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Dear Sir/Madam,

CMA Retail banking market investigation: supplemental notice of possible remedies

The Financial Services Consumer Panel welcomes the opportunity to comment on the additional remedies being proposed in this supplemental notice. We are pleased that the CMA has looked more deeply at the consumer's position in this market. However, we remain disappointed that the CMA has not established the costs and profitability of personal current accounts and related products. A competition inquiry without an understanding of profitability is surely incomplete. The Panel urges the CMA to put the spotlight on the true cost of 'free' banking, and the impact on competition, when it publishes its final report.

It is disappointing that the CMA has not conducted an analysis of the marginal costs that banks incur when a consumer exceeds their overdraft limit or has a payment rejected. As we said in our previous response it is standard practice in many other sectors for contingent charges to be restricted to marginal cost. There is no rationale for banks to act differently.

In its remedies notice the CMA distinguishes between intentional and unintentional overdraft usage, but this does not adequately take account of people in financial difficulty. People in this situation cannot be said to intentionally have placed themselves in financial difficulty but they also do not fit into the CMA's definition of "unintentional" usage as they cannot avoid using their overdraft – even if they are aware of the charges.

The CMA does not appear to have examined the extent to which banks have pushed customers into financial difficulty through excessive charges. We note the reference to the FCA's remit to ensure banks treat their customers fairly, in paragraph 26 of the supplemental notice. However, it is clear that the FCA's 'treating customers fairly' rules simply do not work, as evidenced by persistent mis-selling and poor treatment of customers. The bank/customer relationship needs special recognition and protection by the adoption of a statutory duty of care¹ to be owed by bank staff to their customers. A duty of care would oblige providers of financial services to avoid conflicts of interest and act in the best interests of their customers.

With regard to unarranged overdrafts, these are supposed to be a 'last resort' for consumers who experience unexpected cash-flow problems, not a line of consumer credit. The Panel feels strongly that the emphasis should be on firms using their transaction data to identify and proactively contact consumers who risk drawing on an

¹ https://www.fs-cp.org.uk/sites/default/files/fscp_position_paper_on_duty_of_care_2015.pdf

unarranged overdraft and incurring significant costs from both the firm and potentially a bill originator as well. Banks should not put customers in a position where they are regularly paying charges for using an unarranged overdraft.

The package of remedies suggests that the CMA continues to place excessive faith in the ability of information solutions to address the consumer detriment caused by unarranged overdrafts. This seems to ignore the evidence from other sectors, insights from behavioural economics and the long, failed, experience of attempting to introduce transparency remedies in the PCA market.

The CMA should consider how its proposed remedies will be implemented and monitored, as well as how the FCA and PSR could assess their effectiveness once implemented. It should not leave the design and implementation of the remedies to an industry group dominated by the largest banks. Again, history tells us this approach will fail.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel

Overdraft Remedy 1 – Prompts and alerts to inform customers of imminent and actual overdraft usage and charges

With the important caveat that information remedies alone are not enough, we support the automatic enrolment of customers into alert programmes.

There are a number of things that can be done to make alerts more effective, including clear language and transparent information about potential charges. Alerts could also be given earlier, to warn consumers that discretionary expenditure may mean they will not have enough money left to meet essential expenses due later in the month. It may be possible for consumers withdrawing money from ATMs to be asked a specific question about whether they want to proceed. Some new digital banks offer “Safe to Spend” indicators which show consumers early in the month, how much cash they have left until payday.²

FCA research³ indicates that providing both the alert, and the mechanism to act, such as a mobile banking app, increase the likelihood that consumers will reduce their fees and charges. However, these impacts are likely to be greater for those on higher incomes who have higher sign-up rates to mobile banking.⁴

Further testing in this area will be necessary because the FCA research does not show whether alerts continue to be an effective tool over the longer term.

Alerts could also be given if it is likely that the size of a forthcoming regular payment such as a Direct Debit or Standing Order will take people into an unarranged overdraft. However, this will not work for Continuous Payment Authorities (CPAs) as these payments are taken without notice.

Alerts will only help people who have funds elsewhere to transfer into their account. Because technology will play a large part in providing alerts, and the means of shifting funds into the current account, alerts will not help those who are digitally excluded or who do not wish to manage their finances in this way.

Overdraft Remedy 2 – Measures to encourage PCA customers to make an informed choice on their overdraft options

Banks do not have to allow people to spend beyond their arranged overdraft limit. We question why they choose to do so. Banks might argue that it is a service that customers expect, but they also make money from it. Banks won the overdraft test case brought by the OFT, with the result that the OFT was unable to assess whether unarranged overdraft charges were fair. Unarranged overdrafts are bad for users, due to their high charges, but generally good for banks.

Giving consumers the ability to opt-out of an unarranged overdraft facility does not go far enough, as inertia will generally prevent them from doing so. We believe that consumers should actively opt-in.

Given that unarranged overdrafts are highly lucrative for banks, they may penalise customers who do not want one by levying additional charges elsewhere, or withdrawing services or rewards. This risks making the remedy unworkable, as the CMA notes.

If the remedy is implemented, firms must communicate clearly to consumers the implications of not having an unarranged overdraft facility. The amount of information that is likely to have to be communicated risks undermining the effectiveness of the remedy, given the strong links between ‘information overload’ and consumer inertia.

² See, Lindley (2014), Innovation in Banking: Moven and Simple – the new generation of bank accounts which help consumers spend wisely and achieve financial security, <http://newcityagenda.co.uk/?p=414>

³ <http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-10.pdf>

⁴ Page 16, <http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-10.pdf>

If firms levy charges on consumers who have opted not to have an unarranged overdraft, these should be based on the marginal cost to the firm (as described below). Offering an opt-in or opt-out by transaction type seems overly complex and likely to result in consumer confusion.

Having the default as opt-out, or banning unarranged overdrafts all together, would provide extra safeguards for consumers with continuous payment authorities. If they had no overdraft these payments could not be taken.

An alternative could be to allow consumers to opt-in to a sweep service by providing the detail of a linked savings account, from which funds could be taken, rather than going into an unarranged overdraft. This would give a further option for consumers who want to have payments processed, but want to avoid high costs of unarranged overdrafts. For consumers who do not have savings, firms should proactively contact consumers at risk of incurring charges for unarranged overdrafts, as described above, using the transactional data they hold.

Overdraft Remedy 3 – Suspension periods for unarranged overdrafts

The Panel questions what the purpose of an unarranged overdraft is. We do not believe it is a feature consumers would 'choose to use' if they were aware of the charges and had alternative funds available to them. Lenders who repeatedly allow their customers to go into an unauthorised overdraft are not lending responsibly.

As the Panel said before, unarranged overdraft fees can be seen as a type of discontinuous pricing strategy, used to exploit financial difficulty and small errors from consumers, with charges that far exceed marginal cost. In some circumstances the cost of an overdraft can exceed the cost of a payday loan, which the FCA has capped at 0.8% interest per day. This difference in cost between payday loans and unarranged overdrafts, when banks face very low customer acquisition costs for their unarranged overdrafts, merits closer examination by the CMA. Unarranged overdrafts should also be lower risk as banks possess a significant amount of information about their customers' financial circumstances.

Allowing breathing space for consumers who use an unarranged overdraft before charges are applied would be welcome. However, the CMA should carry out research to find out how grace periods may affect the ability of consumers to act.

Overdraft Remedy 4 – A monthly maximum charge for using an unarranged overdraft

Consumers often underestimate their overdraft usage.⁵ They find it difficult to understand how they currently use their account, are subject to optimism bias and are unable to use a simple heuristic to find a better account for them. Too often the answer will be "it depends" – it depends on how often, how much and how long they use their overdraft and the transactions they make.

Moreover, unarranged overdraft usage occurs typically for a relatively short period of time: days rather than weeks. This suggests that a maximum monthly charge is a fairly meaningless measure, and could disguise punitively high daily rates.

However, there is a case for requiring banks to set out charges clearly in a standard format, covering unarranged overdraft usage for, say, one day, three days, five days and ten days. It is worth considering the format that high-cost short-term credit (HCSTC) providers have to use. This would have the advantage of allowing consumers to make more informed choices about borrowing for emergencies. Recent research has

⁵ Grubb, M.D. (2015) Overconfident Consumers in the Marketplace. Journal of Economic Perspectives, 29(4) Fall 2015. pp 9-36

found that well-informed consumers have worked out that payday loans are generally a cheaper alternative over a few days than an overdraft.⁶

There are two elements to the cost of overdrafts: the initial processing cost (the equivalent of an arrangement fee) and an interest charge for the loan itself. Banks should have to set these individual elements out clearly, but also combine them into a daily charge as we suggest above, in line with the HCSTC cap.

The initial fee could be restricted to the net additional administrative costs which firms incur, including the cost of holding funds available for unanticipated loans. As we have pointed out to the CMA in our previous responses, restricting contingent charges to the net additional administrative costs incurred is an approach which has been taken in other parts of the financial services market and other sectors such as telecoms. An alternative would be that fees might vary with the extent of unauthorised borrowing. One of the problems faced by consumers who slip into overdraft by a small amount is that the charges can be disproportionate. The HCSTC model has an advantage here, as the overall cap is set at 100% of the amount borrowed. Thus a consumer slipping £20 into overdraft would no longer find themselves facing total charges of more than £20. The interest charge could be tied to the charges that banks make for other types of loan: arranged overdrafts, personal loans or credit cards.

All of the major banks already operate a maximum limit on unarranged overdraft charges during a monthly billing or statement period. For the majority of banks these limits are also disclosed as part of their information provision on unarranged overdrafts, although in some cases the clarity of the information could be improved. Therefore it is not clear that the CMA's preferred option of an uncapped monthly maximum charge set by individual banks would have any practical impact. The CMA's preferred option would also mean that consumers could incur significant arranged overdraft charges in addition to the excessive unarranged overdraft charges.

KPIs and Indicators

The Panel has published research⁷ and a position paper⁸ on 'Consumers as co-regulators'. We looked at why people don't switch away from firms that visibly behave badly, and asked how it would be possible to harness the power of the consumer to bring pressure to bear on miscreant firms. Our research found that consumers would find it helpful to have information about firms' behaviour and service quality. We would like to see a score for firm behaviour that gives people an insight into firm culture. A rating for firms could be based on, for example, penalties and redress paid out by firms, quality of service indicators, and customer feedback.

In March 2016, the FSCP published a proposed set of indicators⁹ that would be a useful starting point. The core values, as expressed by the consumers participating in our research, were:

- Being accessible to customers;
- Being open and transparent in all dealings with customers;
- Treating customers as individuals:
 - Having systems that are flexible
 - Being sensitive to difficult situations
- Being proactive in meetings customers' needs;
- Putting customers' needs before profits;

⁶ Rowlingson, K., Appleyard, L. and Gardner, J. *Is there (still) a problem with payday lending?* CHASM Briefing Paper 6-2015, University of Birmingham. <http://www.birmingham.ac.uk/Documents/college-social-sciences/social-policy/CHASM/briefing-papers/2015/bp6-2015-payday-lending.pdf>

⁷ <https://www.fs-cp.org.uk/sites/default/files/consumers-core-regulators-research-2015.pdf>

⁸ https://www.fs-cp.org.uk/sites/default/files/fscp_final_discussion_paper_investment_costs_20160229_2.pdf

⁹ https://www.fs-cp.org.uk/sites/default/files/bank_culture_position_paper_final.pdf

- Going beyond what the regulations require; and
- Taking ownership when things go wrong.

If banks were ranked according to such indicators (as OfCom proposes with the telecoms industry) they might be encouraged to treat all of their customers well, rather than just their new customers.

In addition, the CMA should require each bank to publish details regarding its customers' usage of arranged and unarranged overdrafts and the total revenue the bank receives from the different types of overdrafts and the different fees levied (e.g. interest, arranged fees, unarranged fees, unpaid transaction fees, paid transaction fees). Banks should also be required to publish the average revenue per active PCA for these services as well as the average revenue per account which uses these services.

Banks should also be required to disclose their estimates of how much it actually costs them when customers use their unarranged overdrafts. These estimates of cost and all other KPIs should be independently audited.

It is important to point out that we are deeply sceptical that large amounts of pricing and service information will encourage consumers to switch PCA provider. As our research found, while there is a view that the risk and inconvenience of switching are perceived to be greater in the consumer's mind than the potential up-side, switching will remain at very low levels.