will allow sharing of credit information, as well as create the ecosystem for financial technology firms and existing providers to develop PCA comparison and other tools.

Other remedies

Requirement to provide credit interest will reduce differentiation and dampen competition

1.26 Virgin Money has proposed a remedy that would require providers to pay credit interest. **It is not clear what issue this remedy addresses.** There is already a lot of choice in the PCA market with a range of products that pay credit interest, and other rewards such as £5 Halifax Reward per month and cashback rewards on utility bills. Forcing all providers to pay credit interest will **reduce differentiation and make it harder for entrants to attract new customers**. This suggestion would be **highly disproportionate** to any concern in the PCA market and should not be taken forward.

Structural remedies are not the solution to any concerns

1.27 In its response to the Provisional Findings and Remedies Notice, Nationwide argued that existing providers had a scale advantage from having high market shares and large back books. Nationwide suggested that a structural remedy, such as a divestment, would be a solution to this problem. It is not clear what scale advantages Nationwide is referring to nor why a divestment would resolve such problems. **Any issues with existing customers paying high prices can only be addressed by enhancing engagement.** Moving such customers involuntarily to new providers does not alter providers' incentives to change pricing for existing customers or increase these customers' likelihood to switch. But it could only be delivered at a very high cost and would cause considerable disruption for customers that are required to change provider. As a result, **a divestment remedy would be ineffective and highly disproportionate, and therefore has no justification.**

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[5] Experian charges £14.99 per month for access to a credit report. See MoneySavingExpert.com, "60 seconds on what your credit score really means".

2. SUGGESTED REMEDIES FOR UNPLANNED OVERDRAFT USERS

2.1 Respondents to the CMA have suggested several alternative remedies that target unplanned overdraft customers, and those with the highest overdraft charges in particular. LBG agrees that there is a need to target these customers. The CMA should target its development of remedies to change behaviour and enhance engagement for this group of customers through a programme of trialling. The original list of possible remedies, designed effectively, together with additional behavioural remedies, will address concerns over unplanned overdraft usage by focusing greater competition on this group and avoiding the unintended consequences of direct price regulation.

Economics of unplanned overdrafts

2.2 Respondents to the CMA have suggested a number of alternatives that would directly regulate unplanned overdrafts. These remedies misunderstand the economics of unplanned overdrafts and the rationale for such charges in a competitive market.

Unplanned overdrafts are a valuable service for most customers

2.3 Providing unplanned credit is a valuable service to customers, which means they can make critical payments, such as a mortgage or utility bill, and make payments for essential services, such as buying petrol late at night, even if they do not have the funds or an agreed credit line. This saves all customers, not just those who use an unplanned overdraft, from the worry of missing critical payments or the inability to complete a purchase at a critical time. There are also financial benefits from avoiding missed payments and the missed payment penalties, including withdrawal or cancellation of service, that may result.

2.4 In any market, it would be legitimate and unproblematic for some providers to charge a higher price for this service. There is also nothing to stop a provider trying a free or lower cost unplanned proposition – M&S Bank does not charge for an unplanned overdraft but limits excess borrowing to £50 above their planned limit for all customers.

2.5 The value to a customer of making a payment when funds are not available does not depend on the size of a planned limit. LBG therefore reflects this value in the same daily charge for all customers, rather than by an interest based charge. This also has the benefit of simplicity and therefore more control and transparency for customers.

2.6 Although this is a valuable service, most customers either do not need to use an unplanned overdraft, or use it only occasionally. The CMA found that 76% of customers did not use an unplanned overdraft.[6] The chart below shows the distribution of usage for those that do use an unplanned overdraft across LBG's customers. Around [10-20%] of customers (over half of unplanned users) use an unplanned overdraft for less than 1 day per month. However, some customers have greater usage, with around [0-5%] of customers using an unplanned overdraft for more than 3 days per month on average.

Figure 1 Distribution of unplanned overdraft usage for all LBG brands, 2014

[✂]

Source: LBG transaction data submitted to CMA.

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6 Provisional Findings, Appendix 7.5, Table 1.

There is a large incremental risk associated with an unplanned overdraft

2.7 Some of the Additional Remedies suggested by respondents appear to assume that there are no incremental costs associated with providing an unplanned overdraft, or at least that these costs are equivalent to high-cost short-term credit ("**HCSTC**"). This is an incorrect basis on which to understand unplanned overdraft pricing, which may be a riskier form of lending. The CMA concluded that HCSTC was not a substitute and is in a different market from overdrafts, and that the costs of HCSTC are not relevant for unplanned overdrafts.[7]

2.8 The credit risk associated with customers staying within their planned overdraft limit is low. This is because customers have been assessed for affordability and are meeting an agreement and there is generally no reason for the credit to be impaired. LBG held a provision of [below 5%] of an overdraft balance for planned customers in 2015.

2.9 The credit risk for customers exceeding an unplanned overdraft is much higher. This is because nearly all customers that go on to impair will first use an unplanned overdraft – it is not possible to identify these customers in advance and so the credit risk is pooled across all unplanned customers. LBG held an average provision for customers in excess of their planned limit of [40-50%] of the whole overdraft balance (not just the unplanned part). This provision is [20-30%] for customers with less than 60 days in excess of a planned limit.

2.10 This is a significant incremental cost over and above planned overdrafts. For a customer with a planned limit of £500, the provision when they are below their limit would be around [below £10], but this would increase to [over £100] if the customer exceeded their planned limit (indicating an increased likelihood of impairment) and to between £250 and £400 after 60 days in excess. This increase in cost is reflected in the price of unplanned overdrafts.

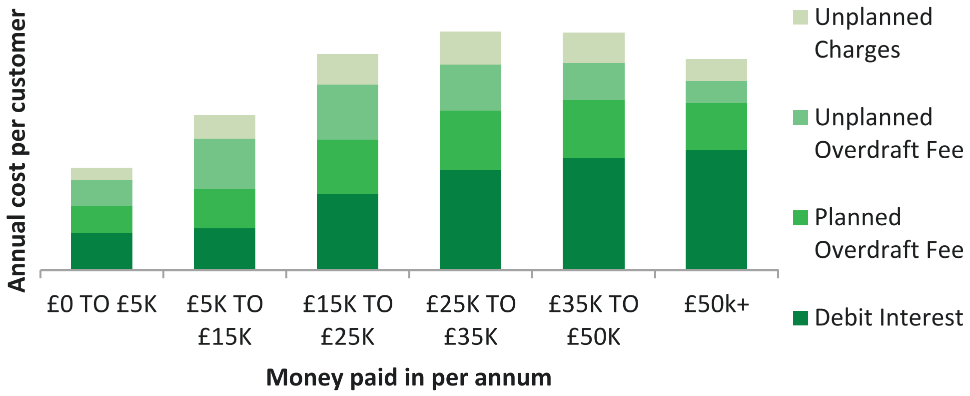
Medium income customers spend more on overdrafts overall

2.11 There is a perception that customers that pay high charges for overdrafts are more vulnerable customers with lower incomes. This is not the case. The lowest income customers, who are eligible, now have the option of basic bank accounts that are completely fee-free, and all customers can choose to use control accounts.

2.12 The chart below shows that it is customers with medium incomes (measured by credit turnover) that have the highest costs from overdrafts, with a peak for those paying in £25,000 to £35,000. However, this falls for customers with the highest incomes.

[7] CMA (2015), Payday lending market investigation, paragraph 5.79.

Figure 2 Annual cost of overdrafts for different credit turnover, Lloyds Bank



2.13 The CMA's evidence on the characteristics of overdraft users finds a similar picture. The table below shows the likelihood of customers in different groups to be unplanned overdraft users. This shows that younger customers, in employment, with up to A-level qualifications are the groups most likely to use an unplanned overdraft. The most vulnerable groups – those over age 65 and those with no qualifications – are least likely to use an unplanned overdraft.

Table 1 Characteristics of customer groups that over and under-index in unplanned usage

	Characteristic	Proportion of group that uses unplanned overdraft
Over-index	Age: 18 - 24	40%
	Age: 25 - 34	37%
	Age: 35 - 44	31%
	Education: A-level	29%
	Working	29%
	Financial literacy: Yes	26%
	O-levels	26%
	Income: Medium	26%
Average	Male	25%
	Income: Low	25%
	Female	24%
	All customers	**24%**
	Age: 45 - 54	24%
	Financial literacy: No	23%
Under-index	Income: High	22%
	Education: Degree	22%
	Not working	17%
	Age: 55 – 64	14%
	No qualification	13%
	Age: 65+	6%

Source: Provisional Findings, Appendix 7.4.

Support already exists for unplanned overdraft customers

2.14 There are already a number of regulatory- and market-driven tools to help customers manage their unplanned overdraft usage:

(a) **Interest and fee-free overdrafts:** Customers are not charged for using their overdraft. Club Lloyds offers up to the first £100, and Halifax Reward up to the first £50, of a planned overdraft as interest-and fee-free. Added value accounts offer larger interest and fee-free amounts.

(b) **Unplanned overdraft buffers:** Customers are not charged for using their unplanned overdraft if the amount in excess is less than £10.

(c) **Unplanned overdraft grace periods:** Customers are not charged if they are able to top-up their account and move back below their planned limit by midnight.

(d) **Fee caps:** Customers are not charged unplanned fees above a certain number of days each month: 20 days for Halifax and 8 days for Lloyds Bank and Bank of Scotland.

(e) **Fee waivers:** LBG will waive fees in certain circumstances, including in cases of financial difficulty and as a gesture of goodwill. LBG waived [over £20m] in fees in 2014.[8]

(f) **Text alerts and mobile banking:** Customers can set up text alerts to tell them when their balance is below a certain level and can use mobile banking to transfer funds to adjust their balance accordingly. The FCA found that customers that use these tools have reduced unplanned overdraft fees by 24%.

2.15 The table below shows the value of these facilities for Lloyds Bank customers. Total unplanned fee and interest revenue for Lloyds Bank in the same period (net of these costs) was [✄].

Table 2 Estimated value of facilities to manage overdraft charges, Lloyds Bank, 2013

Facility	Estimate value to customers
Interest and fee free amounts and buffers	c. [✄] / year
Grace periods, caps and waivers	c. [✄] / year

Source: See PCA Market Questionnaire Question 2.3.

2.16 For those customers with high levels of unplanned overdraft usage there is already support in place to reduce fees, in addition to fee caps and the other facilities above. All overdraft fees are suppressed (i.e. fees are not charged) for customers with more than 30 days in an unplanned overdraft until these customers remain within their limit for 30 days.

2.17 These customers are also contacted and offered support to help them manage their financial situation. The value of suppressed fees for LBG is around [over £100m] per year (compared with total unplanned income of [over double that]). These customers make up a large proportion of the heaviest overdraft customers - in the last three months around [less than 5%] of customers had fees suppressed compared with [less than 5%] of customers with more than 3 days per month unplanned overdraft.

Proposals to regulate overdraft charges would dampen competition

2.18 There are two proposals that would attempt to regulate unplanned overdraft fees in relation to which the CMA has invited comments. These proposals could have large costs in terms of lost revenue for PCA providers – the size of these costs means that the unintended consequences of regulation are likely to be significant.

(a) The Which? proposal would **remove unpaid or returned item fees and prohibit differentiation between charges for arranged and unarranged overdrafts.**

(b) The FSCP proposal is that **unarranged overdrafts should be subject to the price cap for high-cost short-term credit.** In the context of unplanned overdrafts, this means a cap of 0.8% per day for an overdraft (and that the total cost of fees and interest should not exceed the amount borrowed). This would have an impact on customers with lower balances, as most customers, particularly those with large planned limits, already pay less than 0.8% per day in fees and interest.

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8 See LBG's response to PCA Market Questionnaire, Question 10 for further information.

2.19 Regulators are usually reluctant to set prices in a competitive market. This is because it is often not possible to design regulations that work effectively and because there are likely to be negative unintended consequences, not least by dampening competition. It is very likely that regulation of unplanned overdrafts would face such problems.

Regulation would undermine CMA's other remedies

2.20 Regulation to reduce unplanned overdraft fees would remove the gains from switching for those customers for whom the existing remedies need to be targeted. For the proponents of such regulation this would be a positive change in the short-term. However, there would be long-term negative consequences as this regulation would remove much of the reason for these customers to switch, undermining the CMA's other remedies and trials. It would also remove the competitive advantage possessed by those providers and entrants who offer the lowest unplanned charges. The focus of competition and differentiation, instead of shifting towards overdraft customers as is required, would shift away.

2.21 The removal of unplanned fees would remove the incentives for customers to engage with new products and tools designed to help customers manage their credit usage. The competitive advantage of entrants and technology firms in helping customers to manage budgets within planned limits would be diminished, and investment in such tools be reduced. It may also increase the incidence of financial difficulty as customer incentives to plan, monitor and control their cashflow would be reduced.

Which? proposal to prohibit unplanned differential would distort competition

2.22 The Which? proposal to prohibit the differential in unplanned fees assumes that there is no difference in the cost to serve planned and unplanned overdrafts. This is incorrect, as explained in paragraph 2.7 above. There is an incremental credit risk for customers that exceed their planned limit, which is a justifiable economic reason for a premium. Providers can choose whether to offer a higher charge for unplanned usage or differentiate themselves by pooling the risk and having one charge. But forcing all providers to have one charge would reduce innovation and the scope for providers to differentiate. It may also reduce the availability of unplanned lending, which would have consequences for customers who experience or worry about missing payments.

FSCP proposal to cap unplanned overdrafts does not reflect value or costs

2.23 The cap for high-cost short-term credit ("**HCSTC**") was set following a very detailed analysis of costs and credit risk in that market. There is no reason why those costs would be the same for unplanned overdrafts, which the CMA found are not a substitute for HCSTC. In particular, HCSTC is a planned and pre-agreed credit facility. Unplanned customers have already exceeded a pre-agreed credit facility, and so the incremental credit risks for unplanned customers are likely to be greater than for HCSTC. A price cap that was set for overdrafts that did not reflect the incremental credit risks would be likely to distort competition, and reduce the availability of unplanned lending.

2.24 The value of an unplanned overdraft to a customer is the ability to make payments when a customer has no funds. This value is independent of the planned limit a customer may have. LBG therefore believes this is better reflected in a daily charge and not an interest payment on the whole overdraft balance.

2.25 The suggestion to cap fees as a percentage of balances confuses high effective interest rates with high levels of charges. With daily charges customers pay fees that are proportionate to the value they receive for the ability to make payments without agreeing a credit facility. However, when these fees are measured as a proportion of balances, they may appear high relative to other forms of lending for which the value to the customer is related to the size of the balance. For some customers, unplanned overdraft fees are a low proportion of the balance held.

2.26 Price caps can become a focal point for pricing in competitive markets. For unplanned overdrafts, moving to an interest-based charge of 0.8% could actually increase costs significantly for the heaviest overdraft users as those with the highest credit balances would pay more than under a daily charge. Customers with no planned limit and a £20 excess would only pay 16p for the ability to make payments without funds. This significantly undervalues this service and therefore risks providers limiting this service or removing it from certain products.

Prohibition of returned item fees would reduce differentiation and incentives to switch

2.27 The Which? proposal singles out returned item fees for prohibition. There have been problems with the level of returned items fees in the past, with the OFT finding an average charge of £34 in 2007. However, this has fallen significantly since then as providers have changed their overdraft pricing structures. The OFT found that the average was £14 in 2011, and today this is under £7.[9] Returned item fees for the lowest income basic bank account customers are already being phased out from this month.

2.28 Some providers, such as Halifax, HSBC and Co-operative Bank, have also stopped charging unpaid item charges altogether. Other providers and brands may choose to do so as the behavioural and CMA remedies give customers more control of overdraft usage and make costs more transparent and comparable.

2.29 Prohibiting returned item fees would not change how competition works, but would remove the incentives for providers to differentiate and for customers to switch providers. This would undermine the effectiveness of the CMA's other remedies, particularly for overdraft customers. It is not clear why returned item fees should be singled out in this way, compared with other PCA charges. Competition, reinforced with behavioural and the existing CMA remedies, should be allowed to continue to work to reduce returned item fees.

RBS's suggestion of opt-in could be trialled, but there are likely to be significant unintended consequences for customers

2.30 Customers already have the ability to opt-out of unplanned overdrafts by opening a Control Account. However, take-up of this opt-out has been low. LBG has previously researched why customers value the ability to make unplanned payments. Mostly this was to avoid embarrassment or to prevent ongoing issues with service providers. The research found different views depending on a customer's position within the credit cycle. Those in credit appreciated the discretion exercised over making payments, whereas customers in arrears wished, with hindsight, that they had requested more control.

2.31 Many customers understand the financial costs and consequences of missed and late payments. Many service providers and utilities charge missed payment fees, or will remove direct debit discounts if more than two payments are missed in a twelve month cycle. This can have a knock on impact for credit ratings. Therefore, customers value the ability to use an unplanned overdraft to avoid the consequences of late payments. If customers do want the ability to make payments that would take them into an overdraft

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9 This is an estimate calculated using data on unpaid items in table 7.1 of CMA provisional findings, and applying provider market shares.

without incurring fees, then products such as packaged accounts or Club Lloyds offer interest-and fee-free overdrafts.

2.32 RBS has proposed that customers do not automatically have access to unplanned lending. Instead, customers would need to opt-in and, in doing so, RBS believes customer understanding of charges would improve.

2.33 LBG expects that such an opt-in would leave many customers without an unplanned overdraft when they need it, and that customers would subsequently opt-in to avoid this situation the next time. This would mean that many customers would be worse off than under the current opt-out approach. The heaviest users of unplanned overdrafts are likely to be those that do opt-in and so would not be successfully targeted by this remedy.

2.34 There is nothing that prevents RBS from trialling this approach. Key metrics should include take-up of the opt-in, customer understanding of unplanned overdrafts and the effect of payment difficulties for customers that do not opt-in. If the evidence shows this approach to be effective, without customer detriment from missed payments, then it could be considered as a remedy. However, without the evidence, the risks of unintended consequences of applying this across the industry would be very high which would make such a remedy disproportionate.

The CMA's remedies can address issues faced by unplanned overdraft users

2.35 These are clear reasons why price regulation and prohibition are ineffective and disproportionate tools to tackle the concerns regarding unplanned overdraft fees. The alternative remedy suggestions for regulation put forward by Which?, FCSP and RBS, although well-intentioned, will dampen and distort competition, and do not target those high usage customers with most to gain (who do not already have their fees suppressed).

2.36 The right way to address concerns about customers that incur high unplanned overdraft fees is to **give customers better tools** for controlling unplanned usage and to help customers in financial difficulty as part of being a responsible lender. The CMA's original list of proposed remedies (set out in the Remedies Notice of 22 October 2015) will go a long way to addressing issues for unplanned overdraft users.

2.37 The following set of remedies will help to address concerns about high unplanned usage:

(a) Remedies set out in the CMA's Remedies Notice of 22 October 2015:

(i) **Prompts for comparison (remedy 1):** Prompts that are targeted at customers with high overdraft usage could be trialled to identify which are most effective for engaging customers, both in how they use their account and in the alternatives available.

(ii) **API-enabled comparison (remedy 3):** Improved comparison tools, based on APIs, will help customers quickly and easily identify those providers with lower overdraft fees.

(iii) **Overdraft eligibility checker (remedy 7):** LBG supports this concept and has already started testing a version.[10] As this first version did not have the desired impact of increasing account opening, analysis of results are being incorporated into improvements for the next iteration.

[10] See LBG trials data submitted to the CMA.

(b) Additional remedies for consideration:

(i) **Target trial programme at unplanned customers:** The CMA's gains from switching analysis found that most customers would gain by less than £36 per year from switching, but that a small number of customers have potentially large gains. The CMA's trial programme should focus on developing solutions to the particular problems of managing overdraft usage, comparing products and switching for these customers.

(ii) **Opt-in to text alerts:** Customers should be opted-in to low balance and overdraft alerts. Text alerts have been shown by the FCA to reduce fees by 5 to 8%,[11] and in LBG's own trials reduced fees by [5-10%].[12] In combination with other remedies and tools, LBG would expect these effects to grow – the FCA found that text alerts in combination with mobile banking reduced fees by 24%.[13]

(iii) **Availability of planned limits:** Customers that regularly use unplanned overdrafts should be targeted with information about how they can increase their planned limits. LBG trialled such a remedy and found that when a text alert was used to communicate this option to customers with an existing planned limit, there was a [40-50%] uplift in customers changing their limit.[14] LBG would expect repeated messages to have a cumulative effect on the target groups, and different ways of communicating and engaging customers with this message can be trialled to identify the most effective combination.

(iv) **API-enabled 'credit passports'.** Adoption of APIs will also enable sharing of transaction or other data that allows new providers for switching customers to make more accurate credit assessments (see below).

11 FCA Occasional Paper No.10.
12 See LBG trials data submitted to the CMA.
13 FCA Occasional Paper No.10.
14 See LBG trials data submitted to the CMA.

3. REMEDIES TO ENHANCE COMPARISON AND SWITCHING

3.1 Remedies to help improve engagement, including Remedy 1, have the potential to improve outcomes for the group of unplanned users, as well as other groups, and should be included within a programme of trials. Care will be needed in designing how the communication is presented, the channels that are used and how personalised information can be included. The effectiveness of any idea or approach to influencing customer behaviour can only be determined through a programme of trialling. It is not possible to second guess the effectiveness of these or other remedies.

3.2 Following a programme of trials, the CMA will then be able to specify which prompts are most effective at enhancing engagement. The CMA will need to specify clearly how these prompts should be implemented so that each provider can implement them to the same standard. LBG believes that it will be necessary for prescriptive regulation (for example, by way of an Order) to ensure that all providers meet these specifications.

3.3 This section sets out LBG's views on the Additional Remedies and the CMA's Remedy 1 questions on incentivising providers. LBG first explains the role of APIs and midata in helping to deliver these remedies.

midata is not required for remedies – APIs should be prioritised

3.4 There has been some confusion between the need for APIs and midata in responses from providers and in some roundtable hearings. This confusion is in danger of diverting attention from the need to accelerate the progress of APIs.

3.5 The confusion appears to be due to using the term 'midata' to describe different elements of what is required to improve comparison. midata is used to describe the following:

(a) the Government's midata programme, which aims to give citizens greater access to their data. PCA transaction data was one of the first areas the Government focused on;

(b) the spreadsheets containing transaction data which can be downloaded from a customer's existing bank;

(c) the existing comparison engines that use the downloaded spreadsheets to produce price comparisons for customers;

(d) the next generation of tools that will use APIs to access transaction data from a customer's existing bank. LBG has called this 'midata 2' and has built and demonstrated a prototype to the CMA.

3.6 To be clear, the original midata programme is not part of the solution to enhancing engagement. Due to poor governance, it failed to deliver the easy-to-use tool that is required for effective comparison of PCA prices.

3.7 LBG's midata 2 prototype is one example of the possible tools that would follow from developing world class API functionality in the UK. midata 2 does not require the existing midata spreadsheets, and is unlikely to be referred to as midata when taken to market (unless this is useful as a brand).

3.8 World class API functionality is a necessary and critical input to all of the CMA's remedies which involve 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 PCAs, it needs to change, if the risks of similar problems in implementation are to be avoided. 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.

TSB suggestion of 'credit passports' needs quick API adoption and not a centralised resource

3.9 LBG agrees with TSB's suggestion that making information on transaction history more portable will help customers to be offered credit on the same terms by new providers, where that would otherwise not be possible. The solution to this problem is not data sharing with a centralised resource, which would then control access to valuable data (credit reference agencies currently charge customers up to £15 per month for access to data on their credit history).[15] The solution to this problem is to adopt APIs for the sharing of PCA transaction data which would allow the new provider to access the required data. If a central resource is required for this solution, then this should be a shared resource with no charging. Credit reference agencies could provide this, but this should be on the condition that they are part of the midata programme to give free access to customers' own data (although still being able to charge providers).

3.10 This is why it is important for the CMA to set out and design new governance arrangements for APIs for current accounts to prioritise their development within 12 months. This will allow sharing of credit information, as well as create the ecosystem for financial technology firms and existing providers to develop PCA comparison and other tools.

Additional remedy suggestions

3.11 Additional suggestions have been put forward by TSB, Tesco, First Trust and Which?. Any of these ideas, and others that are suggested, may potentially be effective at enhancing engagement for unplanned users or other priority groups, either individually or collectively with other remedies. However, based on LBG's experience of the market and the effectiveness of previous remedies, some of these remedies are likely to be more effective than others. If the CMA or providers believe these suggestions can work, then there is nothing to prevent these ideas being trialled by those providers who support them.

Tesco suggestion of 'traffic lights' can be improved with API-enabled comparison

3.12 The Tesco traffic light proposal could have a positive impact, by prompting customers or helping them to compare products, 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. As the CMA has recognised in its analysis of pricing, a small number of representative profiles cannot be used to compare prices reliably.

3.13 A further development of this suggestion would be to incorporate the traffic light idea with API-enabled comparison. 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.

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15 For example, Experian charges £14.99 per month for access to a credit report. These credit reports are based on incomplete information and do not necessarily reflect what credit a customer would be offered by a provider, see Martin Lewis "What your credit score really means".

3.14 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.

3.15 These messages should be targeted at those customers with 'red' or 'amber' comparisons where they are likely to have the biggest impact. There is an opportunity cost for both providers and customers in receiving information that is less important – which may ultimately reduce engagement with subsequent information that is important. For the majority of customers that would gain less than £3 per month according to the CMA's analysis, there is a careful balance in sending such communications and reducing engagement in future messages.

Suggestions of monthly statements and notifications of charges are unlikely to be effective

3.16 TSB has suggested introducing universal, standard format monthly statements, which it considers would improve pricing transparency for customers and could help periodically to prompt them to take action. First Trust suggests a requirement to notify customers before deducting overdraft fees and interest.

3.17 Statements may be an effective prompt for customers. However, the FCA demonstrated the ineffectiveness of previous interventions to introduce annual statements.[16] The format suggested by TSB is too complex by including forgone interest. There is also no strong reason why repeating such statements at a monthly frequency is likely to be more effective. For most customers, monthly costs are low and the statements will crowd out other information that is more important – for example, leading to customers developing a habit not to open such statements and missing important information when higher charges are incurred.

3.18 The suggestion of notifying customers of charges before they are deducted is more targeted than a monthly statement. However, the effectiveness of such notifications, and monthly statements is unlikely to be effective in isolation. It will depend on how the message is communicated, which channels are used, and how easy it is to take action. These two suggestions can be trialled and TSB or First Trust could do this to provide the evidence as to whether such remedies should be taken forward. LBG has already implemented this remedy for customers outside Northern Ireland.

3.19 LBG trialled an improved annual statement with targeted information about what options customers could take to reduce their PCA costs. This had a mixed impact, with an increase in action taken by customers with high credit turnover switching to an alternative product, but no change in the behaviour of unplanned users. This demonstrates the need to test and learn and then trial different ways of prompting customers, including alternative channels.

3.20 Statements and notifications may prompt customers to compare the market, but they arrive after charges have been occurred, which for many customers is an irregular occurrence. Behavioural remedies can target customers before charges occur, such as opting customers into low balance alerts. Such behavioural prompts are better targeted and may be more useful for customers than statements and notifications.

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16 FCA Occasional Paper No.10.

Remedy 1 does not require an additional incentive scheme

3.21 This section responds to the 'questions for banks on remedies 1' ("Remedy 1 questions").

3.22 LBG strongly supports the CMA's Remedy 1, and has suggested ways in which this can be taken further through explicitly including prompts, such as low balance alerts, designed to help customers manage their accounts. Following a programme of trials, the CMA will be able to identify which prompts are most effective at enhancing engagement. The Prize Fund can also help to identify the most effective prompts in SME banking. These prompts may also best be delivered by third parties, such as formation companies for SMEs. The CMA will then need to specify clearly how these prompts should be implemented so that each provider does so to the required standard.

3.23 It will be necessary for regulation to ensure that all providers meet these specifications. As with existing requirements for communicating information to customers, if providers fail to deliver the required prompts, then the regulator must have the power to enforce the relevant requirements. There is no effective alternative to having this prescriptive process in place, to be available as a back-stop.

3.24 Providers may also be motivated to meet the requirements through other channels, and the CMA has suggested consumer awards, rankings of performance, and publicity. LBG agrees that these other channels can have a role to play, and may be more effective than prescriptive regulation alone.

3.25 The market is motivated to do this and better able to hold firms to account using these other channels. Organisations such as Which?, Fairer Finance and price comparison sites, as well as commentators (such as Martin Lewis) and the media, already provide awards and publicise information on the performance of financial services providers. These organisations have the capabilities to keep providers constantly under review and to engage consumers credibly with relevant information.

3.26 A regulator can assist these organisations by highlighting and responding to issues across the industry and in relation to individual providers. LBG would expect the regulator to review the effectiveness of Remedy 1 following its implementation and would welcome transparency, including the naming of individual providers that fail to meet the standards required. The combination of regulatory review and enforcement, together with the publicity associated with reports, and investigation by these consumer organisations, commentators and the media will be the best way to ensure that providers are incentivised to implement Remedy 1 effectively.

3.27 Elements of the CMA's proposals, including monitoring the effectiveness of the design and content of prompts as well as survey-based measures to assess awareness, may be used as part of a regulatory review or investigation by non-regulatory organisations or a journalist. How this should be done would be at the discretion of the regulator or other organisation and will reflect any emerging issues with implementation and other market conditions, as well as the need to incentivise improvement amongst one or more providers. Specifying in advance, in an overly prescriptive manner, how implementation should be monitored is likely to make any remedy overly complex and may be quickly out-dated.

3.28 The CMA's proposals also refer to "incentivising banks to participate in evaluating the effectiveness of different prompts, for example through lab and field trials (RCTs)". LBG does not expect there to be a problem in the willingness of providers to participate in a trial programme and understands that the CMA has had offers of support from several providers. There is already a strong motive for each provider to be part of such a programme and to contribute to the design of the eventual remedy. It is not necessary for all providers to take part in trials, although there are good reasons to have wide coverage and include smaller providers, as different offers tend to attract different customer groups. In addition, there should be a fair and proportionate distribution of the costs involved. If required, the CMA could determine which banks will provide a representative sample for trial and mandate their involvement.

3.29 LBG's comments in this note therefore focus on providers' incentives to implement the final specification of Remedy 1 effectively. Even so, the CMA's questions suggest that the CMA may be considering a version of Remedy 1 which gives providers considerable scope to develop their own prompts, rather than a mandated trial programme leading to specific remedies to be implemented across the industry. Moving away from a well-designed, regulator-led trial programme will introduce delay, make comparison and assessment difficult and considerably weaken the expected impact of Remedy 1. LBG would therefore request clarification as to whether the CMA does have this in mind and, if so, would wish to comment further on the implications if such an approach were contemplated.

3.30 The focus of Remedy 1 should be for providers to prompt customers about the costs of their product, and how to change their behaviour to reduce such costs. However, some of the CMA's questions relate to Remedy 2 and the **need to increase awareness of switching and CASS**. The CMA suggests that providers could be assessed on their effort to raise awareness amongst their own customers (e.g. question 1(d)(ii)). LBG believes that the focus of Remedy 2 **should be an industry-wide, coordinated and brand-agnostic programme**. This will ensure there are consistent messages and avoid the potential customer confusion from receiving different messages from different providers. To be effective, this will require a change of governance - the core expertise of Bacs means that 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.

3.31 The CMA's proposals for Remedy 1 include both mechanisms for monitoring implementation and techniques for holding providers to account. LBG comments on these different elements below.

Mechanisms for monitoring implementation

3.32 The need for a monitoring process will depend on the complexity of Remedy 1. It may be that the most effective prompts identified through trials are relatively simple and therefore monitoring implementation would be straightforward, not requiring detailed regulatory review or the added complexity of the CMA's incentive proposals.

3.33 The CMA proposes two mechanisms for monitoring implementation – approval of a consumer challenge group and a ranking based on a customer survey of engagement.

Approval of a consumer challenge group

3.34 It is not clear why such a group would be required, and it would be very difficult to constitute a group that is capable of successfully monitoring the design and content of prompts.

3.35 Analysis of the trial results will show which approaches are most effective at changing customer behaviour. The best prompts should then be specified for all providers to implement. Providers should be able to monitor implementation of the prompts against this specification, as they do with current regulations on customer communications, and face enforcement risk if they are not complying. A consumer challenge group would be superfluous to this process and would not be as well placed as the regulator to assess implementation against this specification.

3.36 If providers were to be given more scope to develop their own prompts, then a consumer challenge group would require significant behavioural research capability to monitor design and outcomes across a large number of providers. This could not be done effectively without an industry-wide programme to identify best practice through trialling (which should be the starting point for the design of Remedy 1).

Objective ranking of providers' efforts to engage customers

3.37 Developing prompts through a successful trial programme will require objective measures of the success of these prompts. These should be behavioural measures, such as the propensity to change product, reduce overdraft fees, or encourage switching, with comparison of the outcomes for different treatment groups with a control group. These are the only relevant measures for identifying the effectiveness of prompts, where the behaviour of customers with the most to gain should be the primary focus.

3.38 Without a control group, the objective measures suggested by the CMA may be largely driven by underlying factors such as age and demographics of each provider's target segment. For example, newer providers will, by definition, have customers who have switched recently and so will have more experience of CASS and other tools. If all providers are implementing Remedy 1 as specified, then differences between providers are more likely to be driven by these other factors than relative performance with the prompts. It would therefore be unclear how the relative performance of different providers could be interpreted, and it would be misleading and unscientific to use these metrics as the basis for any ranking, awards or sanctions.

3.39 The different underlying factors would mean that it would not be possible to hold each provider to the same specific targets for determining the effectiveness of prompts. A low score may indicate that standards for Remedy 1 are not being met, but this would require further investigation to explore whether this was due to poor implementation or some other factor. This is why such monitoring needs to be undertaken as part of a wider review, where a regulator has discretion to weigh evidence from such survey-based scores against other criteria. The most important criteria should be whether a provider is meeting the specification for Remedy 1.

3.40 If providers were to be given more scope to develop their own prompts, then the objective measures used should be the effectiveness of a treatment compared with a control. The survey-based metrics suggested by the CMA may lead to the wrong types of remedies that can boost these metrics but do not change behaviour. This is why it is important for remedies to be tested and designed through an industry-wide programme of trials, and not left to individual providers to design.

Techniques for holding providers to account

3.41 The CMA has proposed three techniques for holding providers to account based either on the approval of a consumer challenge group or on survey-based outcome metrics.

Awards used in marketing and promoted through nationwide advertising campaigns

3.42 Award schemes are best left to the market to deliver and advertise. If an award scheme can help to engage or interest customers, then providers will work with consumer organisations to deliver it. Consumer organisations may also develop award schemes without the involvement of providers if they believe they are important to consumers. If neither providers nor consumer organisations support an award scheme relating to Remedy 1, then it is unlikely to be used by providers in their marketing, even if participation in the award scheme is mandated by a regulator.

3.43 A nationwide advertising campaign relating to an award scheme regarding prompting is unlikely to be effective without a significant investment from the industry. It would need to be justified by evidence of the effectiveness of such an award scheme in customer decision making, which could be tested as part of the trial programme (such as by measuring its impact on decision making in a behavioural laboratory). The opportunity cost of this advertising would also need to be considered alongside the need for more effective marketing of CASS, and the likely increase in advertising from API-enabled comparison tools. A regulator-mandated advertising campaign for an awards scheme per se is likely to be ineffective and disproportionate.

Require banks that fail to meet targets to publicise to customers their ranking position

3.44 For the reasons explained in paragraph 3.38 above, it is unclear how meaningful targets could be set given the underlying drivers of any survey-based metrics. Such targets are also a misleading and an unscientific means of assessing how effectively providers implement prompts.

3.45 LBG considers that this is likely to be ineffective, in particular if the sanction for failing to meet such targets took the form of a requirement to communicate this to customers with the expectation that they would take action individually. This is especially the case where providers that are failing to meet the specification of Remedy 1 will, by definition, have a poor track record of communicating information to customers. Such information is likely to be very difficult for customers to interpret and respond to.

3.46 Finally, it is not clear why further sanctions should be applied for a failure to meet targets, if the provider has met the specification of Remedy 1. If a provider fails to meet the specification of Remedy 1 then it should face enforcement action.

Making participation in a Prompting Remedy an integral part of their participation in CASS

3.47 Participation in Remedy 1 should not be optional. The requirements should be incorporated into regulation and providers should face enforcement risk if they do not comply.

3.48 LBG considers that the withdrawal of participation in CASS as a sanction for failing to meet the required standards of Remedy 1 would harm customers. Any reduction in the number of providers participating in CASS will decrease customers' ability to switch. Such difficulties have a disproportionate impact on wider perceptions as they are shared between customers and by the media. Cumulatively, this would undermine the perceived ease of switching precisely at a time when the industry should be increasing awareness of this.

LBG's response to other CMA Remedy 1 questions

Question 2a – What specific targets should be applied initially?

3.49 See paragraph 3.39 above.

Question 2b – How much time should be given?

3.50 It is not possible for LBG to comment at this stage. The time required to meet standards will depend on what prompts are required and how quickly any changes can be implemented given constraints with existing processes and technology.

Question 3 – what exceptions should there be?

3.51 There is no reason for any provider not to implement Remedy 1. However, smaller providers may not have the resources to take part in a trials programme.

4. OTHER REMEDIES

4.1 LBG wishes to comment on two further remedies. In both cases, there is no clear link to the problems identified by the CMA. These are:

(a) the suggestion from Virgin Money that providers should be required to pay credit interest (included in the Additional Remedies); and

(b) the suggestion from Nationwide that a structural remedy, such as a divestment, may be needed.

Virgin money proposal for all providers to pay credit interest

4.2 Virgin Money proposes that providers are required to pay their customers credit interest on PCAs at or above a minimum level. It is not clear what the rationale is for this proposal or what problem such a remedy is trying to solve. Moreover, there would be significant unintended consequences.

4.3 Virgin Money thinks that a move away from the free-if-in-credit ("**FIIC**") pricing model is required. It highlights the Santander 123 product, which pays credit interest and has a monthly fee, as an example of the market moving away from FIIC and towards "reward" accounts. Virgin considers that requiring providers to pay credit interest "*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*". This appears to suggest that Virgin Money would prefer an outcome where there are more products paying credit interest (without balance limits) and a monthly fee.

4.4 There are several serious concerns connected with such an outcome:

(a) **It would remove existing differentiation in the market:** The market is already providing "reward" accounts that offer a monthly fee and pay credit interest, including Santander 123, Club Lloyds and Barclays Blue. There are also some products that offer credit interest and do not charge a monthly fee, such as Nationwide FlexAccount and Tesco Current Account. Requiring all providers to pay credit interest will remove an element of competitive differentiation offered by these products and prevent further differentiation and innovation in the market. This would dampen levels of engagement and switching to these products.

(b) **It would dampen competition from entrants:** In the Competition Competition's ("**CC**") 2002 market investigation of SME banking, a form of price regulation was introduced for a transitional period. The CC specifically rejected a requirement to pay credit interest as being anti-competitive. However, to encourage greater product differentiation in the market (which already exists in the PCA market), the CC required providers to choose whether to:

(i) provide FIIC to SMEs without interest paid; or

(ii) charge for accounts, and then pay interest. In this case, providers were required to pay credit interest at 2.5% below Bank base rate.

4.5 The remedy was only intended to be in place for a transitional period to encourage greater product diversity in SME banking. In its later review of these undertakings, the OFT found that:

> "*All three of the main challenger banks (Abbey, Alliance & Leicester and HBOS) argued that they had been hindered by the transitional undertakings*:
>
> > *'The transitional undertakings have hindered Alliance & Leicester's ability to gain market share and compete on price in the market for SME banking services.'* – Alliance & Leicester
> >
> > *'Price control has, in our view, hindered new entrants' including HBOS's ability to gain market share.'* – HBOS
> >
> > *'The transitional undertakings have not helped Abbey to grow business.'* – Abbey
>
> "*Other smaller banks have also made similar arguments. For example, AIB argued that 'If anything, the undertaking…has probably hindered our ability to gain market share and/or compete on price/service by removing some of our competitive advantage*".[17]

4.6 The OFT recommended that providers were released from these undertakings because of the costs of these distortions in competition. Such distortions would be expected in the PCA market if this remedy was imposed, and would not have the benefit of introducing product differentiation which already exists.

(a) **It does not make comparison easier:** Introducing a monthly fee, alongside credit interest rates and overdrafts does not make it easier to compare products. Customers will still require API-enabled tools that can access information about account usage to allow them to make comparisons.

(b) It would be **complex to design** with some providers offering non-interest based rewards, such as Halifax Reward £5 per month and cashback.

(c) **Prices rebalance towards overdrafts and reduced credit interest on other products:** As Which? recognises, given there are no excess profits, competition would force prices to be rebalanced with increases in overdraft fees, the introduction of monthly fees or reductions in higher credit interest rates. Customers that do not have credit balances would be likely to lose out from this remedy. The CMA would need to judge whether this different distributional outcome is preferable to the existing outcome.

4.7 For these reasons, LBG is strongly against this proposal and submits that it would be an ultimately ineffective and disproportionate remedy. LBG believes that the CMA's existing remedies will enable more engaged customers to use better comparison tools. These tools will allow customers to compare the value of existing 'reward' products in the market. In this way, the market is likely to move to a new mix of products including reward and other product innovations, introduced by providers seeking to differentiate themselves across all pricing dimensions unrestricted by regulation.

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17 OFT (2007), *SME Banking: Review of the undertakings given by banks following the 2002 Competition Commission report*, paragraphs 5.69 and 5.70.

Structural remedies are not the solution to any concerns

4.8 In its response to the Provisional Findings and Remedies Notice, Nationwide argued that existing providers had a scale advantage from having high market shares and large back books. Nationwide suggested that a structural remedy, such as a divestment, would be a solution to this problem.

4.9 It is not clear what scale advantages that Nationwide is referring to nor why a divestment would resolve such problems. Analysis in the CMA's data room, conducted on behalf of Nationwide, found that the gains to switching for 'back book' customers were larger and that customers with larger banks were less likely to switch. It does not follow that larger providers have an advantage. PCAs are a relatively small source of funds for providers, and the savings market, in which Nationwide is one of the largest incumbents, are much more important in determining the cost of funds. Pricing for new customers is also not determined by existing back book customers – all providers must compete based on their expectations of the lifetime value of each newly acquired customer.

4.10 Any issues with existing customers paying higher prices can only be addressed by enhancing engagement. Moving such customers involuntarily to new providers does not alter provider's incentives to change pricing for existing customers or increase these customers' likelihood to switch. In addition, it could only be delivered at a very high cost and would cause considerable disruption for customers that are required to change provider.

4.11 As a result, a divestment remedy would be ineffective and highly disproportionate, and therefore has no justification.[18]

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18 As also set out in LBG's Response to the Remedies Notice.