CMA Retail banking market investigation

Nationwide's comments on Lloyds Banking Group's response to the CMA's PCA pricing analysis

1. Introduction

1.1 On January 18th 2016, Lloyds Banking Group (**LBG**) submitted a document (**'the Paper')** to the CMA outlining LBG's verification of the CMA's personal current account (PCA) pricing analysis (**'the CMA Analysis'**) and the results derived from an alternative approach.[1] In this document, Nationwide sets out its comments on the Paper, in addition to a number of areas that the CMA should consider going forward.

1.2 The CMA contracted Runpath Limited (**Runpath**) to compute PCA prices on the basis of aggregated monthly transaction data, which was submitted by providers to the CMA.[2] Runpath's results allowed the CMA to estimate how much each customer in the sample would have been charged by different providers (the "price") at a point in time, according to his or her own personal banking behaviour. These estimates were then aggregated to obtain average prices for each provider's products, brand and group, where the average price for each brand and group were weighted based on the number of customers using each product and brand, respectively.[3]

1.3 Nationwide notes that insufficient detail has been provided in the Paper to enable it to comment fully, and Nationwide looks forward to the opportunity to comment further, once additional details on the LBG and revised CMA Analysis are made available. Nevertheless, Nationwide considers that there are three key points which the CMA should consider in relation to LBG's analysis, and any revised analysis that the CMA conducts.

(i) The methodology and assumptions used by LBG appear in some cases to be incorrect.

(ii) LBG does not present a full breakdown of its results. As such, it is not possible to ascertain what is driving the differences in results (relative to the CMA Analysis).

(iii) LBG's own analysis supports the CMA's conclusion that LBG tends to have higher prices overall.

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1 This was initially presented in Appendix 5.4 to the Provisional Findings report in the Retail Banking market inquiry. Lloyds Bank's submission was published on the CMA's website on January 22, 2016. On January 22, 2016 the CMA also published a notice of intention to revise its pricing analysis.

2 The same transaction data was also analysed by Runpath to assist the CMA with the gains from switching analysis. See Appendix 5.4 of the Provisional Findings Report.

3 Appendix 5.4 (4-12) of the Provisional Findings Report.

We discuss each of these points in turn below.

2. The methodology and assumptions used by LBG appear in some cases to be incorrect

2.1 In seeking to verify the CMA Analysis and put forward an alternative approach, LBG modifies the CMA's methodology in three ways which Nationwide considers to be flawed:

(i) It uses disaggregated transaction level data[4] on 18,000 LBG customers to identify customer account behaviour, in order to compute the relevant prices of other providers.

(ii) It averages prices for each multi-product provider based on the account a customer is "most likely" to choose, and compares average prices by segments which differ to those used by the CMA.[5]

(iii) It updates account terms to reflect some, but not all, of the changes in the market since the publication of the CMA's provisional findings[6], and removes indirect price benefits.[7]

2.2 Using transaction data instead of aggregated monthly data should allow prices to be calculated more accurately. In addition, segmentation of customers by credit balance and credit turnover may be useful given the potential product and customer mix effects that could stem from taking simple averages when comparing across providers. However, a ranking of providers based solely on price (excluding indirect price benefits) does not take into account other important factors, such as quality of service, which has been shown to be an important factor for customers' choice of provider.[8]

2.3 LBG notes that a sample of 18,000 LBG customers is representative of the underlying customer mix,[9] and as such, the Paper estimates prices for other providers on the basis of LBG customer account usage. It is not clear that this assumption has been verified,

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[4] LBG states that the inclusion of transaction data allows LBG to, for example, more precisely account for overdraft balances at the customer level and to include indicative levels of cashback and foreign transaction charges.

[5] See Paragraph 1.18 of the Paper, which states that LBG segments customers based on credit balance and credit turnover rather than the CMA's segments of credit turnover and number of direct debits.

[6] See paragraph 2.16 of the Paper, which states that prices were updated for Santander and RBS, but other recent price changes such as those for the Co-operative are not taken into account and the prices remain unchanged from the CMA's price assumptions.

[7] See paragraphs 2.17 to 2.18 of the Paper.

[8] The Gfk PCA Survey found that "93% of customers are very or fairly satisfied with the quality of staff and customer service, which was rated the most important element of a PCA."

[9] See paragraph 1 of annex 2 to the Paper.

nor that it is appropriate.[10] As noted by LBG elsewhere in the paper,[11] the product offering of each provider may be targeted at different customer groups, which if true, would imply that LBG customers are not representative of the customers of other providers.[12]

2.4 Nationwide considers that the weighting relied upon by LBG is flawed. LBG uses weights based on customers' likelihood of choosing a PCA product most appropriate for them given their current PCA usage pattern, rather than using weights based on the actual PCA products which customers are currently on at each provider. In our view, this assumption is not consistent with the objectives of the CMA Analysis. The purpose of the CMA Analysis is to report estimates of historical average prices[13] across PCA providers not to provide a price comparison for customers as if they were switching to the most appropriate PCA for them based on their current PCA usage.

2.5 Furthermore, updating for some, but not all, recent price changes is problematic. As explained further below, Nationwide has been unable to verify whether these changes have a material impact on the results, or if in fact the most significant change is the move from monthly to transaction data.

3. LBG does not present step-by-step results so it is unclear what is driving the differences in results

3.1 The Paper presents the final results of average prices across providers which include the impact of all of these changes. It does not provide a step-by-step comparison of how each of its methodological changes affect the relative average prices and ranking of providers.[14]

3.2 There are a number of assumptions and changes to the methodology which Nationwide believes are inappropriate, reducing the robustness of the results and, accordingly, any weight which can be placed on the results.

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[10] However, the Paper does note at paragraph 2.5 that "only the CMA can use a sample that is representative of all segments in the market".

[11] For example, see paragraph 1.6 of the Paper which highlights the fact that some PCA providers may not target certain customers or segments when putting forward the justification for analysing prices on the basis of narrower segments.

[12] For example, customers on the Santander 123 account can earn in-credit interest on balances up to £20,000, compared to £5,000 for the Club Lloyds account. It could therefore be the case that Santander attracts a much higher number of PCA customers with in-credit balances of over £5,000.

[13] Including, for example, the prices currently being charged to those customers on retired accounts.

[14] Although LBG does provide a comparison of the absolute difference in monthly cost between the monthly data and transaction data by brand (Table 1 of the Paper), these prices do not include indirect effects such as travel insurance so they are not directly comparable for some PCAs. In addition, they use the customers from LBG, which LBG states "will affect the results." It is not clear whether this comparison also includes the price changes for certain accounts, which would also affect the results.

3.3 We also note that the Paper suggests LBG's advisors have made a number of manual changes to the Runpath results, the materiality of which is not discussed.[15]

4. LBG's own analysis supports the CMA's conclusion that LBG tends to have higher prices overall

4.1 LBG's final conclusion set out in the Paper is that the CMA must withdraw the conclusion that LBG tends to have higher prices.

4.2 However, we note that LBG ranks 15 and 14 in each of the segments < £1,500 CTO/< £3000 credit balance and £1500+ CTO/< £3000 credit balance, respectively. According to Table 4 of the Paper, these segments account for the majority of LBG's customers, namely between 60% and 80%.

4.3 Accordingly, on the basis of its own analysis, LBG is still the highest, or close-to-highest priced provider for the majority of its customers, supporting the CMA's conclusions.

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[15] The Paper, Appendix 2.