(NON – CONFIDENTIAL VERSION)

TSB Bank plc

Responses to invitation to comment on additional remedy suggestions

Introduction & Overview

1. This response provides TSB's views on the CMA's invitation to comment on additional remedy suggestions (the "Additional Remedies") dated 18 December 2015. It follows TSB's response to the CMA's provisional findings report (the "Provisional Findings") and notice of possible remedies (the "Remedies Notice") published on 22 October 2015, in respect of its investigation into the retail banking market. TSB agrees that it is important that the CMA considers how its proposed package of remedies can be augmented to ensure they transform the competitiveness of the PCA and SME markets.

2. In its first remedies response, TSB proposed two further remedies to strengthen the existing remedies package – a standardised Monthly Bill for all PCA customers, and a Credit Passport. Of all the remedies being considered by the CMA, TSB continues to advocate these solutions as the two most effective and proportionate ways to deliver a sustainable change in customer switching behaviour, drive transparency in banking and thereby make UK banking more competitive. The Additional Remedies are primarily concerned with addressing the difficulties faced by PCA overdraft customers, and in particular those using unarranged overdrafts. They seek to protect overdraft users either by imposing price controls on the level of charges, or by increasing customers' awareness of the charges which will be applied to their account imminently and providing them with an opportunity to prevent this.

3. TSB believes that the most effective way to protect customers is to ensure that customers understand how their behaviour affects how much their account costs, to encourage them to consider alternatives and to ensure that they have tools to compare accounts and switch with confidence. Should overdraft users be more engaged, banks will more readily compete on the level of overdraft charges for the benefit of all consumers. TSB believes that its proposed remedies of the Monthly Bill and Credit Passport will go a significant way to enhance competition and hence are more proportionate remedies than measures such as price controls, which are not required to tackle the customer detriment deriving from a poorly operating market and could, in fact, lead to reduced competition and have other unintended adverse consequences.

4. In respect of increasing the transparency of overdraft charges, TSB is open to exploring how additional alerts, procedures or information could help customers manage their money and understand the value of their banking products. However, TSB remains convinced that the

most effective way to encourage engagement will be through the introduction of the Monthly Bill. By regularly informing customers of the cost of their account, customers will not only be able to quickly identify unexpected costs and modify their behaviour accordingly; they will also be able to understand better the true long-term cost of their pattern of account usage. This is in contrast to the Additional Remedies concerning prompting (considered below) which are more likely to facilitate only an immediate, short-term customer response to avoid the imminent imposition of a specific charge.

5. The subsequent sections of this submission are structured as follows:

   a. First, TSB explains why it believe its two proposals, the Monthly Bill and Credit Passport, are proportionate, effective responses to the problems identified in the Provisional Findings and can be delivered with relative ease and within a short space of time.

   b. Next, TSB provides a response as to why it believes price controls on overdraft charges will be ineffective at addressing the competition issues identified by the CMA and in fact may lead to adverse customer outcomes.

   c. Then, TSB comments on those Additional Remedies designed to encourage greater transparency and engagement in respect of overdraft charges and explains why the Monthly Bill and Credit Passport are better placed to do this.

   d. Finally, TSB comments on the other Additional Remedies suggested by Tesco Bank and Virgin Money.

The Monthly Bill and the Credit Passport

6. TSB believes that the Monthly Bill and the Credit Passport, alongside the existing remedies proposed by the CMA, are the most proportionate, practical method of engaging customers, encouraging switching and thus effectively fostering competition in the PCA market. As discussed at TSB's individual hearing with the CMA on remedies (the "Individual Hearing"), both remedies are necessary to ensure that not only are customers aware of the cost of their account, but also that they can readily access, assess and act on this information.

7. Banks appear to be the only major consumer service providers that do not provide customers with a periodic bill. TSB believes that it is essential that the industry create a Monthly Bill, in a clear standardised format that sets out the costs, charges and benefits of PCA products to customers. This will enable all PCA customers to regularly assess the true value of their PCA and how changes in their behaviour are affecting the overall cost of their banking. This in turn will improve engagement and prompt customers to use a comparison website such as Midata to compare the value of their PCA against others in the market. Transparency over costs will also enable customers to manage their account usage better.

TSB also contends that, because the Monthly Bill would be in a standard format, it should make it easier for comparison websites to structure cost comparisons between PCA providers' products in a format which consumers are familiar with.

8. The Credit Passport provides banks with more relevant and accurate historical transaction data than is currently available. This will make it easier for banks to assess an applicant's risk profile and affordability at the point of application or enquiry, therefore increasing the likelihood that a new provider will match an existing overdraft limit for customers whose underlying behaviour supports such a limit. The introduction of the Credit Passport will therefore address an underlying problem with the PCA market where many overdraft users feel "trapped" with their current provider, as they are unsure that their overdraft will be matched if they switch to a cheaper account; or they may have to wait three, six or even nine months (as transaction data builds up) before becoming eligible for a suitable overdraft – which for many consumers is unaffordable – since banks do not currently have enough data to make an informed decision earlier in the switching process.

Effective

9. TSB believes that the detailed costs and transaction information, provided in the Monthly Bill, in a readily understandable format, will promote sustained, meaningful customer engagement. It will be a kick-start for a change of consumer behaviour in retail banking. This will allow customers to manage the costs of their account better. It also solves one of the fundamental causes of customer inertia – as The Financial Services Consumer Panel (the "FSCP") highlights, currently, "how are consumers supposed to switch away from high prices when they do not know what they paying?"

10. TSB's own customer research indicates that there is significant appetite for the Monthly Bill from customers, with 60% of those surveyed being interested in the introduction of a standardised Monthly Bill that clearly explains the cost of their banking[1]. The same survey also found that a standardised Monthly Bill would prompt 43% of customers to review their current account services and shop around for a better deal. TSB views the Credit Passport as a crucial tool which will allow a customer, including an overdraft user, to complete the journey from understanding and questioning the value of his/her PCA to switching to another provider. TSB internal analysis shows that while heavy overdraft users make up approximately [redacted] of TSB's customer base, this segment represents only [redacted] of TSB's switchers out. Given that the CMA's own analysis shows that heavy overdraft users have the most to gain from switching, there is considerable benefit in ensuring that this part of the market is adequately served by the switching process.

Practicable

11. As mentioned in the Individual Hearing, the Monthly Bill can be integrated into the procedures by which banks already send statements, either digitally or physically. It could

[1] TSB, Survey of 947 TSB customers, (Nov, 2015)

form a summary front-page by which the customer can assess their current balance and the monthly cost of their account, behind which details of individual transactions can be found (similar to a mobile telephone bill).

12. Similarly, Credit Reference Agencies ("CRAs"), which TSB proposes facilitate the Credit Passport, already offer banks validated customer data, have established lines of communications with banks and are well-versed in keeping customer information secure. Although there may be alternatives to using CRAs, TSB believes that CRAs are likely to be the most secure and practical solution to deliver the Credit Passport.

Deliverable in a short time-frame

13. Banks already gather the data required to construct the Monthly Bill – it is simply a matter of presenting it in a different format and on a regular basis. While the exact form of the Monthly Bill would require further market research, TSB does not believe this would prove a significant impediment. Consumer research could take as little as a few weeks.

14. Given that CRAs already have the infrastructure to handle the customer's transaction data securely, the Credit Passport could likewise be implemented quickly.

Proportionate

15. The cost of introducing the Monthly Bill and Credit Passport to the industry will not be significant, given the points on practicality raised above. Since 43% of people find it difficult to make an informed choice when comparing accounts[2] and 35 million customers could be better-off should they switch,[3] any cost of introducing the Monthly Bill will also be more than outweighed by the clear and substantial benefits to all consumers of being able to understand the cost of their account and being provided with a regular prompt to look elsewhere.

16. Equally, in respect of the Credit Passport, TSB believes there is major benefit in opening up the switching process to overdraft users, who represent a significant and valuable part of the market – according to the CMA's own research, over of quarter of all PCA customers (28%) paid for an overdraft in the last quarter of 2014.

17. Additionally many more customers –TSB internal analysis indicates [redacted] of its customer base – have an overdraft limit marked on their account for re-assurance just in case they need it, even though they do not use the facility. Increasing the likelihood of matching overdrafts for these customers will further encourage switching. Particularly when viewed in the context

[2] YouGov, survey conducted for TSB – survey of2,019 respondents (Dec 2014)

[3] Figure based on TSB analysis. TSB estimates that there are roughly 45 million PCA customers in the UK. If, as the CMA has found in the “Provisional Findings” only 23% of these accounts receive interest or cash-back, then of these 45 million, around 35 million could get a better deal.

of a market in which providers collectively earn £8.7 billion a year, TSB's proposals are proportionate.

Additional Remedies imposing price controls on overdrafts

18. Both Which? and the Financial Services Consumer Panel ("FSCP") suggest price control remedies for overdrafts. Which? suggests that banks should be prohibited from differentiating their charging structures for arranged and unarranged overdrafts. The FSCP argues that unarranged overdrafts should be considered as a form of high-cost short-term credit and hence made subject to the price cap for such credit that was introduced by the Financial Conduct Authority ("FCA").

19. TSB believes that forcing one pricing model on the market is an unduly invasive measure that restricts competition and is unlikely to work in the best interests of all customers or improve competition.

Different charging structures between arranged and unarranged overdrafts are justified

20. TSB is supportive of helping customers to manage their money better, but TSB does not believe that controlling prices for unplanned overdrafts will lead to better consumer outcomes. TSB therefore disagrees with Which?'s suggestion that unarranged overdraft charges should not be higher than for arranged overdrafts. An unplanned overdraft, as compared to a planned overdraft, has a fundamentally different purpose and different costs associated with it:

    a. an unplanned overdraft is an emergency, temporary facility for a customer when he/she needs to make a specific payment from their account. This debt may not be as sustainable for the customer over long periods of time;

    b. a planned overdraft is a facility by which the bank allows the customer to borrow a small amount on a short-term, rolling basis up to pre-determined, affordable limit.

21. Unplanned and planned overdrafts, moreover also have different risk profiles, with customers significantly more likely to default on debt from unplanned overdraft usage (see further below).

22. In view of these important differences, TSB does not believe that it would be appropriate to prohibit differential charging for unplanned and planned overdraft usage.

Price caps could lead to the removal of unarranged overdrafts to the detriment of consumers

23. An unplanned overdraft has a different risk profile and cost for the bank. TSB's own analysis has revealed that, in the current charging structure, expected losses from unplanned lending are over [redacted] times higher than for planned lending. If the same rate was applied to unplanned borrowing as for planned borrowing, as Which? suggests, a likely outcome would be that banks would simply cease offering the service to customers as it would be uneconomic to do so. Even if this did not happen, the result with a uniform overdraft charging structure is likely to be a higher price, which as noted would be unfairly born by those customers who do not borrow on an unarranged basis. The FSCP's proposals to apply the high-cost short term credit price cap to overdrafts may also result in banks withdrawing this service from consumers.

24. As noted above, unplanned overdrafts are used in a very different way to planned overdrafts by customers. TSB's own analysis reveals that the majority of customers that do use unarranged overdrafts use them for a handful of days just once or twice a year, demonstrating the 'emergency' nature of their usage. Removing the option to use an unplanned overdraft would lead to significant negative consumer outcomes. While unplanned overdrafts should not be used for regular borrowing, they do provide a valuable safety net by which the bank covers important payments when the customer is in unexpected financial need – such as authorising a payment for a utility that is paid for by direct debit, where if it fails a customer would run the risk of being cut off from the utility service. Without this banking service, a customer could be put in further financial difficulty – for example, as well as resulting in cessation of supply, defaults on important payments lead to penalty fees, and could worsen the customer's credit record.

The Monthly Bill and Credit Passport will encourage changes in customer behaviour and foster competition on overdraft charges

25. TSB believes that the best way to protect overdraft users is to ensure that they understand how they are being charged and can react accordingly both by changing their behaviour in the short-term with their existing bank and by switching to another, more competitive provider. If banks were faced with the real prospect of losing these valuable overdraft customers, there would be more competition for their business, improving the terms and pricing of overdrafts.

Additional Remedies encouraging greater transparency and customer engagement in respect of overdraft charges

26. A number of the Additional Remedies aim to increase transparency and foster engagement of overdraft users. TSB welcomes any initiative proposed by the CMA to increase transparency so that customers can change their behaviour and reduce the cost of their account usage, but remains convinced that the Monthly Bill is the most effective method of helping customers understand how much their account truly costs.

27. First Trust Bank has suggested a UK-wide extension of the requirement of the Northern Ireland PCA Banking Market Investigation Order 2008 (the "NI Order") to provide customers with relevant information including information about overdraft charges and interest. Although it may be sensible for the CMA to explore whether these proposals should be adopted across the UK to the benefit of customers, they are unlikely to make a material difference to competition. Many of the elements of the NI Order are already adopted by banks across the UK. TSB already pre-notifies customers of overdraft charges and interest, and for customers who use the switching service TSB does not charge overdraft interest for the first three months. However, the more fundamental issue is that customers are unlikely to be able to switch their overdraft to the same level as they have with their existing bank, which these remedies would not help address.

28. Lloyds Banking Group ("LBG") has suggested additional remedies aimed at encouraging customers to engage more with how they use their accounts so that they may reduce their PCA costs, regardless of whether they switch provider – e.g. opt-in balance alerts. The CMA noted that prompts to overdraft users could also offer the customer the opportunity to avoid charges – e.g. grace periods before the charge is applied, requirements to pre-authorise the charge and the ability to automate or trigger the transfer of funds from a nominated account. Many of the proposals outlined by LBG are already common practice in the market but TSB would be open to exploring their ideas further, as they may be useful to consumers. However, while certain prompts or procedural steps may prevent customers from incurring fees in the short-term, TSB believes that the richer information provided via the Monthly Bill will foster more meaningful customer engagement, encouraging customers to change their behaviour on a longer-term basis.

29. TSB considers that the other proposals noted in the CMA's Additional Remedies paper aimed at increasing transparency and customer engagement may only have a limited positive effect and be unworkable in practice.

30. TSB believes that there is merit in exploring remedies to improve customer understanding over the fees and charges that they pay, particularly in relation to overdrafts. There may be some merit in exploring Which?'s suggestion to provide customers with clear information about "when they will and will not authorise payments that cause a pre-arranged limit to be exceeded". However, any benefit from this approach needs to be considered alongside the

fact that this information is likely to change on a regular basis, based on the evolving credit profile of customers and could therefore be misleading.

31. The Royal Bank of Scotland has suggested that banks should be prohibited from providing unarranged overdrafts unless a customer has actively opted in to this in order to make the cost of borrowing more transparent. TSB believes that there could be some merit in an "opt-in" approach but a number of considerations need to be taken into account. For example, as the CMA's own research indicates, customers rarely accurately predict the level of their overdraft use and there may be risk that customers "opt-out" of this service when they may benefit from it and experience hardship without it.

Other Additional Remedies

32. Tesco Bank has suggested requiring a standardised labelling approach for PCAs, using traffic light colour coding to make it clear to customers both the cost of their account, and how it compares to others in the market. TSB views a traffic light labelling system as too simplistic a measure to offer genuine value since different prices will mean different things for different customers. For example, with overdraft customers, whether or not an account is "cheap" or "expensive" is heavily scenario dependent on their overall usage pattern and so the labelling system may not reflect what is best for the customer in the long-term.

33. Further, there is a potential risk that banks could end up pricing specifically to look good on the scenarios in the traffic lights, which again may not be in the best interests of customers. Competition could be skewed towards the three aspects of the account shown in the 'traffic lights' – to the detriment of other important metrics which customers value, eg service quality, or other charges which are not reflected in the traffic light labelling.

34. The Monthly Bill, in conjunction with an enhanced Midata, however, will give customers a far richer picture as to the value of each customer's account by providing a concise overview of all the costs and benefits (e.g. cash-back schemes) of the account based on their monthly use. Without such a holistic view, customers will be unable to assess the true value of their account. For example, they will be unable to calculate whether the benefit of their cash-back scheme outweighs the costs of their planned overdraft and/or their low credit interest rate. Furthermore, in respect of credit interest, the Monthly Bill better quantifies the true cost to the customer by providing an interest foregone figure.

35. Virgin Money has suggested that PCA providers should be required to pay their customers credit interest on PCAs at or above a minimum level. As noted by many respondents to the CMA's investigation, different customers value different aspects of their PCA. For example, the emergence of Metro Bank shows that certain customers value branch availability over and above credit interest or cash-back. As such, TSB believes banks should be left free to compete on a range of measures, one of which being payment of credit interest, so that

customers can have a variety of PCA offerings from which to choose the account that best suits their particular needs.

Conclusion

36. TSB shares the CMA's concern that overdraft users have the most to gain from switching and yet are the least likely to switch. However, TSB believes that suggestions by some interested parties to address this by imposing price caps are misplaced – and risk failing to address the most fundamental aspects of the problems in UK retail banking: that is, to remedy the underlying information shortfall and inability to make comparisons between providers which is the root cause of the lack of competition in these markets.

37. In order to facilitate meaningful behavioural change and instigate long-term, sustainable competition on the level of overdraft charges, and more broadly across the market, customers should be informed of what their banking is costing on a regular basis and be given the tools which will allow them to switch to a new provider with confidence.

38. TSB believes that the Monthly Bill and Credit Passport, alongside the CMA's existing package of remedies, are the best way to achieve this.

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