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Dear Professor Smith

Virgin Money response to CMA's *Supplemental notice of possible remedies*

We welcome the opportunity to respond to the Notice that was issued on 7 March 2016. We set out our key points of feedback below with our more detailed response included within the Appendix to this letter.

We agree with the CMA that the PCA market is not working well for many overdraft users, particularly heavy users of unarranged overdrafts who are less likely to be financially literate. We believe it is unfair that 'free' banking for some customers is subsidised by often-high overdraft charges paid by other customers.

We recognise that free-if-in-credit banking is popular with many customers but this model disguises the true costs of banking to customers, acting as a barrier to switching and competition in the market.

We believe that markets function more effectively and efficiently, and deliver better outcomes for customers, if competition is focused on transparent headline pricing and there is less emphasis on generating income from non-prominent fees and charges for ancillary products and services, such as unarranged overdrafts.

As such, we support the CMA's focus on further overdraft remedies to address the poor outcomes faced by many customers who use unarranged overdrafts and to help improve the basis of competition within the personal current account market.

Within the range of possible overdraft remedies included in this supplemental notice, we believe that the proposal to introduce a monthly maximum charge (MMC) for using an unarranged overdraft would most simply and directly address the detriment suffered by heavy users of unarranged overdrafts. In addition, if set at an appropriate level, it could help to encourage a market-driven move away from 'free' banking with its over-reliance on non-prominent fees and charges.

For this remedy to have the desired effect, we believe that the CMA (or another body) should set an upper limit on monthly maximum charges and also on a rolling three or six month basis.

With regard to the other possible overdraft remedies included within the supplementary notice, we highlight the following points as the CMA develops its thinking:

- Low levels of financial literacy in segments of the UK population are an unfortunate reality. Given that people in these segments may well be heavy users of unarranged overdrafts, we consider it important that the remedies should be simple and easy to understand and have a concern that some of the remedies might be overly complex. For example, we think that many PCA customers would find it hard to engage with the concept of unarranged overdrafts and to make an informed decision about whether they wanted to opt into or out of an unarranged overdraft facility.

- Highly detailed and prescriptive requirements introduce systems complexity and additional costs, which are disproportionately burdensome for smaller providers of PCAs. In addition, detailed and prescriptive requirements can reduce opportunities for differentiation in product design and can act as a disincentive to investment in innovation.

As we have noted in previous submissions, we believe that mandating the payment of interest on credit balances would also be a highly effective remedy to help address some of the challenges observed in the PCA market and ensure greater focus is given to transparent headline pricing.
Further detail on each of the four proposed remedies is included within the Appendix to this letter. We would welcome the opportunity to discuss any of these points with you in more detail.

Yours sincerely

Richard Hemsley
Chief Banking Officer
Virgin Money

Virgin Money's response to CMA's *Supplemental notice of possible remedies*: Appendix

Virgin Money is a medium-sized UK bank. It has grown strongly through a combination of organic growth and acquisitions. Its principal activities are in residential mortgages, credit cards and retail deposits. It also has a presence in the PCA market through its legacy closed book of personal current accounts (PCAs), acquired as part of Northern Rock, and its best-in-market basic bank account. Virgin Money is seeking to expand its presence in the UK retail banking market, including in the PCA market.

We provide below some general observations on the approach set out in the *Supplemental notice of possible remedies* followed by more detailed comments on the specific remedies that are proposed in the document.

General Points

We agree with the CMA that the PCA market is not working well for many overdraft users, particularly heavy users of unarranged overdrafts. This was underlined by the high potential savings for overdraft users, particularly heavy overdraft users, identified in the summary of provisional findings report, and by the CMA's findings that these customers are less likely to switch.

Overdraft remedies that seek to shift the balance of PCA charges away from non-prominent fees and charges would reduce the cross-subsidies that exist under the free-if-in-credit banking model. In previous submissions to the CMA, we have expressed the opinion that it is unfair that free banking for some customers (including those who are more affluent or more financially literate) should be subsidised by often-high overdraft charges paid by other customers (including those who are less affluent or less financially literate).

In particular, reliance on non-prominent fees and charges can create barriers to entry and can reduce the potential for new entrants to bring greater innovation and competition to the market. As we have noted in previous submissions, we believe that requiring the payment of interest on credit balances would be a highly effective remedy to help address some of the challenges observed in the PCA market.

In relation to the remedies proposed in the *Supplemental notice of possible remedies* we make the following overarching points:

- Low levels of financial literacy in segments of the UK population are an unfortunate reality. Given that people in these segments may well be heavy users of unarranged overdrafts, we consider it important that the remedies should be simple and easy to understand. For example, we think that many PCA customers would find it hard to understand the concept of unarranged overdrafts and to make a decision about whether they wanted to opt into or out of an unarranged overdraft facility.
- As recognised by various reviews, there are significant barriers to entry and growth in the PCA market. Highly detailed and prescriptive requirements introduce systems complexity and additional costs, which are disproportionately burdensome for smaller providers of PCAs. In addition, detailed and prescriptive requirements can reduce opportunities for differentiation in product design and can act as a disincentive to investment in innovation.
- Highly detailed and prescriptive remedies seem out of step with the FCA's thinking in *Regulatory barriers to innovation in digital and mobile solutions* and *Regulatory sandbox*, and with the objectives of HMT/FCA's *Financial Advice Market Review* and the FCA's *Competition in the mortgage sector* to address unintended consequences of the Retail Distribution Review and the Mortgage Market Review, each of which was detailed and prescriptive and, with the benefit of hindsight, seem to have focused more on process than on outcomes for consumers.
- Complying with a number of relatively complex remedies would also consume high levels of skilled resources, particularly in smaller firms, and could well distract attention and resources from developing new digital and mobile PCA offerings that we think are critical to increasing customer engagement, competition and innovation in the PCA market.

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

We continue to believe that the PCA market is not working well for many consumers, including overdraft users. We note the CMA's findings, in paragraph 53 in *Summary of provisional findings report*, that overdraft users, particularly heavy overdraft users, were less likely to switch than other customers despite having the most to gain from switching.

We therefore agree with the CMA that prompts and alerts could be useful for many customers and that the provision of prompts and alerts should be encouraged to help customers' awareness and understanding. We further agree that, for prompts and alerts to be effective, they need to reach the customer within a short period and at a time that enables the customer to act on the information. If prompts and alerts are offered, we think that it would make sense to opt-in customers, but that there should be an opt-out procedure for customers who do not want to receive prompts and alerts.

However, we are not persuaded that highly prescriptive regulatory requirements regarding the type of alert, including the medium used, the content of messages and options for customers regarding choosing when an alert is triggered and setting multiple warnings at different triggers, would form a proportionate remedy, for two reasons:

- We note in the *Supplemental notice of possible remedies* that the FCA has found that signing up to text alerts alongside using mobile banking reduced the amount of unarranged overdraft charges incurred by customers by only 24%: this may reflect the inability of many heavy users of unarranged overdrafts to take actions to avoid charges, even if they receive prompts and alerts.

- We are concerned that the cost of implementing this possible remedy could be high, and particularly onerous for smaller providers and new entrants.

In the context of the FCA's innovation hub and regulatory sandbox, and its objective to overcome regulatory barriers to innovation in digital and mobile solutions, we prefer an approach under which providers of PCAs are encouraged to compete through innovative and differentiated online propositions that meet the needs of groups of customers using PCAs.

We note that paragraph 69 of *Supplemental notice of possible remedies* asks whether PCA providers should include arranged overdrafts within 'available funds' they report to customers. We believe that this approach is more helpful to customers than the alternative of not including it: we suspect that not including it would lead to customer questions to confirm their position. However, in connection with the CMA's invitation to providers to highlight areas where further customer research may be appropriate, we suggest that questions about this topic could be included within such research.

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

We are concerned that this possible overdraft remedy, while clearly well-intended, would introduce a degree of complexity such that many customers would find it difficult to understand their choice and difficult to make a decision about what is best for them. The CMA's *Summary of provisional findings report* said, in paragraph 53, that many overdraft users believed they did not use an overdraft or they underestimated their usage. We therefore think that asking a customer to decide whether or not they would like to have an unarranged overdraft facility would be likely to lead to confusion and might subsequently lead to accusations of mis-selling if it were to turn out at a later date that the choice made was not appropriate for the customer.

In expressing concern about this possible overdraft remedy, we note that the *UK Financial Capability Strategy*, published in October 2015, found that 36% of the UK population cannot calculate the impact of a 2% interest rate on £100 in savings and that 22% cannot read a bank statement.

We therefore think that it would be simpler and better for customers if providers were able to offer distinct accounts that either incorporated or excluded an unarranged overdraft facility, and if each type of account were to have terms and conditions that were easy to understand and that made the potential cost implications clear to customers at the point of sale. For customers holding accounts with an unarranged overdraft facility, an annual reminder could be provided, including details of accounts offered by the same provider without an unarranged overdraft facility, explaining the possible costs and highlighting the choice available to customers.

We do not support the proposals that would require providers to provide customers choosing to opt out of unarranged overdrafts with a restricted use debit card and to allow customers to opt out by transaction type. We believe that requirements such as these would add to costs and complexity for both providers and customers. We think that customers would be better advised to discuss their overdraft needs with their PCA provider and to agree an approved overdraft facility if they believe that they are likely to face issues in managing the timing of specific payments and/or transactions.

Remedy 3 - suspension periods for unarranged overdrafts

Virgin Money is a participant in the current 'retry' system, mentioned in the *Supplemental notice of possible remedies*, and is happy to continue to support this. Virgin Money also offers a buffer period (fee-free for 30 days) on its current accounts and we note that a number of other banks offer a similar facility.

As for our responses to some other possible overdraft remedies, we are concerned that the technical complexity associated with detailed prescribed requirements relating to grace periods would be costly but would not have a positive impact on competition in PCAs.

While we recognise the good intentions of remedies such as this to protect customers, we are concerned that the imposition of prescriptive requirements could reduce competition in PCAs and choice available to customers. In particular, remedies such as this would be disproportionately burdensome for smaller providers and new entrants and would be likely to reduce their ability to bring greater innovation and competition to the PCA market.

Remedy 4 - a monthly maximum charge (MMC) for using an unarranged overdraft

We consider that this possible remedy would directly reduce the detriment suffered by heavy users of unarranged overdrafts, recognised in paragraph 51(c) in the CMA's *Summary of provisional findings report*, which quantified the amounts that could be saved by different categories of PCA customers. Also, it has the considerable benefit of being simple and easy to understand.

As stated in previous responses, we believe that it is unfair that customers who enjoy genuinely free banking should be cross-subsided by users of overdrafts, including heavy users of unarranged overdrafts. We think that an additional benefit of restricting non-prominent fees and charges is that it could encourage a market-driven move away from free-if-in-credit banking. We think that markets work better for consumers if competition is focused on headline prices rather than on non-prominent fees and charges.

We believe that requiring providers to set their own monthly maximum charge (MMC), without any externally-imposed constraint, would be of relatively little value to overdraft users. In the light of the CMA's finding that many overdraft users believed that they did not use an overdraft or underestimated their usage, we think that many PCA customers would believe that they would not be likely to use an unarranged overdraft facility and so the monthly MMC would not apply to them. Given this, we think it unlikely that MMCs would become a significant point of differentiation in the PCA selection process or that competition between PCA providers would push down the levels of MMCs.

We therefore support the second variant of this possible overdraft remedy, under which the CMA or another body would set an upper limit on MMCs. We note that the *Supplemental notice of possible remedies* identifies a number of challenges associated with setting an upper limit and potential unintended consequences including that it might reduce PCA providers' willingness to offer unarranged overdraft facilities. However, we believe that, with information and insight, it should be possible to strike a level for the limit that would afford fair treatment for heavy users of unarranged overdraft but that would not have unintended consequences for their ability to access unarranged overdraft facilities when required.

In our letter to the CMA dated 8 January 2016, we suggested that it would be helpful for the CMA to estimate the contribution made by each individual source of the £8.7 billion that UK banks made from PCAs in 2014, including the amount that came from overdraft customers and, within that, from customers with unarranged overdrafts. We believe that this information could support a decision about the appropriate level for an upper limit on MMCs. We think that this information would also support the case for a rolling cap relating to the previous three or six months, which we think will be needed to work in tandem with a monthly cap.

We see parallels between setting an upper limit for MMCs and the caps placed on credit card interchange fees and mobile phone roaming charges. We believe that, in these areas, interventions to limit non-prominent fees and charges have improved outcomes for consumers, and have helped to create more competitive markets by reducing the benefits enjoyed by large incumbents and by creating more attractive environments for smaller providers and new entrants.