Santander UK plc

CMA Retail Banking Market Investigation

Response to Working Paper on the Bank Levy and Corporation Tax Surcharge dated 26 February 2016

1 Our Views on the Bank Surcharge

1.1 We have considered the working paper on the bank levy and corporation tax surcharge dated 26 February 2016 (the **Working Paper**), and the conclusions which the CMA is minded to draw.

1.2 We believe that the 8% surcharge on corporation tax for banks (the **Surcharge**) disproportionately affects smaller banks, including scale challengers such as Santander UK (**San UK**). In particular, applying the same surcharge rate to small and scale challenger banks as is applied to the larger incumbent banks risks the ability of those smaller banks to compete aggressively to win market share, and so reinforces the incumbency advantages which the CMA has found to exist in the market. Moreover, smaller banks which derive a greater share of profits from the UK, would see an increase in their tax cost whereas those UK headquartered banks with mainly foreign operations would see a decrease.

Impact on competition

1.3 HM Treasury has acknowledged the concerns about the likely impact of the Surcharge on banking competition which have been raised by a number of challenger banks and building societies. The Chancellor has recognised the *"concerns that the surcharge could have a disproportionate impact on smaller banks and building societies"* and indicated that the Treasury will *"continue to explore these concerns … and will consider the case for proposed legislative amendments."*[1]

1.4 We share these concerns. In hitting small banks and scale challengers hardest, the Surcharge penalises the very institutions that have been extending their lending to UK SMEs over the past few years, in contrast to the largest incumbent banks which have been retrenching.

1.5 We note the CMA's conclusion that there is "no strong evidence at this time" of impacts on "market entry, expansion or exit".[2] However, as a scale challenger in UK banking with experience of what is necessary to invest and grow in this sector, we remain concerned about the medium- and long-term impacts of the Surcharge on the ability of growing challenger banks to continue to expand. Given the significant financial impact on institutions such as San UK, the Surcharge will constrain the ability of growing banks to invest in their expansion and thereby to continue to pose a genuine challenge to the incumbents.

1.6 The Surcharge will have a significantly detrimental impact on challenger banks' abilities to invest to grow their shares of retail banking markets with a negative impact on competition. This is because suppressing potential margins on new lending makes credit expansion less attractive, which in turn would hinder the ability of challengers to continue to invest in products and services in order to compete with the incumbent banks. As the CMA is aware, notwithstanding our

1 Letter to the BBA, 3 September 2015.
2 Working Paper, paragraph 81.

development of bold and innovative products we have made relatively small inroads into the incumbent big four banks' market shares.[3]

1.7 The Surcharge has the additional effect of dis-incentivising inward investment into the UK banking sector, which is an important ingredient in boosting externally-sourced competition in the market. For San UK, the changes to bank taxation make the UK a less attractive place to do business, relative to other jurisdictions. As a result of these measures, our effective tax rate in 2016 will be ✂% (compared to an equivalent tax rate of ✂% in 2015)[4] and higher than rates for equivalently sized businesses in the UK and for banks operating in other European jurisdictions.

1.8 The potential effect of the Surcharge should not be understated. Industry and commentator analysis suggest that the Office of Budget Responsibility's (**OBR**) revenue estimates for the tax yield from these measures underestimate the amount that will be raised. San UK's internal estimates (Figure 1) show that the net effect of the measures would be an additional £✂bn of revenue for the Exchequer from main UK banks by 2017, whereas the OBR forecasts it would deliver £485m for the same period.

Figure 1: ✂

2 The Effect of Regulation in the Round

2.1 San UK has previously invited the CMA to recognise that the effect of banking regulation should be considered in the round as it is the cumulative effect of each set of regulations that affects competition in the retail banking markets.[5] We believe the CMA should also analyse whether individually or collectively the rules and requirements for each area of regulation (e.g. capital requirements, banking reform) are proportionate to their aims, with a view to assessing whether they cause any material impediment to effective competition. In our view, the CMA's provisional conclusion that the rules "balance each other out"[6] and its view that "the six largest retail banks will continue to pay higher effective rates of tax than smaller banks"[7] are misconceived and should be reconsidered.

2.2 We would reiterate that there is a disproportionate effect on challenger banks, including San UK as a scale challenger. This is because, to win customers, particularly when those customers are largely inert, we offer innovative and attractive service propositions, by operating on finer margins than the incumbent big four banks. Our Net Interest Margin is ✂%, while RBS', for example, is more than 3.5%. The CMA has also found that revenue per personal current account is higher for larger banks than for smaller banks. It is harder for challengers, including scale challengers, to find ways to accommodate increases in our cost base, in a way we do not consider to be comparable to the larger banks.

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5 Section 10 of the Provisional Findings considers each regulatory barrier, and summarises conclusions for each, separately.

6 This is particularly so as the effect of certain regulations do not balance out in the way the CMA suggests in the Provisional Findings at paragraphs 10.82 and 10.83. Indeed, San UK's position highlights the illogicality of the offsetting argument. We both pay higher charges and have higher capital requirements so do not benefit from any regulatory offsetting.

7 Working Paper, paragraph 83.

2.3 The Surcharge is a new tax and it is likely that associated unintended consequences will become clearer over time. We urge the relevant policymakers, including HM Treasury and the CMA, to monitor the impact of the Surcharge and to review regularly its implications for competition.