LLOYDS BANKING GROUP

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CMA RETAIL BANKING MARKET INVESTIGATION

Response to Corporation Tax Surcharge and Bank Levy Working Paper

9 March 2016

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1. The Corporation Tax Surcharge ("**CTS**") and Bank Levy Working Paper (**"Working Paper"**) considers specific concerns expressed by building societies and smaller banks in relation to the 2015 budget changes to the tax regime for banks and building societies.

2. The CMA has correctly acknowledged that taxation policy is a matter for government and Parliament, and that the bank levy pursues wider macro prudential and fiscal policy objectives, which are outside the scope of the Market Investigation.[1] Moreover, the 2015 budget changes were aimed at ensuring international competitiveness and ensuring a sustainable model for raising revenue from the banking sector.[2] However, the CMA retains a role in analysing whether the corporation tax surcharge and bank levy restrict or distort competition between providers in the reference markets.

3. If the CMA were to identify an AEC associated with the tax regime (e.g. by increasing barriers to entry), it should then consider how the AEC can be effectively and proportionately remedied, without the risk of unintended consequences. Accordingly, it is premature for the CMA to make recommendations to HMT in relation to the taxation of banks, particularly as it has found that "*the tax regime continues to favour smaller banks, including new entrants.*"[3] To the extent that any barriers to entry are identified as AECs in the Final Report, there may be more effective and proportionate means of addressing these (e.g. by remedies to increase customer engagement).

4. LBG agrees with the CMA's conclusion that "*there is no strong evidence at this time that the introduction of the CTS combined with the changes to the bank levy will deter entry or expansion or will result in banks exiting*".[4] This is entirely consistent with the CMA's Provisional Findings, which identified entry and expansion into the provision of PCAs and SME banking services, including:

   (a) seven providers entering the PCA market since 2004;

   (b) four providers entering the BCA market since 1999;

   (c) recent entry into the SME lending market, including by specialist lenders such as Shawbrook, Paragon Bank and OakNorth; and

   (d) 11 retail firms at the application or pre-application stage of becoming a bank that plan to offer current accounts to personal and/or SME customers.[5]

5. It is also clear that the budget changes have not hindered smaller and new providers from raising investment in recent months, contrary to the assertions of unnamed recent entrants.[6] For example:

   (a) Metro Bank, which raised £400m in its 7 March IPO, with its share price rising by 7.5% on the first morning of trading;[7]

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1 Working Paper, paragraphs 4, 8 and 79.
2 Working Paper, paragraph 19.
3 Working Paper, paragraph 86.
4 Working Paper, paragraph 81.
5 Provisional Findings, paragraph 10.262.
6 Working Paper, paragraph 72.

(b) Atom Bank, which received investment from Spanish bank BBVA of £45 million for a 30 per cent stake in November 2015, valuing Atom at c. £150m, before Atom had even launched to customers;[8]

(c) Mondo Bank, a smartphone PCA banking app which is yet to even obtain a banking licence. When it attempted to launch a crowdfunding round on 29 February 2016, the level of demand overwhelmed Crowdcube's servers, requiring the campaign to be temporarily paused.[9] On 3 March, Mondo relaunched its crowdfunding round and raised £1 million in just 96 seconds, to add to its existing £7m venture capital investment;[10] and

(d) Starling Bank, which is also yet to obtain a banking licence, announced that it had received a $70m investment on 11 January.[11] The Financial Times noted that "*Investors are drawn to new challengers for their high growth prospects and their freedom from the burden of old systems*".[12]

6. The Working Paper refers to limited evidence that the reduction in returns caused by the tax changes could reduce the ability of banks to finance investments in expansion (or the retention of existing customers).[13] However, even if the effect of the tax changes (which had wider policy objectives) is to reduce providers' expected returns, this is an external factor to the competitive process. It cannot amount to an AEC, absent a finding that the tax regime distorts competition between providers. It is also relevant that each provider will have its own expectations of return on equity, which in turn will impact its product pricing model. For example, LBG understands that some smaller providers have higher expectations, and outcomes, for return on equity than their larger rivals.

7. Moreover, it is clear that there continues to be significant investment by providers in the reference markets. The CMA has correctly found that "*there is a considerable level of innovation in the PCA market*",[14] and that, although innovation in SME banking has been less rapid, there have been a wide range of innovations, and the pace of innovation relative to PCAs "…*is likely to be explained, at least in part, by the size of the respective markets rather than any specific bar to innovation.*"[15]

8. In conclusion, the analysis underlying the Working Paper is a valuable contribution to the Market Investigation by clarifying that the tax regime and the recent changes do not have an adverse effect on competition. The CMA can now focus its resources on effectively remedying the provisional AECs it has identified, including by trialling and testing remedies.

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7 http://www.ft.com/fastft/2016/03/07/metro-bank-shares-up-by-7-5-on-first-day/

8 http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/12013069/Spanish-lender-BBVA-to-buy-30pc-stake-in-UK-bank-Atom.html

9 https://getmondo.co.uk/blog/

10 http://www.cityam.com/235956/mobile-challenger-bank-mondo-reaches-1m-crowdfunding-target-in-96-seconds-adding-to-7m-venture-capital-investment

11 http://www.cityam.com/232022/new-mobile-challenger-bank-starling-bank-gets-70m-investment-as-pinsent-masons-finds-38-per-cent-of-londoners-would-consider-using-payment-apps

12 http://www.ft.com/cms/s/0/9dba77a0-b796-11e5-bf7e-8a339b6f2164.html#axzz41xDFsolU

13 Working Paper, paragraph 75.

14 Provisional Findings, paragraph 5.130.

15 Provisional Findings, paragraph 6.124.