Competition & Markets Authority

Retail banking market investigation

Final report

9 August 2016

Website: www.gov.uk/cma

Members of the Competition and Markets Authority who conducted this inquiry

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The Competition and Markets Authority has excluded from this published version of the report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets. [Non-sensitive wording is also indicated in square brackets.]

Contents

Summary

1. On 6 November 2014, the Competition and Markets Authority (CMA) board launched a market investigation into the supply of retail banking services to personal current account (PCA) customers and to small and medium-sized enterprises (SMEs) in the United Kingdom (UK).[1] An inquiry group of five independent members was appointed to conduct the investigation and publish this final report.[2] Alongside this final report, we have published an overview document summarising our approach, our key findings and package of remedies.[3]

2. In relation to personal customers, our terms of reference (ToR) include only the supply of PCAs, which includes overdrafts. In relation to SMEs, our ToR are broader; they include business current accounts (BCAs) and lending products, but they exclude insurance, merchant acquiring, hedging and foreign exchange.

3. We are required to decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. If we decide that there is such a feature or a combination of features, then there is an adverse effect on competition (AEC). Should an AEC be found, we are also required to decide whether action should be taken by the CMA or a recommendation be made to others to take action for the purpose of remedying, mitigating or preventing the AEC or any resulting detrimental effect on customers.[4] This final report sets out our decisions on these questions.

4. In parallel, the same members also conducted a review of the undertakings that were put in place following the 2002 Competition Commission (CC) investigation in SME banking (the 2002 SME Undertakings) and a review of the 2008 Northern Ireland PCA Order (the NI Order) that was put in place following the CC investigation into PCA banking in Northern Ireland (NI). Alongside this final report we have published our final decisions on both reviews.[5]

5. The result of the recent UK referendum on whether to leave the European Union (EU) and subsequent events may have an impact on the economic

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[1] Retail banking market investigation ToR.
[2] The members appointed are Alasdair Smith (Chair); Philip Marsden (Deputy Chair), Tom Hoehn, Jill May and Ed Smith.
[3] Overview.
[4] Enterprise Act 2002 (EA02), section 134.
[5] See the NI Order review case page and the SME Undertakings review case page.

outlook and the regulatory framework that applies to retail banking in the UK. However, there is considerable uncertainty in this regard. At the time of this report, the UK had not triggered the formal process of leaving the EU under Article 50 of the Treaty on European Union.

Background to the investigation

6. The UK banking industry has been subject to many reviews, several of which have raised concerns regarding competition in retail banking. These have included Sir Donald Cruickshank's review of retail banking in 2000, the Independent Commission on Banking (ICB) chaired by Sir John Vickers in 2011, and the Parliamentary Commission on Banking Standards (PCBS) in 2013. Recommendations from these reviews have been far-reaching including: the establishment of what became the Payment Systems Regulator (PSR); the introduction of a current account switching service (CASS); the 'ring-fencing' of the retail banking businesses of the banks from the riskier parts of banks' businesses due to be implemented in 2019; the imposition of a primary objective to promote effective competition for the Financial Conduct Authority (FCA); and a secondary objective to facilitate effective competition for the Prudential Regulation Authority (PRA).

7. In light of these reviews and the market studies into PCAs and SME banking which led to this investigation, we investigated three broad areas in which we had concerns that retail banking may not be working well for customers:

   (a) whether there is a weak customer response due to lack of engagement and/or barriers to searching and switching reducing the incentives on banks to compete on price and/or quality and/or to innovate;

   (b) whether there are barriers to entry and expansion constraining the ability of banks to enter or expand; and

   (c) whether the level of concentration is having an adverse effect on customers.

8. Our market investigation has been carried out against a backdrop of unusual macroeconomic conditions. The financial crisis starting in 2007/08 not only changed the regulatory environment in which banks operate but also banks' strategies and how they fund their operations.

9. During the crisis, the UK government took large holdings in Royal Bank of Scotland Group (RBSG) and Lloyds Banking Group (LBG) to restore financial stability. Following Lloyds TSB's acquisition of HBOS in 2009, which created LBG, the European Commission ruled that the UK government's financial assistance to LBG constituted state aid and required a divestment which

recreated TSB in 2013. Williams & Glyn is anticipated to be separated from RBSG following a similar decision by the European Commission.

10. Since 2008, banks have sought to rebuild their balance sheets and improve their capital position. Use of wholesale funding markets has reduced significantly and banks are generally relying more on retail deposits as a source of funding.

11. In addition, partly in response to tighter capital requirements, there has been a general contraction in lending activity in particular by the larger banks to SMEs. This has facilitated the entry of new banks and non-bank lenders such as peer-to-peer lenders. It also prompted the UK government to set up the British Business Bank (BBB) and, together with the Bank of England (BoE), the Funding for Lending Scheme (FLS) to incentivise banks and building societies to increase their lending to SMEs.

12. In addition to significant regulatory changes which are ongoing, there has been continued technical innovation in retail banking. Internet banking has doubled since 2007 with over half of customers banking online and around a third of customers using mobile banking applications.

13. The development of ‘bank in a box’ technology and the wider digitalisation of banking have lowered the cost of new entry, facilitated digital-only new entry as well as new product and service innovation such as contactless payment technology and mobile payment systems (Paym). Digital banking has also had a significant impact on customer behaviour, in particular on the use of branches and how customers engage with their accounts.

Industry background

14. Retail banking is of fundamental importance to consumers and businesses and to the UK economy as a whole. There are around 70 million active PCAs in the UK and PCAs generated revenues of approximately £8.7 billion in 2014. 97% of adults have a PCA and 5.6 million PCAs were opened in the UK in 2015.

15. Following the financial crisis there has been a rise in the number of SMEs. In 2014 there were over 5 million SMEs accounting for 99.9% of all UK businesses. There are around 5.5 million BCAs, which generated approximately £2.7 billion in revenues in 2014. The total stock of outstanding general-purpose business loan balances at the end of 2015 was £96 billion with a further £9 billion of invoice finance loans and £25 billion of new asset finance loans. Just under 20% of all SMEs have a loan.

16. The five largest banks in GB are LBG, RBSG, HSBC Group (HSBCG), Barclays and Santander UK plc (Santander) (part of the Spanish banking group Banco Santander SA). These banks operate throughout the UK and provide the full range of retail banking services. The leading banks in NI are Ulster Bank (Ulster) (part of RBSG), Santander, Allied Irish Bank (AIB) and Bank of Ireland (BoI) which are both based in the Republic of Ireland, and Danske Bank (Danske) (Northern Bank Limited, trading as Danske Bank), whose parent bank is Danish.

17. In addition to these larger banks, there are a number of smaller banks and over 40 building societies including several new entrants. Some of these banks and building societies are regionally based, some only provide personal or SME banking services, some are part of large retail groups and others focus on digital-only distribution channels. They include Clydesdale Bank and Yorkshire Bank (part of the same banking group), TSB (recently acquired by the Spanish bank Sabadell), Nationwide Building Society (Nationwide), Handelsbanken (part of a Swedish banking group), the Co-operative Bank (Co-op Bank), Metro Bank (Metro), Virgin Money, Aldermore Bank (Aldermore), the Post Office, and Tesco Bank.

18. In addition to banks and building societies, a number of other providers provide elements of retail banking services such as credit unions, alternative finance providers offering, for example, crowd-funding and peer-to-peer lending, and new payment providers offering digital wallets and other services, such as PayPal, Amazon, Google and Apple.

Regulation of banks

19. Banks and building societies are regulated under both UK and European legislation. The European laws relevant to this report will continue to apply for the time being and many of them have been (or will soon be) transposed into UK law and would not be automatically repealed on the UK leaving the EU.

20. The Financial Services Act 2012 (FS Act) introduced a new regulatory framework for financial services in the UK. Under this framework, the BoE is responsible for financial and monetary policy and for the safety and soundness of banks and other financial institutions. The PRA, which is part of the BoE, is responsible for the prudential regulation of banks including the authorisation of deposit-taking activities. The FCA, which replaced the Financial Services Authority on 1 April 2013, regulates the conduct of banks and building societies. As already noted, the PSR is the regulator for payment systems and became fully operational in April 2015.

21. In addition to these bodies, a number of European and international bodies also regulate UK banks and building societies. These include the European Banking Authority, which ensures effective and consistent prudential regulation and supervision across the EU banking sector, and the Basel Committee on Banking Supervision, which issues the Basel Accords setting out the prudential capital requirements for banks globally.

22. The UK has adopted regulations to implement the first EU Payment Services Directive, which came into force in November 2009. These regulations aim to improve competition in the provision of payment services and make cross-border payments easier. The UK government plans to implement the second Payment Services Directive by January 2018 (and this is still the case following the recent EU referendum). This will update the current framework on payment services, extending its scope to payment services providers that were previously unregulated, and improving the transparency and security of payment services. The updated rules extend the requirements on banks to provide certain information to their customers including on charges and interest as well as rules to enable customers to allow third party providers to access their accounts.

23. The UK has also adopted regulations to implement the EU Payment Accounts Directive, which will come into force in September 2016. Several aspects of the regulations are already broadly in place including CASS and the requirement on banks to provide basic bank accounts. The UK regulations will also require that consumers have access, free of charge, to an independent price comparison website (PCW).

24. In January 2016, regulations under the Small Business, Enterprise and Employment Act 2015 (SBEE Act) came into force. They require certain designated banks to provide information about SMEs to designated credit reference agencies (CRAs) and a duty on such CRAs to provide information about SMEs to lenders. In addition, designated banks will be under a duty to forward details of SMEs they decline for finance to designated platforms to help SMEs link to alternative lending opportunities (subject to consent from the SME).

25. UK banks are also subject to various other regulations such as anti-money laundering (AML) and data protection legislation.

Market definition

26. We identified the following product markets to frame our assessment:

(a) PCAs, including PCAs both with and without overdraft facilities;

(b) BCAs, including BCAs both with and without overdraft facilities;

(c) business loans, including both short-term and medium/long-term business loans, with or without collateral; and

(d) business deposit accounts, whether instant-access or long-term.

27. For each of the above product markets, we found that GB and NI should be considered as separate geographic markets. Pricing, product offering, service levels and marketing activities for each brand are determined at UK level and we found no significant variations in customers' needs and behaviour in different parts of the UK.

28. However, we found that customers use different banks and brands in NI compared with the rest of the UK. We found no such differences in relation to Wales. In relation to Scotland, while there were some differences in market share in Scotland compared with England and Wales, these were not sufficient to suggest that Scotland should be viewed as a separate geographic market to England and Wales.

29. Whilst we identified business deposit accounts as a separate product market, we did not receive any evidence to suggest that we should investigate the market for such products.

New entry

30. There has been new entry into retail banking in recent years. Aldermore entered in 2009 providing SME lending. Metro was the first new high street bank in more than 100 years when it received its banking licence in March 2010 and offers both PCAs and SME banking including BCAs. Several other new entrants in PCAs have their roots in ancillary financial or retail services such as Tesco Bank (which entered in 2014), the Post Office (which entered in 2013/14), Virgin Money (which entered in 2014), and Marks & Spencer Bank (M&S Bank, part of HSBCG) (which entered in 2012). Santander entered the UK PCA and SME banking markets through its acquisition of Abbey National plc in 2004, followed by its acquisitions of Bradford & Bingley Building Society in 2008 and Alliance & Leicester Building Society in 2009. Handelsbanken (PCA and SME) has also significantly extended its UK operations, almost doubling its branch network between 2011 and 2015.

31. There are also a number of banks that have recently been authorised or are in the process of being authorised including Atom Bank (Atom) (authorised in June 2015, digital PCA and SME), Starling Bank (digital PCA), CivilisedBank (SME) and OakNorth (authorised in March 2015 SME banking but not BCAs). In addition to traditional bank lending, alternative finance has been growing

rapidly in recent years. Despite the rapid growth, alternative finance currently accounts for a small share of SME lending (less than 2%).

Financial performance of retail banks

32. We considered possible methods that might enable us to form a view as to whether banks were achieving levels of profitability that were in excess of what we might expect in a competitive market. We concluded that there were inherent difficulties with such an exercise which would mean that such an analysis would not be sufficiently reliable to inform our assessment of competition.

33. In particular, none of the larger banks in the UK treat their PCA or SME businesses as separate and were not therefore able to produce separate profit and loss accounts or balance sheets for these businesses. Moreover, there were particular problems in assessing the profitability of PCAs and SME banking including the appropriate allocation of common and shared costs, equity capital and revenues. We also considered that there were particular issues in estimating a benchmark return on equity (ROE) for standalone PCA and SME products and in making an assessment of profitability over time given the impact of the financial crisis and the consequent market restructurings.

34. We therefore analysed available information from banks' annual reports and accounts, together with selected industry publications, reports by equity analysts and consulting/accounting firms, to inform our understanding of the overall financial performance of UK retail banking. These all pre-dated the UK referendum result and several banks' recent half-year results. These reports indicated that banks were benefiting from improved economic conditions, lower impairments and improved net interest margins. However, persistent low interest rates as well as high customer compensation and conduct costs continued to limit profits.

35. While the total reported income of the larger UK banks' retail divisions remained relatively stable between 2012 and 2014, reported profit in general showed an upward trend largely driven by reducing impairments. Reported average ROE of the five largest banks' retail divisions increased from 7.5% in 2012 to 11.8% in 2014 again primarily due to lower impairments. The evidence we reviewed did not suggest that ROE were significantly above banks' cost of equity. Similarly, while our analysis focused on overall industry trends, the evidence we looked at did not suggest that the largest UK banks had significantly higher average ROE or average net interest margins than smaller banks.

Competition in PCAs

Introduction

36. A PCA comprises a number of different services: the making and receiving of payments with or without using cash; the storing of money; most PCAs also offer a facility to borrow money on a short-term flexible basis (overdraft facility) whether arranged in advance with the bank or unarranged.

37. Banks generally offer a range of PCAs targeted at particular customer groups and/or offering different services and pricing structures. Just under two-thirds of active PCAs in 2015 were 'standard' accounts under which customers do not pay regular fees for using the account's core transaction services. Such accounts are frequently termed 'free-if-in-credit' (FIIC) accounts. However, customers do not receive interest on their credit balances (interest forgone) and, like other accounts, pay directly for other services, such as fees and interest for overdraft usage (unarranged and arranged) and foreign transaction fees. Standard accounts have been declining as a proportion of new accounts.

38. A number of banks have more recently introduced so-called 'reward' accounts which, subject to eligibility requirements, pay interest on credit balances, offer cashback on particular types of payments from the account and/or other rewards such as preferential terms on other bank products. Some of these newer reward accounts require a fee to be paid although this is usually offset by the cash benefits received if the eligibility requirements of the account are met. These accounts are primarily targeted at more affluent customers with higher credit balances. In 2015, over a third of new accounts opened were reward accounts compared to only 8% in 2011 and reward accounts accounted in 2015 for just over 16% of active PCAs compared to 6% in 2011.

39. Packaged accounts offer the same facilities as standard and reward accounts but include additional services such as travel insurance, car breakdown cover and/or mobile phone insurance. Such accounts have monthly or annual fees and accounted for approximately 11% of active PCAs in 2015. Like standard accounts, packaged accounts have been declining as a proportion of new accounts.

40. Larger banks are required to offer basic bank accounts which, while otherwise similar to other accounts, typically do not provide a cheque book or overdraft facility. They accounted for approximately 7% of main PCAs in 2014.

41. Student and graduate accounts are limited to UK university students or recent graduates and tend to offer extensive and lower-cost or interest-free overdraft

facilities compared with standard or reward accounts and comprised nearly 3% of main PCAs in 2014. Youth accounts are typically available to 7 to 17 year olds and often have reduced functionality depending on the age of the account holder. They accounted for approximately 3% of main PCAs in 2014.

42. For all types of accounts, the total average revenue per PCA to the bank in 2014 was approximately £177 per year including interest forgone. There is considerable variation in bank revenue across main PCAs with 10% of accounts in our sample generating average revenue of around £15 per year and the highest 10% generating over £700 in revenue per year in the last quarter of 2014.

43. Main or primary banking customers hold a PCA into which they pay their main income and from which the majority of payments are made. These customers generally have more transactions on their account, have higher credit balances and have other personal banking products with the bank and therefore generate the most revenues for banks.

44. Around half of the revenue that banks earn from supplying PCAs comes from interest the bank earns by lending out customers' credit balances (value of funds) rather than from direct charges. Approximately a third of bank revenues comes from overdraft charges. Banks derive higher revenues from customers on higher incomes with high credit balances, with revenues from customers with no overdrafts and low credit balances being the lowest.

45. We also found that, based on each bank's assessment of profitability, their PCA or personal banking businesses are profitable. Packaged accounts tend to be the most profitable type of PCA as they generally require a monthly fee that exceeds the cost to the bank of the additional benefits provided and are more likely to be held by main banking customers. Basic bank accounts and non-adult PCAs (youth, graduate and student) tend to be less profitable than standard or reward accounts because of lower credit balances and/or no access or interest-free access to overdraft facilities.

PCA market structure

46. The PCA markets in both GB and NI are concentrated, whether concentration is measured by volume of main PCAs or, for the UK, by net revenue. Concentration levels have increased since the financial crisis following Santander's acquisitions of Bradford & Bingley and Alliance & Leicester building societies and LBG's acquisition of HBOS (notwithstanding its subsequent divestment of TSB). Although new entrants and smaller banks are gaining market share this has been slow and, excluding the impact of mergers

and acquisitions, the four largest banks in GB account for over 70% of main PCAs and collectively have lost less than 5% market share since 2005.

47. In NI, the four traditional clearing banks (RBSG/Ulster, Danske, AIB and BoI) have lost market share to former and continuing building societies such as Santander, Nationwide and LBG/Halifax.

Pricing, quality and innovation in PCAs

48. The range of services provided by a PCA means that price comparisons between PCAs are not straightforward. Because the prices paid by customers will depend on their usage, including overdraft usage, we calculated prices across a sample of PCA customers taking into account their different usage of banking services.

49. Many banks offer a number of different PCAs, and we found that, at most banking groups, there are substantial differences in the prices of the different products they offer. Banks with higher market shares offer some of the cheapest products as well as the most expensive products, but only a small proportion of their customers in 2014 were on the cheaper products.

50. Approximately 45% of customers use overdrafts. Overdraft users pay substantially more for their PCAs than non-overdraft users and the average price increases with the number of days in overdraft.

51. We analysed the relationship between average prices and market share, and the relationship between average prices and length of time that accounts are held with the bank. In GB, we found that recent entrants and smaller banks tend to offer lower average prices than banks with high market shares. We also found that banks whose customers have been with them for longer on average tend to have higher prices on average.

52. In NI, we similarly found that banks whose customers have been with the bank for longer on average, tend to have higher prices on average, but our analysis did not show a clear relationship between market shares and average prices. However, there were some limitations to the data for NI as a result of which we attach less weight to the comparison for NI than to that for GB.

53. The existence of large variations in prices across banks might indicate that customers of worse-performing banks would be better off switching away from their existing bank. However, it might also be reflective of differences in service quality, with customers making a trade-off between price and quality in choosing their account. We therefore interpret the results of the pricing and quality analysis together.

54. We found that a substantial proportion of customers are paying above-average prices for below-average service quality which suggests these customers would be better off switching product. We also found that there was a significant proportion of customers who are paying above-average prices who are not very satisfied with their account, who could again benefit from switching.

55. While we found that some banks offering lower average prices and/or better quality services have been gaining market share, this was at a slow pace.

56. In a well-functioning market we would expect to see customers responding to variations in prices and quality of service. We estimated gains from switching by focusing only on financial gains, and assuming customers switched to the cheapest products for their usage. It is a static assessment, in the sense that we assume no changes in customer behaviour or provider prices, therefore the gains from switching should not be interpreted as the gains that all customers could achieve in the market through switching.

57. Our estimate of the gains from switching found that many PCA customers could make substantial financial gains from switching. In GB for customers on standard or reward accounts we found that around 90% would gain financially from switching to a cheaper product.

58. The average gain from switching for these customers to one of the five cheapest products is around £92 per year. For customers on packaged accounts, 50% of customers could gain by switching and the average gain tends to be higher at just under £170 per year. However, our analysis of gains from switching for customers on packaged accounts is more caveated, as our assumptions on the value of the benefits offered by packaged accounts may not reflect the true value to all customers of such benefits and not all customers will regard the different benefits available as interchangeable.

59. For GB customers on standard or reward accounts, the average gains are highest for those customers who use overdrafts and increase with the number of days in overdraft. Overdraft users have potentially the most to gain from switching, with GB customers in overdraft for 8 to 14 days a month gaining approximately £180 per year. GB customers who use unarranged overdrafts for eight or more days a month and do not use any arranged overdrafts could gain by switching between £540 and 564 per year. These estimated gains for overdraft users assume that such customers are offered the same size overdraft by their new bank, which may not be the case as banks have different policies and a customer’s financial circumstances may change affecting eligibility.

60. The lowest gains are for GB customers on standard or reward accounts who do not use overdrafts, or are very light users of arranged overdrafts.

61. Our analysis in NI is less robust as our customer data sets are less complete. We found that in NI, around 90% of customers could make annual savings of on average £66 per year, ranging from £43 on average for customers who do not use an overdraft to £124 on average for overdraft users. As for GB, we found that gains from switching generally increase with overdraft usage. We did not find similar trends as in GB of gains from switching increasing with credit balance for customers who do not use an overdraft, nor did we find that customers with one of the larger NI banks gain more from switching.

62. Innovation can be a useful indicator of the level of competition in a market. In a well-functioning market investment in innovation can bring benefits to customers in the form of diversity of choice, cost efficiencies and enhanced service levels.

63. There have been a number of innovations in the PCA market in recent years with respect to products (such as the introduction of reward accounts), service (as part of the wider digitalisation of retail banking); and new business models (for example by firms with only an online presence). When assessed individually, there is a considerable degree of variation in the development of each innovation and the extent to which each innovation has impacted (or is likely to impact) the PCA market. Both the introduction of reward accounts and mobile banking (as part of the wider digitalisation of retail banking) are well established. In contrast, other innovations, such as the use of account aggregation services, big data, and digital wallets, are in the early stages of development, particularly when considering their application to the PCA and wider retail banking market.

Customer engagement in PCA markets

64. As described above, despite variations between banks in prices and quality and the gains from switching, market shares have remained broadly stable with those banks offering the lower average prices and/or higher service quality only gaining market share slowly. This suggests that PCA customers are not responding to variations in price and quality and that the scale of this lack of responsiveness is significant given the gains from switching that many customers can make. We therefore focused on understanding the level of customer engagement and the reasons behind this.

Levels of customer engagement

65. We concluded that customer engagement is low:

(a) Over a third of respondents to our survey had been with their main PCA provider for more than 20 years.

(b) Over a half of respondents had been with their main PCA provider for more than ten years.

(c) Only 3% of PCA customers had switched PCAs to a different bank in the last year. Over the past three years only 8% had switched.

(d) Over three-quarters of PCA customers had neither searched nor switched in the last year.

66. We compared PCA switching rates to rates in other sectors and found that switching rates in the last three years were materially lower for PCAs than for example in savings products (13%) and in energy (over 30%). Internal switching rates – switching PCA products within the same bank – are also very low (2.5%) and nearly three-quarters of internal switchers did not search prior to switching.

Characteristics of engaged customers

67. We analysed whether any particular customer groups are more or less likely to search, switch or hold active PCAs with more than one provider ('multi-bank'). Looking at customers who searched, switched or multi-banked we found that such customers are more likely to have higher income, higher balances and higher education levels than those who did not. Internet banking and/or having confidence in the use of the internet also increases the probability of searching and switching. Customers who hold financial products at other banks are also more likely to search and switch PCAs.

68. We found that customers who use unarranged overdraft facilities are less likely to switch than customers who only use an arranged overdraft facility. Heavier overdraft users are less likely to switch than lighter overdraft users, and the heaviest unarranged overdraft users are least likely to switch compared to other customer groups including non-overdraft users. This is despite overdraft users having much greater potential gains from switching with the gains from switching increasing the heavier the usage, especially heavier unarranged usage. However, lighter overdraft users were more likely to switch than non-overdraft users, although the differences were small and we have assumed that these customers would be offered the same size overdraft after they switch, which may not be the case.

Barriers to engagement, searching and switching

69. Customers engage in various ways with their PCA from understanding the PCA products they currently hold (eg by checking their balance) to participating more actively in the market by searching and comparing various PCA offers, and eventually either choosing to stay with their current provider or applying for a new account and switching providers to obtain a better deal.

70. We considered the process by which consumers engage and make choices in this market. Digitalisation has facilitated customer engagement with their accounts and if properly harnessed has the potential to reduce customer searching and switching costs. However, we found the following:

(a) Unlike other financial services products such as motor insurance, PCAs have no contract end date, which means that customers are not required periodically to consider if their PCA is best for them. Life events such as moving house had no significant effect on searching or switching.

(b) Many customers see no reason to engage as they are satisfied with their bank. Over half and more than a further third of respondents to our survey said they are 'very satisfied' and 'fairly satisfied' respectively. This is despite differences in the prices and quality of service offered by different banks and substantial potential gains from switching. In addition, the low levels of searching suggest that customers are not always making an informed decision to remain with their existing PCA provider and may not realise there are other PCAs that may serve them better.

(c) Many customers believe that there is not much to be gained from switching. PCAs are relatively low-cost products, particularly for those who remain in credit and many customers see little differentiation between banks. We found that over a half of customers did not incur any direct charges in the last quarter of 2014 for using their PCA and the most common source of charges were overdraft charges. Around three-quarters of customers who incurred charges paid less than £10 in the three-month period we analysed.

(d) There are barriers to accessing and assessing information on PCA charges and service quality because:

(i) In order to identify the best account for them, customers need to combine information on the different account charges, eligibility criteria and rewards, and complex overdraft charging structures, with a detailed knowledge of their own account usage.

(ii) Information on account usage is currently only generally available through monthly bank statements. The Midata initiative provides a means for consumers to gain this information by downloading their usage history in a file from their bank's website. Although the Midata initiative is a positive development, it is not straightforward to use, its current application is not fully effective and its usage remains very low.

(iii) In addition to being complex, banks' pricing structures lack transparency and PCWs currently play a limited role.

(iv) Quality of service information is currently very limited despite 80% of respondents to our survey stating that quality of staff and service and handling problems are essential or very important features of a PCA.

71. Customers still perceive significant barriers to switching accounts despite the introduction of CASS. CASS has eased account switching as it provides a useful guarantee. However, our survey found that over half of customers considered that switching was a 'hassle' and over 40% feared that something 'may go wrong'. Research by the FCA published in 2015 found that customers lacked awareness of CASS with only 51% having heard of CASS prior to the survey. The FCA also found that confidence in the service remained low and the Payments Council reported in December 2014 that less than 50% of customers were confident that CASS would complete their switch without error.

72. In addition, there are particular concerns for overdraft users. Around 4.5% of active PCAs used an overdraft in 2014 with around a quarter of PCA customers using an unarranged overdraft. Despite overdraft users tending to have the most to gain from switching, we found that:

(a) Overdraft charges are particularly difficult to compare across banks, due to both the complexity and multiplicity of the charging structures and the difficulties in understanding their own usage. In particular, customers exceeding their pre-arranged credit limit can incur substantial charges but there is no easy way for a customer to find and compare the charges or credit limits an alternative PCA might offer them.

(b) Overdraft users generally have limited awareness of and engagement with their overdraft usage. For example, over half of overdraft users we surveyed underestimated their usage by two or more months in a year and over a third were not aware that they had gone into overdraft. Moreover, around half of unarranged overdraft users did not believe they had gone into unarranged overdraft.

(c) There are additional barriers to switching for overdraft users due to uncertainty surrounding the acceptance and timing of any overdraft approval when opening a new account. In addition, a new bank may not be willing to offer the same level of overdraft facility as a customer's bank, for example because the new bank will not have access to the customer's transaction data but will need to rely on information from the customer and from CRAs.

73. We also found that unarranged overdraft users are likely to find it hardest to effectively engage with the market. Around half of unarranged overdraft users were not aware that they had gone into an unarranged overdraft. Low engagement by unarranged overdraft users is of particular concern because unarranged overdraft usage is not pre-agreed with the bank and in many cases may be inadvertent. Such usage also involves a significant increase in charges. Some customers may therefore not want to use unarranged overdrafts and would avoid doing so if they had greater awareness of their overdraft usage.

Banks' incentives to compete in PCAs

74. The behaviour of customers can play a central role in providing competitive constraints on providers. This happens if customers are engaged and willing to search for and implicitly threaten to switch to another provider, which offers them a better deal. Conversely, a lack of customer engagement in the market reduces banks' incentives to compete.

75. The evidence we gathered indicates that competition between banks is focused on acquiring the primary banking relationship and targeting more affluent customers. Consistent with this, several banks have launched new PCAs with conditions that encourage affluent customers to move their primary banking relationship to these brands.

76. There are an increasing number of initiatives in product development by banks, with the introduction of reward accounts and the introduction of one-off switching incentives, typically in the form of cash payments. Such accounts enable banks to target new to market customers and switchers. Our pricing analysis shows that some of the new reward accounts are relatively cheap compared to standard accounts.

77. Competition to attract new customers is an important aspect of banks' overall competitive behaviour. However, there has been much less active competition on other aspects such as arranged and unarranged overdraft charges and there is no evidence of banks specifically targeting overdraft users despite a significant proportion of PCA revenues deriving from overdraft usage. Many

recent changes to overdraft fees have been driven by regulation rather than the banks. This more limited competition on arranged and unarranged overdraft charges is consistent with our analysis of the levels of engagement, searching and switching by overdraft users.

78. We have considered the impact of the FIIC price model on customer engagement. We have not found that the FIIC price model itself reduces customer engagement. FIIC accounts work well for many customers as it means that such customers are not charged directly for everyday banking transactions. In addition we have found:

(a) Switching rates: evidence from other countries that do not operate a FIIC pricing model does not point to switching being higher under alternative pricing models. Similarly, the BCA market, which does not operate a FIIC pricing model, has similar rates of switching.

(b) Facilitate switching: FIIC pricing may make it easier for some customers to multi-bank and to try alternative accounts before switching.

(c) Customer engagement: whilst our survey suggests that non FIIC accounts have tended to attract more engaged customers, the differences are small and are likely to reflect that customers on reward accounts, which are relatively new accounts, are likely to consist of recent switchers.

(d) Transparency of costs of PCAs: there is a lack of transparency around the cost of PCAs and this makes it difficult for a consumer to compare PCAs and select the best one for them. However, alternative pricing models to FIIC are not necessarily more transparent than FIIC accounts. For example, pricing structures for BCAs that are not generally FIIC accounts are also complex making it difficult for SMEs to compare. Similarly reward accounts are also difficult to compare to assess best value. The underlying reason is the overall complexity of charges and any rewards including interest, and the lack of tools available to consumers to combine the charges and any rewards with their account usage, rather than the FIIC pricing model as such.

(e) Overdraft charges: banks' incentives to set high overdraft charges arise because of the low customer engagement and barriers to searching and switching for overdraft users on all types of accounts and not just FIIC accounts.

79. We also analysed whether the FIIC pricing model means that some customers are cross-subsiding others and/or contributing more to banks' revenues. All types of customers across different income groups and credit balances contribute to banks' revenues once interest forgone is taken into

account, although there is considerable variation between customers in the revenue generated as described in paragraphs 42 to 44 above. Taking into account direct charges and interest forgone, the cost to the customer of a PCA increases with credit balance and the number of days overdrawn. We did not find that it is the customers on the lowest income who pay most for their PCAs.

80. We found that arranged overdraft users tend to have higher incomes and higher education than non-overdraft users and those who use unarranged overdrafts. We also did not find that heavier overdraft users have lower incomes than lighter overdraft users on average.

81. Setting aside basic bank accounts, which are likely to be used by the most financially vulnerable and which are likely to be cross-subsidised by other customers, we found that the costs of PCAs (including interest forgone) are highest for customers in the highest income deciles and this is particularly the case for FIIC accounts. Conversely customers with no overdraft and low credit balances pay the lowest costs.

82. We also did not find that the FIIC model limits banks' abilities to adopt alternative pricing structures to differentiate themselves. Many banks, including new entrants and smaller banks, are adopting alternative pricing models including reward accounts. These alternative pricing models have been relatively successful in attracting new customers. The main barrier to customers engaging with such accounts is not the FIIC model itself but the complexity for customers in comparing and assessing best value and the barriers to switching.

Findings in relation to customer engagement in the provision of PCAs

83. The overall level of PCA customer engagement, while having increased in recent years in particular due to the increasing digitalisation of banking, remains low. This is demonstrated by the low levels of searching and switching and the existence of substantial gains if customers were to switch PCAs. We have also found specific concerns regarding the low level of engagement of and difficulties in searching and switching for overdraft users.

84. The low customer engagement means that the discipline imposed by customers on banks through switching and the threat of switching is not as strong as it would be if more customers were engaged. This in turn weakens banks' incentives to compete to gain new customers and retain existing customers. There is in particular a lack of competitive pressure on overdraft charges especially unarranged overdraft charges. Overall, we have therefore found that competition in PCA markets is not working well.

85. We consider further the overall impact of this low customer engagement on barriers to entry and expansion (together with our analysis of other potential barriers to entry and expansion) and the market power of the banks before summarising our findings on the features giving rise to AECs and the remedies we are putting in place to address these.

Competition in SME banking

Introduction

86. Banking services including BCAs are an indispensable service for the vast majority of SMEs. How an SME uses its bank and what it needs from its bank will depend on a range of factors such as the stage and life cycle of the SME, its size, the type of business and sector in which it operates, the complexity of the business, whether it is an employing business and its growth ambitions.

87. Over 97% of SMEs in the UK had turnover of less than £2 million. Start-up and younger SMEs have the highest failure rates. For example, only 60% of SMEs will still be in business after three years and less than half (around 40%) will be in business after five years. However, nearly half of SMEs are over ten years old and over a quarter are over 20 years old.

88. There is little variation between types of BCA. Banks will typically either charge for each transaction or charge a monthly fee which will include a specific volume of transactions within the fee. Anything not covered by the fee will be paid for on a per-transaction basis. Larger SMEs may negotiate bespoke pricing terms for their BCAs. Most banks offer start-up SMEs (and to a lesser extent SMEs switching BCAs) a period of 'free banking' during which transaction fees are waived.

89. Alongside transactional services, banks generally also offer overdraft facilities (usually subject to an annual arrangement fee) and advisory and support services to SMEs as well as other products such as deposit accounts. How and what advisory and support services are provided by most banks to SMEs will vary with the size of the SME. The smallest SMEs will generally have access to a call centre whereas larger SMEs will generally have a personal relationship manager.

90. For many SMEs, banks are also an important source of finance. SMEs need finance during critical periods of growth when businesses are seeking to expand, as well as during difficult periods when a business may need short-term financial assistance, for example to manage cash flow. There is a variety of business lending available, including general-purpose business loans and commercial mortgages, credit cards, asset and invoice finance and alternative

lending platforms. Different types of finance address different needs and their suitability will depend, for example, on whether short- or long-term finance is needed, whether security is available and the urgency for finance.

91. In 2014, 48% of SMEs had credit cards and 43% had overdraft facilities. However, only 18% of SMEs had held a loan and very few SMEs with turnover below £2 million had taken out commercial mortgages, invoice finance or asset finance. While smaller SMEs represent over 97% of SMEs, they accounted for around three-quarters of new loans by volume and less than half by value.

92. We collected data on banks' UK revenues to understand the profitability of their SME operations and, where possible, the profitability of individual products and customers. BCAs (or wider SME banking, depending on banks' own assessments of profitability) are profitable. The volume and type of transactional activity is particularly important to the profitability of BCAs. Larger SMEs are the most profitable as they tend to hold higher credit balances, have higher transaction volumes and a need for a broader range of banking products and services. Charities, clubs and societies on the other hand are the least profitable SMEs for banks as they usually get 'free' transactional banking, are likely to have lower credit balances and are more likely to use cheques, which are more costly for banks to process.

93. Average net revenue including the value of funds per active BCA in 2014 was £736. As with PCAs, nearly a half of net revenue is from the value of funds deposited and just over a third from overdraft charges. There has been a decline in net revenues from BCAs since 2012 driven by a reduction in revenues from overdraft charges and from transaction charges and other receipts. Unlike PCAs, there has been an increase in the net value of funds.

94. Whilst BCA revenues have declined, total revenues from interest and charges on general purpose loans have increased since 2011. This has been driven by interest charges and other receipts. However, invoice finance revenue and net revenue from business deposits has declined.

Structure of SME banking markets

95. In 2015, the markets for BCAs in GB and NI were concentrated, with the NI market more so. The combined market shares of active BCAs of the four largest providers in GB (RBSG, LBG, Barclays and HSBCG) and in NI (RBSG, Danske, BoI and AIB) were 83% and 86% respectively in 2015. Their combined shares have declined by only 1 percentage point in GB and 2 percentage points in NI between 2012 and 2015.

96. We have considered separately the different SME lending products. We found that levels of concentration in general-purpose business lending (including commercial mortgages) are high in both GB and NI. Similarly, the markets in GB and NI for general-purpose business loans to SMEs with turnover of less than £2 million are more concentrated than for larger SMEs.

97. The equivalent data for invoice finance is incomplete because figures for a significant number of finance providers are not available. However, given the larger number of providers and the larger banks' lower market shares in invoice finance, concentration levels are likely to be lower than in general-purpose business loans. Similarly in relation to asset finance, concentration levels are likely to be even lower. We therefore anticipate that concentration levels for the total SME business loan market are lower than for general-purpose business loans.

Pricing, quality and innovation in SME banking

98. BCA charges are complex and vary significantly between SMEs depending on usage, whether the SME is able to negotiate fees, whether it benefits from so-called 'free' core transactions and whether it pays a per-transaction or a monthly fee. This complexity makes comparisons of BCA pricing challenging. In order to make comparisons across banks, we applied banks' current BCA charging tariffs to representative SME customer profiles for SMEs with SMEs with annual turnover less than £2 million.

99. We found substantial variations in BCA monthly charges between banks. In GB, the difference between the highest and lowest monthly costs was over 100% for the majority of the customer profiles. For five of the profiles, the highest monthly cost was over three times as large as the lowest monthly cost. Similar variations were found in NI and monthly prices are generally higher than those in GB. However, we did not find evidence of a clear association between price and market share in GB or NI.

100. We have not undertaken a similar analysis of SME loan pricing. There is wide variation in types of lending and loan pricing is opaque, complex and tends to be more tailored reflecting the nature of the SME, and the term and size of the loan. Any pricing analysis would therefore be highly data intensive and complex, and the inferences that we could draw from it would be limited.

101. To compare the quality of SME banking services across banks, we considered indicators such as customer satisfaction scores and net promoter scores and also measures of satisfaction with relationship managers. We found that many new entrants in the provision of BCAs in GB typically had higher satisfaction and net promoter scores compared with the larger longer-

established banks, which all had similar satisfaction scores. In NI, results were less clear cut. As with price, however we did not find a clear association between quality and market share in GB or NI.

102. We observed that some banks which appear to offer above-average pricing and below-average quality are gaining market share and conversely that banks appearing to offer below-average prices and above-average quality are either losing market share or are gaining market share at a slow pace.

103. We also assessed the levels of innovation in SME banking. We found that there has been little product innovation and innovation has tended to focus on the digitalisation of banking and reducing customer reliance on branches. These innovations have lagged behind the levels observed for PCAs. For example, some banks do not offer mobile banking to SMEs and/or offer less functionality than they offer to PCA customers. This may be explained, at least in part, by the size of the respective markets.

SME engagement in BCA markets

104. The levels of concentration and stability in market shares despite variations in price and quality between banks and the limited levels of new entry and innovation suggest that SMEs are not responding to variations in price and quality and that competition is not effective. We therefore focused on understanding the level of SME engagement with BCAs and the reasons behind this.

Levels of engagement in BCAs

105. In analysing SME engagement in retail banking, we identified three broad stages in the life of an SME which will impact on an SME's demand for banking products and the nature of its engagement in the market: first the start-up phase when first opening a BCA and establishing a business banking relationship; second, the end of the 'free' banking period usually after 12 to 24 months when an SME will have a more established relationship with its business banking provider and its banking needs may begin to extend beyond the transactional aspects of a BCA; and third, more established SMEs whose needs for other banking products and services, including in particular lending, may increase and the banking relationship may become stronger.

106. In relation to BCAs, we found little evidence that SMEs search or consider switching:

(a) Over half of start-up SMEs in GB went to their owner's PCA provider for their first BCA and a third did so without searching at all.

(b) Over half of all start-up SMEs did not compare providers and nearly a further quarter only did so in a superficial way.

(c) Only 4% of SMEs in GB had switched BCA provider in the last year and only 2.6% of SMEs in NI had switched.

(d) 70% of SMEs in GB and 77% in NI that had been in business for over ten years have been with their main bank for at least ten years.

(e) Over three-quarters of SMEs between two and five years old said that they never compared the costs of their BCA with other providers and two-thirds of SMEs did not consider switching at the end of the ‘free’ banking period.

107. While satisfaction with their provider was the main reason given by SMEs for not considering switching BCA, over a third of SMEs dissatisfied with their bank also did not consider switching and this was consistent with our qualitative research on SME behaviour. In addition, the low levels of searching and the differences in price and quality between providers suggest that many SMEs may not be making an informed decision to remain with their BCA provider.

108. We therefore investigated whether there are other factors that act as barriers to searching and switching.

109. We examined SMEs’ attitudes to banking and found that there are a number of factors that may reduce searching and switching. There is a lack of triggers that would prompt them to consider their BCA, and BCAs are relatively low cost compared with other costs of business. SMEs perceive that remaining loyal to a bank will be beneficial, in particular in relation to future lending decisions. There is also a perception among SMEs that potential gains from switching are not high and that there is limited differentiation between banks. This perception is not borne out by our BCA pricing analysis which found significant differences between the highest and lowest monthly costs of a BCA for almost all our customer profiles. Whilst our estimates should be interpreted carefully, our BCA pricing analysis suggests that, in GB, SMEs could save around £80 per year on average by switching to the bank that was cheapest based on their transaction behaviour. In NI the equivalent figure is around £112 per year.

110. We found that while price information is available, it is difficult for SMEs to compare charges across banks. This is because of the complexity of tariff structures, the variability in usage and the lack of publicly available comparable information on the quality of banks’ services. The equivalent of Midata in PCAs does not exist for SMEs and there is a lack of effective price

comparison tools, making comparison time consuming and difficult. Websites such as Better Business Finance (BBF) and Business Banking Insight (BBI) focus on specific aspects of SME banking – for example, service quality. Finance platforms that currently operate in the market (including Bizfitech, Funding Options and Funding Xchange) provide information on alternative sources of finance to the large banks, but offer limited comparisons of other services such as BCAs. This lack of effective comparison tools is likely to particularly affect smaller SMEs without specialist financial capability.

111. There are also barriers to switching BCAs.

(a) The account opening process can be lengthy and onerous, particularly because of banks' informational requirements for undertaking AML compliance.

(b) Awareness of CASS is low among SMEs, despite most being eligible. Of those who switched in 2014, only 10% switched through CASS. Half of SMEs that had not switched BCA did not know that assistance was available to switch BCA and of those that were aware of assistance, the majority knew little or nothing about the nature of such assistance.

(c) Loss of historical data, potential loss of payments at the end of the CASS redirection period and loss of data on the source of payments were highlighted by SMEs as areas of concern with the switching process.

(d) For some customers, access to lending may deter them from switching for fear that doing so would make it less likely that they would be able to access ongoing lending or future lending.

Banks' incentives to compete in BCAs

112. When looking at how banks compete for start-up SMEs we found the following:

(a) Most banks offer 'free' banking periods of between 12 and 24 months to start-up SMEs for BCAs. However, there has been a lack of dynamism with few changes to the length of 'free' banking offers to start-up SMEs in the last four years.

(b) PCA providers have advantages in acquiring start-up SMEs, with over half of SMEs in GB opening a BCA with their owner's PCA provider. Only one small prospective entrant is planning to provide BCAs but not PCAs. At the end of the 'free' banking period, the most important factors driving choice of BCA provider for start-up SMEs were branch location and the bank being the SME owner's personal bank.

(c) We did not find strong evidence of banks targeting start-up SMEs through marketing or advertising.

113. We looked at how banks compete for SMEs at the end of their ‘free’ banking period and for more established SMEs and found the following:

(a) While there are some offers of ‘free’ banking periods as inducements to BCA switchers, this is becoming less common in particular by newer entrants and smaller banks.

(b) Banks’ acquisition and retention strategies tend to focus on larger SMEs (turnover of above £2 million). In particular, larger SMEs have access to relationship managers, partly to provide these customers a better quality of service but also to sell other products. Where relationship managers have customer acquisition targets, these tend to be geared towards the largest SMEs (turnover above £5 million).

(c) Banks tend to negotiate with larger SMEs, but not smaller SMEs. However, while important for banks in terms of revenues, larger SMEs represent less than 5% of all SMEs.

(d) There has been some innovation on tariffs, particularly with the introduction of electronic banking tariffs, but this has been limited.

SME engagement in SME lending

114. As SMEs grow they are more likely to seek additional products from their bank or other providers. Most SME lending by value is taken by larger SMEs and lending requirements vary significantly between SMEs. The most common reasons for seeking finance are to expand the business (30%), to cover cash flow shortfalls (28%) and purchasing new equipment (22%).

115. We considered, as in PCAs and BCAs, the level of engagement and whether there were barriers to searching in SME lending that prevented SMEs from identifying the best lending products for their needs. Our surveys of SMEs found that:

(a) around 90% of SMEs went to their main bank for overdrafts, general-purpose business loans and credit cards; over two-thirds went to their main BCA bank for invoice discounting and factoring and more than three-quarters for commercial mortgages; and

(b) over half of SMEs considered only one provider when seeking lending.

116. We found that there were three primary reasons why SMEs went to their main bank for finance:

(a) Relationship with main bank: SMEs value the relationship with their bank and believe that loyalty to their main bank will help them obtain finance. In addition, an SME's main bank will have more information on its customers – including financial history – to enable it to assess the risk of the SME defaulting. This information asymmetry between the main bank and other lenders enables the main bank to price credit more accurately, and potentially make lending decisions more quickly.

(b) Time, effort and convenience: SMEs may not consider providers other than their main bank because of the time and effort involved in applying for finance from other providers, particularly when finance is needed at short notice. We found that a quarter of SMEs did not consider other providers because of the 'hassle' or time associated with applying for finance. Time spent searching and completing applications – including gathering necessary documentation – varies significantly and so does the time it takes for banks to subsequently make a decision.

(c) Barriers to searching: it is difficult for SMEs to compare prices, eligibility and other terms across banks. Prices are opaque and lending products are complex. Banks do not publish indicative tables of interest rates, management fees or eligibility unlike other lending products such as residential mortgages. In addition, there is a lack of tools to help SMEs make comparisons, which may particularly affect smaller SMEs without specialist financial capability. We have also identified that there is a potential risk to SMEs' credit ratings from searching.

Banks' incentives to compete in SME lending

117. The nature of customer engagement in the market will affect banks' behaviour. Some banks have sought to increase their lending volumes by improving the availability of finance and the speed with which an SME can obtain a decision on lending applications. However, such initiatives are mainly focused on retaining existing BCA customers. We also found some limited evidence of banks responding to the price offers of competitors seeking to attract customers away from their main bank at a local level. However, this is mostly targeted at larger SMEs which are best able to negotiate and with a view to acquiring the main banking relationship. Evidence of pricing initiatives and discounts aimed at attracting new customers is limited.

Findings on SME engagement in BCAs and SME lending

118. Overall we therefore find that competition for both BCAs and SME lending is not working well for customers. A combination of factors mean there is weak customer response to price and quality weakening the constraints on banks from customer switching or the threat of switching, or in the case of SME lending going to an alternative lender. As a result banks have limited incentives to compete in BCAs or SME lending on price and quality. With greater customer engagement banks will have stronger incentives to compete.

119. We found that in particular smaller SMEs that no longer benefit from a ‘free’ banking period are most likely to be affected by the reduced competitive constraints on banks in BCAs from this weak customer response. We also found that smaller SMEs, in particular those that are less able to negotiate better prices and terms, are also most likely to be adversely affected by the reduced competitive constraints on banks in SME lending.

Barriers to entry and expansion

120. The prospect of entry or expansion within a short period of time will often stimulate competition and provide a source of competitive discipline on incumbent firms. As set out above, there is weak customer response by PCA customers and SMEs in relation to BCAs and SME lending, as well as, in relation to SMEs, strong product linkages and information advantages. New entrants and smaller banks seeking to enter or expand therefore have to invest heavily in order to attract customers away from the incumbent banks over and above the inherent costs of entry and expansion. Even then, it will take some time before they are able to acquire a sufficient volume of customers to recover their costs of entry and expansion and/or to have a sufficient presence in the market commensurate with their initial investment. The high cost of customer acquisition arising from this weak customer response, including strong product linkages, is a barrier to entry and expansion in PCAs, BCAs and SME lending.

121. We considered a number of further potential barriers to entry and expansion. Previous reviews have found the authorisation process for banks, the cost of IT and access to branches as barriers to entry or expansion in retail banking. We no longer find this to be the case. A revised authorisation process has enabled a more flexible approach enabling banks to become authorised with restrictions before committing to large potentially irreversible upfront investments. While economies of scale and scope still exist in retail banking markets, technological developments have reduced the cost and risk of upfront investment in IT systems and enabled the development of alternative

business models that do not rely on branches as a distribution channel. If a branch is part of a new entrant's business strategy, we did not find that it has any cost disadvantages or other difficulties compared to incumbent banks.

122. We also looked at AML regulations and did not find that these were a barrier to entry and expansion but as described above banks' differing requirements for compliance can make it more difficult for customers, in particular SMEs, to search and switch accounts. We also looked at whether accessing funds to set up as a bank or intermediaries as a distribution channel were problems for new entrants and did not find that this was the case.

123. Access to payment systems has long been identified as an issue because the payment systems are owned by the four largest UK banks and many other banks access the payments systems through one of the four banks. The PSR, which has only been fully operational since April 2015, has a primary objective of ensuring that payment systems operate in a pro-competitive way. It has an extensive work programme looking at the issues we identified and we consider that it is best placed to take forward and address these long-standing issues.

124. In July 2015, the government made changes to reduce the bank levy over time. The bank levy had been imposed, following the financial crisis, on the larger banks to ensure that they made a greater tax contribution reflecting the risks they posed to the financial system and the wider UK economy. Also in July 2015, the government introduced the corporation tax surcharge on a wider group of banks. A number of smaller banks raised significant concerns with these changes.

125. We did not find that the changes are currently deterring entry and expansion or causing exit from retail banking. The bank tax regime continues to favour smaller banks including new entrants. However, the recent changes to the bank tax regime have reduced the previous tax advantage that new entrants and smaller banks had over those banks subject to the bank levy. Moreover, there are aspects of the design of the corporation tax surcharge that may lead to differential effects across retail banks and that might impact on competition between banks in the future. We therefore welcome HM Treasury's (HMT) commitment to keeping the impact of the bank tax regime on smaller banks and new entrants under review.

126. We identified three areas of particular concern in respect of barriers to entry and expansion: capital requirements; the costs of funds for lending; and information asymmetries between banks.

Capital requirements

127. The capital requirements regime exists to protect customer deposits, banks' trading counterparties and the economy from banks becoming insolvent. It does this by requiring banks to hold sufficient levels of capital to absorb losses in the event of failure or near failure. The amount of capital a bank has to hold depends on the structure of a bank's asset book, its risk profile, whether it is classed as a systemic bank, and its business decisions. Also the dual system of calculating the amount of capital a bank has to hold against different types of lending, results in some banks, primarily new entrants and smaller banks, having to hold much higher amounts of capital for the same lending than incumbent banks, for many types of lending.

128. The difference is particularly acute in the case of residential mortgages, especially low loan-to-value mortgages. Residential mortgages are a large and profitable part of the activities of many banks and we found that new, and some smaller, banks are at a competitive disadvantage in residential mortgages as a result of the differential in the amount of capital they are required to hold compared to many incumbent banks.

129. Two members of the inquiry group are of the view that the evidence is sufficient to support a finding that the capital requirements regime for mortgages has sufficiently large effects on the costs and returns of banks to be a barrier to entry and/or expansion in retail banking more generally, including the supply of PCAs and of SME banking services. The majority of the inquiry group, however, consider that further evidence would be needed in order to be confident about the materiality of the competitive disadvantage and the impact on outcomes in order to support a finding that the differential in capital requirements in residential mortgages is a barrier to entry and/or expansion in PCAs, and/or SME banking (or indeed in other retail banking markets).

130. We decided that it would not be appropriate to undertake further analysis on this issue. We do not have powers to change the capital requirements regime and the regime as a whole is the subject of a number of significant developments for reform at international level. Moreover and importantly, the PRA, BoE and HMT, which have primary responsibility in this area, have confirmed that they are considering the issues we have identified as a matter of priority to ensure that the competition impacts are given due weight. In light of this and the importance of the capital requirements regime to the safety and soundness of the UK banking system, it would not be appropriate to create regulatory uncertainty in this area by seeking to pre-empt the ongoing work of the PRA, BoE and HMT.

Costs of funding for lending

131. The high cost of customer acquisition means that it is expensive and time consuming for new entrants and smaller banks to attract retail deposits which are then used by banks to fund their lending activities. Incumbent banks on the other hand benefit from access to an existing stable book of lower cost retail deposits. The larger the customer base and the more diversified the product portfolio, due to product linkages, generally the greater the costs of funding advantage for an incumbent bank.

132. We also find that incumbent banks enjoy some cost advantages in wholesale funding. This advantage is most readily quantifiable for those banks that are viewed by investors as ‘too big to fail’ (TBTF). Such banks are viewed by investors as lower risk and therefore benefit from lower wholesale funding costs. Other factors may compound the wholesale cost advantage from TBTF over and above the firm-level differentials to be expected in a well-functioning market.

133. Since the financial crisis, regulators in the UK and internationally have been seeking to address TBTF as it raises not only competition issues but also prudential concerns. The measures taken to date have reduced the impact of TBTF and the ‘ring fencing’ of the larger banks’ retail businesses from the riskier parts of their businesses from 2019 will further address this.

Information advantages

134. Access to an established customer base gives incumbent banks access to information on their customers that can be used to develop products and target promotions. This is common in many retail industries and with increased digitalisation, the use of such data is likely to increase. However, we have not found strong evidence that such informational advantages are acting as a barrier to entry or expansion.

135. In relation to SME lending however, an SME’s BCA provider will benefit from better information about the financial history on their existing SME customers than alternative providers. This gives an SME’s BCA provider an advantage in pricing and assessing default risk. This is particularly relevant for smaller SMEs as there is a lack of publicly available information on the trading and financial performance of such SMEs. Access to such information can also reduce the time involved and inconvenience to SMEs of the loan application process. There are a number of government reforms in train that have the potential to mitigate some of the informational advantages held by the BCA bank in relation to SME lending, however these have yet to be tested. We

therefore conclude that access to financial and transactional data is a barrier to entry and expansion to SME lending.

Overall conclusions on barriers to entry and expansion

136. We therefore find that the high cost of customer acquisition including product linkages and, in relation to SME lending, the informational advantages of the BCA provider, make it difficult for new entrants and smaller banks to expand and are a barrier to entry and expansion. Combined with economies of scale and scope in retail banking, this means that incumbent banks have first mover advantages and are able to spread their costs over an established customer base. They also have lower costs of funds for lending as they have access to stable and lower cost retail deposits from their established customer base and, particularly for the largest incumbent banks, wholesale funding advantages. These incumbency advantages are particularly strong for incumbent banks with larger customer bases.

Market structure and market power in the provision of PCAs and SME banking

137. Market power can arise through firms having unilateral market power or as a result of firms coordinating their behaviour. We have not found evidence to suggest that coordinated behaviour is a feature of any of the markets we investigated.

138. As described above, we found that retail banking markets are concentrated, excluding the impact of mergers and acquisitions, the larger banks in both GB and NI in aggregate have lost market shares, but this reduction has been small.

139. In general, the combination of persistent concentration in a market and barriers to entry and expansion may indicate competition problems and lead to worse outcomes for customers.

140. We analysed prices and service quality in both the PCA and BCA markets in GB and NI. Our comparisons of BCA prices is more limited but overall we did not find any evidence of a clear relationship between BCA market shares and prices. Neither did we find a relationship between market shares and service quality for PCAs. The lack of a corresponding relationship between price or quality and market shares was also the case in relation to NI for both PCAs and BCAs.

141. However, in relation to PCAs in GB, we found that banks with larger market shares have a tendency to charge higher average prices than banks with

lower market shares. This might suggest that larger banks have more market power and we considered carefully whether this was the case.

142. As described above, the majority of PCA customers are not responsive to price or quality. Banks therefore do not need to work hard enough to gain and retain customers. This gives banks a source of unilateral market power over their existing insensitive customers. However, the extent to which PCA customers are insensitive to price varies. Some customers are more price sensitive, actively look for better deals and respond to price and quality differences by switching.

143. The evidence suggests that the proportion of active and inactive customers and product mix are important factors explaining why we find that banks with larger market shares tend to charge higher PCA prices on average. The larger banks offer lower priced accounts to new customers and switchers, but because they have relatively larger proportions of customers on more expensive accounts than the newer and smaller banks, the prices of banks with high market shares are, on average, higher.

144. The difference in the proportion of active and inactive customers at larger banks as compared to smaller banks may have been the result of them having weaker incentives to compete for active customers, including concerns about engaging their own customers to switch. We note in particular, the role that entrants and banks seeking to expand have had in the introduction of lower priced accounts. Overall, however, we find insufficient evidence to support a finding that the current concentrated market structure is itself having adverse effects on competition and detrimental effects on outcomes in PCAs or in SME retail banking.

Our findings on competition in the provision of PCAs, BCAs and SME lending

145. There have been positive developments in recent years such as product innovation, new entry including by firms with new business models, and innovation in digital banking.

146. However the weak customer response to price and quality we have found in the PCA, BCA and SME lending markets means that the discipline imposed by customers on banks through switching and the threat of switching is not as strong as it should be. It also leads to banks having unilateral market power over their existing customer base. As a result banks' incentives to compete on price and/or quality and/or to innovate are reduced.

147. Further, as a result of the weak customer response including product linkages in respect of BCAs and SME lending, customer acquisition costs are high,

which makes it difficult for new entrants and small banks to expand, and is a barrier to entry and expansion. This barrier to entry and expansion, combined with the economies of scale and scope in retail banking markets, gives incumbent banks first mover advantages as they have an established base of customers over which to spread their costs. Such banks also have lower costs of funds for lending in particular due to access to an established book of lower cost retail deposits. These incumbency advantages are particularly strong for longer-established banks with larger existing customer bases. In relation to BCAs and SME lending such incumbency advantages are also particularly strong for banks with an existing PCA or BCA customer base given the product linkages between PCAs and BCAs and BCAs and SME lending respectively and, in relation to SME lending, the information asymmetries between an SME’s BCA provider and other providers of lending products.

148. An overall consequence of this is that larger longer-established banks are able to maintain high and stable market shares.

149. We have therefore found that a combination of low customer engagement, barriers to searching and switching and incumbency advantages in the provision of PCAs in both GB and NI is leading to AECs.

150. We have also found that the combination of low customer engagement, barriers to searching and switching, product linkages and incumbency advantages in the provision of BCAs in both GB and NI is leading to AECs.

151. We have also found that the combination of barriers to searching, strong product linkages, the nature of demand for SME lending products, information asymmetries and incumbency advantages in the provision of SME lending in both GB and NI is leading to AECs.

152. Certain customer groups are particularly affected by the AECs we have identified:

(a) Non-engaged customers who face higher barriers to searching and switching. These customers tend to be the less financially sophisticated and/or less confident in using the internet.

(b) Overdraft users, as charging structures for overdrafts are particularly complex and lack transparency. They also have greater difficulty in switching and have limited awareness of and engagement with their overdraft usage. Heavier overdraft users are particularly unlikely to switch and unarranged overdraft users incur unplanned charges and may not even be aware that they have started to incur such charges.

(c) SMEs that no longer benefit from a ‘free’ banking period.

(d) Smaller SMEs, in particular those less able to negotiate better terms and prices on lending.

153. While we have identified three separate AECs in each of GB and NI in relation to PCAs, BCAs and SME lending respectively these AECs are linked. Larger established incumbent banks will benefit from their established customer base not only in the provision of PCAs but also in the provision of BCAs given the product linkages between the two products. This in turn will give such incumbent banks advantages when competing in the provision of SME lending given the stronger linkages between BCAs and SME lending and the asymmetry of information between the BCA provider and other lending providers. The GB and NI markets are also linked and we have the same features in both. Given this, the detriment to customers from each AEC we have identified will therefore arise not only within each market in which we have identified the AEC but also in the markets of the other AECs.

Our remedies package

154. As the weak customer response plays such a central role in our diagnosis of the competition problems in the retail banking markets, measures to engage, empower and inform personal and business customers are at the heart of our remedies package.

155. This weak customer response does not have a single cause. There is therefore not a single 'magic bullet' that puts everything right. We are proposing a package of remedies the strength of which lies in the fact that the whole package is more than the sum of its parts.

156. As described in paragraph 6 above, there has been a succession of investigations of retail banking markets over the years, resulting in a series of interventions, some of them quite recent. Where it makes sense to do so, we aim to build upon and strengthen existing initiatives rather than replace them.

157. The pace of technological change in retail banking is speeding up – mobile banking tools have been rapidly adopted, and a growing financial technology ('FinTech') sector is developing and applying new tools. Application programming interfaces (APIs) will allow publicly available data and customers’ own data to be shared with trusted third parties, and 'open standard' APIs can be particularly powerful (with necessary safeguards for security and privacy) in opening up new customer information and advice services.

158. The overall shape of our remedies package is also influenced by the insights of 'behavioural economics' which tell us that the differences between effective

and ineffective interventions may be quite subtle. We have drawn on our own and others' customer research in developing our proposals, and in a number of areas we recommend the use of customer research including randomised controlled trials (RCTs) to refine the design of remedies and ensure they are as effective as possible in changing customer behaviour.

159. Before setting out our remedies, we explain why we are not taking forward certain remedies which have been the subject of longstanding debate and concern in retail banking.

(a) **Divestiture**: Some parties argue that the main reason why there is too little competition in UK retail banking is because the market is dominated by a small number of big banks, and that the way to put that right is to bring more competitors into the market by ‘breaking up the big banks’. As summarised in paragraphs 137 to 144 above, we have looked carefully at this, but have come to the view that market concentration may be having an effect on competitive behaviour but the evidence is neither strong nor conclusive that this is leading to worse outcomes for customers. In addition the separation of TSB from LBG and the upcoming separation of Williams & Glyn from RBSG have demonstrated that such divestitures can be prolonged and expensive exercises and are highly disruptive for those customers affected. Improving competition through further divestitures is superficially attractive, but would be sensible only if we had strong evidence that it would be an effective and proportionate remedy to the AECs we have found. We have not found that the evidence supports such an intervention.

(b) **FIIC**: Other parties have suggested that competition problems arise because of the prevalence of FIIC current accounts for personal customers. For the reasons set out in paragraphs 78 to 82 above, the real issue is not the FIIC price model as such, but a wider problem in that it is difficult for customers to work out whether their current account provider is offering them the best value or whether they would be better off with a different provider.

160. Our focus is on improving competition in retail banking to the benefit of personal and business customers by addressing the AECs we have found. Our remedies will drive innovation and improve products and services, disrupting the status quo. If the measures we are introducing lead, as we intend and expect, to increased competition, this will stimulate entry by new competitors and expansion by smaller competitors, putting pressure on the market position of the larger banks. Similarly, we have already seen a move away by customers from FIIC accounts and would expect this to increase with our remedies in place.

161. Our integrated package of remedies is illustrated below, and consists of four elements:

(a) Three cross-cutting **foundation measures** that will underpin increased competition in our reference markets. They have the object of increasing customer engagement and making it easier for personal and business customers to compare the prices and service quality of different providers and of encouraging the development of new services.

(b) Additional measures to make **current account switching** work better, including building on and improving the existing CASS.

(c) A set of measures aimed at **PCA overdraft** users, a group of customers who suffer particularly from the competition failures in the PCA market.

(d) A set of measures targeted at the specific problems in **SME banking**, making it easier for SMEs to compare different providers and reducing the hold that incumbent banks have in the market for BCAs and SME loans.

Overview of the remedy package

Foundation measures		
	Open Banking standard Service quality information Customer prompts	
Current account switching measures	PCA overdraft measures	Additional banking measures for small businesses
Better governance of guaranteed switching service Extended redirection of payments following switching Customer access to transactions history Customer awareness and confidence	Overdraft alerts with grace periods Monthly maximum charge (MMC) Improved account opening and switching process	Competition to develop SME comparison tools Loan rate transparency Loan price and eligibility indicator Standard information requirements for BCA opening Sharing of SME information 'Soft' searches Role of professional advisers

162. We will use our legal powers to impose some of the measures by order, while other measures will be implemented by our accepting legally binding undertakings from Bacs Payment Schemes Limited (Bacs), which operates CASS. Our remedies will not apply to private banks meeting relevant criteria and a number of our remedies apply only to the largest providers, while others only apply above a de minimis threshold.

163. For some of our remedies (including those where the final design will be subject to a programme of RCTs), we will collaborate with the FCA, and work closely with government departments, including HMT and the Department for Business, Energy & Industrial Strategy (BEIS), on the implementation of our decisions.

Foundation measures

164. The foundation of our remedy package is provided by three cross-cutting measures whose objective is to promote customer engagement and help customers make reliable and easy comparisons between banks based on their products' prices and features, quality of service and customers' own transaction history.

165. These measures aim to empower SMEs and personal customers to take greater control of their banking arrangements, reduce the costs to customers of shopping around, and encourage the development of a dynamic intermediary sector including providers of digital comparison tools and other FinTech advisory services.

166. Of all the measures we have considered as part of this investigation, the timely development and implementation of an open API banking standard has the greatest potential to transform competition in retail banking markets. We believe that it will significantly increase competition between banks, by making it much easier for both personal customers and SMEs to compare what is offered by different banks and by paving the way to the development of new business models offering innovative services to customers.

167. APIs are the key to the digital services that are used on computers and smartphones. They enable users to share information, for example on location or preferences. They are the technological drivers behind digital applications like Facebook, Google Maps and Uber. In banking, APIs can be used to share, in a secure environment, information such as the location of bank branches, prices and terms of banking products. APIs may also be used, with the customer's informed consent, to share securely their transaction history to enable access to tailored current account comparisons and other services.

168. We are requiring the largest retail banks[6] in both GB and NI to develop and adopt an API banking standard so as to share information to a specified timetable and we are requiring it to be an open standard so as to enable it to be widely accessible. This will enable intermediaries to access information

[6] RBSG, LBG, Barclays, HSBCG, Santander, Nationwide, Danske, BoI and AIBG.

about bank services, prices and service quality. Customers who are satisfied about privacy and security safeguards, and are willing to give consent, will be able to share their own transaction data with trusted intermediaries, which can then offer advice tailored to the individual customer. This will make it easier for customers to identify the best products for their needs.

169. Open APIs are central to our package of remedies. We will ensure that the programme of work to introduce open APIs is effectively managed and does not get bogged down in debates between market participants by creating a new entity, funded by the banks but led by an independent trustee, to ensure the timely delivery of this core remedy. We will also ensure that the views and interests of other major stakeholders, for example smaller banks and FinTechs, are fully represented.

170. We have considered very carefully the importance of data security and redress for customers. Customer confidence in the security of their information and, if a breach does occur, the availability of appropriate and speedy redress, are likely to matter at least as much to customers as the opportunities and benefit from using new technology. The security measures, as well as provisions in upcoming payment services legislation, provide a blueprint for how these issues can be dealt with effectively, though further detailed work on this issue will be necessary during the implementation of this remedy.

171. To ensure that sufficient time is available to work through the important issues associated with customers' data security and redress, the release of information under this remedy will take place in stages. We are requiring the banks to release the least sensitive information – for example about prices, terms and conditions and branch location – by the end of March 2017. We expect that all aspects of an open banking standard for sharing transaction data would be up and running by early 2018 at the latest.

172. Our second foundation measure will ensure that banks' customers get much better information on service quality than they currently have.

173. We are requiring banks to display prominently a number of core indicators of service quality. Our preferred measures of quality are based on customer willingness to recommend their bank to friends, family or colleagues. Data will be collected twice a year on a standardised basis, so that customers can easily compare across banks.

174. We are also requiring banks to collect and publish a wider range of additional quality measures that they will make available, alongside the core indicators, through open APIs to intermediaries which can use them in new kinds of

advisory and comparison services. The FCA is best placed to work with banks to develop and test which specific additional measures of service quality would be most useful, and then to put these measures in place, and we are making a recommendation to that effect.

175. Our third foundation measure deals with the lack of customer engagement that is in part caused by the ‘evergreen’ nature of current accounts that have no contract end date. Unlike other products, most customers hold a bank account for many years without ever being prompted to make a conscious choice about whether to continue or switch provider. Our remedy is therefore that personal and business customers should receive occasional reminders (‘prompts’), at suitable times, to encourage them to consider their current banking arrangements and shop around for alternative banking services. Some prompts might be triggered by specific events affecting the customer such as the closure of a local branch; others might be periodic, such as a reminder included in an annual statement.

176. We have identified a number of possible prompts and have also reviewed helpful suggestions from interested parties. Rather than trying to ‘pick a winner’, based on our current state of knowledge, the design and timing of such prompts needs to be based on further, careful research if they are to be as effective as possible. We are therefore recommending that the FCA should undertake a programme of RCTs to identify which prompts are likely to be most effective in changing customer behaviour. We are also recommending to the FCA that, subject to the results of the RCTs, it should implement, monitor and (when necessary) update such prompts. To facilitate this process banks will be required to cooperate with the FCA in this research programme. We will also be requiring BCA providers to send prompts to those SMEs not covered by the FCA’s powers.

177. As we discuss further below in paragraph 193, we are also requiring banks to provide prompts to help customers control the charges they pay to their existing bank, especially unarranged overdraft fees.

Current account switching measures

178. Even when a bank customer recognises that they could gain from switching banks, they might not do so if they lack confidence in the switching process.

179. We have found that both personal and business customers fear that switching current accounts is burdensome and time-consuming, and worry that something might go wrong. The risk of something going wrong is of particular concern to SMEs.

180. CASS has already made a positive difference to the switching process and is generally working well, but many customers either do not know about or do not have confidence in CASS. We are therefore requiring:

(a) the governance of CASS to be strengthened, and have it overseen by a regulator;

(b) customer awareness of and confidence in CASS to be increased; and

(c) improvements to specific aspects of the switching process, with a longer period of redirection of transactions from the old to the new account.

181. We are also guaranteeing the provision of transaction history on the old account once an account is closed.

182. Reforming the way in which CASS is governed will provide those managing the service with stronger incentives to operate and develop the service in the interests of customers; seeking new ways to improve the process over time. This in turn will increase customer confidence in the switching process and reduce barriers to switching.

183. We are requiring undertakings from Bacs, which currently operates CASS, to strengthen CASS's corporate governance by including an independent chair in its management committee (MC) and involving representatives of consumer groups and intermediaries in its decision-making. CASS's main decisions and performance against agreed awareness and switching targets will also be made transparent. To support this, we are recommending to HMT that the PSR or the FCA should have regulatory oversight of CASS.

184. CASS provides an efficient and secure service to both personal and business customers who want to change banks, and it deserves to have a higher profile and a higher degree of customer confidence than it currently has. We are therefore requiring undertakings from Bacs to work with the banks to support a long-term promotional campaign to raise the profile of and confidence in CASS. This work should be particularly focused on those groups who at the moment have the greatest concerns about switching, who are least inclined to switch, and/or would gain most from switching. These include SMEs, overdraft users, customers with high credit balances, the young, and the financially disadvantaged.

185. Bacs will also be required to extend the current 36-month redirection period so as to provide further assurance to customers that their payments will not go missing after they switch banks, and by doing so, increase their confidence in CASS. For customers who continue to need it, payments will be redirected

to their new account indefinitely as long as a payment has been redirected into their account in the last 13 months.

186. A more fundamental change to the switching process would be the introduction of Account Number Portability (ANP). ANP would mean that a customer would effectively take their account number (and maybe their sort code) with them when they switch banks. This could make the switching process easier from the customer’s point of view and could give customers more confidence that payments would not go astray.

187. ANP could be implemented in a variety of ways, all of which involve substantial changes to the payments systems used by banks. Estimates of the costs of ANP vary between £2 billion and £10 billion, depending on how radical the changes would be. ANP could also increase customer confidence in switching and the PSR might want to consider ANP at a future date. However, open APIs have the potential to fundamentally change customer experience in banking and reduce the role of bank account numbers, we therefore decided that making CASS work better is a quicker and more proportionate approach.

188. We are also requiring that customers of all current account providers will be able to get a copy of their transaction history after account closure (free of charge or for a reasonable fee). This is particularly important for SMEs, for which loss of access to their previous transaction history following a switch of banks can make it harder (or at least it is perceived by SMEs that it can make it harder) to secure business loans.

189. Some customers want to have accounts at more than one bank at a time. Such ‘multi-banking’ is good for competition – it allows customers of one bank to try out the services of another. Customers can arrange this for themselves or they can use the partial switching service that most banks now offer, which redirects some payments from one account to another. Although we are not introducing a specific remedy on partial switching, Bacs is considering ways of developing and promoting this service, and we encourage them to pursue this.

190. We have considered another measure to improve the CASS switching process – requiring the transfer of continuous payment authorities (CPAs) on debit cards when switching through CASS. In light of the likely cost and complexity of this measure compared to its relatively modest benefits, we are not taking this forward.

PCA overdraft measures

191. Our foundation remedies and current account switching measures will enhance competition and deliver benefits for all types of PCA and SME banking customers.

192. However, as described above in paragraphs 72 to 73, PCA overdraft users have particular difficulties in engaging with the market, searching and switching. We also found that the effects of the problems we have identified are particularly acute for overdraft users, especially unarranged overdraft users who have the most to gain from switching. Our further measures targeted at overdraft users will increase competition and improve outcomes for such customers.

193. The primary objective of these additional measures is to increase customers' awareness of their overdraft usage and help them manage it. This will help PCA customers save money by avoiding unnecessary overdraft charges, and, by increasing customer awareness of and responsiveness to overdraft fees and charges, should also put downward pressure on these charges. To this end, we are:

   (a) requiring banks to automatically enrol all their customers into an unarranged overdraft alert;

   (b) requiring banks to offer, and alert customers to the opportunity to benefit from, grace periods during which they can take action to avoid or reduce all charges resulting from unarranged overdraft use;

   (c) recommending to the FCA that it undertakes further work to identify, research, test and, as appropriate, implement measures to increase overdraft customers' engagement with their overdraft usage and charges. This will be facilitated by an Order to require banks to cooperate with the FCA in its research programme, including RCTs; and

   (d) to increase PCA customers' engagement with overdraft features, we are recommending that the FCA looks at ways for banks to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process.

194. To address concerns about the cumulative costs of overdraft charges for heavier unarranged overdraft users, we are requiring all PCA providers to set an MMC for use of an unarranged overdraft facility. The MMC, which will be set by each PCA provider, will specify the maximum amount that the provider will charge a customer during any given month due to unarranged overdraft

and will include all unarranged overdraft charges including debit interest and unpaid item fees.

195. The MMC remedy will benefit overdraft customers in two main ways.

196. First, it will improve transparency. The introduction of a common measure of this aspect of overdraft pricing will provide a point of comparison for customers wishing to choose a PCA. While other aspects of overdraft pricing will also be relevant, this intervention will help cut through some of the complexity of overdraft fees and charges, in particular for heavier unarranged overdraft users.

197. Second, it will provide some protection for the heavier unarranged overdraft users – a group that incurs the highest charges for using their PCA, but are least likely to switch to another provider. While the MMC will be set by individual banks themselves rather than centrally regulated, the increased visibility of this aspect of pricing and the associated need to have a competitive offering will constrain the level at which this is set by individual banks. Heavier overdraft users would therefore have some comfort as to their maximum monthly exposure to fees and charges, as opposed to the current situation where this exposure can be open-ended.

198. We considered setting a regulated upper limit on the MMC but have decided not to do so. MMCs set by the banks rather than a regulator will mean the banks themselves remain accountable for their overdraft charges, in what we expect to be a significantly more competitive environment. A regulated upper limit might validate a particular level of cap, incentivising some banks to set MMCs at the upper limit as opposed to competing down the level of MMC. It might also lead banks to become significantly more restrictive in allowing unarranged overdrafts, with the associated risk that some customers could lose access to this form of credit.

199. The success of our approach to the MMC will depend on the way in which this new aspect of overdraft pricing is communicated to customers. We will require banks to make the disclosure of MMCs no less prominent than the presentation of other information on overdraft fees and interest. We are recommending to the FCA that it carries out further work to assess the ongoing effectiveness of the MMC and consider whether measures (including the introduction of rules if appropriate) could be taken to further enhance its effectiveness.

200. We have also considered ways in which we could make it easier for PCA customers to find out whether the overdraft facilities they require would be available to them from another PCA provider. This is a complex area that

interacts with our other remedies, particularly in relation to improvements to the switching process and the development of open banking APIs. Therefore, rather than seeking to specify a particular solution, we are:

(a) seeking undertakings from Bacs to work with CASS participants to review the account switching process for overdraft customers; and

(b) recommending that, following the introduction of open APIs (see paragraphs 168 to 171 above), the FCA considers requiring PCA providers to offer online tools that indicate whether a prospective customer is likely to be eligible for an overdraft.

201. Taken together, we believe that these additional remedies will address the specific problems we identified in relation to PCA overdrafts and will reinforce the effectiveness of the package of remedies for these customers.

Additional SME banking remedies

202. Our foundation measures and current account switching remedies will address a number of our competition concerns in SME banking.

203. Given the specific nature of the competition problems identified in SME banking, additional targeted measures are needed in order to deal with all of the issues we have identified.

204. Our remedies will improve the information available to SMEs about loan and overdraft charges and eligibility, make it easier for SMEs to compare the products of different banks, and make it easier for SMEs to open a new BCA. When SMEs have better information about what the market offers and are able to move more freely between providers, they will be able to make better choices, and the banks will have to compete harder for their custom. We particularly want SMEs to have a real choice when they need finance, and not to feel that their existing bank is the only option.

205. We have looked at the availability of effective comparison tools for SMEs.

206. Although there are several comparison websites currently available on the market, as described in paragraph 110 above, they each individually offer only a part of the service required to compare SME banking products and providers effectively. We think that SMEs would be best served by tools that provide a ‘one-stop-shop’ that would enable them to quickly and reliably compare banks on price, service quality and lending criteria across the whole range of providers.

207. We have looked at a number of ways in which such services could be created. The independent charity Nesta is planning to launch a 'challenge prize' to identify possible solutions to the problem of limited access by SMEs to information on banking services. We consider that this offers the best prospect of effectively addressing this problem, as it is most likely to facilitate innovative and commercially sustainable solutions and should encourage new suppliers to enter the market without precluding an ongoing role for existing providers of comparison services. This approach will stimulate the development of comparison services and other advisory services for SME banking. By doing so, it will address the problems we found in this market by helping business customers to effectively and efficiently compare BCAs, lending products, and other banking products and services.

208. This is an innovative approach to implementing a CMA remedy and so we need to be confident that the Nesta proposal is taken forward to a successful conclusion. It needs both financial backing and technical support from the banks. We are therefore requiring the largest SME banking providers to provide product data[7] and samples of customer transaction data[8] to the developers of proposals for the Nesta challenge.

209. We are also requiring these banks to support and fund the organisation of the prize process and to contribute funding to the prize fund, with their respective contributions reflecting their market positions in the provision of BCAs and SME lending in the UK. To help ensure the Nesta challenge produces a result that addresses our concerns and meets the needs of the SME banking market, a CMA representative will be on the Nesta 'prize committee'.

210. Since the Nesta process will not be completed until at least 18 months after the publication of our final report, we want the existing bank-supported services such as the BBI to be kept going. We are therefore requiring, as a transitional measure, that the banks which currently fund the BBI continue supporting the survey that provides the material underlying the BBI. The BBI may have a long-term role as part of the outcome of the Nesta process, or as part of a solution to our proposal for banks to provide information on service quality (see paragraphs 172 to 174 discussed above), but we do not want to pre-judge either of these outcomes.

211. In addition, we think it is necessary to include a safeguard remedy that would only take effect in the event that the Nesta process failed to produce a satisfactory winner or the winner of the prize proved not to be operationally

[7] RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG.
[8] RBSG, LBG, Barclays, HSBCG and Santander.

and/or commercially viable after the launch. This remedy will require the creation of an industry funded SME comparison tool.

212. We are also requiring that all lenders offering loans publish standard rates for unsecured loans and overdrafts of up to £25,000 in value and that this information is made available as open data to intermediaries. Further, we are requiring the largest SME lenders[9] to offer a tool on their websites so that business customers can get an indicative quote and know, provisionally, whether they would be eligible for the loan or overdraft they seek.

213. In addition, we are recommending to HMT that it works with CRAs and SME lenders to implement a mechanism for 'soft' searching, so that SMEs are confident that they can shop around for credit and obtain indicative price quotes without adversely affecting their credit rating.

214. Our remedies on SME lending are generally limited in scope to unsecured loans and overdrafts with a value of up to £25,000, so they do not directly address the barriers to lending for those SMEs that need secured or larger lending products. Secured and larger loans and overdrafts usually require specific credit assessment, will typically be negotiated through a relationship manager, and will have individually tailored terms. Price and quality comparison tools are therefore of limited assistance for such lending.

215. However, we do expect the market for larger loans to benefit from the increased engagement of SMEs and the increased competitive pressure on banks resulting from our overall remedy package. Also, the development of open APIs, the data-sharing initiatives stemming from the SBEE Act and industry-led initiatives should all help those SMEs seeking larger amounts of finance by facilitating sharing of information about SMEs with potential lenders.

216. We do not think that there is a case for us to launch further interventions in this area at this time. It is better to allow time for the market to absorb and respond to existing and proposed initiatives. We are therefore recommending that HMT undertakes a review of the efficacy and impact of these developments two years after the publication of our final report (ie by August 2018).

217. We considered whether further action is needed to require banks to pass to CRAs further information on SMEs such as transaction data. Regulations under the SBEE Act came into force in June 2016, requiring providers to share SME data, through CRAs, with alternative providers. In addition, our

[9] RBSG, LBG, Barclays and HSBCG.

foundation measure to adopt an open API standard will enable SMEs to share their transaction information with intermediaries. Given this, we did not see a need for a further intervention in this area.

218. Even if SMEs consider switching to a different provider, they may be discouraged from doing so if they think that the process of opening a new business account is going to be difficult. We are therefore requiring BCA providers to adopt a core set of standard information and evidence requirements for opening a BCA. We expect this to be achieved through an industry working group co-ordinated by the British Bankers' Association (the BBA) which is currently ongoing. We are recommending that the FCA supports and facilitates the implementation of this remedy through participating in the proposed industry group as an observer.

219. Our overall package of remedies for SME banking will be more effective if more businesses understand the benefits of shopping around for their banking services. Professional advisers, particularly accountants, have an important role in helping SMEs make good business decisions, including decisions about their choice of provider. We are therefore recommending that BEIS works with the BBB and professional associations to explore ways in which their members can channel advice on choice of banks and sources of finance to SMEs.

An effective and proportionate solution

220. We have put together a set of remedies, which in our judgement will deliver a comprehensive and effective solution to the problems we have identified. Although each individual remedy helps personal and business customers improve their banking experience in some way, they should not be viewed in isolation but as part of a package. The integrated nature of our remedies also means that the impact of the overall package would be reduced if not all of the measures were put in place.

221. The elements of the package will work together to address the underlying problems in the following ways:

(a) Our foundation measures will work together to empower personal and business customers to make good choices when considering banking arrangements. Customers will be encouraged to shop around in the first place and will be prompted to consider switching, putting more pressure on banks to compete for custom. The prompt development of open data in banking, through which information can be shared securely, will harness the benefits of new technology and open up opportunities for new business models to shake up what is still a fairly traditional banking

industry. Open data and robust and comparable information about service quality will make it easier to access and assess information on banking products and providers.

(b) Our overdraft measures will help personal customers to understand the offer they are getting and better manage their use of overdrafts, which in turn will reduce their cost of banking.

(c) Once current account customers decide to act, our switching remedy package will make switching banks more straightforward and customers will have more awareness of and confidence in the process.

(d) By making it easier for SMEs to shop around and open a new BCA, we expect to reduce the reliance on business owners' existing PCA bank when selecting a BCA. Further, our SME remedies will increase transparency of prices and availability of lending products, and facilitate comparisons of current accounts, loans and overdrafts. This will mean that the majority of businesses will not need to turn directly to their existing bank for finance (as is the case now), but are more likely to consider other options. Our remedies combined with recent regulatory changes will also decrease the information advantages of existing credit providers, which should allow other lenders to price more competitively. As a consequence of these interventions, we expect established banks' incumbency advantages to be reduced substantially.

222. We have considered how best to implement, monitor and enforce compliance with our remedy package. We paid particular attention to ensuring the effectiveness and sustainability of the package we are implementing, and have consulted extensively with colleagues in regulators and government about how we can work together to implement these important measures.

223. We also see our remedy package as a proportionate response to the problems we have found. We have considered a wide range of alternative options and have avoided taking forward other measures that are less effective than our proposals, or that would impose unnecessary costs. We have also considered carefully which banks should be subject to which remedies. We have also sought, where possible, to build on existing industry, government and regulatory initiatives. This will avoid creating additional costs by 'reinventing the wheel' and will keep down the overall costs of implementing our package of remedies.

224. We believe that the beneficial effects of our remedies package will outweigh its costs by a substantial margin. The markets for PCAs and SME banking services are very important sectors of the economy in their own right –

generating combined revenues of over £14 billion in 2014 – and are of vital importance to the wider economy. Making these markets work better, by empowering customers and harnessing technological change, will deliver substantial benefits for small businesses and personal customers.

225. It is not possible to measure all of the dynamic benefits of future innovation and increased competition that we expect our remedies to stimulate. However, it is possible to make broad estimates of some of the direct, static benefits of our remedies, which we cautiously estimate will be at least in the region of £150 million to £250 million per year post implementation. We expect these benefits to persist and to accumulate to an amount in the order of at least £700 million to £1 billion within a period of around five years. In addition to these direct gains, we expect further very substantial dynamic benefits from our remedies through increased pressure on banks to improve their quality of service, to innovate and to compete on prices. This is in comparison to our estimate of the costs of implementing our remedies of around £75 million to £110 million. These will predominantly be one-off upfront costs.

226. Our package of remedies will therefore be both an effective and a proportionate solution to the competition problems we have found in PCA and SME banking markets in GB and NI.

Final decision on the AECs and remedies

227. Section 11 of this report sets out the AECs that we have found and Section 19 of this report sets out in full the remedies we will be taking forward to address the AECs that we have found.

228. We have aimed through our remedies package to build upon and strengthen existing initiatives and to reflect ongoing regulatory and importantly technological change. We believe that our remedies package will address the main causes of the poor customer outcomes we have found. The other issues that we have identified, in particular in the context of barriers to entry and expansion, are complex and longstanding.

229. The UK government and various regulators and authorities, both UK and international, have a lead and ongoing role to play in making the UK retail banking market more competitive. In all these areas, we urge the relevant authorities to give due weight to competition objectives. In this context we welcome what is happening on various fronts to address some of the issues we have identified:

(a) The PRA's work programme to improve the ability of smaller banks to transition to adopting their own internal risk models to calculate their risk weights by making the application process more proportionate. The PRA has confirmed in particular that it is making additional resources available to support banks to transition and is reviewing data requirements including the use of external data.

(b) BoE and PRA's commitments to supporting wider reform with a view to achieving a more proportionate approach to the prudential regulation of retail banks in the UK.

(c) HMT, BoE and the PRA's proactive identification of areas of regulation where a more proportionate approach could be adopted whilst still achieving relevant regulatory objectives and HMT's programme aimed at reducing the regulatory burden on banks and in particular smaller banks.

(d) The BoE and PRA's commitment to narrowing the differentials between capital requirements where there is discretion and, together with HMT and the European Commission, in the negotiation of the current proposed reforms to the calculation of risk weights and of capital risk floors as well as future reforms.

(e) The UK government's and BoE's ongoing work to strengthen bank resolution to address TBTF.

(f) The PSR's extensive work programme to improve access and the cost of access to payment systems.

(g) HMT's commitment to keeping under review the impact on smaller banks and on new entry of the bank tax regime in light of the specific issues we have highlighted. We also urge HMT to continue to monitor the impact of its fiscal policies on competition in retail banking more generally.

230. In addition, while we find that there is insufficient evidence to support a finding that the levels of concentration themselves have adverse effects on outcomes, this does not mean that an increase in concentration would not raise competition issues.

231. Our analysis is based on the current evidence and current levels of concentration, including the recent divestment of TSB from LBG. Any changes to the current level of concentration, either through merger and/or divestment, should be considered on their merits as to their impact on competition. The high levels of concentration in the market and the incumbency advantages stemming from the weak customer engagement that we have found are sufficient to justify a cautious approach to any future merger activity. The loss

of rivalry from any bank merger could raise competition concerns. While any merger would need to be looked at on its merits against the backdrop of the market as it stands at the time of the merger, we would expect that any significant merger involving the four largest GB banks may lead to adverse effects.

232. Different considerations apply to concentration changes only involving smaller banks. We have found that because of the weak customer response it is difficult for new entrants and smaller banks to expand organically. Expansion by smaller incumbent banks through acquisition enabling such smaller banks to spread their fixed costs across a greater number of customers, may somewhat improve the competitive threat from such banks, although without increased customer engagement the main barrier to expansion would remain. Similarly, an effective demerger of Williams & Glyn from RBSG has the potential to provide a stimulus to competition, in particular if it is of sufficient scale. Consequently, mergers only involving smaller banks may have the potential to improve competition in the relevant markets.

233. Below we summarise our remedies which will be implemented by way of a CMA Order or by accepting undertakings, and separately our remedies where we are making recommendations. Given the scale and ambition of our remedies, it will take until the summer of 2018, for all elements of the package to come into force although some of the remedies will be in place within a year.

Summary of remedies by Orders and Undertakings

Remedy	*Responsibility*	*Order or Undertakings*	*Commencement date – by or between*
Development and adoption of an open API standard	Largest banks in GB and NI	Order	Q1 2017 and Q1 2018
Service quality metrics: core measures	All banks*	Order	Q3 2018
Prompts: cooperate with FCA research and trials	All banks*	Order	Q1 2017
Facilitating switching: CASS governance	Bacs	Undertakings	Q3 2017
Facilitating switching: CASS awareness and confidence	Bacs	Undertakings	Q3 2017
Facilitating switching: CASS redirection	Bacs	Undertakings	Q4 2017
Transaction history for customers	All banks*	Order	Q1 2018
Overdraft alerts with grace periods	All PCA providers*	Order	Q1 2018
Alerts: cooperate with FCA research and trials	All banks*	Order	Q1 2017
Monthly maximum charge	All PCA providers	Order	Q3 2017
Firm overdraft decision to customer prior to switching account provider	Bacs	Undertakings	Q3 2017
Development of a comparison services for SMEs	Largest banks in GB and NI	Order	Q1 2017
Publication of SME lending product prices	All SME lenders	Order	Q3 2017
Development of SME loan price and eligibility tool	Largest banks in GB	Order	Q1 2018
BCA opening procedures	All banks*	Order	Q1 2018

* Subject to a de minimis threshold.

Summary of remedies by recommendation

Who	*What*
FCA	Undertake a programme of research into customer prompts and to implement measures as appropriate
	Additional measures of providers' service performance
	Identify, research, test, and, as appropriate, implement measures to increase customers' engagement with their overdraft usage and charges
	Assess ongoing effectiveness of the MMC and consider whether other measures could be taken to further enhance its effectiveness
	Consider requiring PCA providers to offer online tools indicating customers' overdraft eligibility
	Investigate how to engage customers more in considering overdraft features during the PCA opening process
	Attend the BCA opening industry group as an observer
HMT	Give an authority powers to have regulatory oversight of CASS
	To work with CRAs and SME lenders to enable SMEs to undertake soft searches for loans
	Review commercial, technical and regulatory developments in the area of sharing SME data
BEIS	Work with the BBB and professional associations to explore ways in which their members can channel advice on identifying and choosing providers and sources of finance to SMEs

Part 1: Findings and adverse effects on competition

1. Introduction

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1.1 On 6 November 2014 the Competition and Markets Authority (CMA) board, in exercise of its power under sections 131 and 133 of the Enterprise Act 2002 (EA02) made a reference for a market investigation into the supply of retail banking services to personal current account (PCA) customers and to small and medium-sized enterprises (SMEs) in the UK. The terms of reference (ToR) for our investigation are provided in Appendix 1.1.

1.2 On 10 November 2014, the CMA appointed from its panel a group of five independent members for the investigation.[1]

1.3 This document sets out our findings based on the evidence we have reviewed and the analysis we have carried out during the course of our investigation.

Our statutory task

1.4 Section 134(1) of EA02 requires the CMA to decide whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom'. If the CMA, acting through a group of independent members, decides that there is such a feature or combination of features, then there is an adverse effect on competition (AEC).[2]

1.5 Under section 131(2) of EA02, a 'feature' of the market refers to:

(a) the structure of the market concerned or any aspect of that structure;

[1] Details of the members of the group are published on our website.
[2] EA02, section 134(2).

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

1.6 If the CMA finds that there is an AEC, it is required under section 134(4) of EA02 to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers[3] so far as it has resulted from, or may be expected to result from, the AEC; and, if so, what action should be taken and what is to be remedied, mitigated or prevented. EA02 requires the CMA 'to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effects on customers so far as resulting from the AEC'.[4] In considering remedies, the CMA may take into account any relevant consumer benefits (RCBs), as defined in EA02, arising from the feature or features of the market.[5]

1.7 Under the terms of reference, PCA services comprise the provision of an account marketed to individuals rather than businesses, offering facilities to hold deposits, to receive and make payments by cheque and/or debit card, to use ATM facilities and to make regular payments by direct debit and/or standing order. Many PCAs also offer overdraft facilities, whether arranged or unarranged, which enable account holders to withdraw cash beyond the amount held in the account up to a specified amount. However, as set out in the terms of reference, PCA services do not include for the purposes of this investigation:

(a) an account in which money is held on deposit in a currency other than the official currency of the UK; or

(b) a current account mortgage, ie a single account comprising both a PCA and a mortgage, which is regulated and marketed principally as a mortgage.[6]

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[3] A detrimental effect on customers (including future customers) is defined in section 134(5) of EA02 as one taking the form of: *(a)* higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the markets to which the feature or features concerned relate); or *(b)* less innovation in relation to such goods or services.
[4] EA02, section 134(6).
[5] EA02, section 134(7).
[6] Where products marketed as 'offset accounts' comprise two separate accounts, a mortgage and a PCA with credit interest on the PCA being credited to the mortgage account, the mortgage account falls outside the terms

1.8 The terms of reference define an SME as a business that has annual sales revenues (excluding VAT and other turnover-related taxes) not exceeding £25 million. The provision of retail banking services to SMEs, as defined in the terms of reference, includes, but is not limited to, the provision of general purpose business loans, deposit accounts, business current accounts (BCAs) and overdrafts. However, for the purposes of this investigation such services exclude other non-lending products such as insurance products, merchant acquiring, hedging services and foreign exchange services.

1.9 In the remainder of this section, we set out *(a)* the background to the reference; *(b)* our conduct of the investigation; and *(c)* the structure of the remainder of the report.

Background to the reference and parallel reviews

1.10 The two separate market studies[7] leading to this investigation focused on the supply of PCAs, and on the supply of banking services to SMEs (together 'the Market Studies'). The CMA found that there were reasonable grounds for suspecting that a feature, or combination of features, of the markets for the provision of PCAs and SME banking services prevents, restricts or distorts competition in the UK. The CMA decided that both PCAs and the supply of banking services to SMEs should be incorporated into a single market investigation into the supply of retail banking services.

1.11 In addition, the CMA also decided to review the undertakings that were put in place following the 2002 Competition Commission (CC) investigation into SME banking[8] ('the 2002 SME Undertakings'). While the 2002 SME Undertakings review was separate to this market investigation, given that there was significant commonality of analysis between the market investigation and the review of the 2002 SME Undertakings, we ran the two projects concurrently, with the same group of members. A copy of the Final decision has been published alongside this final report. Further details can be found on the review page.

1.12 The Northern Ireland PCA Banking Market Investigation Order 2008 ('2008 NI Order') was put in place following an investigation by the CC into the PCA

of reference and the PCA falls within, even though the two products are linked for the purposes of interest calculations.

[7] The personal current accounts study ('the PCA Market Study') and personal current accounts and banking services to small and medium-sized enterprises study ('the SME Market Study').

[8] Nine banks originally provided these undertakings in 2002. These were: AIB Group (UK) plc (AIBG) (known as First Trust Bank); Bank of Ireland (BoI); Barclays Bank plc (Barclays); Clydesdale Bank PLC (Clydesdale); HBOS plc (now part of Lloyds Banking Group (LBG)); HSBC Bank plc (HSBC); Lloyds TSB Bank plc (now part of LBG); Northern Bank Limited (now known as Danske Bank (Danske)); and The Royal Bank of Scotland Group plc (RBSG) (which also includes Ulster Bank Ltd (Ulster) in NI). The nine banks became eight following the acquisition of HBOS plc by LBG in 2009.

banking market in Northern Ireland. The 2008 NI Order was then reviewed and varied in 2011. Under the 2008 NI Order banks are required to comply with information and switching requirements. The CMA consulted on reviewing the 2008 NI Order on 20 May 2015. Following responses to this consultation, the CMA launched a review on 28 August 2015. Like the review of the 2002 SME Undertakings, the review of the 2008 NI Order was undertaken concurrently with the market investigation with the same members forming the remedy group. A copy of the Final decision has been published alongside this final report. Further details can be found on the review page.

Conduct of the investigation

1.13 The following paragraphs provide an overview of the process we have followed in our investigation and how we have analysed the evidence, data and information we received. Further details can be found in Appendix 1.1.

1.14 We published an issues statement on 12 November 2014 taking into account the Market Studies. The issues statement identified three hypotheses or theories of harm to help frame the conduct of the investigation. These hypotheses encompassed the broad range of issues identified by the Market Studies which formed the basis for the market investigation reference.

1.15 Throughout the investigation we had contact with and/or received submissions from a number of interested parties including banks,[9] consumer and SME representative groups, financial services and technology providers, government departments including in the devolved nations, regulators, price comparison websites (PCWs), academics, consumers, SMEs and trade associations.

1.16 A significant focus of our investigation has been on collecting and analysing data and other evidence from a large number of industry participants as well as regulators and other interested parties. We consulted on our approach to key pieces of analysis including various surveys and qualitative research and analysis on profitability, pricing, switching and comparing perceived and actual behaviour of consumers.

1.17 On 21 May 2015, we published an updated issues statement which set out our thinking based on the evidence received and the analyses we had undertaken by that time. It highlighted those issues which would be the focus

[9] For convenience we use the term 'bank' to refer to both banks and building societies throughout our report.

of the investigation going forward and those issues which were of lesser concern. Between May and August 2015 we published a number of working papers.

1.18 We commissioned GfK NOP Ltd (GfK) to conduct a customer survey and to undertake qualitative research into PCA customers, the results of which were published on our website in May 2015.[10] We also commissioned Deloitte LLP (Deloitte) to investigate the impact of innovation in the UK retail banking market[11] and Research Works to carry out qualitative research into SME banking.[12] We acquired data held by Charterhouse Research (Charterhouse) from its Business Banking SME surveys and also commissioned additional surveys from Charterhouse into SME banking. Our analysis of the Charterhouse data and the additional survey on NI was placed into a confidentiality ring and the other additional surveys we commissioned from Charterhouse were published on our website in August 2015.

1.19 Between January and March 2015, members and staff attended 12 site visits to banks throughout the UK. In addition, a number of regulators and other parties attended meetings with members and staff at this time as part of our information gathering. Between June and August 2015 we held 14 hearings with interested parties, four of which were roundtable hearings held with members of the British Bankers' Association (BBA) 'challenger bank' group, the Welsh government and SME representatives in Wales, consumer organisations, and SME representative bodies respectively.

1.20 We notified our provisional findings on 22 October 2015 and published our report in full on 28 October 2015. We also published our Notice of possible remedies (Remedies Notice) on 22 October 2015. On 28 October 2015, in order to allow parties, through their external advisers, to review and understand further our analysis and/or modelling on PCA pricing, on PCA customer switching behaviour and on Actual versus Perceived behaviour of PCA customers and to prepare submissions and representations concerning the analyses, we disclosed the data in a disclosure room.[13] A number of submissions commenting on both our provisional findings and possible remedies were received and published on our website. Fifteen response hearings, six of which were roundtable hearings, were held during November and December 2015 to gain a greater understanding of parties' views.

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[10] GfK PCA report (April 2015).
[11] Deloitte (30 July 2015), *The impact of innovation in the UK retail banking market* ('Deloitte innovation report').
[12] Research Works (July 2015), *Small and medium enterprise customer research into the retail banking market: qualitative research report* ('Research Works SME qualitative research').
[13] See Appendix 1.1.

1.21 Further to consideration of the responses received to our Remedies Notice, we published an invitation to comment on additional remedy suggestions in December 2015. A number of respondents had raised some concerns regarding the extent to which our proposed remedies may address difficulties faced by arranged and/or unarranged PCA overdraft users. Furthermore, some respondents suggested alternative remedies or further variants on our proposed remedies that may address issues faced by PCA customers with overdrafts.

1.22 We commissioned Optimisa Research (Optimisa) to conduct qualitative research to inform the development of some of our proposed remedies aimed at increasing engagement in the retail banking market and commissioned BDRC Continental (BDRC) and GfK to conduct quantitative research (the 'Omnibus survey') to guide the development of the measures aimed at improving the account opening and switching process, building on the qualitative and quantitative evidence from the Financial Conduct Authority (FCA) Current Account Switch Service (CASS) review, the results of which were published on our website in March 2016.

1.23 In February 2016 we published a working paper setting out our assessment of the potential impacts of the changes to the tax regime for banks which came into effect from January 2016.

1.24 On 7 March 2016 we announced that we would be extending the reference period until 12 August 2016 under section 137(2A) of EA02. In taking this decision the inquiry group had considered the further work required to develop the analyses and to develop a suitable comprehensive package of remedies. We also published a supplemental notice of possible remedies (Supplemental Remedies Notice) which looked at a number of proposed remedies targeted at PCA overdraft users and a working paper setting out our further thinking on our proposed remedy for a PCW for SMEs.

1.25 Following to the publication of our provisional findings, we further investigated whether there were features of the UK retail banking markets arising from the regulatory capital requirements regime that were restricting competition in the provision of PCAs, BCAs and SME lending in each of GB and NI by creating a barrier to entry and expansion in retail banking. In April 2016 we published an addendum to our provisional findings (provisional findings addendum) on the capital requirements regulatory regime.

1.26 In May 2016 we published our provisional decision on remedies and provisional decisions on the reviews of the 2002 SME Undertakings and the 2008 NI Order to see whether these older remedies will still be needed in light of market changes and the new remedies that we proposed.

1.27 In May 2016 we also published a working paper presenting the updated results of our PCA pricing analysis and a notice of intention to operate a confidentiality ring. In order to allow parties, through their external advisers, to review and understand further our analysis and/or modelling and to prepare submissions and representations concerning the PCA pricing analysis, we also disclosed data in a disclosure room.[14]

1.28 We have published a number of documents on the CMA website. These include non-confidential versions of parties' written submissions, non-confidential versions of summaries and transcripts of hearings held with parties, and parties' responses to our working papers, provisional findings including addendum, Remedies Notice and provisional decision on remedies. We have also published a number of updates to keep parties informed of progress of our investigation. Further details can be found in Appendix 1.1.

Structure of final report

1.29 This document, together with its appendices, constitutes our final report. It refers, where appropriate, to material published separately on the CMA website. The report, however, is self-contained and is designed to provide all material necessary for an understanding of our findings.

1.30 The remainder of this report is set out as follows:

Part 1: Findings and adverse effects on competition

- Section 2: Industry background
- Section 3: Regulatory framework
- Section 4: Market definition
- Section 5: Structure and market outcomes: PCAs
- Section 6: PCAs: competition and customer behaviour
- Section 7: Structure and market outcomes: SME banking
- Section 8: SME banking: competition and customer behaviour
- Section 9: Barriers to entry and expansion

[14] See Appendix 1.1.

- Section 10: Market structure and market power
- Section 11: Adverse effects on competition findings

Part 2: Remedies

- Section 12: Remedies: Introduction and framework for consideration
- Section 13: Foundation remedies to make PCA and SME banking markets work better for customers
- Section 14: Current account switching package
- Section 15: Additional remedies targeted at PCA overdraft customers
- Section 16: Additional SME remedies
- Section 17: Other remedy options
- Section 18: Relevant customer benefits
- Section 19: Effectiveness and proportionality of the package of remedies
- Section 20: Our decision on remedies

1.31 Appendices supporting each section are numbered according to the first section where they are relevant and are listed in full in the table of contents at the beginning of this report.

2. Industry background

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Introduction

2.1 In this section we provide an overview of the UK retail banking industry, focusing on:

(a) the macroeconomic environment and previous competition reviews;

(b) an overview of retail banking, including a brief description of PCAs and SME banking products, of customers and distribution channels, and a summary of the main banks and other market participants; and

(c) how retail banks generate income and profits, including an analysis of retail banking profitability.

2.2 The banking industry is highly regulated and this is considered in detail in Section 3.

Macroeconomic environment and previous reviews

Macroeconomic environment

2.3 We recognise that our market investigation is being carried out against a backdrop of highly unusual macroeconomic conditions following the global financial crisis in 2007/08 and the subsequent economic downturn.

2.4 The following factors are particularly relevant to our assessment:

(a) Very low central bank interest rates over a prolonged period. The Bank of England (BoE) official rate had been held at 0.5% since March 2009, before being cut to 0.25% on 4 August 2016: such near-zero interest rates have led to very low savings rates on instant access savings accounts, reducing the opportunity cost to personal and SME customers of holding deposits in low- or zero-interest current accounts. Several banks have also launched interest-bearing PCAs to attract customers who might otherwise open a savings account. We consider this aspect in Sections 4 and 6.

(b) The financial crisis impacted banks in many ways, for example:

(i) it resulted in significant government intervention in the banking sector to restore financial stability including the taking of large government holdings in RBSG and LBG; and

(ii) it showed banks that reliance on the wholesale funding markets can be risky: banks' ability to access wholesale funding markets reduced significantly during the crisis. This has increased the importance of current account balances as a source of funding, known as retail funding. We consider funding in more detail in Section 9.

(c) As banks sought to rebuild their balance sheets and improve their capital position after the financial crisis, partly in response to tightening regulatory capital requirements and as a result of high levels of impairments, there was a general contraction of lending activity by the major banks, particularly to the SME sector. This contraction has also reflected a decreased demand for lending. Nevertheless, the contraction has in part facilitated entry/expansion by new lending providers, including both new banks such as Aldermore and Shawbrook, and non-bank institutions such as peer-to-peer lenders. We analyse this in more detail in Sections 4 and 9.

(d) The UK government has made a series of interventions with the aim of stimulating business lending, including the Funding for Lending Scheme (FLS), and the creation of the British Business Bank (BBB). We consider this in more detail in Sections 3 and 9.

(e) Following the financial crisis, the UK government has introduced a bank levy and more recently a bank corporation tax surcharge, details of which are set out in Section 9.

2.5 We recognise that the results of the recent EU referendum may have an impact on the economic outlook at least in the short-term. However we are not in a position to consider what, if any, effects there may be in the longer-term at the time of this report.

Previous competition reviews

2.6 The UK retail banking sector has been the subject of substantial scrutiny by the UK competition authorities and by other UK bodies over the last 15 years. These reviews have included:

- Sir Donald Cruickshank's review of retail banking, published in 2000;
- the CC's investigation into the supply of SME banking services, published in 2002 which resulted in the 2002 SME Undertakings;
- the CC Northern Ireland PCA investigation in 2007, which resulted in the 2008 NI Order;
- previous Office of Fair Trading (OFT) market reviews, 2008 to 2013, relating to SME banking and PCAs;[1]
- the Independent Commission on Banking (ICB), chaired by Sir John Vickers, whose final report was published in 2011;
- the Parliamentary Commission on Banking Standards (the PCBS), whose report was published in 2013;
- the two CMA market studies published in 2014, which resulted in this investigation.

2.7 Many of the measures adopted in the past to address competition concerns identified by these reviews in PCA and SME banking have been enabling measures intended to improve customer engagement and in particular, transparency of bank charges and terms.[2] Some of these measures have been implemented through voluntary compliance on the part of the industry.[3]

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[1] These included *Personal current accounts in the UK. An OFT market study* (July 2008); *Personal current accounts in the UK. A follow up report* (October 2009); *Personal current accounts in the UK. Unarranged overdrafts* (March 2010); *Personal current accounts in the UK. Update on unarranged overdraft charges* (July 2010); *Personal current accounts in the UK: Progress update* (September 2010); *Review of barriers to entry, expansion and exit in retail banking* (November 2010); *Personal current accounts in the UK. Progress update* (March 2011), *Review of the personal current account market* (January 2013).

[2] The following are examples of measures introduced/proposed as a consequence of various OFT reviews carried out between 2008 and 2013: the provision to customers of an annual summary of cost of account; making charges more prominent on statements; providing average credit and debit balances; the provision to customers of illustrative scenarios showing unarranged overdraft charges. These measures were largely in the nature of voluntary initiatives agreed between the OFT and the industry.

[3] For example, the Lending Standards Board developed minimum standards on opt out of unarranged overdraft facilities and best practice guidance for PCA providers in dealing with customers in financial difficulty. These were

Others have required regulatory intervention. A remedies package focused on providing greater information to customers and helping facilitate the switching process was put in place by the CC following its 2007 market investigation on PCA banking services in NI.[4]

2.8 Measures have been also taken to improve the availability of credit information in order to facilitate switching, particularly for SME customers. For instance the Small Business Enterprise and Employment Act 2015 (SBEE Act) provides for regulations to require larger banks to share data on their SME customers with other lenders through credit reference agencies, which are then required to ensure equal access to that data for all lenders. This is discussed in more detail in Appendix 3.1.

2.9 The Cruickshank review recommended in particular the launch of the 2002 CC investigation and the establishment of what became the Payment Systems Regulator (PSR).

2.10 Most notably the ICB report proposed that the retail banking businesses of the banks be 'ring-fenced' from the riskier parts of banks' businesses.[5]

2.11 The ICB report also recommended the introduction of the seven-day CASS, to facilitate switching of current accounts by personal and SME customers. CASS was launched in September 2013, as a voluntary scheme set up as part of an industry-wide programme by the Payments Council and is now owned and operated by Bacs Payment Schemes Limited (Bacs).[6] The effectiveness of CASS and consumer confidence in CASS is discussed in more detail in Sections 6 and 8.

2.12 One of the remedies implemented following the CC's SME banking investigation in 2002 intended to directly control outcomes by requiring the four largest clearing banks in England and Wales to pay interest on BCA credit balances. This requirement was removed in 2007, following the OFT's review of the remedy.

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incorporated in the Revised Lending Code published on 31 March 2011, a voluntary code of conduct within the banking sector.

[4] This remedy was implemented through the CC's Northern Ireland PCA Banking Market Investigation Order 2008 and came into effect in February of that year. The Order was varied in 2011 following a review by the CC, which found that there had been a change of circumstances as a result of the coming into force of the Consumer Credit Directive (CCD) and the Payment Services Directive (PSD).

[5] See Section 3 for more information on ring-fencing.

[6] The FCA published a review of the effectiveness of CASS in March 2015: *Making current account switching easier: The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability*.

2.13 Both the ICB and the PCBS recommended that consideration should be given to the CMA carrying out a market investigation reference by 2015, if not before, unless there had been sufficient changes in the state of competition in the retail banking sector.

2.14 Structural remedies such as divestitures have been considered by many inquiries, but have never been implemented on purely competition grounds; the divestiture of TSB in 2013 from LBG was undertaken in order to comply with the European Union's (EU's) state aid requirements. Under the same EU requirements, RBSG is required to divest Williams & Glyn by the end of 2017. RBSG[7] recently announced that there is a significant risk that divestment will not be achieved by this date and that it is currently exploring alternative means to achieve separation and divestment. (See Appendix 2.1 for further details.)[8] While RBSG continues to work to achieve separation and divestment by the EC-mandated deadline of full disposal by 31 December 2017, on 28 April 2016 RBSG announced that there was a significant risk that divestment would not be achieved by 31 December 2017. On 5 August 2016, RBSG announced that due to the complexities of the Williams & Glyn's separation, and while good progress has been made on the programme to create a cloned banking platform, it had concluded that the risks and costs inherent in a separation programme are such that it would not be prudent to continue with it. RBSG would instead prioritise exploring alternative means to achieve divestment. Work has continued to explore these alternative means and RBS has had positive discussions with a number of interested parties concerning an alternative transaction related to substantially all of the business previously described as Williams & Glyn, although these discussions are at a preliminary stage.

2.15 The CMA SME market study and the PCA update reports published on 18 July 2014, noted that there had been important developments and initiatives to improve competition in the sector in recent years. However, despite these developments, these reports identified a number of features which the CMA suspected prevent, restrict or distort competition in connection with the provision of retail banking services to SMEs and the provision of PCAs. Accordingly the CMA also published its provisional

[7] This describes the position as at 28 July 2016.
[8] In May 2015, the CMA was asked by HM Treasury (HMT) to assess the likely impact of the latest proposals for the divestment of Williams & Glyn for competition in the UK banking sector, work which was being carried out separately from this market investigation. On 15 December 2015, HMT asked the CMA to suspend its work on the review in light of RBSG's decision to launch a trade sale process, which would be likely to raise different issues from an initial public offering depending on the identity of a buyer and which would be subject to merger control as appropriate.

decision to make a market investigation reference. This decision was confirmed on 6 November 2014 when the CMA launched this investigation.

Background to UK retail banking

2.16 Retail banking is of fundamental importance to consumers and businesses and to the UK economy as a whole. In 2014 there were more than 68 million active PCAs in the UK and 97% of adults have a PCA. PCAs generated revenues of approximately £8.7 billion in 2014.

2.17 In 2014 there were over 5 million SMEs in the UK, which accounted for two-thirds of the private sector workforce and half of all UK private sector turnover. There were approximately 5.5 million BCAs which generated approximately £2.7 billion in revenue in 2014. The total stock of outstanding general-purpose business loan balances at the end of 2014 was £90 billion with a further £9 billion of invoice finance loans and £25 billion of new asset finance loans.

Overview of retail banking: products and customers

2.18 Retail banking generally refers to the provision of products and services provided by banks to personal customers and businesses, including SMEs, through a variety of channels including branches, telephony, internet and mobile technology. Retail banking is generally used to distinguish these banking services from investment banking or wholesale banking. The main functions of retail banks are accepting deposits, making loans and providing payment services.

2.19 All retail banks distinguish between personal and business customers but may further organise their activities according to products offered (eg mortgages, credit cards) or size (eg smaller versus larger businesses). Many large UK retail banks have separate retail banking divisions or business units, with their own management and reporting structures. Appendix 2.2, Table 1 sets out further details on how the five largest UK banks segment their retail businesses.

2.20 There are many other products and services that comprise retail banking apart from PCAs and SME banking services (which are the reference products for our investigation). These include, for example, residential mortgages, personal loans, personal deposits, insurance, and merchant acquiring. The product characteristics of PCAs and SME banking are described in more detail in Section 4.

2.21 Typically, individuals and small businesses constitute the core of a retail bank's customer base. Some UK banks only serve or have standalone businesses serving high-net-worth individuals although customer eligibility criteria differ significantly between banks. Retail divisions of the UK banks tend to serve start-ups and smaller SMEs, while larger SMEs and corporates are generally served by commercial or corporate banking divisions. Most banks categorise SMEs by annual sales/turnover and/or borrowing requirements to determine which of their divisions would cater to these businesses, although the cut-off for separating SMEs and larger corporate customers varies between banks. PCA and SME customer characteristics are considered in detail in Sections 6 and 8 respectively.

Overview of retail banking: channels

2.22 Historically, customers interacted with banks solely through high street branches and by post. Since the 1990s, banks have increasingly offered access to banking services via telephone, online, and more recently through mobile applications (apps). The distribution channels through which customers can access products and services from their bank continue to evolve.

Branches

2.23 Branches have traditionally been the principal distribution channel for banks, used by customers for checking account balances, handling cash payments and withdrawals, paying in cheques, and obtaining advice. On average 78% of PCAs were opened in branch in 2014, down from 81% in 2013.[9] A Charterhouse survey of SME start-ups found that 82% use their local branch to open their BCA.[10]

2.24 In recent years the number of bank branches in the UK has been in decline. At the end of 2013, there were 10,208 bank branches in the UK[11,12] reducing to 9,661 by the end of 2014. Some banks also have stand-alone 'business

[9] See Section 9.
[10] See Section 9.
[11] Based on data provided by banks as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014). See Section 9 for further details.
[12] Includes retail branches and co-located business centres. Excludes business centres that only service SME customers.

centres' for SME customers, and the total number of these was 495 in 2014.[13] Further information on branches is set out in Section 9.

Telephone

2.25 Telephone banking services were launched in the 1980s with Girobank[14] offering the first telephone banking facility in Europe and first direct launching in 1989 with the world's first telephone-only bank. Most banks now provide a range of telephone-based banking services to complement their other distribution channels.

Digital banking

2.26 Mobile banking is growing very rapidly. By the summer of 2015 nearly 23 million banking apps had been downloaded, a rise of 8.2 million in one year.[15] There are some 10.5 million banking app logins each day.[16]

2.27 The BBA survey found that apps usage is now eclipsing internet banking for a growing number of customers. Nearly two-thirds (65%) of all online banking by Halifax customers is now conducted by smartphone, significantly more than personal computers (26%) or tablets (9%).

2.28 Nevertheless, the overall use of internet banking transactions continues to grow. During March 2015 there were on average 9.6 million logins a day – a rise of 10% on the same period in 2014.[17]

Other channels

2.29 Other channels for customers to access their banking services include:

(a) Post Office – PCA and smaller SME customers of most UK banks can undertake a range of transactions at over 11,500 Post Office counters

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[13] Based on data provided by banks as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014). Branches (business centres) that service SME customers only. See Section 9 for further details.
[14] Girobank was launched by the Post Office in 1968 and was intended to offer a complementary service to that of the clearing banks mainly for those people without a bank account. It relaunched as National Girobank and by the late 1980s, National Girobank had managed to become Britain's sixth largest bank. It became independent in 1988, became a public limited company, and was bought by the Alliance & Leicester Building Society in 1990; (now part of Santander). Source: Development of the post office network, Business and Enterprise Committee, HoC.
[15] BBA Report (2015), *World of Change*.
[16] ibid.
[17] ibid.

across the UK (as at March 2015) including depositing and withdrawing money, and checking account balances.[18]

(b) Inter-bank agency agreements – some banks offer their customers the ability to undertake a range of transactions at other bank branches, usually those with large geographic coverage across the UK.[19]

Market participants

Recent history: structural changes and M&A activity

2.30 There have been a number of mergers and demergers in the UK banking market in the last 15 years, which have shaped the structure of the retail banking industry today. We list the most significant below:

(a) In November 2004, Santander a whole owned subsidiary of Banco Santander SA, entered the UK market with its acquisition of Abbey National plc.

(b) In September 2007, Northern Rock sought and received a liquidity support facility from the BoE, to replace funds it was unable to raise on the money markets. This led to a 'bank run' by depositors, seeking to withdraw deposits en masse. Following two unsuccessful bids to take over the bank, it was taken into state ownership in February 2008, and split into two parts: assets (the so-called 'bad bank') and banking (the so-called 'good bank'), in January 2010. Virgin Money acquired the 'good bank' in January 2012 and the assets (the 'bad bank') in June 2012.

(c) In October 2008, Santander acquired Alliance & Leicester Building Society. Santander also acquired in 2008 from the UK government the deposits and branches of Bradford & Bingley Building Society.

(d) In January 2009, Lloyds TSB acquired HBOS to create LBG in the light of serious concerns that without external support HBOS would fail. The OFT recommended that the merger not proceed, but the UK government in exercise of its powers under EA02 approved the merger on public interest grounds to ensure the stability of the UK financial system.

[18] House of Commons Briefing Paper number CBP02585 (9 October 2015), *Post Office Numbers*.
[19] See, for example, LBG inter-bank agency agreements.

(e) Following the RBSG bailout by the UK government in October 2008, as described at paragraph 2.14 above, RBSG is in the process of divesting Williams & Glyn.

(f) As described at paragraph 2.14, following LBG bail out by the UK government in October 2009, the European Commission required LBG to divest its TSB business, which it did via an initial public offering in June 2014.

(g) In March 2015 Banco de Sabadell, the fifth largest bank in Spain, announced an agreed acquisition of TSB.

(h) Clydesdale Bank plc (Clydesdale) operates under the Clydesdale and the Yorkshire brands in the UK. It is ultimately owned by CYBG PLC (CYBG), which acquired Clydesdale's holding company from National Australia Bank Limited in February 2016 as part of a demerger from the National Australia Bank Limited Group. On the same day CYBG completed an initial public offering to become an independent company listed on the London Stock Exchange and the Australian Securities Exchange.

Market participants

2.31 The UK retail banking landscape is complex and has changed substantially over the last 15 years because of the impact of the macroeconomic environment, government interventions and structural changes mentioned above, but also the development of new business models and advancements in technology. Retail banking providers in the UK can be broadly categorised as follows.

(a) Large UK banks, such as LBG, RBSG, HSBCG, Barclays and Santander, which have UK coverage and a full retail banking product offering. LBG, RBSG, HSBCG and Barclays have had in one form or another a UK-wide presence in retail banking for over 100 years; Santander entered the UK retail banking market with its acquisition of Abbey National plc over a decade ago.

(b) NI-focused banks: Allied Irish Bank (AIB), BoI and Danske.[20]

(c) Other banks, including new entrants and banks with more limited geographical coverage or which focus on particular products, customer segments and/or distribution channels include: Clydesdale, TSB,

[20] Ulster Bank (Ulster) also operates in NI and is wholly owned by RBSG.

Handelsbanken (part of a Swedish banking group), Tesco Bank, Virgin Money, the Co-operative Bank (Co-op Bank), Metro Bank (Metro), Aldermore Bank, Shawbrook Bank, Secure Trust Bank, Marks and Spencer Bank (M&S Bank) and Paragon Bank (Paragon). See our case studies in Appendix 9.1 for more detail on some of these new entrants. There are also several banks, often referred to as 'private banks', who only provide wealth management services to high net worth indivdiuals. Some of these banks are owned by larger banks, for example Coutts (RBSG), and Cater Allen (Santander) or are part of investments banks (eg BNP Paribas, Credit Suisse and UBS Wealth Management) or selfstanding (Adam & Company).[21]

(d) Building societies, which are owned by their members (ie customers) and not shareholders. Historically, they tended to focus on offering mortgages and savings products, but since 1986 many now offer a broad range of retail banking products. There are over 40 building societies in the UK, many of them with regional customer bases. The five largest building societies are Nationwide Building Society (Nationwide) (by far the largest UK building society), Yorkshire Building Society, Coventry Building Society, Skipton Building Society and Leeds Building Society.

(e) Credit unions, which are small and local non-profit lending institutions, owned by their members and typically serving those customers who are unable to access standard retail bank products through the banks or building societies. Examples include London Mutual, Bristol Credit Union and Glasgow Credit Union.[22]

(f) Other market participants:

(i) Alternative finance providers cover a large range of different types of lending. These include crowd-funding, peer-to-peer lending, invoice trading/finance, community shares, pension-led funding and debt-based securities.

(ii) New payment providers offer alternative ways for customers to manage their money, including different ways to make payments and receive funds, facilities to hold credit balances, and to borrow money. Examples include digital wallets and other services offered by non-traditional digital market participants in the payments sector

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[21] Standalone 'private such banks' have not been the focus of our investigation as they are generally very small operations in terms of number of accounts,
[22] For more examples of credit unions see the Association of British Credit Unions Ltd (ABCUL) website.

such as PayPal, Amazon, Google and Apple, which are further considered in Section 4.

2.32 A more detailed description of the main banks and building societies operating in the UK is provided in Appendix 2.1 and in Appendix 9.1 on new entrants.

How retail banks generate income and profits[23]

2.33 As discussed above, retail banks offer a range of banking services, which include borrowing, saving, transaction services and insurance. Products offered include PCAs, savings accounts, mortgages, personal loans, credit cards, insurance products and investment products.

2.34 In this section we provide an overview on how retail banks use both the assets and liabilities on their balance sheets to generate income and profits. At the end of this section we present our findings on retail banking profitability. In Sections 5 and 7 we look at the financial performance of PCAs and SME banking respectively.

Balance sheets: assets, funding and capital

2.35 The majority of a retail bank's assets consists of loans made to customers (including loans secured by mortgages). Those assets are funded by liabilities, in the form of retail funding (customer deposits) and wholesale funding. During the financial crisis there was a move away from wholesale funding as prices spiked relative to retail funding, and retail funding remains the main funding source for UK retail banks.[24]

2.36 Banks are also required to hold capital[25] to cover potential losses, such as impairments (see paragraph 2.40 below). The amount of capital a bank is required to hold depends on the bank's total assets and the risk weighting of these assets, which in turn depends on the risk profile of the underlying loans. Following the financial crisis, banks are now required to hold more capital than previously, enabling them to absorb some or all of their losses more readily in the event of a crisis.

2.37 Figure 2.1 illustrates a stylised bank balance sheet, showing a bank's sources of funds (liabilities and capital) and its use of those funds (assets).

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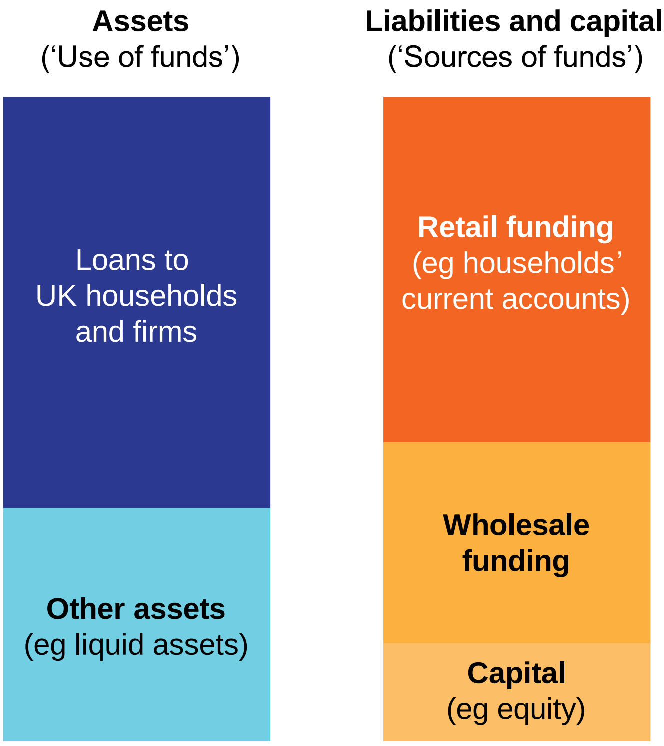
[23] This section draws on the information contained in the TSB IPO document (Price range prospectus, 9 June 2014).
[24] See Section 9 for further details on cost of funding.
[25] Capital is on the liabilities side of the balance sheet.

Total liabilities plus capital must equal assets, for the balance sheet to balance.

Figure 2.1: Stylised bank balance sheet



Profit and loss

2.38 Figure 2.2 illustrates a stylised bank profit and loss account, showing sources of income and costs.

Figure 2.2: Stylised bank profit and loss account

Net interest income	X
Net fees and commissions	X
Other income	X
Total income	X
Direct expenses, eg staff costs	X
Indirect costs, eg head office costs	X
Conduct and litigation costs	X
Total operating costs	X
Impairments	X
Total costs	X
Profit before tax	X

Income and expenses

2.39 Retail banks have two primary sources of income: interest income; and fees and commissions income.

(a) Interest income is primarily earned by a bank lending money to customers and charging interest on the amount lent. A bank earns interest income by lending money to customers at higher rates of interest than it costs the bank to borrow funds from depositors and/or wholesale markets.

(b) Fees and commissions income: banks earn fees and commissions income by charging customers fees for services and receiving commissions from, and participating in profit-sharing agreements with, other product providers. Examples of fees and commissions include fees for use of an overdraft, fees for packaged accounts, and income from the ATM (cash machine) network.

2.40 Retail banks have two main categories of costs: operating costs and impairments.

(a) Operating costs. A bank's operating costs typically consist primarily of costs relating to employees, IT and property. A common way of measuring a bank's operating cost efficiency is the cost-to-income ratio, which is defined as the ratio of operating costs (excluding impairments) to income.

(b) Impairments. Impairment charges are caused by losses on loans where customers have defaulted or are expected to default. Macroeconomic conditions, and in particular house prices, interest rates and unemployment, are significant drivers of impairment charges.

2.41 Recent years have seen increased volatility in the net profitability of retail banks in the UK as a result of regulatory fines and other sums paid by banks, including sums paid in settlement of regulatory proceedings, and their associated provisions (mainly related to the mis-selling of payment protection insurance (PPI)).

Net interest income and net interest margins

2.42 A bank's profit comes from the difference between its income and its costs. At a bank level, net interest income (NII) is the difference between the interest received on assets (loans) and that paid on liabilities (deposits). NII is then used to determine the bank's overall net interest margin (NIM), which at a bank level is typically calculated as the bank's total NII expressed as a percentage of the bank's average interest-earning assets during a year.

2.43 In addition to measuring NII and NIM at a bank level, banks also use a variation of the concepts of these, at a product level. Product NII and product NIM are used for internal purposes by a bank's management to reflect and monitor relative performance/profitability of a particular product or range of products.[26]

2.44 The starting point for the determination of product NIM is the customer rate, being the interest rate charged to the customer (in the case of loans) or paid to the customer (in the case of deposits).

2.45 For a customer loan, the product NIM is defined as the applicable customer rate less the applicable cost of funds. The cost of funds is an internal estimate of how much it costs the bank to raise the funding required to provide that customer loan. Therefore, product NII and product NIM measure the difference between the income generated by the assets and the estimated cost to the bank of funding those assets.

2.46 For a customer deposit, the product NIM is defined as the applicable value of funds, which is an internal estimate of how valuable that deposit is to the bank as a source of funding, less the applicable customer rate.

Cost and value of funds

2.47 The cost of funds is an internal estimate of how much it costs the bank to raise the funding required to provide a customer loan, and the value of funds is an internal estimate of how valuable that deposit is to the bank as a source of funding. The cost of funds and value of funds vary by product and depend on that product's characteristics, most notably its expected lifetime (often referred to as its behavioural maturity). The cost/value of funds is typically higher for products with longer behavioural maturities. Banks have different approaches to calculating their internal cost of funds and value of funds, but most banks use the cost of wholesale funding with the same behavioural maturity as the relevant product. For loans and deposits of the same behavioural maturity, the cost of funds and value of funds are typically very similar.

[26] See further details in Sections 5 and 7 where we consider product profitability.

Retail banking financial performance

2.48 In paragraph 2.4, we discussed the effects of the global financial crisis on banks, including their efforts to rebuild their balance sheets and improve their capital position, partly in response to tightening regulatory capital requirements, and partly as a result of high levels of impairments.

2.49 The following section summarises an analysis of retail banking profitability in the UK. This section is supplemented by Appendix 2.2 which contains more detailed analysis and evidence on retail banking financial performance.

2.50 The purpose of conducting a market-wide profitability analysis is to understand whether there are levels of profitability in excess of what we might expect in a competitive market. If excess profits have been sustained over a relatively long period of time, this could indicate limitations in the competitive process.

2.51 We decided it would not be possible to carry out a robust profitability analysis which would give us certainty as to whether this was, or was not, the case.

2.52 There are no stand-alone providers of PCAs or SME banking in the UK. Furthermore, no providers in the UK treat their PCAs or SME banking businesses as separate: they are reported within their retail banking businesses. Therefore, no providers were able to produce a separate profit and loss account or balance sheet for each of their PCA or SME banking businesses which had been produced as part of their management information reporting pack.

2.53 There were factors specific to the assessment of profitability in the PCA and SME banking markets which would have made any analysis particularly problematic. These included the appropriate allocation of common and shared costs, equity capital, and revenues. We discuss each of these allocation issues in turn.

2.54 We also considered that there were issues surrounding the estimation of a benchmark return on equity (ROE) for stand-alone PCA and SME banking products. The background, in particular the impact of the financial crisis and the market restructuring which followed, would also have made any analysis of profitability over time complex.

Shared and common costs

2.55 PCAs and SME banking services are typically shared with one or more other customer groups or banking products and there is a significant degree of joint production. Branch networks, frontline staff, payment systems, ATMs, self-service kiosks, and IT systems are parts of the value chain that are shared with other customer groups or banking products. In addition to the shared costs, providers incur a variety of common costs such as head office costs. Thus, measuring income and costs for a specific product category (like PCAs) or customer segment (like SME banking services) would not be straightforward.

2.56 We noted that each bank uses a range of methods to allocate its shared and common costs, and that each bank's approach to the allocation of shared and common costs would differ depending on its organisational structure, activities, strategy and other business needs. In addition, different banks adopt different business models, and some provide only a subset of personal and/or business banking products to different subsets of customers. Furthermore, we acknowledged that reported fully allocated costs for a product or service would not be comparable across providers; cost allocation methods would need to be adjusted regularly to reflect providers' changing business needs and cost structure; and that total cost data for a provider may not have been consistent over the relevant period. The range of outcomes from an allocation of costs would therefore be extremely wide.

Equity capital

2.57 As noted above, no providers were able to produce a separate account or balance sheet for each of their PCA or SME banking businesses which had been produced as part of their management information reporting pack, and therefore an appropriate amount would have had to be estimated.

Revenues

2.58 Given the interdependency of PCAs and SME banking with other banking products, no providers were able to produce a profit and loss account for each of their PCA or SME banking businesses which had been produced as part of their management information reporting pack, therefore as with equity capital an appropriate figure would have had to be estimated. Funds transfer pricing (FTP) is the means by which banks attribute funding costs to the business unit making use of the deposits raised (ie loans originated) and to attribute income to the business unit generating the deposit (ie deposits taken). FTP arrangements are necessarily provider specific and will reflect each provider's individual circumstances, including its balance sheet position, credit rating and possibly its business strategy.

2.59 We considered that there were a particularly large number of allocation adjustments and assumptions necessary in order to arrive at a profit and loss account for each provider. Taken cumulatively, this would have made an objective judgement extremely difficult. We also considered that any scenario analysis would have resulted in a very wide range of outputs, rendering the results of any analysis meaningless.

2.60 Due to these reasons, we decided not to undertake market-wide profitability analysis, and instead have used the financial information from banks' annual reports and accounts, together with selected industry publications, reports by equity analysts and consulting/ accounting firms, to inform our understanding of the overall profitability trends in retail banking in the UK.

Data sources

2.61 The publications and reports we used for our analysis include the following:

- *(a)* Oliver Wyman's reports on UK and European retail banking (2012, 2014).[27]
- *(b)* Deutsche Bank report on UK retail banking (2014).[28]
- *(c)* Deutsche Bank market research on UK banks (2016).[29]
- *(d)* Credit Suisse UK retail banking Seminar (2014 and 2015).[30]
- *(e)* KPMG reports on UK banks' financial results (2015 and 2016).[31]
- *(f)* A T Kearney retail banking radar (2015 and 2016).[32]
- *(g)* Association of British Insurers (ABI) report on UK banks (2012).[33]
- *(h)* EY European banking barometer (2015 and 2016).[34]

[27] Oliver Wyman (2012), *Perspectives on the UK Retail Banking Market.* Oliver Wyman (2014), *European Retail and Business Banking: Laying the Foundations for Recovery.*
[28] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014.
[29] Deutsche Bank Markets Research. UK Banks. May 2016.
[30] Credit Suisse UK Retail Banking Seminar (July 2014) and Credit Suisse UK Retail Banking Seminar 2015 update (July 2015).
[31] KPMG (2015), *A paradox of forces. Banking results: What do they mean for you?* KPMG (2015), *The game changers – Challenger Banking Results*, KPMG (2016). A new landscape: Challenger banking annual results and KPMG (2016), *The search for growth (Annual results from the top five UK banks in 2015*.
[32] AT Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model* and *The 2016 Retail Baking Radar: The Retail Banking Champions step up Their Game.*
[33] ABI (2012), *Investibility of UK Banks.*
[34] EY (2015), European Banking Barometer and EY (2016) European Banking Barometer.

2.62 In addition, we gathered data and financial metrics on the financial performance of the selected divisions of the five largest UK retail banks,[35] using their published annual reports and accounts for the period 2012 to 2014.[36,37] The financial metrics we analysed included:

(a) NIM;

(b) cost-to-income ratio;

(c) impairments and other provisions as percentage to total income;

(d) share of NII in total income; and

(e) ROE.

2.63 Although using data from published reports and accounts has the advantage of having been reviewed by the banks' management, and being largely based on audited financial information, it also has many limitations, including the following:

(a) Each bank is organised differently, and there is no common definition of retail banking. Banks' divisional structures do not align with the definitions of PCA and SME banking services in our terms of reference. Banks' divisions include businesses that are not relevant, or exclude the ones, which are relevant to understand financial performance of their UK retail banking operations.

(b) Some banks allocate their common/central costs to their main business divisions or units, while others keep them in a central division.

(c) Where banks have undergone organisational changes, they have not always reported or restated prior years' financial data at a divisional level.

(d) Lastly, reported results are affected by the accounting policies and definitions of metrics each bank follows; some banks present profits and financial metrics net of what management considers exceptional or non-recurring items, while others do not.

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[35] The information and data we gathered was from the published annual reports and accounts of Barclays, HSBC, LBG, RBSG and Santander. See Appendix 2.2 for details about the retail divisions we included in our analysis.
[36] We would have liked to present data across a wider time period/full economic cycle, but this was not possible due to the lack of comparability between years and banks due to changes in the banks' reporting structure, as the time period increased.
[37] See Appendix 2.2 for further details, and definitions of these metrics.

2.64 Due to these limitations, financial data and metrics reported in annual reports and accounts are not directly comparable between banks. That said, financial accounts provide a useful overview of the banks' performance, especially of the evolution of a bank's financial metrics over time.

Summary evidence on retail banking performance

2.65 At a macro level, the BoE's December 2015 Financial Stability report stated that profitability for the UK banking sector as a whole, remained weak and broadly flat. While UK banks' profitability improved very marginally between 2014 H1 and 2015 H1, it remained low relative to historic levels. Further, the report pointed out that misconduct costs reduced banks' pre-tax profits by 40% on average between 2011 and June 2015, and given the number of ongoing investigations and redress actions, it was likely that misconduct costs will remain high in the near future.[38]

2.66 Based on the other reports we looked at, UK retail banking performance and its outlook paint a mixed picture. Although banks appear to be benefiting from lower impairments and improved NIM, they continue to face high customer remediation and conduct costs, which has an adverse impact on profitability. Further, persistent low interest rates continue to limit profits, even as banks' risk provisions decline from the 2012 historical highs.[39]

2.67 Banks are becoming more reliant on NII rather than fees to increase their total income. Mortgages appear to be the most profitable business segment within UK retail banking, although it faces some pressure on margins. Banks also continue to benefit from having access to stable customer deposits, which remain a valuable source of relatively cost-effective funding.

2.68 While the total reported income of the banks' retail divisions we analysed remained relatively stable between 2012 and 2014, the reported profit, in general, showed an upward trend during this period. Impairments and other provisions for the retail banking divisions declined sharply during 2012 to 2014; overall, changes in impairment charges accounted for over half of the profit changes for these divisions during this period.[40]

2.69 The average ROE estimates in different reports we referred to, varied substantially. The 2014 Oliver Wyman report stated that the retail banking industry in the UK earned high (around 20%) ROE in the recent years after

[38] Bank of England, *Financial Stability Report, December 2015*, p46.
[39] A T Kearney, *The 2015 Retail Banking Radar: Time to Reinvent Your Banking Model,* p1.
[40] Refer to Figure 5 in Appendix 2.2 for further details.

excluding exceptional items such as PPI redress costs. Estimates provided by other reports were significantly lower, in the range of about 7 to 13%. Our analysis showed that UK retail banks' average reported ROE during 2012 to 2014 was about 9%.[41]

2.70 Our analysis further revealed that the banks' retail divisions' average reported ROE (and therefore accounting profitability) improved from 7.5% in 2012 to 11.8% in 2014, as banks continued to recover from the effects of the financial crisis and gained from lower impairments. However, a report by KPMG based on 2015 annual results of the five largest UK banks suggested that low interest rates and high costs were putting a downward pressure on profits. Four of the five banks reported a fall in ROE, with ROEs ranging from –4.7% to 7.2%.[42]

2.71 We have not undertaken an analysis to estimate the cost of equity of retail banks in the UK, and so cannot provide a view on how much higher banks' reported ROE is above their cost of equity. An ABI study suggested that the cost of equity for retail banking in the UK was in the range of 8 to 10%.[43]

2.72 Due to our focus on identifying overall industry trends as a result of the difficulties and complications in undertaking profitability analysis, we did not undertake an analysis comparing the profitability of the larger/longer-established and smaller/newer entrant UK retail banks at the retail banking level. A KPMG report presented an analysis of the financial results of 'challenger' banks, including some comparisons with larger, longer-established UK banks (referred to as the 'Big Five' by KPMG) during the period 2012 to 2014. Its findings included the following:[44]

(a) 'Smaller Challengers' achieved a higher average ROE of 18.2% in 2014 compared with ROE of 2.1% of 'Larger Challengers'.[45] KPMG stated that among the 'Larger Challengers', there was a wide range of reported

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[41] Some of the reasons for the differences between these estimates could be due to a combination of the following: *(a)* treatment of conduct penalties and charges; *(b)* coverage in respect of number of banks and type of operations; and *(c)* methodology to calculate ROE. For details, refer to Appendix 2.2.
[42] KPMG (2016), *The search for growth*. This report summarised and made reference to the 2015 results of the following UK headquartered banks: Barclays, HSBC, Lloyds, RBSG and SCB.
[43] ABI (2012), *Investibility of UK Banks.* p6.
[44] KPMG (2015), *The game changers – Challenger Banking Results*'. 'Large Challengers' were defined by KPMG to include BoI (Post Office), National Australia Bank Group, TSB and Virgin Money. 'Small Challengers' were: Aldermore, Handelsbanken, Metro, OneSaving Bank, Shawbrook Group and Secure Trust. 'Big Five' UK banks as defined by KPMG were Barclays, HSBCG, LBG, RBSG and Santander. KPMG's report made reference to the 2014 results. It obtained the information for its analysis from published 2014 year-end reports and company websites. The total numbers presented in the report were the total of the sub-division of banks in scope as described above, excluding Metro which had not released its 2014 results at the date of drafting the report. p2, p22.
[45] ibid.

ROE, from –7.2% to +10.4%, reflecting (at the lower end) conduct-related charges and accounting adjustments.[46]

(b) Average cost-to-income ratio of the largest five banks was 63% in 2014, which was similar to that of all the 'Challengers' (excluding National Australia Bank Group) at 64%.[47] The 'Smaller Challengers', however, had a much lower cost-to-income ratio of 53% in 2014, which according to KPMG, could be down to a range of factors, including a number of one-off costs offset by a simpler business model and product set.[48]

(c) The 'Smaller Challengers' average NIM during the period 2012 to 2014 was in the range of about 2 to 3%, while the corresponding range for the 'Larger Challengers' and the largest five UK banks was lower at about 1.5 to 2%.[49] The 'Smaller Challengers' achieved an increase in average NIM between 2012 and 2014 primarily as a result of cheaper funding, which was largely because of the introduction of the FLS. The 'Larger Challengers' also gained from the FLS, but according to KPMG, this benefit was offset by the effect of increased competition in prime residential mortgage lending.[50]

(d) 'Challenger' banks had on average a higher ROE than the largest five banks in 2014.[51] Average ROE for the Challenger banks grew from –4% in 2012 to +3.8% in 2014, while the corresponding ROE for the largest five UK banks was 0.7% and 2.8% in 2012 and 2014 respectively.[52]

2.73 KPMG acknowledged that ROE based on reported profits was a crude measure of profitability, given the complexity of accounting and the scale and frequency of non-recurring items. However, it stated that 'directionally the picture was clear' in respect of improvement of profitability across the 'Challenger' banking sector. Further, according to KPMG, the 2014 average ROE of 18.2% for the 'Smaller Challengers' demonstrated that despite record low interest rates and intensifying market competition, there were 'pockets of profitability' in UK banking.[53]

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46 ibid.
47 ibid, p3.
48 Ibid.
49 KPMG stated that the, 'Larger Challengers mostly offer retail mortgages, while the Smaller Challengers offer a mix of SME lending, second charge mortgages, asset finance, invoice financing and unsecured lending – all of which, for the moment at least, generate higher margins.' KPMG (2015), *The game changers – Challenger Banking Results*. p8.
50 ibid.
51 ibid, p4.
52 ibid, p6.
53 ibid.

2.74 The difference between the 'Smaller and Larger Challengers' as categorised by KPMG appears to be that most of the banks in the former category are 'niche players',[54] while the latter offer a wider range of banking products and services. This difference could potentially be one of the reasons driving higher relative profitability of the 'Smaller Challengers'.

2.75 In a recent update on 'Challenger' banks' 2015 financial performance, KPMG stated that the rise of 'Challengers' continues. The 'Small Challengers' average ROE[55] reached 17%[56] (against 15.8% in 2014), which contrasted with a 4.6% average ROE for the 'Big Five'. The 'Larger Challengers' (excluding Clydesdale) also had improved returns with an average ROE of 9.5% in 2015 (against 8.8% in 2014).[57] According to KPMG, the strong performance of the 'Challenger' sector continued to reflect higher NIM than the 'Big Five'.[58]

2.76 Similarly, according to KPMG, in 2015, as in 2014, the 'Challengers' outperformed the 'Big Five' on costs, with an average cost-to-income ratio of 59.6% (excluding Clydesdale) compared with 80.6%.[59] The 'Smaller Challengers' produced a cost-to-income ratio of 48.5% in 2015 (against 52.1% in 2014, both excluding Metro), while the 'Large Challengers' reported a weighted average cost-to-income ratio of 59.2% in 2015 (against 58.0% in 2014).[60]

2.77 Overall, according to KPMG, 2015 saw the 'Smaller Challengers' build on their strong profitability metrics from 2014, while the 'Larger Challengers' used their strong capital bases as a platform for growth.[61]

2.78 Due to the differences in the definitions and methodology to calculate the banks' profitability metrics in the published accounts and other reports we looked at, we cannot draw any definitive conclusions about the relative profitability of retail banks in the UK. However, we note the following general

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[54] ibid.
[55] Pre-tax return on tangible equity.
[56] Excludes AIB.
[57] For this report published in 2016 based on banks' published 2015 reports, KPMG categorised the banks in following categories: The Big Five banks: Barclays, HSBCG, LBG, RBSG and Santander; Larger Challengers: Clydesdale and Yorkshire Banking Group, Handelsbanken (UK division), Paragon, TSB, Virgin Money and Williams & Glyn; Small Challengers: AIB (UK division), Aldermore, Close Brothers, Metro, OneSavings Bank, Shawbrook and Secure Trust. The banks included in 'Large Challengers' and 'Small Challengers' are different in this analysis compared to KMPG report on Challenger banking results published in 2015, which was based on banks' 2014 results. KPMG (May 2016), *A new landscape: Challenger banking annual results*, p4.
[58] ibid, p6.
[59] Excluding conduct-related costs, the differential was much smaller (based on 63.4% cost-to-income ratio for the Big Five in 2015). Ibid, p5.
[60] Excludes Clydesdale.
[61] ibid. p6.

highlights of the financial performance of the retail banking divisions in scope of our analysis during 2012 and 2014:[62]

(a) stable total income;

(b) improving profits and average ROE (from 7.5% in 2012 to 11.8% in 2014), largely driven by lower impairments;

(c) stable or increasing NIM: average NIM increased from 2.5% in 2012 to 2.7% in 2014;

(d) declining cost-to-income ratio: average cost-to-income ratio declined from about 63% in 2012 to about 60% in 2014;

(e) declining impairments: percentage of impairments and other provisions to total income declined from an average of 14% in 2012 to about 6% in 2014; and

(f) declining share of non-interest income in banks' total income: this share decreased from 32% in 2012 to about 28% in 2014.[63]

[62] See Appendix 2.2 for further details and analysis.
[63] This means that the share of NII in banks' total income increased from 68% in 2012 to about 72% in 2014.

3. Regulatory framework

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3.1 This section provides a high-level overview of the key aspects of banking regulation affecting retail banks operating in the UK market. Please refer to Appendix 3.1 on the regulatory background to the retail banking industry for a greater level of detail on many of the points covered in this section.

3.2 Following the recent UK referendum on whether the UK should leave the EU it is possible that there could be significant changes to the regulatory framework that applies to retail banking in the UK in the future. However, the CMA notes that the UK currently remains bound by its EU treaty obligations and that Article 50 of the Treaty on European Union contemplates a process under which, from the date the UK gives notice under that Article, the UK would remain a member of the EU for a period of at least two years. It also notes that many of the relevant European laws have been transposed into UK law and would not be automatically repealed on the UK leaving the EU.

3.3 The section is structured as follows:

- UK regulatory bodies and their respective roles (paragraphs 3.4 to 3.28).
- Key European and international regulatory bodies and their respective roles (paragraphs 3.29 to 3.36).
- A description of core banking regulations with which banks must comply (paragraphs 3.37 to 3.62).
- Ongoing UK government, EU and regulatory initiatives affecting the retail banking sector (paragraphs 3.63 to 3.121).
- Data protection rules applicable in the banking sector (paragraphs 3.122 to 3.130).

UK regulatory authorities

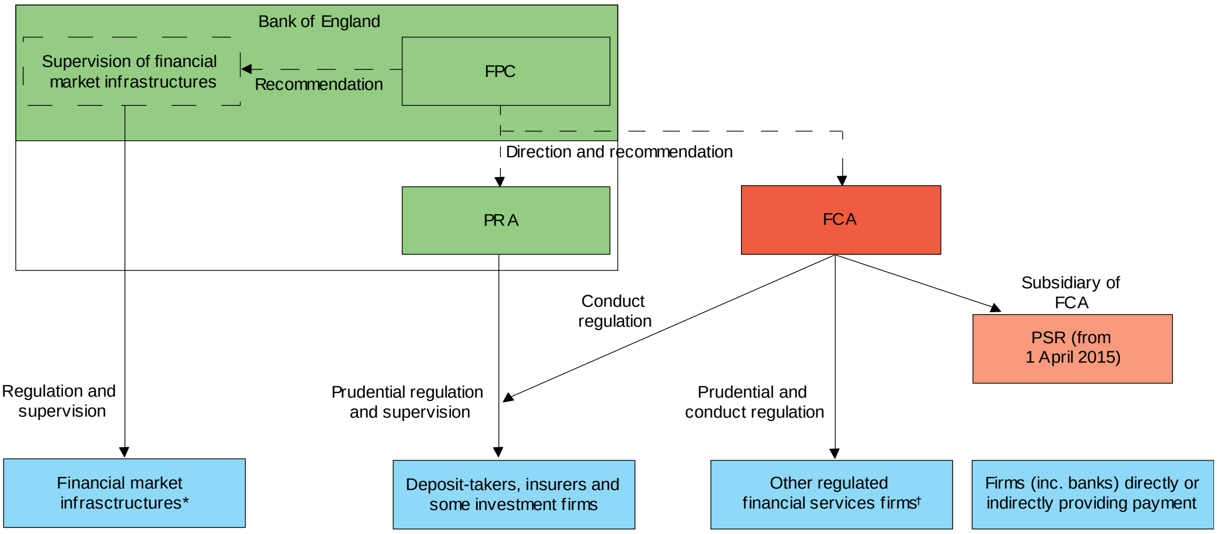
3.4 The Financial Services Act 2012 (FS Act) implemented a new regulatory framework for financial services in the UK. Changes introduced by the FS Act include separating the prudential and conduct regulation of banking operations. Both forms of regulation were previously carried out by the Financial Services Authority (FSA). From 1 April 2013, prudential regulation of banking operations has been carried out by the Prudential Regulation Authority (PRA), which was established by the FS Act, and conduct regulation by the FCA, which replaces the FSA.

3.5 In addition to the changes to the regulatory framework brought about by the FS Act, the Financial Services (Banking Reform) Act 2013 (FSBRA) enacted a number of further reforms related to the UK's banking sector. In particular, FSBRA gave HM Treasury (HMT) and the relevant regulators, primarily the PRA, powers to implement some of the recommendations made by the

Information Commissioner's Office (ICB)[1] – in particular, the ICB's recommendations for ring-fencing requirements for banks.[2]

3.6 It also provided for the establishment of the Payment Systems Regulator (PSR). Figure 1 provides an overview of the financial institutions regulatory framework.

Figure 3.1: Overview of regulatory landscape



Source: CMA.
*Excludes regulation of trading platforms, which is the responsibility of the FCA.
†Includes asset managers, hedge funds, exchanges, insurance brokers and financial advisers.

The Bank of England

3.7 The Bank of England (BoE) is the central bank of the UK. The FS Act brought about a major expansion of the BoE's main responsibilities, which are now clearly defined by Parliament.

3.8 The BoE performs its main functions through the following committees and authorities:

- Financial policy (eg looking out for future risks and weaknesses in the financial system) – the Financial Policy Committee.

[1] The ICB was a UK government inquiry looking at possible reforms to the banking industry in the wake of the financial crisis of 2007-08. It was established in June 2010 and published its final report (also known as the Vickers report as the inquiry was chaired by Sir John Vickers) and recommendations in September 2011. Its headline recommendation was that banks should 'ring-fence' their retail banking divisions from their investment banking arms, to safeguard against riskier banking activities. The UK government announced the same day that it would introduce legislation to implement the recommendations.
[2] The PRA is required to make policy to implement the ring-fencing of core UK banking services, following HMT's publication of secondary legislation. The government has stated its intention for ring-fencing to take effect from 1 January 2019. The PRA undertook further consultations during 2015 and has published final rules in its July 2016 Policy statement (see also paragraphs 3.82 and onwards).

- Monetary policy (eg setting interest rates, decisions on quantitative easing) – the Monetary Policy Committee.[3]

- Safety and soundness of banks and other financial institutions – the PRA.

3.9 The FS Act established both the Financial Policy Committee and the PRA, and gave each of these bodies new responsibilities for the supervision of financial institutions.

3.10 The BoE has responsibility for overseeing certain payment systems, as well as securities settlement systems and central counterparties.[4] The BoE's oversight regime concerns only the stability of recognised payment systems and does not give rise to any responsibility for relationships between members of payment systems and individual users or consumers; these responsibilities fall to the FCA and PSR.

3.11 The BoE has entered into a joint Memorandum of Understanding (MoU)[5] with the FCA, PRA and PSR, covering payment systems regulation.

The Prudential Regulation Authority

3.12 The PRA is responsible for the prudential regulation and supervision of all deposit-taking institutions (banks, building societies and credit unions), insurers and major investment firms. The PRA works alongside the FCA creating a 'twin peaks' regulatory structure in the UK,[6] with the FCA carrying out conduct regulation of deposit-takers, and prudential and conduct regulation of other financial firms. Under the Bank of England and Financial Services Act 2016,[7] the PRA will become the Prudential Regulation Committee of the BoE, following the integration of the PRA into the BoE, ending its status as a subsidiary of the BoE.

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[3] The activities of the Monetary Policy Committee are not relevant to the CMA's investigation so are not discussed further in this section.
[4] Its oversight powers derive from Part 5 (Interbank Payment Systems) of the Banking Act 2009: Part 5 (Interbank Payment Systems) Banking Act 2009.
[5] MoU outlining how the PSR will interact with the BoE, the FCA and the PRA. The MoU will be reviewed annually. See also FCA, BoE, PSR and PRA Statement on the MoU's review in July 2016.
[6] The FCA is a separate institution and not part of the BoE.
[7] Sections 12–13, Bank of England and Financial Services Act 2016, amending the Bank of England Act 1998 and Financial Services and Markets Act 2000 (FSMA), an Act of Parliament from 4 May 2016. Apart from those provisions that have a specified commencement date, the other provisions will come into force (or have come into force) on a day or days to be appointed in commencement orders. On 7 June 2016, the Bank of England and Financial Services Act 2016 (Commencement No. 3) Regulations 2016 (SI 2016/627) were published, which bring into force the majority of the provisions of the Act on 6 July 2016. However, the date that the reforms to the status of the PRA will come into force has not yet been announced.

3.13 The PRA has two primary statutory objectives: to promote the safety and soundness of the firms it supervises and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders.

3.14 The PRA has a secondary objective to facilitate effective competition in relevant markets, so far as reasonably possible. The PRA has no concurrent competition powers, and this secondary objective only applies when the PRA is advancing its primary objectives and therefore does not operate as a self-standing objective.[8]

The Financial Conduct Authority

3.15 The Financial Conduct Authority (FCA) replaced the Financial Services Authority (FSA) on 1 April 2013. It is accountable to HMT and Parliament, but operates independently of government and is funded entirely by the firms it regulates. The FCA's strategic objective is to ensure that the relevant markets function well. To support this, it has three statutory objectives:[9]

- to secure an appropriate degree of protection for consumers;
- to protect and enhance the integrity of the UK financial system; and
- to promote effective competition in the interests of consumers.

3.16 The FCA is responsible for the prudential regulation of those financial services firms not supervised by the PRA, such as asset managers, payment service providers (except those which are also credit institutions) and independent financial advisers.

The FCA Handbook

3.17 Firms regulated by the FCA are bound by the rules contained in the FCA Handbook.[10] The Handbook was developed out of the FSA Handbook, which was split between the FCA and the PRA to form the FCA Handbook and the PRA Rulebook.[11] The FCA's Handbook contains rules applicable to banks, and sits alongside those provisions that are imposed and monitored only by the PRA. Dual-regulated firms have to attend to the provisions of both the FCA Handbook and the PRA Rulebook.

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[8] The obligation on the PRA is only to facilitate competition, not to behave as a competition advocate, promoting competition in markets.
[9] Set out in section 1B FSMA (as amended by the FS Act).
[10] FCA Handbook.
[11] PRA Rulebook.

3.18 The FCA is required to consult before making rules. The consultation paper must be accompanied by a cost-benefit analysis, an explanation of the purpose of the proposed rules, a statement setting out whether the impact of the proposed rules will affect mutually owned firms, an explanation of the FCA's reasons for believing that making the proposed rules accords with its duties and advances one or more of its operational objectives and a notice that representations about the proposals may be made to the FCA within a specified time.

3.19 After having regard to any representations received to the consultation the FCA will publish the rule-making instrument and an account, in general terms of the representations made to the FCA about the proposed rules and the FCA's response to those representations.

Concurrent competition powers of the FCA

3.20 One of the FCA's operational objectives is to promote competition in the interests of consumers. As a result it can, for example, make rules and exercise certain firm specific powers to advance that objective. In addition, the FCA must, so far as is compatible with acting in a way which advances its consumer protection or integrity objectives, discharge its general functions (broadly, making rules or codes, giving general guidance and determining its general policy and principles) in a way that promotes competition in the interests of consumers. The FCA has concurrent powers with the CMA to:

- enforce the competition law prohibitions under Chapters 1 and 2 of the Competition Act 1998 (CA98) and Articles 101 and 102 of the Treaty on the Functioning of the European Union in relation to the provision of financial services; and

- conduct market studies and make market investigation references to the CMA under EA02, for detailed review of a particular financial services market.

3.21 The FCA and CMA entered into a MoU on 12 June 2014,[12] setting out the framework for cooperation between the two authorities in relation to competition issues, consumer protection and access to payment systems. The FCA and CMA entered into a revised MoU related to the concurrent competition and consumer protection powers on 21 December 2015 and a revised MoU related to concurrent consumer protection powers on

[12] MoU between CMA and FCA.

12 January 2016.[13] These MoUs have been revised to reflect practical experience of the enhanced concurrency arrangements since they took effect in April 2014.

The Payment Systems Regulator

3.22 The FSBRA created a new economic regulator, the PSR, with concurrent competition powers in relation to the participation in payment systems. The PSR has been fully operational since 1 April 2015.

3.23 FSBRA also provided that the PSR will regulate those domestic payment systems that are designated by HMT. The following payment systems[14] are currently designated by HMT for regulation by the PSR:

- Bacs Payment Schemes Limited (Bacs);
- Clearing House Automated Payment System (CHAPS);
- Faster Payments Service (FPS);
- LINK;
- C&C (Cheque & Credit);
- NI Cheque Clearing;
- MasterCard; and
- Visa Europe.

3.24 The PSR has published a series of guidance documents[15] setting out how it intends to act, the expectations it has and the procedures and processes it will typically follow.

The PSR's duties

3.25 In discharging its functions relating to payment systems, the PSR must, so far as is reasonably possible, act in a way that advances one or more of its payment systems objectives, which are set out in statute.[16] Its objectives include:

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[13] Revised MoUs on concurrent competition and consumer protection powers between CMA and FCA.
[14] For further details of all these payments systems please see Appendix 3.1.
[15] PSR's written guidance.
[16] Section 49(1) FSBRA. For the PSR's objectives, see sections 50–52 FSBRA.

- The competition objective – to promote effective competition in:
  - the market for payment systems;
  - the markets for services provided by payment systems; and
  - the interests of those who use, or are likely to use, services provided by payment systems.
- The innovation objective – to promote the development of, and innovation in, payment systems in the interests of users of services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems. This includes in particular promoting the development of, and innovation in, infrastructure to be used for the purpose of operating payment systems.
- The service-user objective – to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who use, or are likely to use, services provided by payment systems.

3.26 The PSR's regulatory powers as set out in FSBRA are wide-reaching and fall into the following categories, which are covered in greater detail in Appendix 3.1:

- **Directions** – the PSR can give participants in regulated payment systems written specific or general directions, for example requiring or prohibiting the taking of specified action in relation to a system.
- **System rules** – the PSR has the power to require a system operator to establish rules for its system or to change existing rules.
- **Access to payment systems** – if a person applies to the PSR for access to a regulated payment system, the PSR can require a system operator or a payment service provider with direct access to a system to grant access to the applicant.
- **Variation of agreements relating to payment systems** – the PSR has power to vary the terms and conditions in existing agreements relating to payment systems.
- **Disposal of interest in payment systems** – the PSR has the power to require a person who has an interest in the operator of a regulated payment system or an infrastructure provider in relation to such a system to dispose of all or part of that interest. The PSR is only able to do this if it

is satisfied that, if it does not exercise its power, there is likely to be a restriction or distortion in competition in the market for payment systems or the market for services provided by payment systems. This power is subject to the consent of HMT.

- **Reports** – the PSR may prepare and publish a report into any matter which it considers relevant to the exercise of its functions if it considers that it is desirable to do so in order to advance any of its payment systems objectives.

Concurrent competition powers of the PSR

3.27 The PSR has enforcement powers under Chapters I and II of CA98 and market study and market investigation reference powers under Part 4 of EA02, as far as these powers relate to participation in payment systems. These powers will be exercised concurrently with the CMA.

3.28 In August 2015, the PSR published guidance relating to the exercise of its concurrent competition powers under both EA02[17] and CA98.[18] In December 2015, the PSR and CMA entered into a new MoU on concurrent competition powers.[19] This MoU reflects practical experience of the enhanced concurrency arrangements since they took effect in April 2014.

EU/international regulatory authorities

European Supervisory Authorities

3.29 The European System of Financial Supervision consists of the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities: the European Securities and Markets Authority (ESMA) based in Paris, the European Banking Authority (EBA) based in London and the European Insurance and Occupational Pensions Authority based in Frankfurt.

3.30 The ESRB monitors and assess potential threats to financial stability that arise from macroeconomic developments and from developments within the financial system as a whole.

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[17] PSR's Market Studies Guidance.
[18] PSR's CA98 Guidance.
[19] MoUs between PSR and CMA.

3.31 ESMA contributes to the work of the ESRB, by providing data and undertaking stress tests in close coordination with the fellow ESAs and the ESRB.

3.32 The EBA is an independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.[20]

DG FISMA

3.33 The Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) is one of the Directorates-General and specialised services that make up the European Commission.

3.34 DG FISMA is responsible for initiating and implementing policy in the area of Banking and Finance. It is based in Brussels and is managed by Director General Olivier Guersent. Until recently it worked under the political authority of EU Commissioner Jonathan Hill. After his resignation from the European Commission, the financial services portfolio has been transferred to the Vice-President, Valdis Dombrovskis.

Basel Committee on Banking Supervision

3.35 The Basel Committee on Banking Supervision (BCBS) is a committee made up of representatives of banking supervisory authorities from major economies and banking hubs, providing a forum for regular cooperation on banking supervisory matters, and to encourage convergence toward common standards. It is expected that member authorities and other nations' authorities will take steps to implement BCBS recommendations in their own national regulatory frameworks, whether in statutory form or otherwise. The BCBS is part of the Bank for International Settlements. One of the key roles the BCBS has played in recent years is to set regulatory capital standards via the Basel Accords.

The Financial Stability Board

3.36 The Financial Stability Board[21] is an international body that monitors and makes recommendations about the global financial system. The Financial Stability Board promotes international financial stability; it does so by coordinating national financial authorities and international standard-setting

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[20] EBA website.
[21] Financial Stability Board website.

bodies as they work toward developing strong regulatory, supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions. The current chair of the Financial Stability Board is the Governor of the BoE, Mark Carney.

Core banking regulation

3.37 The following section considers some of the key pieces of regulation, and regulatory frameworks, with which UK retail banks must comply.

Becoming authorised as a bank

3.38 One of the PRA's key functions is the authorisation of new banks.[22] In March 2013, the FSA and the BoE published a 'Review of requirements for firms entering or expanding in the banking sector'.[23] This report led to a number of changes to the authorisation process. The three main features of the changes were:

- reduced capital requirements at the authorisation stage;
- removal of new bank liquidity premium; and
- a changed authorisation process to ease business start-up (the so-called 'mobilisation' approach, under which firms are authorised, but with a restriction, to enable them to have the certainty of being authorised before committing to costly infrastructure builds and staff hire).

3.39 When authorising a firm, the PRA and the FCA must ensure that the applicant firm will currently satisfy, and will continue to satisfy, the Threshold Conditions for which each regulator is responsible. The PRA and the FCA's Threshold Conditions are set out in statute,[24] but in summary include consideration of the following matters:

- Viability of the business plan.
- Capital and liquidity.

[22] A bank, which is a deposit taker and a credit provider, would be subject to prudential regulation by the PRA and conduct regulation by the FCA. This is known as being dual-regulated.
[23] Review of requirements for firms entering or expanding in the banking sector.
[24] Set out in Schedule 6 to FSMA, as amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013.

- Governance arrangements (including ownership, legal structure and management).
- Risk management and controls.
- Resolvability[25] of the applicant firm (relevant to the PRA's assessment of an applicant bank, building society or credit union).[26]

3.40 The process for obtaining authorisation as a bank is set out in detail in Appendix 3.1. Section 9 also considers whether the authorisation process is a barrier to entry in the retail banking market.

Ongoing compliance: PRA Rulebook and the Fundamental Rules

3.41 Firms must ensure they are compliant with all applicable PRA rules and directly applicable EU regulations,[27] including the Fundamental Rules[28] as set out in the PRA Rulebook. The Fundamental Rules require firms to act in accordance with the PRA's 'safety and soundness' objective, by setting specific high-level requirements.

3.42 The Fundamental Rules are supported by more detailed rules, contained in the PRA Rulebook,[29] and directly applicable EU regulations.

Reporting to the PRA

3.43 The PRA works closely with the FCA in the collection and management of regulatory data, most of which is collected by the FCA through its GABRIEL[30] online system.

Supervision and intervention by the PRA

3.44 The PRA supervises firms to judge whether they are 'safe and sound', and whether they meet, and are likely to continue to meet, the Threshold Conditions.[31] Its approach is forward-looking; it assesses firms not just

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[25] For example, how easy it would be to put the bank into bankruptcy or restructuring while inflicting the minimal damage possible on the rest of the UK financial system.
[26] Firms judged to be resolvable are eligible for lower capital requirements.
[27] The term 'directly applicable' in the context of EU legislation means that it applies directly to firms and/or individuals within the EU, without first having to be transposed into domestic law.
[28] BoE Policy Statement outlining Fundamental Rules.
[29] PRA Rulebook.
[30] GABRIEL.
[31] The PRA and the FCA's Threshold Conditions are set out in statute, but in summary judging new firm applications against the PRA and FCA Threshold Conditions will include consideration of the following matters: Viability of the business plan; Capital and liquidity; Governance arrangements (including ownership, legal structure and management); Risk management and controls; Resolvability of the applicant firm (relevant to the PRA's assessment of an applicant bank, building society or credit union).

against current risks, but also against those that could plausibly arise in the future.

3.45 Where the PRA judges it necessary to intervene, it generally aims to do so at an early stage. It focuses on those issues and those firms that pose the greatest risk to the stability of the UK financial system, and the frequency and intensity of supervision applied by the PRA to a particular firm increases in line with the risk it poses.

Regulatory capital framework

3.46 All UK banks are required to maintain a minimum capital base, to protect themselves in the event of a banking crisis. The aim of the capital adequacy regime is to require banks always to hold a certain amount of 'safe' capital resources (ie capital that is not owed to anybody) to absorb some or all of its losses in the event of a crisis.

3.47 The PRA is the competent authority for implementing and overseeing the various rules which govern minimum capital requirements. A brief summary of these is set out below. Section 9 (from paragraph 9.35 and Appendix 9.3) on barriers to entry and expansion set out in detail what requirements on capital adequacy, leverage and liquidity UK banks must meet.

Basel Accords I, II & III

3.48 The Basel Accords – Basel I, Basel II and Basel III – is a set of recommendations for regulations in the banking industry. They are issued by the BCBS.

3.49 Under the Basel Accords, among other requirements a bank must hold sufficient capital against its total assets held, weighted for risk.[32] In order to apply a risk weight to each asset it holds, a bank has two approaches available under Basel II:

- Standardised Approach – using standardised risk weights.
- Internal Ratings Based (IRB) approach – risk weights based on a firm's own estimates of risk parameters.

[32] Assets are ascribed a value according to how high the risk is that the bank will not recover its investment. Risk weights can reflect credit risk, market risk and operational risk. For example, a high loan-to-value residential mortgage will be ascribed a higher risk-weight than low-risk EU nation sovereign debt.

3.50 The PRA is responsible for reviewing firms' IRB models and granting approval for their use where the IRB requirements are met.

The EU Capital Requirements Directive IV

3.51 The EU Capital Requirements Directive IV (CRD IV) imposes the standards set out in Basel III on EU member states, and that Directive has been transposed into UK law by the PRA,[33] which will also be responsible for ongoing compliance with its requirements.

3.52 CRD IV comprises:

- the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and implements the Basel III standards on capital, leverage ratios, liquidity and related matters such as large exposures and standardised regulatory reporting; and
- the Capital Requirements Directive (CRD), which must be implemented through national law, and which makes changes to rules on corporate governance, remuneration and introduces capital buffers.

3.53 CRD IV is a maximum harmonisation Directive,[34] meaning national authorities have little discretion to apply standards other than those set out in CRD IV, to create a level playing field in banking regulation across all EU member states. We consider the impact of the capital requirements regime on competition in Section 9.

Anti-money laundering regulations

3.54 UK banks must comply with anti-money laundering (AML) legislation aimed at preventing money laundering and combating terrorist financing. This AML legislation is based on internationally agreed standards from the Financial Action Taskforce (FATF), which are enacted in the EU through the Third

[33] The provisions of the CRD were transposed into UK law by inclusion in the PRA Rulebook. Under paragraph 16 Schedule 1ZB FSMA, the PRA is able to legislate through the making of rules. The CRR is directly applicable to firms, so did not need to be transposed into UK law.
[34] Most EU legislation is not directly applicable, and instead has to be transposed by the governments of the member states into domestic law, in order to be binding on the citizens of those member states. If a piece of EU law is described as 'maximum harmonisation', this means that when a member state transposes it into domestic law, the resulting domestic law must meet the standards set out in the Directive, but must not exceed the terms of the original EU legislation. This creates a level playing field between member states. 'Minimum harmonisation' means that the original piece of EU legislation contains only the minimum requirements that must be transposed into domestic law; member states are free to include more onerous requirements if they wish (but cannot 'water down' the original EU law). It is common for EU legislation to consist of a mixture of maximum harmonisation and minimum harmonisation clauses.

Money Laundering Directive and transposed into UK law by the Money Laundering Regulations 2007 (the MLR).

3.55 The FCA is the competent authority for supervising the compliance of most credit and financial institutions with the MLR. Relevant guidance on the implementation of these regulations is provided by the Joint Money Laundering Steering Group (JMLSG). The FCA also publishes a financial crime guide, which sets out what firms can do to reduce their financial crime risk and brings together all its guidance on financial crime, from thematic reviews and other work.

3.56 All firms that are subject to the MLR (including all banks) are required, in accordance with the requirements of the FCA Handbook, to put in place policies and procedures to prevent and detect money laundering.

3.57 The MLR establishes a risk-based regime where firms are expected to apply the rules in a manner proportionate to the risk assessed. The rules and guidance set out are principles based and enable firms to exercise appropriate discretion in their implementation of AML processes. Firms must ensure the policies and procedures they establish include systems and controls that:

- enable firms to identify, assess, monitor and manage money laundering risk; and

- are comprehensive and proportionate to the nature, scale and complexity of a firm's activities.

3.58 As part of these systems and controls, banks are obliged to carry out customer due diligence (CDD) measures and monitoring to manage the money-laundering risks identified. Banks must determine the extent of CDD measures and monitoring on a risk-sensitive basis depending on the type of customer, business relationship and product or transaction.[35]

3.59 FATF published revised standards in February 2012. These form the basis of a new set of European AML directives – the Fourth Money Laundering Directive (4MLD) – which came into effect on the 25 June 2015 and must be implemented into UK law within two years.[36] HMT anticipates laying a replacement to the MLR in autumn 2016 with the intention that they come into effect by the end of the two-year implementation period. 4MLD is a

[35] The AML requirements the FCA imposes on banks are contained in the FCA Handbook at SYSC 6.1 and SYSC 6.3, which should be read in conjunction with other relevant guidance, such as the Financial Crime Guidance and JMLSG Guidance.
[36] Directive (EU) 2015/849 of the European Parliament and of the Council.

minimum harmonisation directive which allows the UK to implement 4MLD in a way that is more stringent or specific. Consultation on draft implementing regulations is due to begin in the second half of 2016.

3.60 In August 2015 the government also launched a review to improve the effectiveness of rules designed to prevent money laundering and terrorist financing as part of the government's Cutting Red Tape review programme.[37] This Review seeks evidence of the impact on business of the current AML and terrorist finance regime, and specifically the role of supervisors in that regime.

3.61 Evidence gathered by the review will be shared with relevant government departments, authorities and regulators. Relevant findings from this exercise will also be fed into the analysis of responses received regarding the implementation of the MLD4.

3.62 We consider AML requirements on customer engagement in Sections 6 and 8 respectively and as a potential barrier to entry and expansion in Section 9.

Current EU, BCBS and UK initiatives affecting the banking industry

3.63 A detailed summary of the main initiatives and actions currently being taken by UK regulators, the UK government, and/or deriving from EU legislation that have an impact on the retail banking industry within the UK is included in Appendix 3.1. These are briefly summarised below.

Current and recent PRA projects

Pillar 2: supervisory review

3.64 On 29 July 2015, the PRA issued a policy statement[38] on how it will assess capital adequacy under a new framework for the Pillar 2 regime, which came into force on 1 January 2016.

3.65 The policy statement sets out changes to rules and supervisory statements and finalises a separate statement of policy: 'The PRA's methodologies for setting Pillar 2 capital'.[39] The policy statement is relevant to banks, building societies and PRA-designated investment firms.

3.66 The Pillar 2 capital framework for the banking sector is intended to ensure that firms have adequate capital to support the relevant risks in their

[37] Cutting Red Tape.
[38] Assessing capital adequacy under Pillar 2 - PS17/15.
[39] Statement of Policy - The PRA's methodologies for setting Pillar 2 capital.

business, and that they have appropriate processes to ensure compliance with CRD IV.

Implementation of leverage ratio

3.67 On 1 July 2015, the Financial Policy Committee directed the PRA to implement a UK leverage ratio framework, as follows:

- A 3% minimum leverage ratio requirement that is to apply immediately to UK global systematically important institutions (G-SIIs)[40] and major UK banks and building societies on a consolidated basis.

- A G-SII additional leverage ratio buffer (ALRB) that is to apply to UK G-SIIs identified by the PRA, also on a consolidated basis. The rate of the G-SII ALRB is to be calibrated at 35% of a relevant firm's G-SII buffer rate. This buffer will be phased in from 2016, alongside the risk-weighted G-SII buffer.

- A countercyclical leverage ratio buffer (CCLB) that is to apply immediately to UK G-SIIs and major UK banks and building societies on a consolidated basis. The rate of CCLB is to be calibrated at 35% of a relevant firm's countercyclical capital buffer rate, and rounded to the nearest 10 basis points. It comes into force on the same timescale as the minimum leverage ratio requirement.

3.68 The PRA issued a consultation paper[41] the same day, setting out how the PRA intends to achieve the new leverage ratio framework. The consultation is relevant to PRA-regulated banks and building societies with consolidated retail deposits equal to or greater than £50 billion. The consultation closed on 12 October 2015. In December 2015, the PRA issued its Policy Statement setting out the final rules for the UK leverage ratio framework, requiring banks within scope to calculate their leverage ratio from 1 January 2016 and publicly disclose those ratios from 31 December 2017.[42]

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[40] Defined in the consultation paper as 'global systematically important institutions (G-SIIs) and other major domestic UK banks and building societies, including ring-fenced banks [ie under the new ring-fencing regime]'. The Financial Policy Committee has further signalled that it intends to expand the scope of the leverage framework to all PRA-regulated firms from 2018, subject to a review in 2017. This review will take into account developments on an international leverage ratio framework. In line with the Financial Stability Board and BCBS, the Financial Policy Committee's review of the leverage ratio refer to global systemically important banks (G-SIBs). In European legislation and the Financial Policy Committee's Direction, these institutions are referred as global systemically important institutions (G-SIIs). Current UK banks meeting the threshold for G-SIB/G-SII status are HSBC, Barclays, RBS and Standard Chartered. The list will be updated again in November 2016.
[41] Implementing a UK leverage ratio framework – CP24/15.
[42] PRA Policy Statement: Implementing a UK leverage ratio framework. The PRA confirms that it will ensure that banks hold the minimum leverage ratio requirement, and sufficient CET1 to satisfy the CCLB, requiring that at

3.69 The PRA is also providing UK input on a number of international initiatives.

Proposed standard for Total Loss Absorbing Capacity for systemically important firms

3.70 On 10 November 2014, the Financial Stability Board, in line with its agenda for addressing the risks arising from G-SIIs, published a consultation on a proposed standard for 'Total Loss Absorbing Capacity' (TLAC) for Global Systemically Important Banks (G-SIBs).[43] On 9 November 2015, it published its final TLAC standard.[44] TLAC requires G-SIBs to be funded by a minimum amount of capital and unsecured, uninsured liabilities with a residual maturity of more than one year. These requirements are additional to the capital requirements placed on all banks.

BCBS consultations affecting internal ratings based/Standardised Approach approaches

3.71 The BCBS is consulting[45] on the design of a standardised floor to be applied to banks using the IRB approach to setting their capital adequacy ratio, to replace the current transitional floor, which is based on Basel I risk-weighted assets.

3.72 The floor would be a percentage of standardised capital charges, but this calibration is yet to be discussed. The BCBS intended to publish the final standard, including calibration and implementation arrangements, by the end of 2015.

3.73 The BCBS is also reviewing the IRB[46] and standardised approach (SA)[47] to setting the capital adequacy ratio.

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least 75% of the minimum leverage ratio requirement be met by CET1 capital and that 100% of the buffers be met by CET1. Rules for the G-SII ALRB will be set specifically for individual banks by the PRA under separate powers under the FSMA (section 55). The accompanying Supervisory Statement sets out the PRA's expectations for banks regulated under the CRD, and provides some clarification on the PRA's rules.

[43] In November 2011 the Financial Stability Board published an integrated set of policy measures to address the systemic and moral hazard risks associated with systemically important financial institutions. In that publication, a G-SIB is defined as a financial institution whose distress or disorderly failure, because of its size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. See also, Consultation paper.

[44] Final Total Loss-Absorbing Capacity Standard. The Financial Stability Board will monitor implementation of the TLAC standard and will undertake a review of the technical implementation by the end of 2019.

[45] BCBS consultation on a standardised floor for IRB.

[46] In March 2016 the Basel Committee published a consultative document proposing changes to the advanced IRB approach and the foundation IRB approach. The consultation was open for comments until 24 June 2016.

[47] In December 2014 the Basel Committee published a consultation on proposed revisions to the risk weights. The revisions are intended to address existing 'weaknesses' in the SA to credit risk, including lack of granularity and risk sensitivity. The consultation closed on 27 March 2015. Also, in December 2015, BCBS published a

DG FISMA consultation on CRR and CRD IV

3.74 DG FISMA has consulted[48] on the potential impact of the CRR and CRD IV on bank lending to the economy and on 18 December 2015 DG FISMA published a summary of the responses received.[49] The replies to the consultation will serve as one input to the Commission report to respond to the reporting obligations laid down in articles 501, 505 and 516 of CRR.

Current and recent FCA initiatives

3.75 The initiatives set out below are all ongoing, or have recently been completed by the FCA. Of most note are the following:

- **Current Account Switch Service (CASS) review**:[50] the FCA's CASS review found that CASS addresses the main concerns expressed by consumers about switching, such as having to transfer salary payments and utility bills. The vast majority of switches are completed within seven days and without error, and most consumers who have used the service rated it positively. However, it also found that consumers lack awareness and confidence in CASS, and uncovered a small number of operational issues associated with CASS and the switching process more broadly. The FCA has recommended measures to address these points.

- **Study of Account Number Portability (ANP)**:[51] alongside its review of CASS, the FCA also gathered evidence on other measures that may help make switching current accounts simpler and easier for consumers, including account number portability. The FCA found that being able to keep bank account details (ie account number and sort code) could increase consumer confidence in the bank account switching process and that a significant minority of individual and small business customers said that they would be more likely to switch if they could retain their account details.

  The FCA has provided the PSR with the evidence gathered in relation to account number portability for it to consider, alongside other possible innovations in payment systems, as part of its work going forward.

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second consultative document differing in several ways from its initial proposals. The consultation ended on 11 March 2016. BCBS has published the comments received but has not yet produced a response.

[48] Consultation homepage.

[49] DG FISMA Summary of responses.

[50] FCA CASS review.

[51] FCA Account Number Portability review.

The Payments Strategy Forum, which was set up by the PSR, in considering a wider set of strategic initiatives for payment systems in the UK, has considered ANP.

The Forum believes that the expected time, resource and funding required to deliver ANP would be better focussed elsewhere. This position was articulated in the Forum's draft strategy published on 13th July 2016.[52]

We consider ANP in Section 14 in the context of our current account switching remedies package.

- **Cash savings market study**:[53] the FCA has carried out a study to examine how competition is working. The FCA concluded that the cash savings market is not working well for many consumers, and consulted on a number of proposed remedies. The consultation closed on 12 October 2015.

  In December 2015, the FCA confirmed a number of final rules and guidance.[54] They will come into force in December 2016.

3.76 Other FCA initiatives include (for more detail see Appendix 3.1):

- credit card market study;[55]
- monitoring of overdrafts;[56]
- review of handling of unauthorised transactions;[57]
- review of packaged bank accounts;[58]
- Project Innovate (to encourage start-ups and established firms to bring innovative ideas to financial services markets, including innovation in retail banking);[59]
- market study into investment and corporate banking;[60]

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52 Payment Strategy Forum launches Draft Strategy for Consultation.
53 Cash savings market study.
54 FCA policy statement: Cash savings remedies.
55 Credit card market study.
56 Review of overdraft usage.
57 Review of handling of unauthorised transactions.
58 Review of packaged bank accounts.
59 Project Innovate.
60 Market study into corporate and investment banking.

- work on SMEs as users of financial services; [61]
- Call for Inputs on competition in the mortgage sector;[62] and
- work on sharing of SME credit information.

Current PSR initiatives

3.77 Ahead of its launch on 1 April 2015, the PSR published a Policy Statement alongside its planned programme of policy work. This work included the establishment of a Payments Strategy Forum (a new strategy setting process for the payments industry), and a programme of work in relation to card payment systems to examine the implications of the interchange fee caps and business rules introduced by the Interchange Fee Regulation (IFR), taking into account the wider characteristics of card payment systems.

3.78 In May 2015 the PSR launched two market reviews.[63] The first aims to assess the ownership and competitiveness of infrastructure provision in payment systems in the UK and consider whether the current provision of infrastructure services in UK interbank payment systems delivers a good outcome for service users. On 28 July 2016, the PSR published its final report on this market review.[64] The PSR found that there is no effective competition for the provision of UK payments infrastructure for three payment systems - Bacs, Faster Payments Service and LINK. As a result of these findings, the PSR is consulting on a series of changes to remedy the current situation. These include adopting a common international messaging standard to encourage new entrants, and creating a competitive procurement process that addresses consumer needs. In addition, the regulator has identified the common ownership and control of both the payment systems and the infrastructure provider as a key concern. Payment system operators are currently controlled by a relatively small number of large banks, which also own and control VocaLink – the single infrastructure provider that the operators use to process payments. The regulator is proposing that the four largest banks that have common control of the payment system operators and the infrastructure provider should sell all or part of their stakes in VocaLink, in order to open up the market and allow for more effective competition and innovation.

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[61] Our approach to SMEs as users of financial services.
[62] Call for Inputs
[63] Terms of Reference of PSR market reviews.
[64] PSR Final report.

3.79 The second market review aims to assess the supply of indirect access to payment systems, and whether competition is working well for service users. On 21 July 2016, the PSR published the final report[65] of its market review. After considering the feedback it received on its interim report, it found that competition in the supply of indirect access is generating increasingly positive results. However, it has specific concerns about the quality of access, limited choice for some payment service providers (PSPs), and barriers to switching providers. The PSR is seeing developments that may address these concerns so will be focusing its efforts on encouraging those rather than intervening directly. It will monitor and support these developments as part of its ongoing access program. It has also published a consultation[66] on its proposed approach to assessing applications it receives under sections 56 and 57 of FSBRA. These powers enable it to require a payment system operator or indirect access provider to provide access or vary the terms of existing access.

3.80 Section 9 of this report considers further the role of payment systems as a potential barrier to entry and/or expansion.

UK government initiatives and actions

3.81 The initiatives set out below are all ongoing, or have recently been completed by the UK government. Of most note are:

- **The Midata project**.[67] This is a programme of work being carried out by the UK government, together with businesses and consumer groups, to give consumers more control over, and better access to, personal data that companies hold about them. The aim of the Midata programme is to give consumers access to their transaction data in an electronic, portable and safe way, so that they can make more informed choices.[68]

  Consumers are able to use their historical transaction data on price comparison websites (PCWs) to estimate likely future charges from different PCA providers. The Midata project launched on the Gocompare PCW in March 2015.

[65] PSR Final report.
[66] PSR Consultation.
[67] Midata.
[68] Department for Business, Innovation and Skills (December 2012), *Better Choices: Better Deals: Report on progress on the Consumer Empowerment Strategy*.

- **Open API standard in banking**. The government has announced[69] its intention to deliver an open Application Programming Interface (API) standard in UK banking. The aim is to increase consumer engagement by making it easier for customers to see where they could get a better deal. It also aims to increase competitive intensity by supporting the growth of technology that can be adopted by banks and non-bank providers to compete to offer new products. In March 2015, HMT published its response to the call for evidence[70] and in September 2015 the Open Banking Working Group (OBWG) was set up at the request of HMT to explore how data could be used to help people transact, save, borrow, lend and invest their money. The OBWG has set out an Open Banking Standard to guide how open banking data should be created, shared and used by its owners and those who access it.[71]

- **Divestiture of TSB by LBG, as required under state aid regulations (Project Verde)**. In November 2009, the European Commission approved, under state aid rules, a restructuring plan for LBG, following the bail-outs of LBG by the UK government in October 2008 and November 2009.

  In order to limit the impact of the state aid on competition, the restructuring plan required LBG to divest part of its UK retail banking operations, code-named Verde, and subsequently rebranded as TSB.[72]

  The new TSB Bank began operations on 9 September 2013. TSB Banking Group plc was listed on the London Stock Exchange in June 2014 and by the end of September 2014 LBG had sold approximately 50% of TSB's ordinary shares. On 20 March 2015, LBG announced that it had agreed to sell a 9.99% interest in TSB to Sabadell, and had also entered into an irrevocable undertaking to accept the offer in respect of its entire remaining 40.01% shareholding in TSB. The sale of the stake in TSB has been approved by the European Commission from a merger control perspective and on 30 June 2015 the acquisition was approved by the PRA and FCA. The sale was completed on 8 July 2015.

- **Divestiture of Williams & Glyn by RBS, as required under state aid regulations (Project Rainbow)**. In December 2009 the European Commission approved, under state aid rules, a restructuring plan for

[69] HMT (18 March 2015), Call for evidence on API in banking.
[70] HM Treasury: Data sharing and open data in banking.
[71] The Open Banking Standard. Further information on open APIs in banking is set out in Section 13 in the context of our foundation remedies package.
[72] European Commission (18 November 2009), 'State aid: Commission approves restructuring plan of Lloyds Banking Group' (IP/09/1728).

RBSG, which had also been bailed out by the UK government in October 2008.

Under the restructuring plan, RBSG was required to divest certain insurance, merchant acquiring and commodity trading operations and also (through Project Rainbow) a part of its UK retail, SME and mid-corporate banking operations based around the RBS branch network in England and Wales and the NatWest branch network in Scotland. The Rainbow entity was initially required to have a 5% market share in the SME and mid-corporate banking markets.[73]

RBSG had stated that Williams & Glyn would begin operating by the end of 2016. While RBSG continues to work to achieve separation and divestment by the EC-mandated deadline of full disposal by 31 December 2017, on 28 April 2016 RBSG announced that there was a significant risk that divestment would not be achieved by 31 December 2017. On 5 August 2016, RBSG announced that due to the complexities of the Williams & Glyn's separation, and while good progress has been made on the programme to create a cloned banking platform, it had concluded that the risks and costs inherent in a separation programme are such that it would not be prudent to continue with it. RBSG would instead prioritise exploring alternative means to achieve divestment. Work has continued to explore these alternative means and RBS has had positive discussions with a number of interested parties concerning an alternative transaction related to substantially all of the business previously described as Williams & Glyn, although these discussions are at a preliminary stage.

- **Funding for Lending Scheme (FLS)**. The FLS is designed to incentivise banks and building societies to boost their lending to SMEs.[74] Further details are contained in Section 9 and Appendix 9.3.

- **Bank levy and the corporation tax surcharge.** During the course of the investigation, the UK government introduced the Corporation Tax Surcharge on banks (including building societies) and announced changes to the bank levy. Further details are contained in Section 9 and Appendix 9.3.

[73] European Commission, 'State aid: Commission approves impaired asset relief measure and restructuring plan of Royal Bank of Scotland' (IP/09/1915) (14 December 2009).
[74] Funding for Lending Scheme.

- **Review of regulatory requirements on smaller banks.** The UK government in the recent 2016 Spring Budget stated that it was undertaking a wide government programme aimed at reducing the regulatory burden on banks, in particular smaller banks.[75] Further details are contained in Section 9.

Implementation of ICB recommendations: ring-fencing of retail banking functions

3.82 FSBRA set out a number of requirements intended to implement the core recommendations of the ICB, contained in the ICB Report.

3.83 It introduces a ring fence around ‘core deposits’ (mainly retail and SME) held by UK banks, with the aim of separating certain core banking services critical to individuals and SMEs, from other banking services. The ring-fencing regime will be established through amendments to FSMA made by FSBRA, as well as statutory instruments made by HMT setting out the detail of the ring-fencing regime, specifying which entities will be ‘ring-fenced banks’ and the activities and services that RFBs can, and cannot, carry out.

3.84 Currently the only UK banks that would meet the threshold requiring them to ring-fence their retail and SME activities are HSBCG, Barclays, Santander’s UK arm, Co-op Bank, LBG and RBSG. However, this list is subject to change as any bank with deposits of £25 billion or more by 2019 could also be expected to become subject to the ring-fencing requirements in due course, which has implications for smaller banks.

3.85 The primary and secondary legislation will be supported by ring-fencing rules to be made by the PRA,[76] intended to achieve legal, economic and operational separation between ring-fenced banks and other members of their groups (ie the parts of banking groups that fall outside the ring fence). The FCA will also make rules relating to disclosures that non-ring fenced banks should make to consumers.

3.86 The PRA will play a key role in establishing the ring fence, by making ring-fencing rules and supervising the ring fence. It will be required to carry out annual reviews of the operation of the ring fence, and a review of the ring-fencing rules every five years.

3.87 The government has stated its intention for ring-fencing to take effect from 1 January 2019.

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[75] Budget 2016 (March 2016), paragraph 1.198.
[76] In October 2014, the PRA published its first consultation paper (CP19/14) on these rules.

3.88 In October 2014, the PRA issued its first consultation paper[77] on rules and guidance relating to the ring fence. On 27 May 2015, the PRA issued a Policy Statement[78] providing feedback on the responses received to that consultation paper, and some amendments to the draft rules and supervisory statements included therein.

3.89 On 15 October 2015 the PRA published a further consultation paper[79] on the implementation of ring-fencing: prudential requirements, intra-group arrangements and use of financial market infrastructures.

3.90 The paper sets out PRA policy proposals in three areas:

- the capital and liquidity requirements applicable to a ring-fenced body and how the PRA will determine the adequacy of its financial resources;
- the management of intra-group exposures and arrangements; and
- the use of financial market infrastructures.

3.91 The paper also includes a preliminary discussion on potential reporting requirements, setting out the PRA's initial thinking ahead of future consultation.

3.92 In its October 2014 consultation paper, the PRA also set out policy proposals on legal structure issues intended to supplement these legislative provisions. The PRA published a supervisory statement on legal structure issues in its July 2016 Policy Statement, which set out the PRA's expectations in relation to the ownership structure of banking groups containing one or more ring-fenced banks. Final versions of the PRA's rules and supervisory statements included in the first two consultations were published in the PRA's Policy Statements of July 2016.[80]

3.93 The PRA also published a third consultation paper in July 2016.[81] This included proposals relating to reporting requirements to allow it to monitor firms' compliance with the ring-fencing requirements, as well as a number of residual issues that it needs to consult on to complete the ring-fencing rules.

[77] PRA consultation on ring-fencing Guidance.
[78] PRA Policy Statement on ring-fencing.
[79] PRA consultation paper.
[80] PRA July 2016 (PS 20/16 and 21/16) Policy statements
[81] PRA July 2016 Consultation paper (CP 25/16).

Implementation of the Small Business, Enterprise and Employment Act 2015

3.94 The Small Business Enterprise and Employment Act 2015 (SBEE Act) includes provisions designed to give SMEs easier access to credit facilities. It received royal assent on 26 March 2015 and comes into force in stages from 2015. It aims to:

- enhance the transparency in the ownership of UK companies and increase trust in UK businesses;
- simplify company filing requirements and reduce 'red tape';
- improve the ability of SMEs to access finance; and
- reform aspects of the UK restructuring and insolvency regime.

3.95 The SBEE Act contains provisions on access to finance for SMEs, and from an SME banking perspective, these are the most significant provisions contained in the Act.

3.96 On 7 September 2015 HMT laid before Parliament the Small and Medium Sized Businesses (Credit Information) Regulations 2015, which came into force on 1 January 2016. The regulations impose a duty on designated banks to provide information about SME customers to designated credit reference agencies (CRAs), and impose a duty on designated CRAs to provide information about SME customers to lenders.

3.97 On 7 September 2015 HMT also laid before Parliament the Small and Medium Sized Businesses (Finance Platform) Regulations 2015, which came into force on 1 January 2016. These regulations impose a duty on banks to forward on details of SMEs they decline for finance to platforms that will help them be linked up with alternative lending opportunities (subject to the SME's consent).

EU initiatives

The Payment Accounts Directive

3.98 The Payment Accounts Directive (PAD) sets common regulatory standards that member states must meet in order to improve the transparency and comparability of fees related to current accounts; facilitate switching of those accounts; and ensure access to bank accounts with basic features. PAD covers most PCAs. Business accounts fall outside the scope of the PAD, unless they are held as a personal account.

3.99 The FCA is the lead competent authority under the PAD, with a specific limited role falling to the PSR in relation to certifying that alternative payment account switching services permitted by the directive are compliant with the requirements in the PAD.

3.100 EU member states must implement the terms of PAD by 18 September 2016. PAD requires member states to give effect to the following provisions:

- **Fee information** – banks will be legally required to provide more detailed information on fees[82] to consumers than is presently the case, and will have to do so in a standardised format.[83]

- **Comparison website** – PAD requires member states to ensure that consumers have access, free of charge, to at least one independent PCW comparing fees charged by payment service providers for commonly used services.

- **Payment account switching** – banks must put in place a switching service for payment accounts held in the UK and falling within the scope of PAD. PAD stipulates the duties on both the 'old' and 'new' bank conducting the switch, including maximum periods within which certain elements of the switching process must be completed. Member states can maintain or put in place switching arrangements that depart from the PAD provided they are not less beneficial for consumers.

- **Basic bank account provision** – anyone legally resident in the EU will have a right to open a basic bank account in any EU member state. PAD stipulates some basic features that the account must have, such as ATM access and the ability to perform basic payment transactions, and stipulates that the accounts can be made available either free of charge, or for a reasonable fee.

3.101 Member states have discretion to extend the PAD's application in a number of areas. The UK government's starting position was not to extend the application of the PAD beyond what is strictly required. The exceptions to

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[82] The statement of fees must include at least the following information: (a) the unit fee charged for each service and the number of times the service was used; (b) the total amount of fees incurred for each service, each package of services provided and services exceeding the quantity covered by the packaged fee; (c) the overdraft interest rate applied and the total amount of interest charged relating to the overdraft (where applicable); (d) the credit interest rate and the total amount of interest earned; and (e) the total amount of fees charged for all services.

[83] The PAD requires each member state to create a standard list of 10 to 20 of the most representative services for which a fee might be applied. These services have to be those that are most commonly used by consumers, or which generate the highest costs for consumers. In June 2015 the FCA published a call for input setting out the UK's submission for the most representative terms and in September 2015 it published its feedback statement with the provisional list of the most representative services.

this are the provisions on payment accounts with basic features (basic bank accounts) and the switching services under CASS, where UK policy is more developed than that set out in the PAD (for details see paragraphs 273 and onwards of Appendix 3.1).

3.102 As a result the government implemented the PAD in such a way as to preserve the UK's existing basic bank account policy and CASS as far as possible, while creating the necessary legal certainty for consumers required by the PAD. The Payment Accounts Regulations 2015 were published on 16 December 2015 and will come into force on 18 September 2016.[84]

The Payment Services Directive (and Payment Services Regulations)

3.103 The Payment Services Directive (PSD)[85] harmonises the regulatory regime for payment services across the EU. The aim of the directive is to make cross-border payments as easy, efficient and secure as national payments. The PSD further seeks to improve competition between banks and other types of payment institutions in the provision of payment services. The PSD introduced an EU licensing regime for certain large payment institutions and harmonised conduct of business rules, which regulate the rights and obligations for PSPs and their customers. The PSD is a maximum harmonisation directive; however, several provisions of the PSD leave a margin of discretion to member states.

3.104 The Payment Services Regulations 2009 implement the PSD. They came into force on 1 November 2009 and are monitored and enforced by the FCA. The principles in the Payment Services Regulations are reflected in the FCA handbook called Banking: Conduct of Business and Sourcebook (BCOBS).[86]

3.105 The legislation sets out information which must be provided to payment service users, including micro-enterprises and consumers. Information has to be provided whenever a payment occurs, but different rules apply depending upon the nature of the relationship between the payment service user and the PSP. As between a consumer and their bank, the information will almost always be provided through the bank's terms and conditions (framework contract).

3.106 Under a framework contract, information has to be provided about the PSP, the service, charges and interest, how information will be transmitted, the

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84 Payment Accounts Regulations 2015.
85 Payment Services Directive (2007/64/EC).
86 FCA BCOBS.

safeguards and corrective measures, the length of the contract, and how it can be varied and terminated.

3.107 The Payment Services Regulations 2009 also include information in relation to the authorisation process of a payment institution or the registration process of a small payment institution, detailed provisions on the rights and obligations in relation to the provision of payment services and safeguards to the rights of payment users to access payment services.

Second Payment Services Directive

3.108 The European Commission published a proposal for a Second Payment Services Directive (PSD2) in July 2013. The Directive was published on 23 December 2015 and came into force on 12 January 2016, repealing the current PSD.[87]

3.109 Like the current PSD, PSD2 is a maximum harmonisation directive. Member states are required to transpose the Directive into national law within two years. The UK plans to initiate a formal consultation in summer 2016 and publish regulations at the beginning of 2017, which will come into force in January 2018.

3.110 PSD2 updates the current framework on payment services, extending its scope to payment services providers that were previously unregulated, and to improve the transparency and security of payment services. The updated rules aim to stimulate competition to provide payment services and foster innovative payment methods, especially for online payment services.

3.111 The PSD2 also introduces new rules aimed at increasing competition by facilitating the use of third party PSPs. The proposals include an obligation on banks to allow customers who have an online account to use payment initiation[88] and account information[89] services provided by third party PSPs. Banks will also be required to provide appropriate access and information to third party PSPs acting for payers, and to treat payment orders transmitted through the services of third party PSPs in a non-discriminatory way.

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[87] Revised Payment Services Directive (2015/6366/EU).
[88] A payment initiation service is defined as a 'payment service enabling access to a payment account provided by a third party payment service provider, where the payer can be actively involved in the payment initiation or the third party payment service provider's software, or where payment instruments can be used by the payer or the payee to transmit the payer's credentials to the account servicing payment service provider' (the account holder's bank).
[89] An account information service is defined as a 'payment service where consolidated and user-friendly information is provided to a payment service user on one or several payment accounts held by the payment service user with one or several account servicing payment service providers'. This includes services that enable users to have a consolidated view of their online bank accounts.

3.112 The EBA will develop regulatory technical standards which will provide how banks will need to allow third party payment providers access to accounts. They will then come into force 18 months after they are adopted by the European Commission.

3.113 The PSD2 also requires banks to apply strong customer authentication measures where a user accesses their online account or initiates a payment transaction.

3.114 The information and transparency conditions pre-contract and before and after a transaction are maintained in the PSD2. The PSD2 requires all framework contracts to include a condition that the payer may require the information to be provided or made available periodically at least once a month free of charge and in an agreed manner.

Interchange Fee Regulation

3.115 The IFR imposes a cap on the level of interchange fees for transactions based on consumer debit and credit cards of 0.2% and 0.3% respectively. It also bans the imposition of surcharges on transactions using these types of cards. The caps reflect those accepted in the European antitrust cases against Visa and MasterCard.

3.116 On 27 July 2015 HMT issued a consultation paper[90] setting out the government's proposed steps to meet the UK's obligation to put in place an adequate and efficient regulatory regime to supervise compliance with the IFR. The consultation closed on 28 August 2015 and the consultation response was published in October 2015.[91]

3.117 On 9 December 2015, the Payment Card Interchange Fee Regulations 2015 (SI 2015/1911) came into force.[92] In particular, the Regulations:

- appoint competent authorities, the FCA and the PSR, to monitor and enforce compliance with the IFR and enable non-compliance to be penalised;

- exercise options available to the UK on some of the requirements of the IFR; and

[90] HMT interchange consultation.
[91] HMT interchange fee regulation consultation response.
[92] *Payment Card Interchange Fee Regulations 2015 (SI 2015/1911)*.

- give the PSR power to publish guidance relating to the IFR. The PSR published its final guidance on 24 March 2016.[93]

3.118 HMT is required to review the Regulations every five years and publish a report, setting out its conclusions, following each review.

Bank Recovery and Resolution Directive

3.119 The Bank Recovery and Resolution Directive (BRRD) establishes a recovery and resolution framework for EU credit institutions and investment firms. The BRRD provides national authorities with harmonised tools and power to tackle crises at banks and investment firms early on, and to minimise costs for taxpayers. As of 1 January 2015 all member states have to apply a single rulebook for the resolution of banks and large investment firms, as prescribed by the BRRD. The new rules harmonise and improve the tools for dealing with bank crises across the EU.

The Consumer Credit Directive

3.120 The Consumer Credit Directive (CCD) harmonises certain aspects of the law in member states relating to consumer credit agreements. The CCD applies to most types of credit agreement not secured on land and has been implemented in the UK by various statutory instruments and rules made under the Consumer Credit Act 1974 and the FSMA.

3.121 Some aspects of the CCD are 'maximum harmonisation'. The CCD includes a variety of requirements, including duties and obligations on lenders, certain rights for consumers, rules on the content of advertising and specified information to be provided to consumers before and after they enter into credit agreements.[94] For more information on the CCD and the UK consumer credit regime see also paragraphs 354 and onwards of Appendix 3.1.

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[93] PSR Final guidance.
[94] SME lending falls outside the scope of the CCD, but is some cases, it is caught by provisions in national legislation (ie lending below £25,000 to a small subset of SMEs), for more details, see paragraphs 361–362 of the Appendix.

Data protection rules

Data Protection Act 1998

3.122 In the UK, the collection and use of personal data is primarily governed by the Data Protection Act 1998 (DPA).[95] The Information Commissioner is responsible for enforcing and overseeing the DPA.

3.123 The DPA aims to to promote high standards in the handling of personal information and to protect the individual's right to privacy. The DPA sets out eight main principles applying to personal data and the processing of personal data. The terms 'personal data' and 'processing of' personal data are very widely defined under section 1 of the DPA.

3.124 The DPA draws a distinction between a 'data controller' and a 'data processor'. The data controller is defined as the person who (either alone, jointly or in common with other persons) determines the purposes for which and the manner in which any personal data is, or is to be, processed. All the obligations under the DPA fall on the 'data controller'.

Privacy and Electronic Communications Regulations 2003

3.125 The Privacy and Electronic (EC Directive) Communications Regulations 2003 (PECR)[96] were designed to complement the DPA, and set out more detailed rules relation to direct marketing activities through electronic means (eg fax, email, and telephone). There is no restriction on sending solicited marketing (ie marketing material that has been specifically requested) through electronic means. The PECR rules only apply to 'unsolicited' marketing (ie marketing material that has not been specifically requested).

3.126 Consent is key to allow unsolicited direct marketing. The definition of consent set out in the Data Protection Directive[97] also applies for PECR but PERC goes further also requiring that: 'the [recipient] has previously notified the [caller or sender] that he consents for the time being to such communications being sent by, or at the instigation of, the [caller or sender]'.

[95] The DPA implemented the EU Directive 95/46/EEC on the protection of individuals with regard to the processing of personal data and on the free movement of such data (the 'Data Protection Directive').
[96] The PECR implemented the Electronic Communications Directive (2002/58/EC).
[97] Article 2 of the Data Protection Directive 95/46/EC defines the data subject's consent as 'any freely given, specific and informed indication of his wishes by which the data subject signifies his agreement to personal data relating to him being processed'.

General Data Protection Regulation

3.127 In January 2012, the European Commission proposed a comprehensive data protection reform package consisting of two distinct proposals:

- a General Regulation (the Regulation) covering the bulk of personal data processing in the EU; and
- a Directive on processing data to prevent, investigate, detect or prosecute criminal offences or enforce criminal penalties.

3.128 The Regulation updates the principles set out in the Directive and harmonises data protection procedures and enforcement across the EU. The objectives are to protect individuals with regard to the processing of personal data and enable the free movement of personal data between member states and third countries able to provide adequate protection standards.

3.129 The Regulation aims to keep pace with major changes in data processing. It covers, for example, online (social networks, online shopping and e-banking services) and offline (hospital registers, company registers etc) data.

3.130 The Regulation was published in the Official Journal of the EU on 4 May 2016.[98] It will be directly applicable in the UK from 25 May 2018.

[98] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ L 119/1.

4. Market definition

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Introduction

4.1 Our guidelines state that defining the market helps to focus on the sources of any market power and provides a framework for the assessment of the effects on competition of features of a market. However, market definition and the assessment of competition are not distinct chronological stages of an investigation but rather are overlapping and continuous pieces of work, which often feed into each other.[1]

4.2 A market is a collection of products provided in particular geographic areas connected by a process of competition. The process is one in which firms seek to win customers' business over time by improving their portfolios of products and the terms on which these are offered, so as to increase demand for them. The willingness of customers to switch to other products is a driving force of competition. In forming our views on market definition, we therefore consider the degree of demand substitutability. In some markets, supply-side constraints will also be important.[2] Market definition in a market investigation flows from the statutory questions the investigation is required to address. Markets defined in the context of answering other statutory questions, or under other regimes, may not therefore be comparable.[3]

4.3 Our guidelines also state that market definition is a useful tool, but not an end in itself, and that identifying the relevant market involves an element of

[1] *Guidelines for market investigations: their role, procedures, assessment and remedies: CC3*, April 2013 (The Guidelines), paragraphs 94 & 132.
[2] The Guidelines, paragraph 130.
[3] The Guidelines, footnote 74 (paragraph 132).

judgement. The boundaries of the market do not determine the outcome of our competitive assessment in any mechanistic way. The competitive assessment takes into account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others.[4]

4.4 There are normally two dimensions to the definition of a market:

(a) a product dimension where the relevant product market comprises a set of substitute products; and

(b) a geographic dimension, where the relevant geographic market may be national (or wider), regional or local.

4.5 We consider each of these aspects below.

4.6 In considering the substitutability of goods or services or areas of supply set out in the terms of reference (ToR), the CMA may conclude that the market definition goes wider or narrower than those goods and services.[5] Our starting point for assessing market definition is therefore the ToR for this investigation, which concern PCAs and SME banking products, including BCAs, overdrafts, general-purpose business loans and deposit accounts.[6]

4.7 The guidelines also state that, in some cases, the CMA may treat a group of product, geographic or other types of markets together for the purposes of assessing competitive effects. This can be the case where a feature manifests itself in a similar way across several different markets (for example, the need for an operating licence may be an aspect of many local markets) and the CMA is able to reach a view about the effects of the feature on competition across the group of markets as a whole.[7] Thus we are not required to identify the narrowest possible market(s).

PCAs

Previous approaches to market definition

4.8 The OFT and the CC looked into the provision of PCAs on a number of occasions. A more detailed summary of previous approaches to market definition is provided in Appendix 4.1.

[4] The Guidelines, paragraph 133.
[5] The Guidelines, paragraph 131.
[6] For further details see the retail banking market investigation terms of reference.
[7] The Guidelines, paragraph 152.

4.9 The CC's 2007 market investigation into PCA banking services in NI listed the following as the main characteristics of a PCA:

(a) provision of a facility to deposit and store money, with quick and easy access;

(b) provision of a facility to receive payments by cheque or electronic transfer;

(c) provision of a facility to make instant and/or regular payments without using cash, eg through cheques, switch payments, bank transfers, standing orders and direct debits; and

(d) provision of the means for short-term borrowing through an overdraft.

4.10 The CC concluded that the relevant product market should include all PCAs, including packaged accounts, but should not be drawn more widely to include basic bank accounts, instant access savings accounts, credit union accounts, offset/current account mortgages or other personal financial products.[8]

4.11 With regard to the relevant geographic market, the CC saw no need to define the market at a local level and considered that the market in NI was separate from that in GB (and also that in the Republic of Ireland).[9]

4.12 The OFT and CMA have subsequently carried out a number of market studies into PCAs and the OFT also investigated the issue in its 2008 Lloyds TSB/HBOS merger report to the Business Secretary. These followed the CC's 2007 approach to market definition, but basic bank accounts were considered with other PCAs as part of its competitive assessment.[10]

Relevant product market(s)

4.13 As regards PCAs, our ToR refer to the provision of an account marketed to individuals rather than businesses, which provides the facility to hold deposits, to receive and make payments by cheque and/or debit card, to use

[8] CC (2007), *Personal current account banking services in Northern Ireland market investigation*, paragraphs 3.2–3.30.
[9] ibid, paragraphs 3.31–3.37.
[10] The question of whether basic bank accounts should be included in the same market as PCAs is discussed below in paragraphs 4.34–4.37.

ATM facilities and to make regular payments by direct debit and/or standing order.[11]

4.14 All PCAs enable customers to make and receive payments and provide a store of value. PCAs may or may not offer other facilities such as personal banking advice and borrowing facilities.

4.15 The majority of PCAs offer borrowing facilities (overdrafts) – an ability to withdraw money beyond the amount held in the account, entering into a negative balance in the PCA. Overdrafts can be arranged or unarranged:

(a) An arranged overdraft is one where the bank agrees in advance the amount that can be borrowed: arranged overdrafts may be provided at the customer's request, though banks may also provide an arranged overdraft facility so that the customer can borrow on arranged terms without specifically requesting it.

(b) An unarranged overdraft is one where a customer borrows money when they have none left in their account and this has not been agreed with the bank in advance or when the customer exceeds their arranged overdraft limit.[12] A bank can let this happen, rather than refuse a customer's payment.

4.16 We consider PCAs both with and without overdraft facilities to be within our ToR as they both provide the facilities described in the ToR (as set out in paragraph 4.13 above). PCAs with overdraft facilities make up the majority of PCAs.

4.17 PCAs are conventionally divided into a number of categories according to features or customer type:

(a) **Standard and 'reward' accounts**:

(i) We regard standard accounts as accounts which pay zero or very low (for example, 0.01%) rates of interest on credit balances and do not attract other benefits such as cashback, and not falling into any

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[11] Our ToR exclude non-UK sterling accounts, accounts that do not have all the functionalities set out in our ToR, such as managed accounts and credit union accounts, and current account mortgages. However, where a mortgage product (often marketed as an 'mortgage offset account') comprises two separate accounts, a mortgage and a PCA with credit interest on the PCA being credited to the mortgage account, the mortgage would fall outside and the PCA would fall inside our ToR, even though the two products are linked for the purposes of interest calculations.

[12] These descriptions are consistent with the definitions proposed by the FCA as part of its work to standardise these terms under the EU's PAD. See FCA (September 2015), Terms and definitions for services which are linked to payment accounts and subject to fees, Provisional list of the most representative services within the meaning of Article 3 of the Payment Accounts Directive 2014/92/EU, Annex 1.

of the other categories below. These accounts typically do not charge monthly or yearly fees.

(ii) We regard reward accounts as those paying higher interest rates on credit balances and/or significant rewards such as a monthly cash payment or cashback on utility bills. Reward accounts usually contain eligibility conditions, for example requiring the customer to pay in a certain amount per month and to set up a certain number of direct debits on the account. Some reward accounts have a monthly fee of about £2 to £5 per month though if the customer meets the eligibility conditions this would usually be offset by cash rewards received.

Approximately 74% of all PCAs in the UK in 2014 were standard or reward accounts (62% standard and 12% reward). The proportion of reward accounts has increased. In 2014 they accounted for 25% of new PCAs (compared with 8% in 2011). Reward accounts account for a higher proportion of main accounts[13] (15% of all main PCAs and 37% of new main PCAs in 2014).

(b) **Packaged accounts**: provide additional services such as travel insurance, car breakdown cover and mobile phone insurance. Such accounts have monthly or annual fees, typically of £10 to £15 per month. Rules on selling packaged accounts have been tightened in recent years, in particular banks are required to inform customers whether or not they would be eligible to claim under each policy.[14] The Financial Ombudsman Service (FOS) recently reported an increase in complaints about mis-selling of packaged accounts.[15] Packaged accounts represented about 9% of all UK PCAs in 2014, a decline from 12% in 2011 (they accounted for a larger share, 13%, of main PCAs in 2014).

(c) **Basic bank accounts**: are fee-free for standard transactions, do not provide an arranged overdraft facility, minimise the opportunity for unarranged overdrafts and do not charge for an overdrawn balance.[16] They may also have other limitations, for example no cheque books and no contactless debit cards. Basic bank accounts do not require a credit check and hence are attractive to those with low credit scores and those dependent on government benefits. In December 2014, the UK government agreed with nine banks that they would within 12 months

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[13] Accounts where £500 or more is paid in per month. See paragraph 5.10 for more details.
[14] See FCA packaged account summary.
[15] See Financial Ombudsman complaints data.
[16] See HMT (15 December 2014), Revised basic bank account agreement.

provide basic bank accounts (including debit cards) free of all charges to anyone who does not already have a bank account or who cannot use their existing account due to financial difficulty.[17] Basic bank accounts represented approximately 11% of all UK PCAs (and 7% of main PCAs) in 2014.

(d) **Student/graduate accounts**: available only to students at UK universities or those who have recently graduated, they are similar to standard accounts but offer lower-cost or interest-free overdraft facilities; they may also offer a reward such as a free student travel card. Student and graduate accounts comprised nearly 3% of all UK PCAs in 2014.

(e) **Youth accounts**: these are typically available to customers between the ages of 7 and 17 years and, depending on customer age, have reduced functionality, for example, no cheque book or overdraft facility. They accounted for 3% of all UK PCAs in 2014.[18]

4.18 The great majority of PCAs do not charge directly for a variety of common transactions in the UK including cash withdrawals and payments into the account by cash or cheque at ATMs, branches, and electronically via faster payments (so-called 'free-if-in-credit' (FIIC) charging model). Charges and/or interest are levied when a customer is in overdraft, for foreign currency transactions and for less commonly used services such as stopping a cheque. Most (but not all) banks also charge when payments are refused due to lack of funds[19] and for opting out of unarranged overdrafts[20] on accounts other than basic bank accounts. As described in the previous paragraph, some accounts, however, have monthly fees in particular if they are reward or package accounts.

4.19 The definition of PCAs in our ToR represents the starting point for defining the relevant product market(s). We therefore consider whether *(a)* the relevant product market is wider than PCAs and *(b)* whether we need to define more than one product market within PCAs.

[17] See Section 3 and Appendix 3.1 for more details on the provision of basic bank accounts.
[18] Other types of account that are sometimes identified include private bank accounts (providing a relationship manager and usually other benefits and requiring high income and/or savings), mortgage offset accounts (where account balances are set against a mortgage) and Islamic accounts (Shariah-approved). The number of such accounts is small.
[19] Usually referred to as unpaid item charge. From December 2015 this will not apply on basic bank accounts of the nine major banks.
[20] Often referred to as adding 'control' to the PCA.

Whether the product market should be wider than PCAs

4.20 In the UK, around 97% of adults aged 16 and over have a PCA[21] which they regularly use to receive and make payments and to organise their finances. The very small proportion (3%) of those who remain without a PCA transact in cash, and may use alternative products, such as instant access savings accounts, home credit and payday loans to replace some of the functionalities of a PCA.

4.21 Various financial alternatives can act as a substitute for one or more of the different facilities offered by a PCA. For example, credit cards, personal and payday loans can be used to substitute for an overdraft facility; savings accounts and cash instant access savings accounts could be used to substitute for the facility to hold deposits; and credit cards, pre-paid debit cards and digital wallets could be used to substitute for the facility to make payments. Nevertheless, none of these products could fully substitute for all the features of a PCA.

4.22 During the course of the investigation we took the view that these alternative products did not exercise a sufficient constraint on PCAs to be included in the product market. Parties were generally of the same view with the exception of the four biggest GB PCA banks, which argued that the competitive pressure exerted by digital wallets, such as those provided by PayPal, should be taken into account.

4.23 Below we consider in more detail the extent to which each of these alternative products may act as a substitute for services offered by PCAs, ie the facility to make and receive payments, to store money and borrow money on a short-term flexible basis.

- *Digital wallets*

4.24 A digital wallet is a service that facilitates the storage of payment (and possibly other) credentials and enables users to make payments, either online or via a mobile device. In some cases it can also be used as a facility to store money. In the UK, digital wallets are currently offered by several providers, including PayPal, Apple, Google and Amazon but not by banks, with further entry possible (for example Samsung Pay). Digital wallets are

[21] Source: GfK FRS.

discussed further in Appendix 4.2 and in the report by Deloitte on the impact of innovation in the UK retail banking market.[22]

4.25 Digital wallets compete directly with payment systems, which is an upstream market to the supply of PCAs. While the growth of digital wallets may potentially impact on PCAs,[23] for example by lowering income from interchange fees, we have not seen evidence of digital wallets substituting for PCAs, or of a significant impact on banks' income from interchange fees. Although digital wallets provide a money transfer service, customers will still need a PCA to make full use of their PayPal or Apple Pay account or other digital wallet facilities. Several banks have also indicated that they see digital wallet services as enhancements to their PCA and credit card offerings, suggesting a degree of complementarity rather than substitutability.[24]

4.26 Importantly, their ability to provide an alternative to a money storage facility is very limited. The difficulty of paying salaries into digital wallets limits their ability to act as a substitute for PCAs. In addition, at present Google Wallet only provides a deposit storage service for an additional fee of 2.9% and PayPal payments made directly from PayPal account balances amount to only 10% of transactions.[25]

4.27 None of the banks have reported changing their PCA prices or improving the quality of their PCA offering as a response to suppliers of digital wallets products. Although the four biggest banks have reported that they have been innovating and improving their digital proposition, it is unclear to what extent such innovations were prompted by digital wallets rather than being developed for other purposes, including responding to the actions taken by other banks. Apple Pay and Android Pay launched in the UK only in July 2015 and May 2016 respectively and other digital wallets (eg Samsung Pay) may launch in the future thus suggesting that the impact on PCAs may increase in the future. However, the longer-term extent of such impact on PCAs remains highly uncertain and as described above, at present and in the foreseeable future, digital wallets will not be a substitute for a PCA but rather a complementary product.[26]

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[22] Deloitte innovation report.
[23] In fact, some larger banks referred to increasing competitive pressure from digital wallet providers, in particular through loss in transaction revenues, disintermediation and reduction of access to customer data (LBG, RBS, HSBCG, and Nationwide). See also responses to the updated issues statement and banks' hearing summaries.
[24] See banks' hearing summaries. For instance, Apple Pay is currently offered as an additional payment method feature by LBG, HSBCG, RBSG, Santander, TSB and Nationwide (see Apple pay website).
[25] See Deloitte innovation report, p33.
[26] See also Deloitte innovation report, pp33–36.

- *Savings accounts*

4.28 Savings accounts allow money to be held in a bank and also pay interest on the money deposited in the account. Although some savings accounts, in particular instant access savings accounts, allow for payments and withdrawals to be made whenever needed without incurring a penalty, in essence, such accounts are designed to serve as a device for storage and savings, rather than to handle day-to-day operations.

4.29 Although it might be possible to use instant access savings account together with an ATM/debit card where a customer is in credit, this would only substitute for a limited set of a PCA's functionalities and is rarely used this way in practice.[27]

- *Personal and payday loans*

4.30 Personal loans and payday loans are unlikely to act as substitutes for overdrafts due to the inherent differences in their main characteristics and usage. Overdrafts act as a short-term lending facility offering instant and automatic access to credit for a wide range of transactions. Whereas personal loans are usually available for a fixed term and are better suited to meeting long-term financial needs. Similarly, evidence from the CMA's payday lending market investigation confirms that there is only limited substitutability between overdrafts and payday loans,[28] which is also supported by banks' responses.[29]

- *Credit cards*

4.31 Credit cards can be used for making payments, provide quick and easy access to borrowing funds and often allow for cash withdrawals (albeit at significant additional cost). While some customers may be able to use credit cards to avoid overdraft fees, credit card accounts do not provide other PCA facilities, in particular the possibility to receive payments, make electronic

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[27] For example, Clydesdale reports that its analysis undertaken in 2014 suggested that around [✄] of its instant access savings accounts (equivalent to [✄]% of its PCAs) exhibited some usage characteristics similar to those of a PCA.
[28] For instance, the payday lending market investigation found that consumer willingness to substitute payday loans with other credit products was very low and that payday lending was typically used as a last resort when other types of credit, including overdrafts, were not available. See CMA (24 February 2015), *Payday lending market investigation: Final report*, Section 5, for more information.
[29] For instance, Barclays stated that it did not consider that payday loan providers competed with its core offering; Clydesdale indicated that, using internal data as at May 2014, it found that the number of customers who were making payments to payday lenders from their PCAs was [✄], accounting for [✄]% of its current account base and had been [✄] over time; similarly, LBG reported that 'many payday loan customers would be outside LBG's risk appetite' and the number of LBG's customers with payday loans amounted to less than [✄]% of all its PCA customers in 2013.

transfers, direct debits and standing orders. This significantly limits their ability to act as a substitute for a PCA. Credit cards also do not currently provide a way to borrow funds automatically, if required, when a PCA's balance drops below zero (for example, to make a direct debit payment).

- *Conclusion on whether market is wider than PCAs*

4.32 While some products may potentially be able to substitute for elements of the facilities provided by a PCA, there is no other product or combination of products that can fully replicate the core facilities of a PCA. Although some products in combination could technically be used as a substitute for a PCA, this would require significant additional input from customers in managing several different facilities without a significant benefit for doing so. The customer would also still lack some of the core facilities of a PCA such as setting up direct debits and standing orders, making free cash withdrawals and this would limit the ability to receive salary credit and clear cheque payments.[30] In addition customers would incur significantly more fees in combining such products than in using a PCA. The majority of customers generally use these alternative products in addition to their PCAs and indeed some products require a PCA to function fully, which suggests that they are not substitutes for a PCA.

4.33 Therefore we consider that the market is not wider than PCAs.

Whether we need to define more than one product market within PCAs

4.34 As discussed above, there are a number of different types of PCA (see paragraph 4.17). Demand-side substitutability between different PCA types may be limited to some extent by certain restrictions as to which types of customers are eligible for them (for example, student accounts). However, many customers are eligible for various types of the most common PCAs. The degree of supply-side substitutability also appears to be high – the majority of retail banks supply all types of PCAs and are easily able to switch resources from the supply of one type to the supply of another, in response to changes in demand.

4.35 Our ToR include PCAs that do not provide overdraft facilities, for example basic bank accounts and youth accounts. Banks' submissions did not indicate that they view current accounts with and without overdraft facilities to be in separate product markets. Banks told us that there was demand for

[30] For instance, Santander indicated that 'the majority of customers are unlikely to consider such alternatives as substitutes for a PCA given the additional complexity such approach would provide'.

a current account without an arranged overdraft facility and that they would offer basic bank accounts even absent the requirements imposed by the government.[31] In addition, banks have started offering the ability to opt out from using unarranged overdraft facilities in other types of account, either for a fee or in a few cases free of charge.

4.36 As mentioned in paragraph 4.7, our guidelines do not require us to identify the narrowest possible market(s) when the conditions of competition are similar across them.[32] We also consider that the issues underlying our theories of harm[33] are common to the different types of PCAs identified and within our ToR. Therefore, while the approach of the 2007 CC inquiry would imply a separate market for accounts without a borrowing facility such as basic bank accounts (see paragraph 4.9),[34] we consider that it is sufficient for us to identify differences between different types of PCA where appropriate in our competitive assessment.

4.37 Parties in response to our provisional findings did not suggest that we should define separate markets for different types of PCAs or service elements within PCAs. We therefore consider there is a single market for PCAs including all the facilities provided by most PCAs, including overdrafts, with relevant differences between different types of PCA, as noted above, dealt with in our competitive assessment.

Relevant geographic market(s)

4.38 Our guidelines state that geographic markets may be based on the location of suppliers and defined as an area covering a set of firms or outlets which compete closely because enough customers consider them to be substitutes.[35] Our ToR are limited to UK sterling bank accounts and given the UK-wide regulatory framework and conditions of supply and demand, we did not consider that the PCA market was wider than the UK.

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[31] For instance, LBG reports [✂] customers opening a basic bank account in 2014 despite being eligible for a full facilities PCA and asserts that basic bank accounts 'are likely to be very attractive to a large number of customers'.
[32] The Guidelines, paragraph 152.
[33] See Section 1, paragraph 1.14.
[34] We note that CC's decision not to include basic bank accounts in the market for PCAs in its 2007 market investigation might have been influenced by several factors: (i) the CC interpreted the terms of reference for the 2007 market investigation to include only accounts with overdraft facility; (ii) the investigation only looked at the demand side and did not consider supply-side substitutability between different current accounts offered by banks; and (iii) at the time of the investigation basic bank accounts had been introduced only relatively recently which could have added some uncertainty. See Appendix 4.1 for more details on previous approaches to market definition.
[35] The Guidelines, paragraph 145.

4.39 In this section we consider whether the market for PCAs is local and whether separate markets can be identified in the four nations of the UK. Our approach to geographic market definition is discussed in more detail in Appendix 4.3.

4.40 Although the local dimension, mainly through the usage of local branches for customer acquisition and retention, remains important,[36] pricing, product offering, service levels and marketing activities are determined for each brand at a UK-wide level. Regulatory requirements[37] do not differ materially across the UK and customers' needs and behaviour are broadly similar across different parts of the UK. Some banks argued that the increasing importance and widespread availability of digital banking rendered any regional differences between banks immaterial. Some banks also noted that the barriers to entry and expansion were similar across the UK and that new entrants, including alternative service providers, with a few exceptions, were entering the market on a UK-wide level.[38]

4.41 We have not received any evidence or submissions from parties that we needed to consider separate local (ie sub-national) markets. The majority of banks agreed that the market for PCAs was at least GB- or even UK-wide.[39] As mentioned in paragraph 4.7, we do not need to define the narrowest possible markets – our guidelines state that the CMA may treat a group of geographic markets together for the purposes of assessing competitive effects, for instance, where a market feature manifests itself across several different markets.[40] Accordingly, we have not defined local banking markets.

4.42 We now turn to which separate regional and/or national markets we should identify. As previously mentioned in paragraph 4.40, pricing, product offering, service levels and marketing activities are determined for each brand at a UK-wide level and regulatory requirements do not differ materially across the UK. However, the fact that banking brands have a UK-wide offering would not necessarily imply a UK-wide market if customers in different parts of the UK use different brands (because brands in each area would compete only with each other). We have looked at the extent to which this is the case for the devolved nations and the English regions by looking

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[36] For example, the GfK PCA consumer survey reported that local branch convenience was the third most important reason for PCA customers in choosing whom to bank with. However, the reliance on local branches has been diminishing over the years and the usage of internet and mobile banking has been growing significantly. This is also in line with the expected growth of online-only banks, such as first direct, Smile and Atom. For more information on the role of branches, see Section 9.
[37] The main exception is the Northern Ireland PCA Order. See Appendix 3.1 for more details.
[38] See Appendix 4.3.
[39] See Appendix 4.3.
[40] The Guidelines, paragraph 152.

at differences between regions/devolved nations in individual brand market shares, see Appendix 4.3, paragraphs 20 to 21.[41]

4.43 The Welsh government told us it considered that there was a separate Welsh geographic market, but no other party suggested Wales was a separate geographic market. As already mentioned, pricing, product offering, service levels, marketing activities and regulatory requirements do not differ between England and Wales. Our analysis showed that market shares in Wales were also broadly similar to market shares for the whole of GB, as was also the case for the English regions. Hence, for the purposes of our analysis, we consider there is a single geographic market covering England and Wales.

4.44 Most parties that expressed a view considered there was a single geographic market covering the whole of GB. We found some differences in market shares between Scotland and the rest of GB. In Scotland, most PCAs were supplied in 2015 by RBSG (through the RBS brand), LBG (through the BoS and Halifax brands), TSB, Clydesdale and Santander. In England and Wales the five biggest banking groups in 2015 were LBG (through the Lloyds and Halifax brands), Barclays, RBSG (through the NatWest brand), HSBCG and Santander.[42] In addition, the NatWest and RBS brands of RBSG have almost identical product offerings across both brands, and apply the same criteria and charging structures. The Lloyds and BoS brands of LBG also have very similar products.[43] Our analysis suggests that there are some, although limited, differences between Scotland and the rest of GB. However, as mentioned before, the majority of banks view GB as a single market. In addition competition in both Scotland and England and Wales occurs, to a large extent, between the same banks because the vast majority of PCAs in both regions are provided by the same banking groups and each offer similar products in all three nations subject to the same regulatory requirements and similar customer characteristics. Accordingly, we do not consider that there is enough difference between Scotland and England and Wales to consider them as separate geographic markets.

4.45 However, the situation is different in NI, where 61% of main PCAs were supplied in 2015 by RBSG (through the Ulster brand), Danske, BoI, and AIB, whereas four of the larger GB-based banks (LBG, Barclays, HSBCG and

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[41] We combined the market shares of the RBS and NatWest brands of RBSG and those of the Lloyds and Bank of Scotland (BoS) brands of LBG as they have very similar product offerings.
[42] For further details on banks market shares please see Section 5.
[43] Halifax has a different product offering and is marketed as a ‘challenger’ brand in England, Wales and Scotland. Its market shares across these markets do not vary as much as for other brands.

Santander) had only 31% of the market combined.[44] While Ulster is owned by RBSG, its product offering and management is currently separate from NatWest and RBS.[45] Of the larger GB-based brands, only Santander, Halifax and Nationwide also have a relatively large market share in NI.

4.46 As discussed in more detail in Appendix 4.3, parties, in general, were of the view that NI is a separate geographic market, but some banks suggested there was a single UK-wide market. These banks noted that each provider had a consistent offering in terms of price and service levels across the UK; that there were similar customer needs in NI to the rest of the UK and that GB-based banks were expanding in NI.[46] However, as discussed in the previous paragraph, banks' market shares in NI remain quite different to those in GB. Although we have seen evidence that some GB-based banks, in particular Santander and LBG (through its Halifax brand), have been able to increase their market share in NI, we have not seen the reverse namely Irish banks trying to expand their presence in GB, which is currently very small. We take this as evidence that competition in NI is, to a large extent, between different banks to those who compete in GB. Accordingly, we consider there is at least the potential for competitive conditions to differ between GB and NI.

4.47 Our view is therefore to regard NI and GB as separate geographic markets for the purposes of our analysis. We recognise that some aspects of the two geographical markets are similar and we do not consider that the distinction between NI and GB affects most of our competitive analysis, which is to a large extent the same for both geographic markets.

Conclusions on PCA market definition

4.48 We consider that:

(a) the relevant product market is limited to PCAs, both with and without overdraft facilities; and

(b) GB and NI should be considered as separate geographic markets.

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[44] For further details on banks market shares in NI please see Section 5.
[45] [✂]
[46] See Appendix 4.3.

SME banking

Previous approaches to market definition

4.49 In the past there have been several instances in which the OFT and the CC have looked into the provision of SME banking services. A more detailed summary of previous approaches to market definition is provided in Appendix 4.1.

4.50 In its 2002 SME banking market investigation, the CC identified four separate product markets within the banking services provided to SMEs:

(a) liquidity management services: BCAs, together with short-term bank deposit accounts and overdraft facilities provided in conjunction with current accounts;[47]

(b) general-purpose business loans;

(c) other types of business loans: invoice discounting and factoring, hire purchases, leasing and other asset finance; and

(d) business deposit accounts.

4.51 The CC did not define geographic local markets. It considered that England and Wales, Scotland and NI constituted three separate geographic markets for liquidity management services and for general-purpose business loans, while the markets for other types of loans and other deposit accounts were found to be UK-wide.[48]

4.52 The OFT and CMA have subsequently considered the issue in the 2008 Lloyds TSB/HBOS merger report to the Business Secretary and a BCA market study report. However, these did not engage in a formal market definition exercise, but relied on the previous findings by the CC.

Relevant product market(s)

4.53 The ToR refer to ‘the provision of banking services, which includes, but is not limited to, the provision of business current accounts, overdrafts, general-purpose business loans and deposit accounts, but which excludes

[47] This excludes PCAs used by SMEs.
[48] CC (2002), *The supply of banking services by clearing banks to small and medium-sized enterprises*, paragraphs 2.31–2.61.

the provision of other non-lending products such as insurance, merchant acquiring, hedging and foreign exchange'.[49]

4.54 Our ToR therefore encompass a wide range of products and services provided to SMEs. We have focused in our investigation on the three banking services specifically referenced in our ToR, namely BCAs and overdrafts, general-purpose business loans and deposit accounts. We have not received any submissions to suggest that we should broaden our focus from these core SME banking products. We now consider whether these different products constitute distinct product markets. We then consider differences between SMEs and their relevance for product market definition in paragraphs 4.90 to 4.96.

BCAs

4.55 BCAs are core payment accounts, generally used to make and receive payments and to manage cash flow, offered to business customers and designed to meet all of their everyday basic banking needs.

4.56 Most BCA customers pay a monthly fee and/or transaction fees for using their account. SMEs, particularly larger SMEs, may negotiate bespoke pricing terms for BCAs. Start-up businesses usually benefit from a period of 'free banking' during which these fees are waived, and SMEs switching to another BCA provider also often benefit from a free banking period.

4.57 Like PCAs, BCAs may include an overdraft facility. Typically, SMEs use overdrafts to meet working capital requirements or to manage fluctuations in cash flow. However, unlike PCAs, overdrafts are granted for a one-year period, meaning that businesses have to re-apply for an overdraft facility each year and pay arrangement fees. In some cases security might be required which will depend on the risk assessment. The Charterhouse Business Banking Survey (Charterhouse BBS) reports that 15% of BCA holders had an arranged overdraft facility in 2014.[50]

4.58 Banks also provide special accounts for charities, clubs and societies, schools and other educational establishments, which are generally provided free for in-credit customers. As in the case of PCAs and for the same reasons, we do not see a need to define separate product markets for different types of BCAs.

[49] See the retail banking market investigation terms of reference.
[50] Source: Charterhouse BBS.

4.59 For the purposes of our analysis we define a BCA as a bank account which includes the following services:

(a) provision of a facility to deposit and store money, with quick and easy access;

(b) provision of a facility to receive domestic and international payments; and

(c) provision of a facility to make instant and/or regular domestic and international payments without using cash, eg through switch payments, bank transfers, standing orders, direct debits.

A BCA may or may not offer other facilities, such as overdrafts and access to relationship managers/business advisers.

4.60 From a demand-side point of view, there is no product that could fully substitute for all the services provided by a BCA. While other products, such as digital wallets, instant access savings accounts and business loans, can substitute for some services of a BCA in the same way as for a PCA (see paragraph 4.21 above), none of them could substitute for a BCA in full.

- *Digital wallets*

4.61 Some banks said they faced increasing competitive pressure from digital wallet providers, such as PayPal and Apple Pay and potentially others such as Google Wallet. Digital wallets are discussed further in Appendix 4.2. As mentioned in the previous paragraph, none of these products can be used to effectively substitute for the full set of features of a BCA. As in the case of PCAs (see paragraph 4.25), digital wallets compete directly in the upstream payment systems market. PayPal is increasingly competing with banks in merchant acquiring for SMEs (which is outside our ToR) and may be impacting on banks' BCA income, for example through loss of transactional fees (if SME customers use PayPal rather than cheques or faster payments) as well as through loss of interchange fee income. However, we have not seen evidence that PayPal or other digital wallet providers have yet had a significant impact on banks' BCA supply or that there has been a competitive response from BCA suppliers. Therefore (and for the reasons given above for PCAs) we do not consider the provision of digital wallets to be part of the BCA market.

- *PCAs as an alternative to a BCA*

4.62 There are significant interlinkages between BCAs and PCAs, for instance, Charterhouse BBS reports that more than a half of SMEs open a BCA with their main PCA provider.[51] We have considered the use of a PCA as an alternative to a BCA. We have found that the number of businesses that use PCAs for business purposes is small (14%)[52] and the usage of PCAs is mostly prevalent among the smallest SMEs, mainly sole traders.[53] However, we have been unable to calculate how many PCAs are being used by SMEs for business purposes as the banks have told us that they do not typically monitor whether PCAs exhibit business activity.

4.63 Although a PCA can offer the core transfer, storage and lending services associated with a BCA, it lacks some additional features which are attractive to business customers and which can only be provided by a BCA. This includes access to business centres and business advice or a relationship manager. BCAs can also be used by SMEs to build up their credit record, apply for a business loan and other business banking products, assist with record keeping for audit or tax purposes, offer currency conversion services, provide access to internet banking services to multiple members of staff and permit various methods of business payment processing. The fact that most businesses choose BCAs and incur additional costs associated with them, despite potentially being able to use a PCA for business purposes free of charge, indicates that the availability of these additional services is important to SMEs.

4.64 In addition, we have observed other market features indicating that PCAs and BCAs are in separate relevant product markets. First, the charging structures are different, with most PCAs being FIIC and most BCAs carrying a monthly fee and/or transaction charges even if customers are in credit. Secondly, trends affecting PCAs and BCAs appear to be different, with increasing payment of interest to PCA customers in credit, but no such trend for BCAs. Finally, the majority of the banks have indicated that they either seek to discourage or even prohibit businesses from using a PCA for business purposes.[54] This indicates that there is limited substitutability between BCAs and PCAs.

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[51] Source: Charterhouse BBS. See Section 8 for more details on cross-product holdings.
[52] See BDRC SME finance monitor, Q4 2014, p65.
[53] SME finance monitor reports that 94% of the SMEs using a PCA for business purposes were sole traders, see BDRC SME finance monitor, Q4 2014, p65.
[54] For instance, RBSG and TSB indicated that their terms and conditions prohibited the use of a PCA for business purposes; Santander indicated that its PCA terms contained a clause requiring that the account was not used for business purposes; Barclays noted that its terms and conditions required that PCA use met regulatory

4.65 Given the above, we consider that PCAs and BCAs are separate relevant product markets for the purposes of our analysis.

- *Business loans and business deposit accounts as substitutes for BCAs*

4.66 Business loans and business deposit accounts may be a substitute for specific services provided by BCAs – a business loan may be a substitute for an overdraft and a business deposit account may be an alternative to a BCA as a store of value. As explained previously, they do not substitute for all the services provided by a BCA and therefore we do not consider that they should be included in the same product market.[55]

4.67 There are some similarities between overdrafts and business loans, which we take into account in our competitive analysis. Overdrafts are usually granted for a set period, usually 12 months, after which SMEs have to reapply for an overdraft facility and pay an arrangement fee.[56] This is similar to most business loans, though the term of a business loan would usually be longer than 12 months. In addition, as discussed in paragraphs 4.75 to 4.77 below, there is some overlap between the purposes for which overdrafts and business loans tend to be used.

4.68 However, despite a degree of substitutability between overdrafts and other types of business loans, overdrafts are characterised by distinctive features, including a unique relationship with BCAs, in that it is not possible to use an overdraft without having a BCA. The combination of deposit storage, payment and short-term lending facilities together provide an integrated liquidity management service for SMEs. Accordingly, we consider that it is more appropriate to regard overdrafts as an add-on facility to BCAs rather than a stand-alone business loan and our view is, therefore, to consider BCAs and overdrafts to be part of the same relevant product market.

4.69 We have considered overdrafts within our competitive assessment as part of the services offered by BCAs in Section 7 and 8. But we have also analysed

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requirements, which meant that where a business used a distinct legal form, eg company or partnership, the option of opening a PCA would not be available to them; Danske reported that it required the use of a BCA for customers operating a business; AIB informed us that it required business customers to open a BCA and might even close the PCA, if the account was being used for business purposes and the customer did not agree to transfer to a BCA; similarly, HSBCG noted that PCAs were not intended for use by business customers and where such use was identified the customer would be given notice of intention to close the account if the account continued to be used for business purposes.

[55] We note that, in relation to business deposit accounts, this is different from the approach of the CC in its 2002 inquiry, which included BCAs and short-term business deposit accounts in a liquidity management market. This is because business deposit accounts only substitute for one of the services provided by a BCA.

[56] Arrangement fees will generally be payable annually at renewal but also if extending an existing overdraft facility or if it is necessary to renegotiate the terms of an overdraft.

overdrafts alongside other SME lending products in our competitive assessment, as they share a number of similarities.

4.70 We consider business loans and business deposit accounts further below.

- *Conclusion on BCAs*

4.71 We consider that the market should be defined as a market for BCAs, with or without an overdraft facility.

Business loans

4.72 Banks and other providers provide a variety of business lending products to SMEs which can differ in various respects, such as the loan term, type of security required and interest rates. In the following paragraphs we consider different types of business loans, including general-purpose business loans, credit cards, asset finance, invoice finance and alternative lending platforms, and examine the competitive constraints posed by the different types of lending products on each other. See Section 8 and Appendix 8.2 for more details on SME lending.

4.73 In this section we focus our analysis on debt-based finance. We recognise that some businesses might choose to obtain equity finance rather than a business loan. However, we consider that equity finance exhibits different characteristics to debt-based financing options and would be only attractive to a specific group of SMEs. Therefore it is unlikely to act as an effective constraint on debt-based finance.[57]

4.74 We consider that the market for business loans could be further subdivided into the following segments depending on their characteristics:

(a) Short-term loans, which are generally used to finance short-term business needs and to manage working capital and day-to-day cash flows. This includes credit cards, invoice finance and various forms of alternative finance.

(b) Medium- and long-term loans, which are suitable for dealing with longer-term financial business needs, eg investing in business development, acquisition of property or other business assets. General-purpose business loans, including commercial mortgages, and asset finance are the most common types of business loans in this segment.

[57] See Appendix 8.2 for more information.

4.75 General-purpose business loans may or may not require security whereas asset finance and invoice finance are linked to specific assets of the business. The charging structures and terms and conditions may also differ depending on the nature of any security required as well as the providers.[58]

4.76 Our analysis has shown that there is a degree of overlap between various types of lending products. Loans are offered on a bespoke basis and are tailored to the individual needs of each customer. Banks have told us that during the standard loan application process all different types of lending products are considered and the most suitable product is then chosen based on the specific business needs and the nature of borrowing, taking into account the purpose of the loan, repayment options, type of facility required, the interest rate preferred, and the type of collateral required. Often, businesses tend to purchase several lending products which are then used in combination to finance different business needs. The availability of external finance and the urgency with which it is required will also influence the decision to obtain a specific type of a loan.[59] Notwithstanding the fact that different loan types are more suitable to address different business needs, different types of loans can be used to substitute for each other when the preferred option is not available.

4.77 While we recognise the different characteristics of different lending products and of providers, in light of the above we do not think that the differences in product characteristics are sufficient to warrant defining separate product markets for each of them for the purposes of our analysis. Moreover, the issues underlying our theories of harm are common across the different types of SME lending products and we are not required to identify the narrowest possible product markets. We take into account the differences between the various types of business loans in our competitive assessment.

4.78 We recognise the growing importance of alternative lending platforms, such as peer-to-peer lending and invoice trading. Currently, alternative finance accounts for a very small proportion of business lending,[60] but it has been growing rapidly. Alternative lending platforms are not within our ToR, but our view is that they should be included in the competitive assessment as another way that SMEs can borrow.

4.79 From a supply-side perspective, certain types of business loans are offered by a wider range of banks and other types of providers than general-purpose business loans. For instance, some smaller banks, including Aldermore,

[58] See Appendix 8.2 for more information.
[59] See Section 8 and Appendix 8.2 for more information on the importance of access to finance.
[60] See Appendix 8.2.

Close Brothers and Shawbrook offer specific types of SME loan (commercial mortgages, asset finance and invoice finance) rather than a full range of SME banking products. This indicates that there are differences in the nature and strength of competition, which we take into account in our competitive assessment.

4.80 To summarise, there are distinctions between different types of business loan, in particular between shorter- and longer-term loans and the nature of any collateral required, but there are also overlaps between them. Therefore we will consider competition within business loans as a whole, particularly in light of the common issues underlying our theories of harm.[61] We also consider that alternative lending should be included in the market for business loans. However, we do, where relevant, take into account the differences between business loans in our competitive assessment.

Business deposit accounts

4.81 Business deposit accounts allow SMEs to hold money on deposit, in exchange for which interest is received. Business deposit accounts are not designed to handle day-to-day operations, but serve as a device for storage and savings. Banks offer a wide range of business deposit accounts, including instant access savings accounts, which differ in length of term, minimum/maximum amounts to be deposited, interest rates and limits of amount and mode to be withdrawn.

4.82 Our analysis has shown that the possibilities to substitute business deposit accounts with other products are very limited. Most banks do not offer interest on BCA credit balances to SMEs. Only a few banks[62] have reported paying interest on positive BCA balances and the interest rates appear to be lower than the ones paid on business deposit accounts. We also do not consider that investments in equity, government or corporate bonds could substitute for long-term deposit accounts, as these alternatives are significantly less liquid, carry higher risk and do not generally provide quick access to funds. Personal savings accounts could be a substitute for sole traders, although not for other types of SMEs.

4.83 Banks may offer SMEs the ability to sweep funds between BCAs and instant-access business deposit accounts. The Charterhouse BBS suggests

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[61] We recognise that this is different from the approach of the CC in its 2002 inquiry, which distinguished between general-purpose and other types of business loan. We did not define explicitly different markets for these two types of loan but we do recognise the importance of the distinction in our competition analysis.
[62] This includes AIB, [✄], RBS/NatWest, Santander and Co-op Bank.

a high level of linkage between SMEs' choice of a BCA and of business deposit accounts, reporting that of those SMEs that have an instant access savings account, around 95% hold this with their main BCA bank. Similarly of those that were using a term deposit account, around 82% held it with their main BCA bank.[63]

4.84 From a supply-side perspective, business deposit accounts are offered by a wider range of banks than BCAs, including building societies and smaller banks, such as Aldermore, Close Brothers and Shawbrook.

4.85 Hence, we consider that there is a separate product market for business deposit accounts.

Classification of SMEs

4.86 The ToR define an SME as a business that has annual sales revenues (exclusive of VAT and other turnover-related taxes) not exceeding £25 million.[64] We recognise that there are differences in the provision of banking services to larger and smaller SMEs, particularly with regard to their specific banking needs and possibilities to negotiate better contract terms.

4.87 Below we consider *(a)* whether the upper turnover limit of £25 million is a reasonable upper limit for our assessment and *(b)* whether separate economic markets should be identified according to SME size.

- *Whether the upper turnover limit of £25 million is a reasonable upper limit*

4.88 The upper limit of £25 million is a widely accepted definition of an SME and is also consistent with the definition provided in the Companies Act 2006.[65] This was also the definition used in the CC's 2002 SME banking market investigation.

4.89 Four of the five largest banks[66] use £25 million as one of their thresholds for helping to determine the level of relationship management offered to businesses which supports the use of £25 million as a cut-off point. Accordingly, £25 million seems to us a reasonable upper limit to adopt.

[63] Source: Charterhouse BBS.
[64] The ToR state that a 'business' shall have the same meaning as an 'undertaking' under CA98. Clubs and charities may be undertakings in this sense (if they carry on commercial or economic activities relating to goods or services) and hence banking services provided to clubs and charities may be within the ToR.
[65] Companies Act 2006, Articles 382 and 465.
[66] [✂]

- *Whether separate economic markets should be identified according to SME size*

4.90 Our guidelines state that one set of customers may be more affected than others by any particular feature. Where such diversity exists, and where suppliers can charge different prices to different groups (ie price discriminate), the CMA will recognise these differences. In terms of market definition, depending on the market and the evidence presented, the CMA may choose either to treat these different groups as separate markets, or as segments within one market, noting the scope for price discrimination between different groups within the market.[67]

4.91 SMEs can be grouped into several different categories based on their turnover or life stage. For instance, the CMA's 2014 market study divided SMEs into the following groups:

(a) Start-ups, establishing a business banking relationship for the first time and which often benefit from introductory offers.

(b) Smaller established SMEs. These tend to have simple banking needs, often requiring a transactional relationship with their banks (making payments, cash handling). Usually, SMEs with turnover below £2 million would be included in this category.

(c) Larger established SMEs. These have a greater degree of financial sophistication (including employing financial management staff) and often require a wider range of products and services. Generally, these include SMEs with turnover of over £2 million.[68]

4.92 Different types of SMEs have different financial needs and require different services. For example, larger SMEs tend to require more sophisticated products and services, whereas start-ups often benefit from 'free-banking' offers and have simpler banking needs. They also have little experience and therefore may require more advice. The range of products offered to SMEs also differs by SME type. For example, start-ups, sole traders and small SMEs typically take out a simpler range of products, whereas larger SMEs are more likely to obtain more specialised products, such as invoice or asset finance. Unlike smaller SMEs, which obtain products on their standard terms and prices, larger SMEs are also often able to negotiate bespoke terms.

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[67] The Guidelines, paragraph 150.
[68] SME Market Study, paragraph 3.6.

4.93 Banks segment their business customers according to turnover and their need for relationship management. As indicated in Table 4.1, different banks tend to use different categories and different thresholds. Smaller banks, including banks whose main UK activities are limited to NI, tend to have less clear segmentation and fewer categories, with some segmenting on the basis of amount of lending rather than turnover. Thus, we have not seen any clear separating point, in terms of turnover or other variable, which would allow us to easily subdivide SMEs into different segments according to their size or life stage.

Table 4.1: Segmentation of SME customers by the major UK banks

*Barclays**	*HSBC*	*Lloyds (excluding BoS)*	RBS†	*Santander‡*
[✄]	[✄]	[✄]	[✄]	[✄]

Source: Information from banks.
*[✄]
†[✄]
‡[✄]

4.94 We recognise that there are important differences between the provision of banking services to smaller and larger SMEs. Some providers might put more focus on specific SME segments, leading to different levels of competition for different segments of SMEs. However, there is a high degree of supply-side substitutability as banks are easily able to shift their focus to other groups of SMEs in response to changes in demand.

4.95 It may also be possible to segment SMEs based on alternative categorisations, such as the sector in which they operate, eg agriculture or construction. Although there may be differences between banks in the distribution of the SME types they serve, we have not seen evidence that would indicate a need to define separate product markets according to different sectors. From the supply-side perspective, banks tend to serve all types of SMEs and are easily able to switch resources in response to changes in demand.

4.96 Accordingly we have not defined separate product markets by SME size or type for the purposes of our analysis. Our view is to consider different size and types of SMEs as falling into different market segments of the relevant product markets, in the light of the different intensity of competition to which they are subject. Therefore where relevant in our competitive assessment we take into account differences between SMEs, in particular between start-ups and established SMEs and between smaller and larger SMEs.

Conclusions on relevant product market(s)

4.97 We consider that the following relevant SME banking product markets may be distinguished:

(a) BCAs (including both BCAs with an overdraft facility and those without);

(b) business loans, including both short-term and medium/long-term business loans; and

(c) business deposit accounts.

Relevant geographic market(s)

4.98 In this section we consider whether the markets for BCAs, business loans and business deposit accounts are local or whether separate national markets can be identified. Our approach to geographic market definition is discussed in more detail in Appendix 4.3.

4.99 As for PCAs, the local aspect, mainly through the usage of local branches for customer acquisition and retention, remains important in relation to BCAs, business loans and business deposit accounts.[69] However, as mentioned earlier in paragraph 4.40, our analysis has shown that banking brands' policies are largely centralised, with pricing, product offering, service levels and marketing activities being determined at a UK-wide level. Regulatory requirements and customers' needs also do not differ materially across the UK.

4.100 We note that previous inquiries have tended to focus on three geographic markets (England and Wales, Scotland and NI). We have not received any evidence or submissions from banks that we should consider separate local (ie sub-national) markets. Banks, by and large, were of the view that the geographic markets for SME banking were at least GB-wide. Our guidelines do not require us to define the narrowest possible markets.[70] Accordingly, as in the case of PCAs, we have not defined local banking markets, but we consider aspects relevant to local competition as part of our competitive assessment.

4.101 We now consider whether separate regional and/or national markets should be identified. As mentioned above, pricing, product offering, service levels

[69] For instance, the Charterhouse BBS reported that local branch convenience was the second most important reason for SMEs in choosing whom to bank with. For more information on the importance of branches, see Section 9.
[70] The Guidelines, paragraph 152.

and marketing activities are determined by brands at a UK-wide level and that regulatory requirements do not differ across the UK. However, the fact that each brand has a UK-wide offering would not necessarily imply a UK-wide market if customers in different parts of the UK tend to use different brands (because brands in each area would compete only with each other). Our analysis and the views of parties are similar to those in regard to PCAs (see paragraphs 4.42 to 4.46) and are set out further in Appendix 4.3.

4.102 As in the case of PCAs, we do not find that market shares in the regions of England and Wales are significantly different to market shares for the whole of GB or the UK. Similarly, pricing, product offering, marketing activities and regulatory requirements do not differ in both regions. We therefore consider that there is a single geographic market covering England and Wales.

4.103 In Scotland, the largest share of BCAs were held by LBG (through the BoS brand), RBSG (through the RBS brand) and Clydesdale. However, this was relatively similar to England and Wales, where LBG, RBSG (through NatWest), HSBCG and Barclays held the largest share. While LBG and RBSG operate via different brands in Scotland compared to England and Wales, the NatWest and RBS brands of RBSG have almost identical product offerings across both brands, and apply similar criteria and charging structures, as is also the case for the Lloyds and BoS brands of LBG.[71] Therefore, although there is some difference between Scotland and the rest of GB, the competition in both markets, by and large, takes place between the same market players. Thus, on balance, we do not consider that there is enough difference between Scotland and England and Wales to consider the two as separate geographic markets.

4.104 By contrast, in NI, the largest share of the market for BCAs was held by different brands (including Ulster Bank which has a distinctive different offering from the rest of RBSG).[72] In 2015 86% of the market for BCAs was shared between RBSG (through the Ulster brand), Danske, BoI and AIB, whereas four of the larger GB-based banks (HSBCG, Barclays LBG and Santander) collectively had less than 14% of the market for BCAs. Of the larger GB-based banks, only Santander had a relatively large market share of [5–10]%.[73] As in the case of PCAs, competition for BCAs in NI is to a large extent between different brands to competition in the rest of the UK and we have not seen evidence that this might change in the foreseeable future. We therefore consider that the competitive situation in NI is

[71] The similarities seem somewhat less in the case of the LBG brands than the RBSG brands.
[72] [✂]
[73] BCA market share figures based on share of active BCAs.

sufficiently different from the rest of the UK, to treat NI as a separate geographic market.

4.105 This analysis relates to BCAs only. We do not have sufficient data to carry out a similar analysis for business loans and business deposit accounts. We acknowledge that there is more uncertainty, in particular about whether NI is a separate market from GB, for business loans and business deposit accounts than for BCAs as the range of providers is wider (see paragraphs 4.79 and 4.84). However, we expect analysis for these markets to show broadly similar results to that for BCAs, as SMEs generally take out these products with their main BCA provider.[74]

4.106 We consider therefore that NI and GB are separate geographic markets for SME banking products for the purposes of our analysis. We recognise that some aspects of the two geographical markets are similar and we do not consider that the distinction between NI and GB affects most of our competitive analysis.

Conclusions on SME banking market definition

4.107 We consider the following relevant product markets:

(a) BCAs (including both BCAs with an overdraft facility and those without);

(b) business loans, including both short-term and medium/long-term business loans, with or without collateral; and

(c) business deposit accounts whether instant-access or long-term.

4.108 Our view is that the relevant geographic markets are GB and NI.

[74] For more details see Section 8.

5. Structure and market outcomes: PCAs

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5.1 To develop our findings on whether or not features in the markets for PCAs are harming competition, we have analysed information on the main characteristics of the markets, including on market shares and concentration.

5.2 We have also analysed information on the outcomes of the competitive process within the markets. Information of this nature, including on profitability, levels of prices, quality and levels of innovation, can provide important information on how well the market is functioning.

5.3 This section is structured as follows:

- **Market structure and concentration**: analysis of the market structure for PCAs and concentration levels.
- **Financial performance**: analysis of PCA net revenues by source, impairment margins and we discuss the available evidence on the profitability of PCAs.
- **Price outcomes**: analysis of estimated average PCA prices for a sample of customers.
- **Quality outcomes**: analysis of quality of service metrics across PCA providers.
- **Price-quality outcomes**: analysis of price and quality outcomes together, as we expect customers to make trade-offs between price and quality in choosing their product.
- **Innovation**: a summary of the available evidence on the degree of innovation within and around the PCA market, and our assessment of the potential impact of these innovations on competition.
- **Summary conclusions**: we set out our summary conclusions on market structure and outcomes in the PCA market and the implications for the wider investigation.

5.4 In formulating our findings on structure and market outcomes we have paid particular attention to the strength of customer response to variations in price and quality outcomes, and separately, whether there is evidence of a relationship between outcomes and market shares.

Market shares and concentration

5.5 If a firm has a high market share it might have less incentive to compete vigorously with its rivals. When market shares have been stable over time, especially in the face of historical changes in prices or costs, high concentration may indicate that competition within the market is weak.

5.6 We here summarise our findings on the structure and concentration in the market for the provision of PCAs. As set out in Section 4, we have defined

PCAs (with and without overdraft facilities) as a relevant product market and separate geographic markets for the provision of PCAs in GB and in NI.

5.7 For our analysis of market shares, we have used data obtained directly from banks, and supplemented this with time series data from GfK FRS.[1]

Background

5.8 There were approximately 69 million active PCAs in GB in 2015,[2] and 1.8 million in NI. Around 70% of active accounts in both GB and NI received average incoming monthly payments of more than £500.

5.9 New account opening in the UK has remained broadly constant since 2011. In 2015, approximately 5.5 million accounts were opened in GB and 140,000 in NI.

5.10 Two-thirds of new accounts opened in the UK in 2015 were either standard or reward accounts and around 4% were packaged accounts.

5.11 Reward accounts have greatly increased their share of new account openings: 34% of new PCAs that were opened in 2015 were reward accounts, against only 8% in 2011. Reward accounts have also gained overall market share, albeit at a slower pace: from only a 6% share of active accounts in 2011 to 16% in 2015.

Market shares

5.12 In assessing market shares by volume, we have focused on primary or 'main' accounts:[3] when survey data is used a main account is defined as one which the survey respondent identifies as their main account; and when data from banks is used we define a main account as one where £500 or more is paid in per month.[4]

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[1] While we have sought to cross-check our findings against those obtained from the GfK FRS, we recognise that particular caution should be exercised in interpreting market shares where data on a market participant(s) is not available.
[2] Active accounts are defined as an account that has had at least one customer-generated payment or transfer (including standing orders and direct debits, but excluding charges and interest on the account) coming into, or leaving, the account in the previous 12 months.
[3] The evidence we saw indicated that competition focused on acquiring and retaining the primary banking relationship with customers, ie on the PCA into which the customer's income is paid and from which direct debits and other payments are paid (see Section 10 and Appendix 6.6). Some customers may have two such accounts: for example a joint account with their partner, from which joint expenses are paid, and an individual account, from which individual expenses are paid, with regular payments from one to the other.
[4] More precisely, an account is defined as a main account if it has at least an average of £500 credit turnover per month in the previous 12 months (or since the account was opened if less than 12 months).

5.13 In GB the four largest banking groups for PCAs are LBG, RBSG, Barclays and HSBCG, and these had a combined market share of just over 70% in 2015 (see Table 5.1).[5]

5.14 There have been several mergers and divestments in recent years which have affected levels of concentration: Santander's acquisition of Alliance & Leicester in 2008; LBG's acquisition of HBOS in early 2009; and its subsequent divestment of TSB in 2014. The net effect of mergers and divestments – in particular the merger of LBG and HBOS – increased concentration more than the subsequent divestment of TSB reduced it. Since 2005, excluding the impact of mergers and acquisitions, the combined shares of the four largest providers have decreased only slightly (see Figure 5.1).

5.15 Santander, Nationwide and Co-op Bank experienced an increase in their share of GB main accounts since 2005, but again only slightly: the combined absolute impact on the market has been a total increase in their share of less than five percentage points between 2005 and 2014, which includes the acquisition of Alliance & Leicester by Santander in 2008. Metro entered the PCA market in 2010 and has gained only a small market share by 2015. Clydesdale Group, another smaller bank, has experienced a slightly declining market share.

Table 5.1: GB market shares by volume of main PCAs

%

Banking group	*2013*	*2014*	*2015*
Barclays	[10–20]	[10–20]	[10–20]
Clydesdale	[0–5]	[0–5]	[0–5]
Co-op Bank	N/A	N/A	[0–5]
Danske	[0–5]	[0–5]	[0–5]
HSBCG	[10–20]	[10–20]	[10–20]
LBG	[20–30]	[20–30]	[20–30]
Metro	N/A	N/A	[0–5]
Nationwide	[5–10]	[5–10]	[5–10]
RBSG	[10–20]	[10–20]	[10–20]
Santander	[10–20]	[10–20]	[10–20]
TSB	[0–5]	[0–5]	[0–5]

Source: CMA calculations based on data submitted by banks.

Figure 5.1: GB market shares by volume of main PCAs

[✂]

Source: CMA analysis of GfK FRS.

[5] CMA calculations based on data submitted by banks.

Table 5.2: 2014 GB market shares calculated using different measures

%

Banking group	*All accounts* GfK FRS data*	*Active accounts† CMA data*	*Main accounts GfK FRS data*	*Main accounts CMA data*
AIBG	-	-	-	-
Barclays	[10–20]	[10–20]	[10–20]	[10–20]
BoI	-	-	-	-
Clydesdale	[0–5]	[0–5]	[0–5]	[0–5]
Co-op Bank‡	[0–5]	[0–5]	[0–5]	[0–5]
HSBCG	[10–20]	[10–20]	[10–20]	[10–20]
LBG	[20–30]	[20–30]	[20–30]	[20–30]
Metro‡	[0–5]	[0–5]	[0–5]	[0–5]
Nationwide	[5–10]	[5–10]	[5–10]	[5–10]
RBSG	[10–20]	[10–20]	[10–20]	[10–20]
Santander	[10–20]	[10–20]	[10–20]	[10–20]
TSB	[0–5]	[0–5]	[0–5]	[0–5]

Source: CMA calculations using data submitted by banks and GfK FRS data.
*CMA data not available.
†GfK FRS data not available.
‡Co-op Bank and Metro only provided UK-level data. We calculated their GB market shares as follows:
(i) For Co-op Bank, we weighted its account data using the ratio of total GB active/main accounts to total UK active/main accounts in 2014.
(ii) Since Metro does not have branches in NI, we assumed that the distinction between the UK and GB did not matter in its case.

5.16 Table 5.2 shows that 2014 shares were similar as measured by active accounts, indicating that market shares are not sensitive to the choice of measure or source used.

5.17 We calculated market shares on the basis of the number of all new PCAs opened (see Table 5.3), which will include new-to-market customers as well as switchers. On this measure, the share of the GB market of the four largest banking groups was 60% in 2015, lower than their share of PCA stock. Santander, Nationwide, TSB and Metro had a share of new accounts in excess of their share of all PCAs in 2015.[6]

Table 5.3: GB market shares of new PCAs*

%

Banking group	*2013*	*2014*	*2015*
Barclays	[20–30]	[20–30]	[10–20]
Clydesdale	0–5]	[0–5]	[0–5]
Co-op Bank	N/A	N/A	[0–5]
Danske	[0–5]	[0–5]	[0–5]
HSBCG	[5–10]	[5–10]	[5–10]
LBG	[20–30]	[20–30]	[20–30]
Metro	N/A	N/A	[0–5]
Nationwide	[5–10]	[5–10]	[5–10]
RBSG	[20–30]	[20–30]	[20–30]
Santander	[20–30]	[20–30]	[20–30]
TSB	[0–5]	[5–10]	[5–10]

Source: CMA calculations based on data submitted by banks.
* Note that this is all new PCAs not new main PCAs.

[6] Source: CMA calculations based on data submitted by banks.

5.18 The four largest banking groups in GB are, together with Clydesdale, the successors through merger to the ‘clearing banks’ which cleared cheques between themselves and thus provided payment transaction services prior to the advent of electronic transactions.[7] In NI, the four traditional clearing banks in NI are RBSG (Ulster), Danske, AIBG and BoI and these have a smaller total share of PCAs than the four in GB (at around 60%), reflecting a greater loss of market share to former and continuing building societies (namely, Santander, Halifax[8] and Nationwide) in NI compared to GB. Indeed, the four largest PCA providers (in terms of both active as well as main PCAs) in NI for 2015 were RBSG, Danske, Santander and AIBG with a combined market share of around 70%, which is similar to that of the largest banks in GB.

5.19 Several providers have a larger share of new PCAs than of their stock of all PCAs, including Santander which had the largest share of new accounts in 2015 (around [20–30]%). In contrast, RBSG and AIBG in NI have a smaller share of new PCAs than of their stock of all PCAs.

Table 5.4: NI PCA market shares

%

	Active PCAs			*Main PCAs*			*New PCAs*		
Banking group	*2013*	*2014*	*2015*	*2013*	*2014*	*2015*	*2013*	*2014*	*2015*
AIBG	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[5–10]	[5–10]	[5–10]
Barclays	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]
BoI	[10–20]	[10–20]	[10–20]	[10–20]	[5–10]	[5–10]	[10–20]	[10–20]	[10–20]
Danske	[10–20]	[10–20]	[10–20]	[20–30]	[10–20]	[10–20]	[10–20]	[10–20]	[20–30]
HSBCG	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]
LBG	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]
Nationwide	[5–10]	[5–10]	[5–10]	[5–10]	[5–10]	[5–10]	[5–10]	[5–10]	[5–10]
RBSG	[20–30]	[20–30]	[20–30]	[20–30]	[20–30]	[20–30]	[20–30]	[10–20]	[10–20]
Santander	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[10–20]	[20–30]	[20–30]	[20–30]
Other	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]	[0–5]

Source: CMA calculations based on data submitted by banks.

5.20 We also considered market shares on the basis of net revenue.[9] We were only able to do this on a UK-wide basis, but we consider that the results are

[7] Some other financial institutions, eg trustee savings banks (subsequently acquired by LBG) and Co-op Bank started to clear cheques and provide PCAs from the 1960s and 1970s. The building societies were able to clear cheques and hence provide PCAs from 1986.
[8] Halifax is part of LBG.
[9] We have considered net revenue comprising the following:
(a) receipts from fees and interest charged on overdrafts;
(b) receipts from other charges and sources of PCA revenue, including interchange fees;
(c) less any interest paid to customers on credit balances together with any other payments made to customers (eg cashback); and
(d) plus the value that banks obtain from net credit balances (ie the value of funds from credit balances less the cost of funding overdrafts).

nevertheless useful for considering how far revenue shares may differ from volume shares for the UK.

5.21 Table 5.5 shows 2014 market shares by volume and net revenue for the UK. For most banks, market shares by volume and by net revenue are very similar.[10]

Table 5.5: UK 2014 market shares – on volume and revenue basis

%

	Volume	*Revenue*	*Adjusted revenue deducting the cost of providing packaged account benefits **
AIBG	[0–5]	[0–5]	[0–5]
Barclays	[10–20]	[10–20]	[10–20]
BoI	[0–5]	[0–5]	[0–5]
Clydesdale	[0–5]	[0–5]	[0–5]
Co-op Bank	[0–5]	[0–5]	[0–5]
Danske	[0–5]	[0–5]	[0–5]
HSBCG	[10–20]	[10–20]	[10–20]
LBG	[20–30]	[20–30]	[20–30]
Metro	[0–5]	[0–5]	[0–5]
Nationwide	[5–10]	[5–10]	[5–10]
RBSG	[10–20]	[10–20]	[10–20]
Santander	[10–20]	[5–10]	[5–10]
TSB	[0–5]	[5–10]	[5–10]
Ulster	[0–5]	[0–5]	[0–5]
Total	100	100	100
HHI	1,573	1,731	1,681

Source: CMA analysis based on data from banks shown above.
* Revenue of largest five banks is adjusted by deducting the cost of packaged account benefits. The cost of packaged account benefits is not available for other banks. Our main revenue calculations net off interest and cashback payments to customers, but do not take account of non-monetary benefits to customers from packaged accounts (which are costly for banks to provide relative to non-packaged accounts). Consequently they may overstate the share of banks with a higher proportion of packaged accounts. As a way of assessing the significance of this point, we deducted the cost of providing packaged benefits for the largest five banks from their revenue. As we did not have information on the packaged account benefits of other smaller banks, the resulting shares are likely to understate the share of the largest banks. Nevertheless, the total revenue share of the largest four banks is slightly greater than their volume share.
Note: Volume and revenue market shares relate to the average for the year. Volumes are based on averages of number of accounts at start and end of the year (hence are not on exactly the same basis as shown in Tables 5.1 and 5.3). Revenue is based on revenue for the year.

Concentration

5.22 Table 5.6 shows concentration levels in GB and NI for 2015 as measured by Herfindahl-Hirschman Indices (HHIs). These are 1,600 and 1,500 for GB and NI respectively in terms of main accounts, and in line with our guidelines, this indicates that these markets are concentrated.[11]

[10] In its response to our provisional findings (paragraph 1.11), LBG stated that it expected banks which targeted higher-income customers and/or did not offer national, branch service to have higher value than volume shares given the drivers of revenue under the current pricing model. We note, however, that this is not consistent with the evidence set out in Table 5.5.
[11] The Guidelines, p87.

Table 5.6: Herfindahl-Hirschman Indices in GB and NI, 2015*

	Main PCAs
GB	
Share of largest four banks %	73
HHI	1,623
NI	
Share of largest four banks %	71
HHI	1,539

Source: CMA analysis of data submitted by banks. PCA shares are based on main accounts.
* We have used banks' data to calculate HHI and GfK FRS data for other market share calculations. Only the HHI analysis is available for 2015.

Summary of evidence on market shares and concentration

5.23 The largest four banking groups in GB have a combined market share of around 70% for main PCAs. Overall market shares in GB have been stable since 2005. The combined market share of the largest four banking groups increased as a result of Lloyds TSB's acquisition of HBOS but, if the impact of mergers and divestments is excluded, the largest four banks have collectively experienced a small reduction in market share and conversely other smaller banks have experienced a small gain. The flow of new main PCAs is less concentrated than the stock, with the share of GB market flow of the four largest banking groups standing at 55% in 2015.

5.24 The combined share of the four largest main PCA providers in NI is around the same as in GB in 2015 at around 70%. The combined NI share of the four largest main PCA providers in the flow of new PCAs in 2015 was lower than their corresponding share of stock at 60%.

5.25 The HHIs for GB and NI in 2015 are around 1,600 and 1,500 respectively in terms of main accounts, and in line with our guidelines, this indicates that these markets are concentrated.

5.26 Market shares on the basis of net revenue on a UK basis are very similar to those based on account volumes.

Financial performance

PCA revenues

5.27 In our analysis of PCA revenues we have sought to gain an understanding of the primary sources of PCA revenue, how this has evolved over time, and the degree of variability between banking groups.

5.28 We have considered net revenue comprising the following:

(a) receipts from fees and interest charged on overdrafts;

(b) **plus** receipts from other charges and sources of PCA revenue, including interchange fees;

(c) **less** any interest paid to customers on credit balances together with any other payments made to customers (eg cashback); and

(d) **plus** the value that banks obtain from net credit balances (ie the value of funds from credit balances less the cost of funding overdrafts).

5.29 We have normalised net revenue by the number of main PCAs held so as to obtain net revenue numbers that are comparable over time and between banks. In doing so, we use the main account as the basic unit of analysis.

5.30 Our analysis relates to banks' net revenue across the UK, and includes results from banks operating across the UK (eg RBSG, the Halifax brand of LBG, and Santander); from banks whose NI shares are small (eg Barclays and HSBCG) and banks whose UK operations are primarily in NI (AIB, BoI and Danske). We consider that the results are applicable to each of the geographic markets we identified (ie GB and NI).

5.31 Table 5.7 summarises the results of our analysis of aggregate revenue per main PCA over the period 2011 to 2014.

5.32 In interpreting this analysis, we note the following:

(a) The net value of PCA funds has been calculated as the value of funds from credit balances less the cost of funding debit balances divided by the aggregate net credit balance. However, there are differences between banks in the way they calculate this valuation of funds.

(b) Interest, cashback and other payments to customers are included, but non-pecuniary customer benefits are mostly omitted. Packaged or added-value PCAs include various types of insurance as a benefit, and the omission of any valuation of this benefit is likely to lead to an overstatement of the net revenue from these accounts. While it is difficult to estimate the value consumers attribute to these benefits, we obtained information from the five largest banks on the cost incurred in providing benefits: averaged across all accounts, this was about £13 per main account in 2014 (ie if the cost of providing packaged account benefits is deducted, average net revenue in 2014 would reduce from £177 per main account to about £164 per main account).

(c) There may be differences between banks in how they have defined revenue and how or when they recognise revenue.

5.33 Since the decomposition of revenue represents a weighted average across banks, changes over time will reflect both changes in the composition of accounts, both within and across banks, as well as more general trends (affecting all accounts) over time.

5.34 Revenue from charges and overdraft interest accounted for around 60% of net revenue per main account in 2014. The net value of funds accounted was the next most important source of revenues, accounting for around 50% of net revenue per main account in 2014. This illustrates that banks earn revenues from the accounts of customers who maintain positive credit balances.

Table 5.7: Analysis of revenue (£ per main PCA per year,* 2014 prices) 2011 to 2014

Type of revenue	*2011 (£)*	*2012 (£)*	*2013 (£)*	*2014 (£)*	*2014 (%)*	*Decomposition of Δ in net revenue since 2011 (%)*
Arranged overdraft	39.89	37.11	35.75	34.86	20	9
Unarranged overdraft and unpaid item fees	31.35	30.00	27.14	24.45	14	13
Foreign ATM and debit card fees	10.55	9.04	8.73	8.67	5	4
Interchange fees (debit card)	16.56	16.41	16.68	17.01	10	–1
Monthly account fees	31.83	26.96	23.77	21.24	12	20
Other receipts (net)†	4.25	2.24	2.73	3.53	2	1
Total receipts from charges and interest	**134.43**	**121.76**	**114.80**	**109.76**	**62**	**46**
Interest payments to customers	–8.77	–7.86	–12.13	–18.17	–10	18
Other payments to customers	–0.10	–0.84	–2.03	–2.99	–2	5
Net value of funds‡	104.71	88.86	81.78	88.03	50	31
Net revenue	**230.03**	**201.91**	**182.42**	**176.62**	**100**	**100**

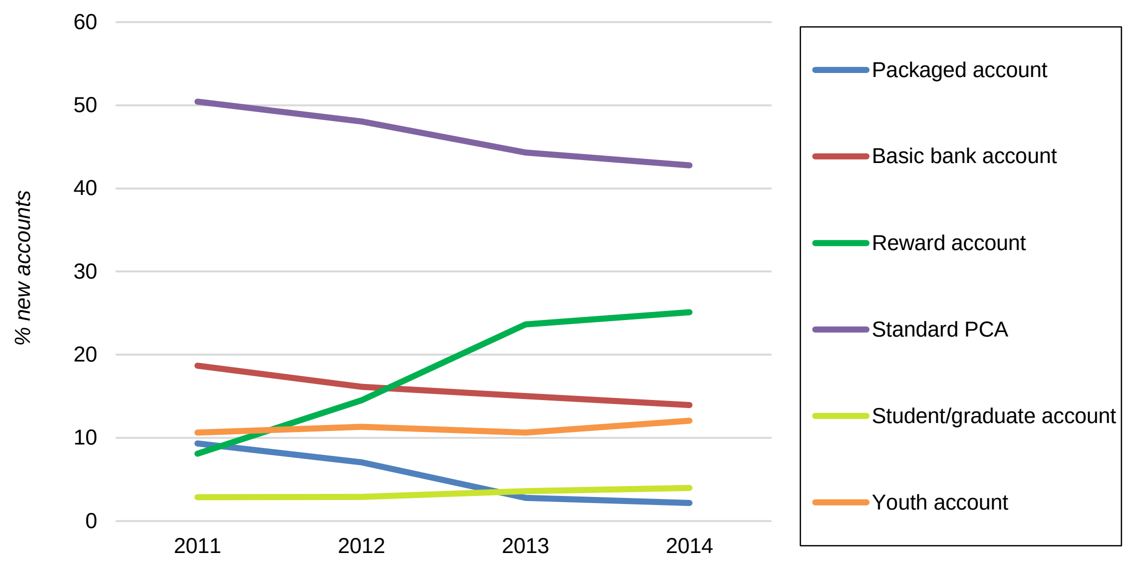
Source: CMA calculations based on data submitted by banks in response to data requests. 2014 prices used across years for comparability.
* Aggregate revenue is divided by the average number of main PCAs at the start and end of the year.
† Other receipts consists of revenue from charges for failing to meet account criteria, revenue from charges for withdrawing cash from ATMs abroad, revenue from charges relating to cheques, revenue from charges relating to domestic payments, revenue from charges relating to foreign payments, revenue from account management charges, other revenue from account holders and other revenue which is not from account holders.
‡ Banks' own assessment of the value of funds from PCA credit balances less cost of funding PCA debit balances (except for Clydesdale, Co-op Bank and Metro, where the weighted average for the other banks has been used).
Note: 2011 data is not available [✂]; 2012 data is not available for [✂]. In order to assess the effect of different coverage in 2011 from 2012, we recalculated 2012 revenue per main account for those banks providing 2011 data. The reduction in average net revenue per main account between 2011 and 2012 for these banks was 6% (compared with the 10% for all banks shown in the table). No bank included revenue from cross-selling other products to PCA customers.

5.35 Net revenue per account declined over the period 2011 to 2014 by about 20% in real terms[12] driven by: an increase in interest payments to customers; a reduction in revenue from monthly account fees; a reduction in revenue from unarranged overdraft fees; and a decline in the net value of funds from credit balances.

[12] The 20% figure is calculated after adjusting for differences in coverage of the data between 2011 and 2012.

5.36 The increase in interest payments to customers reflects an increase in the share of accounts making significant interest payments to customers, such as Santander 123 and the decline in monthly account fees per account reflects a decline in the share of packaged accounts which have relatively high monthly fees (see Figure 5.2 below).

Figure 5.2: Distribution of UK new PCAs by type of account



Source: CMA calculations using data submitted by banks.

5.37 The declining share of packaged accounts has also reduced the average cost per account of providing packaged account benefits, since customers who no longer had a packaged account also lost the benefits from those accounts. We estimate that the majority of the reduction in monthly account fees appears to have been offset by reductions in the costs of packaged account benefits.[13]

5.38 There has been a reduction in the relative importance of unarranged versus arranged overdraft charges since 2011. One reason for the decline in unarranged overdraft and unpaid item fees is that customers have increased information about their accounts through SMS messages from banks and increased usage of internet and mobile banking, which helps them avoid incurring such fees.[14] However, the number of customers receiving these

[13] We estimated that the reduction in costs per main account for the five largest banks between 2011 and 2014 represented about 17% of 2011 monthly account fees compared with an actual reduction, adjusted for coverage of 23%.
[14] See FCA (March 2015), *Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour*, and Appendix 5.3, Annex B.

types of alerts is limited because only a few PCA providers automatically enrol customers into these alerts (see Appendix 6.6).

5.39 The decline in the net value of funds from credit balances is likely to reflect a reduction in term interest rates during the period and more than offsets an increase in net balance per account. Despite the observed reduction, the net value of funds remains the largest source of PCA revenue, accounting for approximately 50% of net revenue in 2014 (or 40% if interest paid to customers is subtracted). Although we found variation between banks in the value of funds attributed to PCA credit balances, in nearly all cases the assigned values were higher than the BoE base rate, which was 0.5% throughout the period 2011 to 2014, as shown in Table 5.8.

Table 5.8: Value and cost of funds applied to credit and debit balances of PCAs

By bank for 2014	*Value of funds (credit) %*	*Cost of funds (debit) %*	*Net value of funds %*	*Average net balance per main account*	*Number of main accounts**
AIBG	[✂]	[✂]	[✂]	[✂]	[✂]
Barclays	[✂]	[✂]	[✂]	[✂]	[✂]
BoI	[✂]	[✂]	[✂]	[✂]	[✂]
Clydesdale				[✂]	[✂]
Co-op Bank				[✂]	[✂]
Danske	[✂]	[✂]	[✂]	[✂]	[✂]
HSBCG	[✂]	[✂]	[✂]	[✂]	[✂]
LBG	[✂]	[✂]	[✂]	[✂]	[✂]
Metro				[✂]	[✂]
Nationwide	[✂]	[✂]	[✂]	[✂]	[✂]
RBSG	[✂]	[✂]	[✂]	[✂]	[✂]
Santander	[✂]	[✂]	[✂]	[✂]	[✂]
TSB	[✂]	[✂]	[✂]	[✂]	[✂]
Ulster	[✂]	[✂]	[✂]	[✂]	[✂]
By year†					
2011‡			3.54	2,762	
2012§			3.15	2,706	45,078,541
2013			2.62	3,073	47,330,265
2014			2.42	3,636	49,171,414

Source: CMA calculations.
* Average of number at start and end of year.
† Weighted average for all banks except Clydesdale, Co-op Bank and Metro.
‡ Excludes Danske, RBSG and Santander.
§ Excludes Danske.
Note: The net value of funds is the absolute difference between the value and cost of funds as a percentage of net balances. So, the net value of funds is (vB–cD)/(B–D) where v is value of credit funds (%), B is average credit balance over the year, c is cost of debit funds (%) and D is average debit balance over the year.

5.40 The increasing number of main accounts will also have an impact on the net revenue per main account. We estimate that the increase in the number of main accounts was about 11% above the increase in the adult UK population. If this is due to multi-banking, we might expect charges and interest revenue per main account to decline, since we would expect multi-banking customers to incur charges on one or other of their accounts but not on all of them.

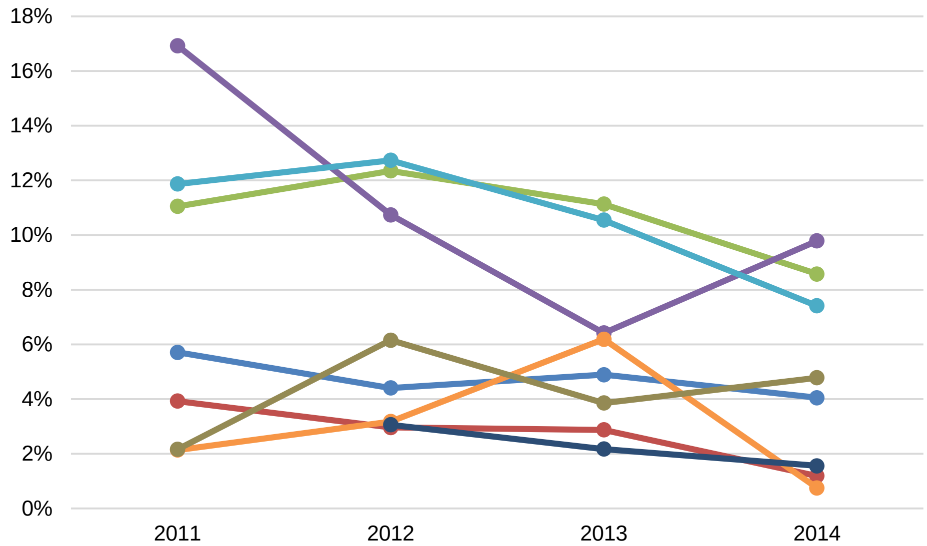
Impairments

5.41 The comparability of banks' revenues may be affected by banks having different customer characteristics: for example a bank with a higher proportion of less creditworthy customers would, other things being equal, obtain higher revenue from overdraft charges but would also be likely to have higher impairment costs.

5.42 To understand the impact of impairments (ie costs for credit and first party customer fraud losses)[15] on banks over time, we have examined the impairment margins of the eight largest banks' PCA businesses,[16] using the financial data collected from banks.

5.43 We looked at impairments as a percentage of revenues, including value of funds as measured by each bank.[17] Figure 5.3 shows the impairment rate for each of the eight banks for 2011 to 2014.

Figure 5.3: PCA impairments as a proportion of total revenues, 2011 to 2014



Source: CMA analysis based on data provided by the parties.

[15] Third party fraud losses are included in direct costs.
[16] Barclays, Clydesdale, Co-op Bank, LBG, HSBCG, Nationwide, RBSG and Santander.
[17] [✄] told us that this measure was an uninformative metric to compare between providers: it told us that impairments were driven by customers' credit quality and lending balances, whereas total income was driven by customers' credit and debit balances. We consider that our impairment measure provides some useful context in considering PCA revenues.

5.44 In general, impairment rates improved over the period and by 2014 were under 10% for all eight banks.[18] This will to some extent offset the trend of declining net revenue per account observed over the same period.

5.45 The reduction in impairment rates appears to reflect in part an improving macroeconomic environment resulting in lower provision levels than in previous years. There appear to be two broad groupings among the eight banks: LBG, Santander and RBSG with higher impairments, and Nationwide, Barclays, HSBCG, Clydesdale, and Co-op Bank with lower impairments, with the later three banking groups having particularly low rates.[19]

Profitability of PCA customers and products

5.46 Our ability to conduct our own analysis of the profitability of PCAs is complicated by the difficulty and subjectivity of allocating a significant proportion of common or shared costs (eg branch costs, HR costs and marketing spend) to individual products and/or customers (see Section 2).

5.47 We have nevertheless collected information from the five largest UK banks (LBG, Barclays, HSBCG, RBSG and Santander)[20] on ways in which they assess the profitability of PCAs or wider personal banking and, to the extent possible, the profitability of individual products and customers. The details of our findings are included in Appendix 5.1.

5.48 In analysing this information we have sought to understand whether PCAs are profitable on a stand-alone basis and whether certain types of customer or usage patterns are more or less profitable.

5.49 Banks take different approaches to assessing the performance of PCAs and they do not all assess the profitability of PCAs in the normal course of business. Therefore we do not have a comprehensive view of PCA profitability across all the banks.

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[18] The impairment rate for [✂] declined steeply between 2011 and 2013 and rose in 2014. [✂] told us that the decline from 2011 was mainly due to lower defaults, and that the small increase in 2014 was due to 2013 including higher one-off adjustments from provision adequacy (balance sheet) adjustments in 2013 than in 2014.
[19] [✂] told us that the increase in 2013 was due to methodological changes to credit model parameters on loss rates, and that the figures prior to 2014 included fraud costs.
[20] We focus our analysis on the PCA banking activities of the five largest banks in the UK, as together they had a combined market share (by number of main PCAs) of [✂] in 2014 and 2015. See Table 5.1 for further information. Our assessment is based on financial data provided by the banks and generally reflects accounting (and not economic) profits.

5.50 Across a five-year period, for [✂] and [✂], PCAs are [✂], and for [✂] and [✂], personal banking, including the provision of PCAs, is [✂].[21]

5.51 Packaged accounts tend to be the most profitable type of PCA, as they generally require a monthly fee for their use (which exceeds the cost of the benefits provided to customers) and are more likely to be held by main banking customers who are active users of their account, have higher credit balances, and use other personal banking products.

5.52 Both standard and reward PCAs are less profitable than packaged accounts, as either there is no monthly fee, or in the case of reward accounts, if there is a monthly fee it is usually waived or offset by customer benefits. There also tends to be a greater proportion of secondary PCA customers within these groups.

5.53 Basic bank accounts and non-adult PCAs (ie youth, graduate and student accounts) tend to be less profitable than standard and reward PCAs. The reasons for the lower profitability of such accounts typically include: low credit balances, and either no or interest-free access to an overdraft facility.

5.54 Primary banking customers[22] tend to hold a greater proportion of their personal banking products with their primary bank and tend to be more active users of their account.

Summary of evidence on financial performance

5.55 Our analysis of PCA net revenues shows a reduction in net revenue per account since 2011, driven by: an increase in interest payments to customers; a reduction in revenue from overdrafts; and a decline in the net value of funds associated with credit balances. Nevertheless, the net value of funds remains an important source of PCA revenues, accounting for around 50% of net revenue in 2014. This illustrates that banks earn revenues from the accounts of customers who maintain positive credit balances. In general, impairment rates improved over the period.

[21] [✂],[✂] and [✂] provided stand-alone profit and loss forecasts for their PCA propositions, whereas [✂] and [✂] provided forecasts for their personal banking businesses, which includes the provision of PCAs and other personal banking products.
[22] We understand that a bank deems a customer to be a primary banking customer if they hold their main transactional account (ie the account in which they hold their income and from which the majority of their payments are made) and therefore, their main banking relationship with them, and that all other customers are deemed to be secondary banking customers, as they hold their main banking relationship elsewhere.

5.56 Banks take different approaches to assessing the performance of PCAs, but the evidence we have seen suggests that PCAs are profitable for the five largest banks across a five-year period.[23]

Price outcomes

5.57 Comparisons of prices between banks can provide information on the competitive conditions in a market. For example, the existence of a wide range of prices between banks for a similar product alongside stable market shares could indicate that customers are not switching to better value products, and therefore be evidence of a weak customer response. A comparison of prices between banks may also provide information on the existence of a relationship between market share and price outcomes.

5.58 Variations in price between banking groups may reflect differences in the quality of PCA service provided. We have considered price and quality outcomes together in drawing our conclusions about market structure and outcomes.

5.59 PCAs are complex products providing a number of different services to customers and the structure of PCA pricing differs between accounts. Given the complexity both of services provided and of pricing, making comparisons between PCA prices is not straightforward. Further details of the data, methodology, results and testing are presented in Appendix 5.2.

5.60 The data on fees and charges for each product are from the database held by our contractor, Runpath Digital Ltd (Runpath). To estimate product prices that are representative of what customers across the market would pay (and which are not influenced by differences in customer mix at different providers), we have used a sample of customer accounts.[24] The customer data is from the anonymous transactions data collected from a number of banks operating in GB and NI,[25] which contains information on account usage each month.[26] We did the analysis separately for GB and NI.

[23] [✂] and [✂] provided stand-alone profit and loss forecasts for their PCA propositions, whereas [✂] and [✂] provided forecasts for their personal banking businesses, which includes the provision of PCAs and other personal banking products.
[24] There are limitations to the representativeness of the sample of customers used in the analysis. We undertook sensitivity tests (see Appendix 5.2), and we found that the relationships observed are robust under various tests.
[25] The underlying customer transactions data for NI customers was incomplete in some respects and so we have had to make adjustments for this, leading to price estimates which are less robust than for GB.
[26] Including: average credit balance; average debit balance; number of days in arranged and unarranged overdraft usage; inbound payments and transfers into the account (excluding charges). The data used does not contain values for all types of transaction and all components of price. We have used estimates for some price components (see Appendix 5.2 for details).

5.61 Runpath calculated the following, using our customer data and its database of fees and charges:

(a) the net price per month of each account, using prices as of May 2016; and

(b) the net price per month if each account holder switched to other PCAs to which it is eligible.

5.62 To estimate product average prices, we aggregate the prices each customer in the sample would pay for each product. To estimate brand- and group-level average prices, we weighted the product prices of each brand/group based on the brand/group customer mix (ie the number of customers using each product at the brand/group as according to the number of weighted observations in the transactions data set). We consider that for this analysis the weighting by existing customer mix is appropriate, because our analysis seeks to estimate the prices that customers would currently pay for each product available to them in the market in order to assess current prices across the market. The data we hold on the customer mix at each brand/group is from 2014, and as such, it is possible that the customer mix across products at some banks has changed since then.

5.63 In interpreting the brand/group level prices, it is important to consider that, as products at a provider have different prices, the aggregated brand/group price does not represent prices that all current customers of a provider pay or that new customers would pay, and so it should not be taken as customer advice as to the best products or providers in the market.

5.64 The average prices we present are estimates at a snapshot in time. Our analysis is a static assessment, in the sense that we assume no changes in customer behaviour or provider prices, and should not be interpreted as long-run prices. This is because, over time, customer behaviour may change, for example due to life events, and also in response to switching to a different product with a different price and reward structure. Banks may also change their prices over time in response, for example, to changes in their customer mix if customers switch products.

5.65 Producing estimates of PCA prices is not straightforward methodologically, as different approaches can be taken on such aspects as how to incorporate different features of the product offer (such as switching incentives and product benefits), and on the method of price calculation to estimate prices over a horizon of several years. Inevitably, then, it is necessary to interpret calculated prices as estimates. To reflect the fact that the prices are estimates and so subject to some degree of imprecision, the inferences we draw on the pricing analysis are on the basis of the relationships we observe, rather than the exact numbers.

5.66 We produced the first iteration of the price analysis at provisional findings. We updated the analysis in a second iteration to undertake updates and refinements, and in response to parties' submissions. These were: using updated prices; to update benefits and cashback values; to include customers on accounts no longer available to new customers ('back-book' customers) in the analysis; and to include estimates of paid and unpaid items.

5.67 Following the consultation of the second iteration of the price analysis and the data room, we have made the following subsequent adjustments to the data:

(a) M&S vouchers: LBG submitted that M&S vouchers were a temporary offer for the first 12 months after a customer switched and that they were no longer available to new customers. We investigated this and found that the M&S Bank Premium Current Account does offer a switching incentive voucher in the first year plus shopping vouchers (on a yearly basis) but that the M&S Bank Current Account product does not offer shopping vouchers. We have corrected the M&S product prices accordingly in the analysis.

(b) LBG product prices: LBG submitted that its Lloyds Classic and BoS Classic accounts had the same pricing structure, so should have the same prices. Runpath confirmed that it had not applied caps correctly to the Lloyds Classic account overdraft fees, and that the BoS Classic prices were the ones that were correct for both products. We have replaced the Lloyds Classic unarranged overdraft fees with those of BoS Classic in the updated analysis. We corrected prices for TSB's Classic account in the same manner. We have also corrected the monthly fees applied to the Club Lloyds product value calculations after LBG told us that these were waived for more customers than was previously the case in our data.

(c) Miscategorisation of paid fees for TSB: TSB put forward queries regarding its product prices. We investigated the accuracy of TSB's prices and found that there was a misinterpretation of their paid fees as these actually referred to unarranged overdraft daily fees. We therefore eliminated TSB's paid items fees (which TSB does not charge) and recalculated its prices.

5.68 In reviewing our analyses more generally, we found that for some of our sample the number of days in overdraft had been underestimated in the price calculations. This limits the representativeness of the sample of customers used in the analysis, and so we undertook a sensitivity test in order to understand the impact of this on the inferences we are drawing from the analysis. We found that the relationships observed remain robust under this testing.

5.69 We have tested the robustness of the relationships observed under different assumptions, and found that these had little impact on the results.

5.70 We have also checked the consistency of the analysis with other analysis undertaken, namely: LBG's own pricing analysis using disaggregated data; PCA revenue analysis, as suggested by LBG; and the pricing profiles analysis we previously undertook. We find that the relationships observed are consistent across these approaches.

5.71 We next outline the results for standard and reward products for GB.[27] We first discuss estimated product prices and then estimated average brand and group prices.

Product prices

5.72 Most banking groups offer a number of different products and there are often substantial differences between the prices of these products (see Table 5.9 and Figure 5.4). At the four largest banking groups in GB by market share, the difference in average price between the most expensive and the cheapest products within the banking group varies between around £3 to around £8 per month.

5.73 Variation in product prices within banking groups is also seen when we consider estimated prices by customer segments based on common account eligibility criteria (ie the number of direct debits and value paid into the account). We see banking groups are offering products which are better value for money for all customers compared with other products they offer.

5.74 For overdraft users the prices are substantially higher than for non-overdraft users. There is no clear pattern emerging in terms of the types of products which have lower or higher overdraft charges: we see a mix of standard and reward products among the most expensive on average for overdraft users.

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[27] The results for packaged accounts are presented in Appendix 5.2. For packaged products we made assumptions on the value to customers of the benefits from packaged accounts.

In general average prices across products increases as the number of days in overdraft increases.

5.75 Since the variation in prices for overdraft users is greater than that for non-overdraft users, and 45% of the sample for standard/reward customers are overdraft users, the variation in overall estimated product prices (and therefore the subsequently calculated brand and group level prices, see Table 5.9) is dominated by the variation in overdraft prices across products.

Table 5.9: Product average prices, standard and reward, Year 5 prices including benefits, GB

			Overdraft usage				*Customer segmentation based on account eligibility across the market (ie the number of direct debits and value paid into the account)*											
Banking group	*Brand*	*Product*	*15+ days in over-draft*	*8–14 days in over-draft*	*4–7 days in over-draft*	*1–3 day(s) in over-draft*	*Less than £500*	*Fewer than 2 DDs & £500 to less than £750*	*2+ DDs & £500 to less than £750*	*Fewer than 2 DDs & £750 to less than £1,000*	*2+ DDs & £750 to less than £1,000*	*£1,000 to less than £1,500*	*Fewer than 2 DDs & £1,500 to less than £1,750*	*2+ DDs & £1,500 to less than £1,750*	*£1,750 or more*	*Over-draft user*	*Non-overdraft user*	*Product price*
LBG	Lloyds Bank	Lloyds Bank Classic Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£13	£0	£6
	Lloyds Bank	Lloyds Bank Club Lloyds Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£12	–£7	£1
	Halifax	Halifax Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	–£1	£4
	Halifax	Halifax Current Account – with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£17	£9	£12
	Halifax	Halifax Reward Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	–£1	£4
	Bank of Scotland	Bank of Scotland Classic Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£13	£0	£6
	Bank of Scotland	Bank of Scotland Classic Account with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£16	£10	£12
	Bank of Scotland	Bank of Scotland Classic Account with Vantage	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£12	–£5	£3
RBSG	NatWest	NatWest Reward Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£13	£3	£8
	NatWest	NatWest Select Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£0	£5
	Royal Bank of Scotland	Royal Bank of Scotland Reward Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£10	£4	£6
	Royal Bank of Scotland	Royal Bank of Scotland Select Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£0	£5
Barclays	Barclays	Barclays Bank Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£0	£5
		Barclays Bank Account – with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£15	£8	£10
		Barclays Bank Account with Blue Rewards	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£14	£3	£8
		Barclays Premier Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£10	£2	£7
		Barclays Premier Current Account – with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£15	£10	£12
HSBCG	HSBC	HSBC Advance Bank Account (New)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£7	£0	£4
		HSBC Bank Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£7	£0	£3
		HSBC Bank Account Pay Monthly	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£13	£10	£11
		HSBC Premier Bank Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£1	–£2	–£1
	first direct	first direct 1st Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£7	£1	£3
	M&S Bank	M&S Bank Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£1	–£1	£0
	M&S Bank	M&S Bank Premium Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	–£2	–£5	–£4
Santander	Santander	Santander 1|2|3 Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£10	–£8	£0
		Santander Choice Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£15	£10	£12
		Santander Everyday Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£15	£0	£7
Nationwide BS	Nationwide BS	Nationwide BS FlexAccount	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£4	–£4	£0
		Nationwide BS FlexDirect Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£7	–£2	£2
TSB	TSB	TSB Classic Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£13	£0	£6
		TSB Classic Current Account – with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£15	£10	£13
		TSB Classic Plus Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£9	–£4	£2
		TSB Classic Plus Account – with Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£12	£5	£8
Clydesdale	B	B B Current	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£2	£6
	Clydesdale Bank	Clydesdale Bank Current Account Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£5	£7
		Clydesdale Bank Current Account Plus	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£10	–£2	£3
	Yorkshire Bank	Yorkshire Bank Current Account Control	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	£5	£7
	Yorkshire Bank	Yorkshire Bank Current Account Plus – 16 and over	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£10	–£2	£3
	smile	smile Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	–£1	£4
Co-op Bank	The Co-operative Bank	The Co-operative Bank Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£11	–£1	£4
Metro	Metro Bank	Metro Bank Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£4	£0	£2
Post Office	Post Office	Post Office Standard Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£3	£0	£1
Tesco Bank	Tesco Bank	Tesco Bank Current Account	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	£2	–£3	–£1

Source: CMA analysis on Runpath price outputs.

Figure 5.4: Product average prices and group market shares (standard and reward, Year 5 prices including benefits), GB

[✂]

Source: CMA analysis of Runpath price outputs.
Notes:
1. CMA calculations based on data submitted by banks.
2. RBSG was not able to provide GB and NI shares for RBS and NatWest separately.
3. For Metro, we have assumed all accounts are in GB.
4. Co-op Bank market share was calculated based on NI/UK ratio to total.
5. Tesco's market share and the Post Office's market share in GB were obtained from 'Main PCAs (FRS data)' in 2014 and are [✂]% and [✂]%, respectively.

Average group prices

5.76 To estimate average group prices we weighted the product prices of each banking group based on the number of customers at the banking group using each of the products based on 2014 data on product usage.

5.77 This approach to aggregating prices across banking groups means that while higher market share banking groups offer some relatively cheap products as part of their portfolio, if only a small proportion of their customers in 2014 held these products, then these cheap products will have only a minor impact on the overall estimated average group price.

5.78 Average group prices are generally higher at banking groups with higher market shares in GB (see Figure 5.5, with correlation coefficient of 0.56 between average price and market share at group level). Generally recent entrants and expanding banks seem to offer lower average group prices.

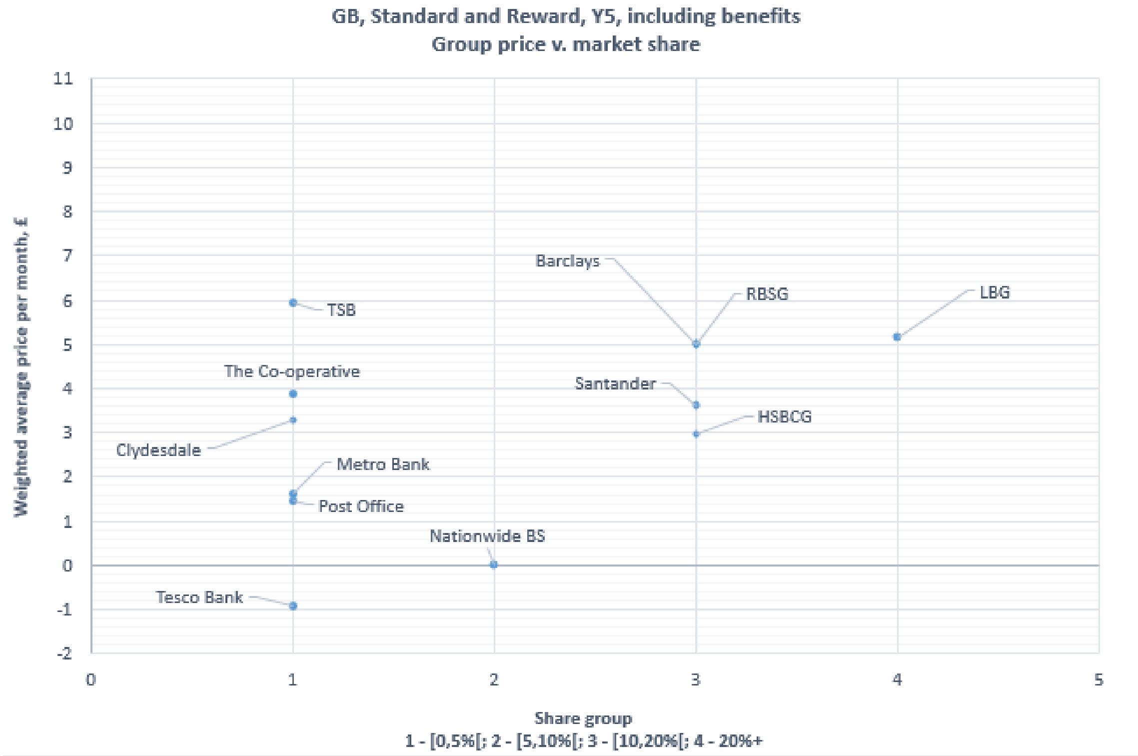
5.79 There is little variation in prices across customer segments based on account eligibility criteria using the number of direct debits and value paid into the account (see Table 5.10). Thus, for each of the customer segments considered, average prices are generally higher at banking groups with higher market shares.

Table 5.10: Group average prices (standard and reward, Year 5 prices including benefits), GB

[✂]

Source: CMA analysis on Runpath price outputs.

Figure 5.5: Group-average prices and market shares (standard and reward, Year 5 prices including benefits), GB



Source: CMA analysis of Runpath price outputs.
Notes:
1. Market shares based on data from subsection above.
2. RBSG was not able to provide GB and NI shares for RBS and NatWest separately.
3. For Metro, we have assumed all accounts are in GB.
4. Co-op Bank market share was calculated based on NI/UK ratio to total.
5. Tesco's market share and the Post Office's market share in GB were obtained from 'Main PCAs (FRS data)' in 2014 and are [✂]% and [✂]%, respectively.

5.80 We also considered the relationship between average prices and the length of time that accounts are held with the bank. We do this at the banking brand level to allow for more data points. We find that banks whose customers have held their accounts for longer tend to have higher prices on average (see Figure 5.6, with correlation coefficient of 0.75). This means that GB banks who have a relatively less active customer base (as indicated by length of time products are held) are charging higher prices on average.

5.81 We note that the length of time that products are held and group market share are reasonably closely correlated (with correlation coefficient of 0.55 for GB).

Figure 5.6: Brand average prices and average time products are held for that brand (standard and reward, Year 5 prices including benefits), GB

[✂]

Source: CMA analysis of Runpath price outputs.
Note: We have conducted a sensitivity analysis when calculating average time held per brand excluding transactions data observations whose date of PCA opening was prior to 1984, as the time held data showed unusual patterns prior to that date.

5.82 For NI, results are subject to more limitations because the underlying data is less complete. Results for NI are presented in Appendix 5.2. We find similar trends as those for GB, except that there is no clear relationship between average product prices and market shares of banking groups.

Summary of evidence on price outcomes

5.83 Most banking groups offer a number of different products, and there are often substantial differences between the prices of these products. For overdraft users, the product prices are substantially higher than for non-overdraft users.

5.84 Our comparison of average group prices shows variation between banking groups. In GB the results suggest that banks whose customers have had their accounts for longer periods and with larger market shares tend to have higher average prices. For NI, banks whose customers have had their accounts for longer periods have higher average prices but there is no clear relationship between average group prices and market shares of banking groups.

5.85 It is difficult to draw inferences on the existence of any relationship between market structure and outcomes by reference to the pricing analysis alone, because variations in price between banking groups may reflect differences in the quality of service provided. We have therefore undertaken comparisons between banks based upon a number of indicators of service quality. We have considered these, together with the pricing analysis, in drawing our conclusions about market structure and outcomes.

Quality outcomes

5.86 We have sought to identify: *(a)* whether there is a relationship between market structure and quality outcomes; and *(b)* how and to what extent customers respond to variations in quality outcomes.

5.87 To assess and compare quality between banks, we defined a set of proxy performance indicators which encompass evidence from a range of sources (both subjective and objective in nature) including survey data, complaints volumes, and other parameters of the service offering. A more detailed discussion of the methodology and results is contained in Appendix 5.3.

Indicators of overall quality

5.88 Customer experience metrics, such as customer satisfaction and advocacy ratings, can be useful as indicators of the overall quality of service received by customers, and are widely used as a measure of overall service quality, by both private companies and regulators.[28]

5.89 This analysis concentrates on two measures of overall quality:

(a) The net promotor score (NPS). This is a customer loyalty metric widely used by banks as part of their quality monitoring process, and is available from the GfK FRS survey.

(b) The proportion of customers that are satisfied with their current account provider. This data is available from the GfK FRS survey, GfK PCA survey and Which? survey.[29,30,31]

5.90 We recognise that there are limitations to the use of these measures as a proxy for quality, and for this reason the results of such analysis should be interpreted carefully, especially when considering absolute levels of satisfaction. In particular, ratings are likely to reflect customers' expectations of quality, which may be bounded by the range of service offered by current market participants. However, to the extent that this is true, products that offer high quality should still receive strong satisfaction ratings: products that receive lower satisfaction ratings are failing to meet their customers' expectations of quality.

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[28] For example, since 2010/11 Ofwat has used customer satisfaction as one of its key metrics to compare and incentivise improvements in the service quality delivered by regulated water companies. Since 2009 Ofcom has used customer satisfaction surveys to quantify and monitor the customer service experience delivered by the main communications providers in the UK. Similarly, customer satisfaction forms part of the Broad Measure of Customer Service (BMCS) used by Ofgem in its DPCR5 and RIIO-ED1 price controls to incentivise improvements in the customer service delivered by electricity distribution network operators.

[29] The GfK PCA measures satisfaction on a five-point scale (from 'very satisfied' to 'very dissatisfied') and the GfK FRS measures satisfaction on a seven-point scale (from 'extremely satisfied' to 'extremely dissatisfied'). We classify those in the PCA survey as 'satisfied' if customers responded that they are 'very satisfied' or 'fairly satisfied' with their provider, and those in the GfK FRS survey as 'satisfied' if customers respond that they are 'extremely satisfied', 'very satisfied' or 'fairly satisfied'. The Which? satisfaction score is a hybrid measure calculated using a combination of respondents' overall satisfaction and how likely they are to recommend their bank to a friend.

[30] As there are definitional differences between the three sources, the scales are not directly comparable. Satisfaction measures from these data sets show differing degrees of variation in ratings (ranging from 86 to 98% from the GfK PCA consumer survey, 89 to 97% from the GfK FRS and 52 to 82% from the Which? satisfaction survey), and we note that each of the data sets follow different methodologies.

[31] A number of parties questioned the robustness of the Which? survey results (see Barclays response to provisional findings, paragraph 2.5; and LBG response to provisional findings, paragraph 2.32.). Both LBG and RBSG raised specific concerns about the composite nature of the survey (which combines both willingness to recommend and satisfaction metrics), as well as the weighting of survey responses on an exponential scale which they argued exaggerated small differences between banks (see RBSG response to provisional findings, Annex 1, p3). While we recognise these methodological features of the Which? survey we consider that it provides a useful complementary source of evidence to the GfK FRS satisfaction scores, in particular, because it is an indicator that is available for PCA customers to use in their own search and switching decisions. We also note that even given the definitional, methodological and time period differences, there remains a reasonably strong (nearly 80%) correlation between the GfK FRS and Which? survey results.

5.91 It is also possible that perceived quality does not coincide with the actual quality of the service delivered, for example if the service is not well understood by the customer or due to brand taint effects.[32]

5.92 Customer experience metrics do have the benefit over alternative indicators (such as operational performance measures) of measuring service outcomes as perceived by the customer, as opposed to single inputs or components of the overall quality outcome. In this way they will reflect the implicit weighting attached by customers to the various attributes of service.

5.93 Customer-reported indicators of service quality are also the most appropriate measures to use in assessing the strength of competitive dynamics in the market, and in particular, how customers respond to perceived variations in service quality between providers. Also, as noted above, these metrics are widely used as a measure of overall service quality by both private companies and regulators.

5.94 We therefore consider customer satisfaction and advocacy measures to be a primary indicator of service quality outcomes, particularly when making comparisons between providers or across geographic markets.

5.95 To augment the information provided by customer experience metrics we have also undertaken comparisons of objective indicators of quality along specific dimensions of service (eg IT service failures and average branch opening hours).[33]

5.96 LBG submitted that customer satisfaction was not a meaningful indicator of quality, as it reflected customers' expectations and could be influenced by non-quality factors such as what we refer to as brand taint effects.[34] While we recognise that there are limitations to the use of satisfaction measures as a proxy for quality outcomes, we maintain our view that customer satisfaction is a useful and important indicator of quality for the reasons set out above.

[32] In particular a customer's reported NPS and satisfaction ratings may be impacted by positive or negative publicity surrounding a bank over issues that are not relevant to the provision of the PCA product. For example, in its submission on measuring consumer outcomes in retail banking, RBSG noted the divergence in NPS scores received by its NatWest and RBS brands (despite the similarity of their service offerings). RBSG considered that this might be a result of the RBS brand being more readily associated by customers with the negative media coverage received by RBSG during and after the financial crisis.
[33] See Appendix 5.5 for further details of this additional analysis.
[34] LBG response to provisional findings, paragraphs 18a, 1.5 and 2.30–2.31.

Comparisons with providers of other financial products

5.97 According to the results of the GfK PCA consumer survey, around 90% of UK PCA customers were satisfied or very satisfied with their PCA provider in 2015.[35] Similar proportions were observed for GB and NI respondents separately.

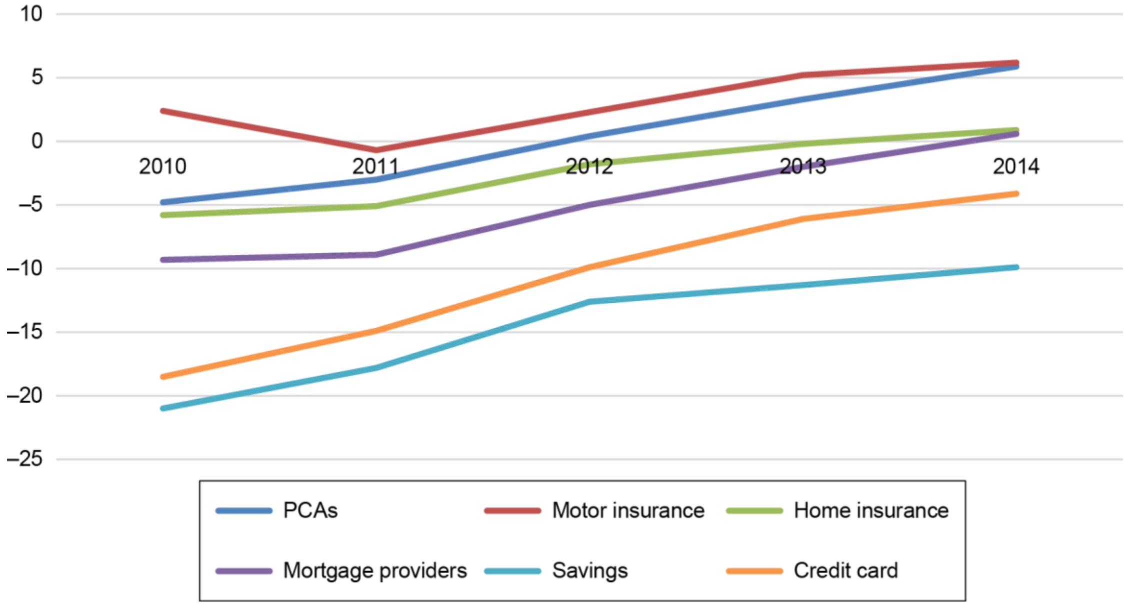
5.98 GB PCA providers appear to score relatively well on indicators of service quality compared with providers of other financial products.[36] For example, comparisons of net promotor scores (NPS)[37] across sectors between 2010 and 2014 show that PCA providers receive higher advocacy rates than providers of home insurance, credit cards, personal savings and mortgages respectively, and receive a similar rating to motor insurance providers by 2014 (see Figure 5.7).

5.99 A similar result is observed from comparisons of customer satisfaction ratings in GB,[38] which show that PCA customers are at least as satisfied with the quality of service received from PCA providers as with that received from providers of other financial products.

5.100 Several parties submitted that the high levels of satisfaction suggested that the market was working well.[39] However, we consider that customer experience metrics such as satisfaction will be determined at least in part by customers' expectations of product or service quality. Since this expectation is likely to be influenced by the range of service offered by current providers, high absolute levels of satisfaction cannot necessarily be interpreted as implying that the market is delivering good outcomes for customers. For this reason our analysis of customer experience measures is largely focused on the comparative performance between banks.

[35] On a five-point scale from 'very dissatisfied' to 'very satisfied'.
[36] Due to data limitations it is not possible to perform a similar benchmarking of willingness to promote for PCA providers against providers of other personal finance products in NI.
[37] NPS is a customer experience metric derived from survey evidence in which customers are asked on a scale of 0 to 10, how likely they are to recommend their provider to friends and family. The NPS is then calculated as the percentage of customers reporting a score of 9 or 10 (ie 'promoters') less the percentage of customers reporting a score of 6 or less (the 'detractors').
[38] See Appendix 5.5.
[39] AIB response to Remedies Notice, p1.

Figure 5.7: Comparison of GB NPS across sectors, 2010 to 2014



Source: CMA calculations using the GfK FRS.
Note: Data does not include NI.

Comparisons of overall quality

5.101 Comparisons of overall service quality using satisfaction measures from the GfK PCA consumer survey, GfK FRS and Which? show differing degrees of variation in satisfaction ratings (ranging from 87% to 96% from the GfK PCA consumer survey, 91% to 97% from the GfK FRS and 56% to 73% from the Which? satisfaction survey[40]). These results are consistent across the measures.

5.102 The banks with the highest scores on the GfK PCA survey and Which? measures (Metro and Nationwide) have experienced growth in market share, but the pace of growth has been slow ([✂] percentage points each in 2014). Similarly, although Barclays and Clydesdale (which performed relatively poorly on each metric) experienced a loss in market share, this was limited to less than [✂] percentage points in 2014.

5.103 The satisfaction ratings are suggestive of an inverse relationship between quality of service and market share in GB (see Figures 5.8, 5.9 and 5.10 below). A similar pattern emerges in our analysis of satisfaction indicators by brand. However, the presence of this relationship appears to be driven by

[40] We note that the Which? satisfaction scores are derived using a much smaller sample compared with the GfK FRS. It has also not been possible for us to verify the representativeness of the sample and robustness of the survey methodology.

the performance of a small number of banking groups. We observe similar results from a comparison of NPS.

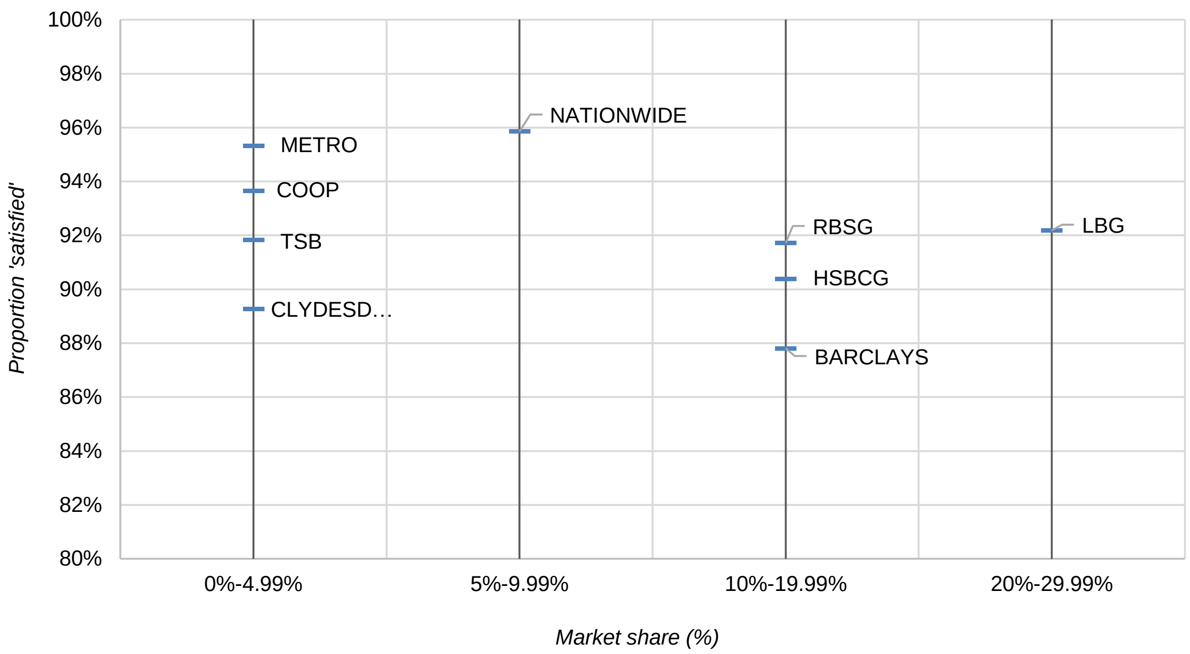
5.104 For NI, it is not possible to reach any firm conclusions from this analysis due to the small samples obtained for NI banking customers and in particular for the smaller PCA providers.

Figure 5.8: Comparison of GB satisfaction scores by market share, using GfK FRS (2014)

[✂]

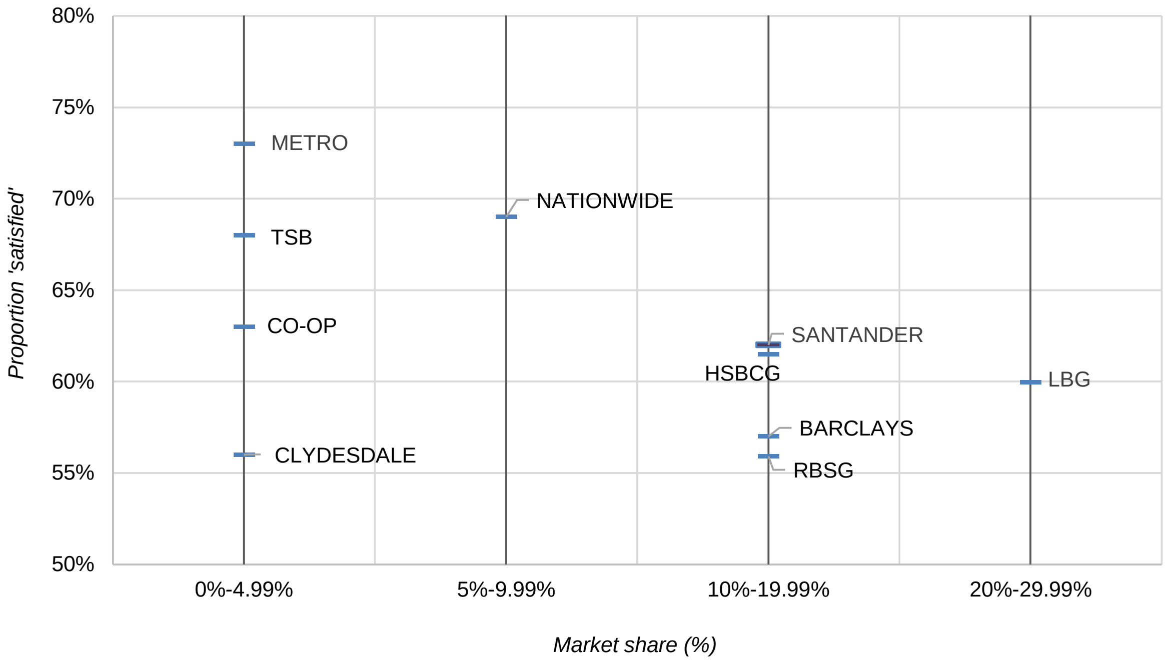
Source: GfK FRS (GB only) and CMA calculations using data submitted by banks.
Note: Market shares refer to GB share of main accounts at year end.

Figure 5.9: Comparison of GB satisfaction scores by market share, using GfK PCA consumer survey (2014)



Source: GfK PCA consumer survey and CMA calculations using data submitted by banks.
Note: Market shares relate to share of GB main accounts.

Figure 5.10: Comparison of satisfaction by market share, using Which? satisfaction index (2016)



Source: Which? (January 2016) and CMA calculations using data submitted by banks.
Note: Market shares relate to the share of GB main accounts.

Comparisons by service attribute

5.105 We have also undertaken comparisons of indicators relating to attributes of service quality that customers have rated as most important in the GfK PCA consumer survey, namely:

(a) the 'quality of staff and customer service': this was ranked as the most important feature of a bank account, with 83% of customers rating it as either 'essential' or 'very important';[41]

(b) the 'quality and speed of handling problems': this was ranked as the second most important feature of a bank for customers, with 82% rating it as 'essential' or 'very important'.[42]

Comparisons of quality of staff and customer service

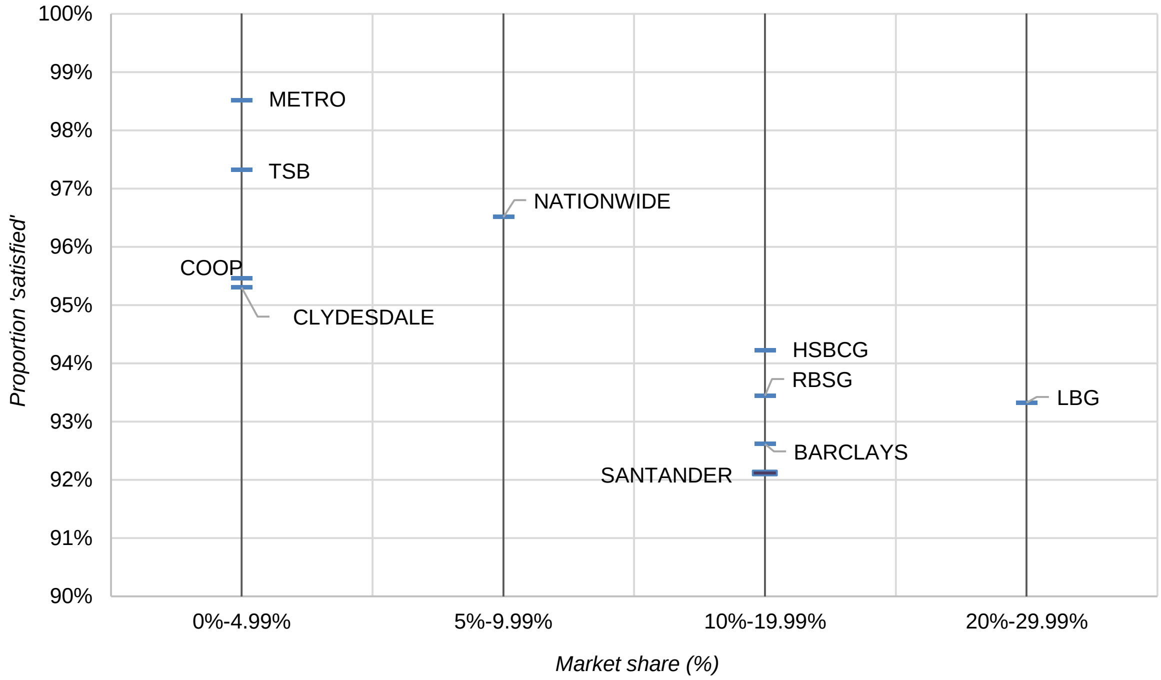
5.106 We use customers' self-reported satisfaction with the quality of staff and customer service as a proxy for this quality dimension.

[41] Figure 40 of GfK NOP PCA banking survey report.
[42] Figure 40 of GfK NOP PCA banking survey report.

5.107 For the GB market, as set out in Figure 5.11, we find that banking groups with the highest reported levels of satisfaction with the quality of staff and customer service are also the banks with the lowest market shares (Metro, TSB, Nationwide and Co-op Bank), indicating a possible inverse relationship between market share and satisfaction with the quality of staff and customer service.

5.108 In NI there does not appear to be a relationship between satisfaction with quality of staff and customer service and market share, however, the small sample size limits the strength of the inferences that can be drawn from this data.

Figure 5.11: GB satisfaction with the quality of staff and customer service in 2015



Source: GfK PCA consumer survey and CMA calculations using data submitted by banks.
Note: Market shares refer to share of GB main accounts at year end.

Comparisons of quality and speed of handling problems

5.109 We collected data for GB and NI banks from the two primary sources of complaints data available:

(a) Banks are required to report all complaints that are not resolved within one working day to the FCA. These are known as FCA-reportable complaints.

(b) Customers who are not satisfied with the response from their bank can escalate their complaint to the FOS.

5.110 The complaints included may also include complaints related to BCAs, although only those made by private individuals or micro-enterprises.[43]

5.111 Figure 5.12 plots each of these complaints series by banking group for 2014, normalised by the number of main accounts.

5.112 Performance between FCA-reportable and FOS complaints varies within banks. For example, while [✂] has the third largest volume of FCA reportable complaints, it also has the fewest complaints referred by customers to the FOS. This disparity between the measures may indicate that while the service offered by some banks may generate a higher volume of reportable complaints, some of these banks are relatively successful at resolving these complaints to the satisfaction of their customers.

5.113 We do not find evidence of clear relationship between market share and either measure of customer complaints in either GB or NI.

Figure 5.12: Normalised customer complaints in 2014

[✂]

Source: FOS, and CMA calculations using data submitted by banks.
Notes:
1. FOS complaints relate to the April 2014–March 2015 reference period, complaints relating to overdrafts not included.
2. FCA-reportable complaints relate to 2014 H2 reference period.

5.114 We have also examined the extent to which variations in the rate of complaints are reflected in market dynamics. Some banks with higher comparative FOS complaints performance (such as TSB and Nationwide) have experienced an increase in market share, but in general the relationship between the rate of complaints and change in market share is relatively weak (see Figure 5.13).

Figure 5.13: FOS complaints and changes in market share in 2014

[✂]

Source: CMA calculations using data submitted by banks.
Notes:
1. Complaints relate to April 2014–March 2015 reference period, complaints relating to overdrafts not included.
2. Change in market shares refer to change on 2013 in share main accounts at year end.

5.115 We note that there have been a number of high-profile service failures affecting PCA customers over recent years. One of the most significant of these was RBSG’s IT failure in June 2012 which resulted in Ulster’s IT

[43] Only complaints made by private individuals or micro-enterprises (defined as business with an annual turnover of up to two million euros and fewer than ten employees) can be referred to the FOS.

systems being unavailable for three and a half weeks. We note that, following this failure, Ulster lost [✂].

Summary of evidence on quality outcomes

5.116 The banks with the highest scores on measures of overall quality have experienced growth in market share, but the pace of growth has been slow. Similarly, banks which performed relatively poorly on measures of overall quality experienced only a limited loss in market share in 2014.

5.117 In GB, banking groups with the highest reported levels of satisfaction with the quality of staff and customer service are also the banks with the lowest market shares. In NI, there does not appear to be a relationship between satisfaction with quality of staff and customer service and market share, although there are limitations to the data.

5.118 With respect to the quality and speed of handling complaints, we do not find evidence of clear relationship between this measure and market share in either GB or NI.

Price-quality outcomes

5.119 The existence of large variations in prices across banks might indicate that customers of worse-performing banks would be better off switching away from their existing bank. However, it might also be reflective of differences in service quality, with customers making a trade-off between price and quality in choosing their account. We therefore interpret the results of the pricing and quality analysis together.

5.120 The analysis focuses on two measures of quality:

(a) The NPS, using data from the GfK FRS survey.

(b) The proportion of customers that are satisfied with their current account provider, using data available from the GfK FRS survey, GfK PCA survey and Which? survey.

5.121 Below we present the results of our analysis of the price and quality offerings by brand.[44] In the figures, we consider four possible outcomes:

(a) Customers pay **above**-average prices for **above**-average quality.

[44] Appendix 5.2 presents the detailed analysis and results.

(b) Customers pay **below**-average prices for **below**-average quality.

(c) Customer pay **above**-average prices for **below**-average quality.

(d) Customers pay **below**-average prices for **above**-average quality.

5.122 Outcomes (a) and (b) are consistent with customers making rational trade-offs between price and quality. However, evidence that customers pay above-average prices for below-average quality (outcome (c)) suggests that these customers would be better off switching product.

5.123 Our baseline scenario in the figures below consists of customers in GB with standard and reward accounts.[45] We use prices inclusive of benefits in the baseline, and include results using prices excluding benefits in Appendix 5.2. The results are similar in both cases.

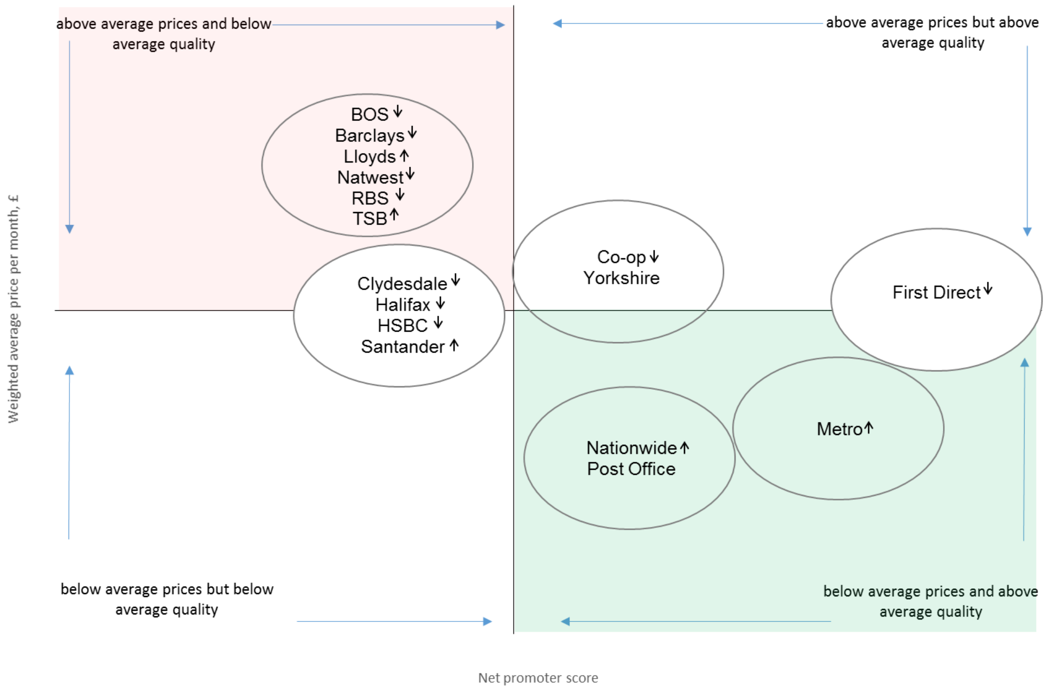
5.124 Figure 14 shows the quadrant of each brand based on its average price and its NPS from the GfK FRS survey, in which customers are asked how likely they are to recommend their provider to friends and family. We present the location of each brand within a 'bubble', providing its general location within the price-quality plane so as not to focus on the exact positioning of providers given that the average prices are estimates.

5.125 It is notable that there is a large cluster of providers with above-average prices and below-average quality. Indeed, while eight brands are in this category, there are only two providers that have both above-average prices and above-average quality. In a well-functioning market, we would expect to find that customers are prepared to pay higher prices only in return for higher quality. Insofar as some providers are offering below-average quality products and above-average prices, we would expect these providers' share to decline rapidly as customers switch to better quality/lower priced providers.

5.126 Two of the providers offering below-average prices and above-average quality – [✄] and [✄] – have been gaining market share in 2014.[46] This indicates that customers are switching to the best-performing banks, however, the market shares of both providers have increased only slowly, with a combined increase of less than [✄] percentage points between 2013 and 2014.

[45] There is very limited quality data available to replicate this analysis for NI. From the GFK PCA survey however, we are able to generate satisfaction ratings for 6 banks. Although this is a very small sample, we find that some of these banks have above-average prices but below-average quality. This is consistent with our findings for GB.
[46] We do not have comparable data on market share changes for the Post Office or Yorkshire Bank.

Figure 5.14: Comparison of NPS and PCA pricing by brand



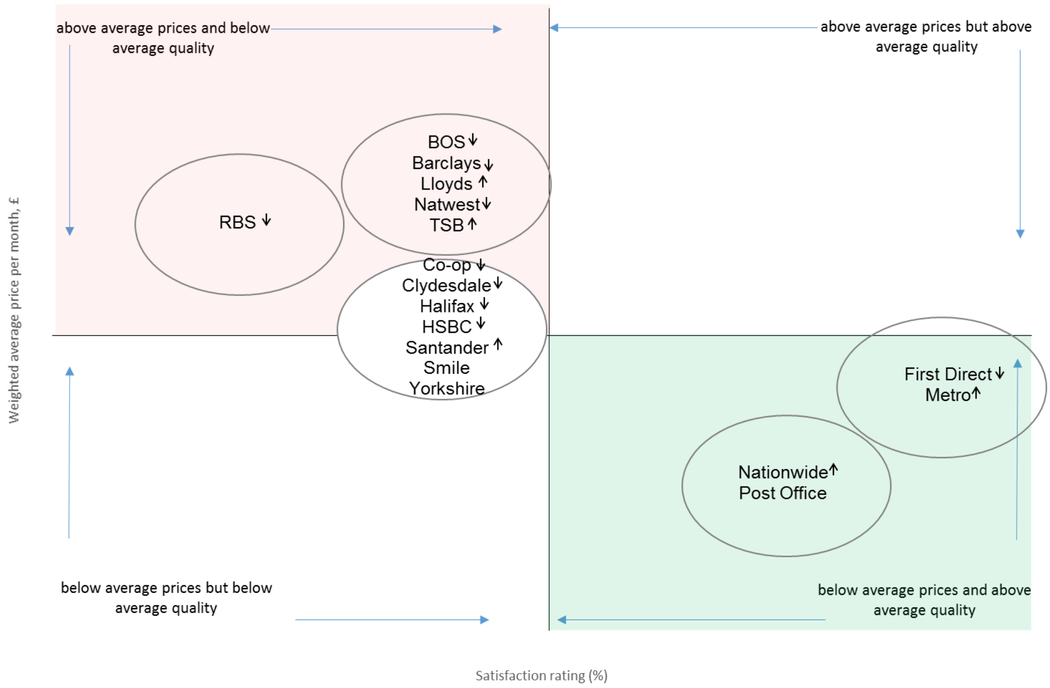
Source: CMA analysis of Runpath price outputs and GfK FRS. [✄]
[✄]

5.127 We considered satisfaction as an alternative measure of quality – specifically the proportion of customers that are satisfied with their current account provider. We used data from the GfK FRS survey, GfK PCA survey and Which? survey.[47]

5.128 While there is some movement in the positioning of brands (see Figures 5.15 to 5.17 below) and more variation in the distribution of providers using the data from the GfK PCA survey, we again see that a number of providers charge above-average prices and also have below-average satisfaction ratings, meaning that some providers are able to charge higher prices despite offering lower quality.

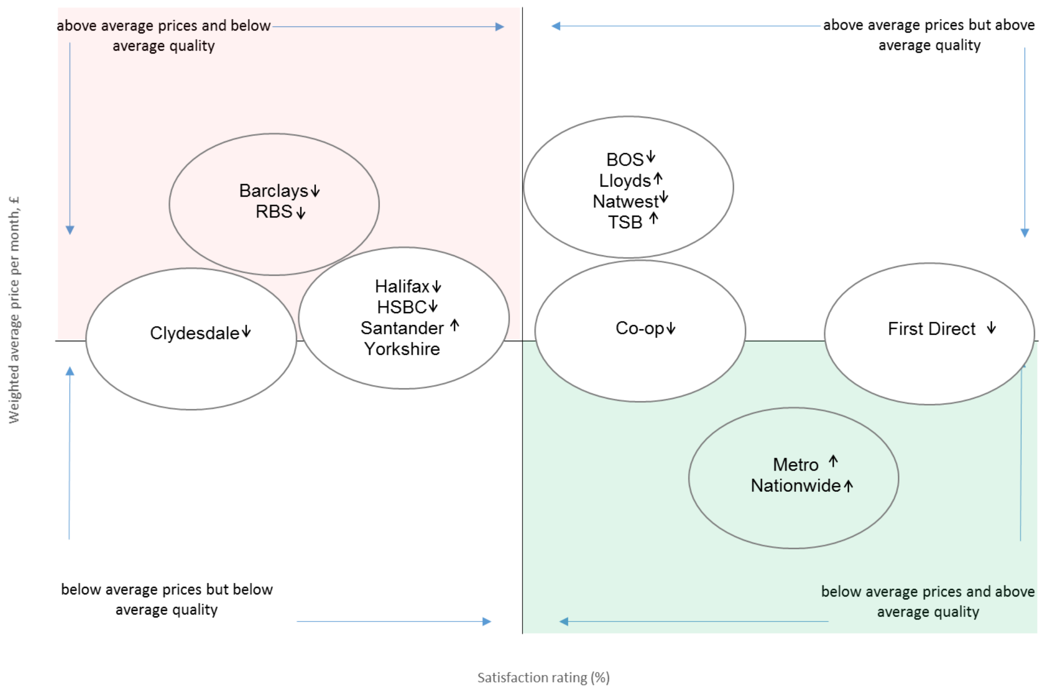
[47] The Which? results are derived using a much smaller sample compared with the GfK FRS and it has not been possible for us to independently verify the survey methodology. While we have some methodological concerns regarding the Which? survey, we prefer to include these results for completeness, and we note that the results are very much in line with our other sources of satisfaction data.

Figure 5.15: Comparison of GfK FRS satisfaction and PCA pricing by brand



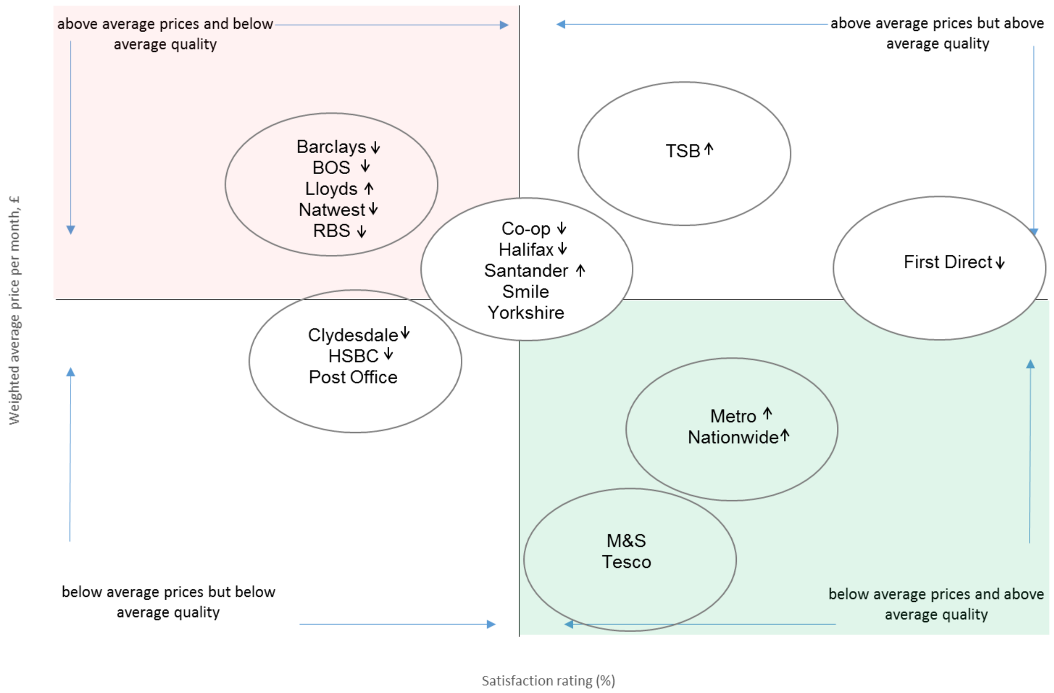
Source: CMA analysis of Runpath price outputs and GfK FRS. [✂]
[✂]

Figure 5.16: Comparison of GfK PCA satisfaction and PCA pricing by brand



Source: CMA analysis of Runpath price outputs and GfK PCA. Price estimates include benefits. Price data is for 2016 and quality data is for 2014. The arrows denote whether the bank's market share increased or decreased during 2014. We do not have comparable data on market share changes for Yorkshire Bank.
Note: The GfK PCA survey measures satisfaction on a five-point scale (from 'very satisfied' to 'very dissatisfied'). We classify those in the PCA survey as 'satisfied' if they respond that they are 'very satisfied' or 'fairly satisfied' with their provider.

Figure 5.17: Comparison of Which? satisfaction and PCA pricing by brand



Source: CMA analysis of Runpath price outputs and Which?.
Note: The prices in the figure include benefits. Price data is for May 2016 and quality data is for January 2016. The arrows denote whether the bank's market share increased or decreased during 2014. We do not have comparable data on market share changes for M&S Bank, the Post Office, Tesco, Yorkshire Bank or Smile.

5.129 We also assessed the relationship between average prices and quality within particular customer segments, such that within each segment the set of customers will be relatively more homogeneous. As in our more aggregated results, we find a large proportion of providers charging above-average price and offering below-average quality.

5.130 Next we used customer-level data (as opposed to the aggregate data used above) on price and quality. This allows us to directly compare, for given customers, the relationship between the price that customers are paying and the quality they report. This enables us to assess the extent to which there is a price-quality trade-off that may be obscured in our analysis of aggregate price and quality data. To do this analysis we used a sample of around 3,700 customers that were surveyed in the GfK PCA survey.[48]

5.131 Table 5.11 provides summary statistics on reported levels of satisfaction and average prices. It is notable that the average price per month steadily increases as the level of satisfaction decreases. It is clear from the table that the most satisfied customers on average paid much lower prices than the

[48] 84% of the respondents are in GB, and 16% are in NI. To maximise the number of observations we do not distinguish between the GB and NI here. For the same reason we do not distinguish between 'packaged' and 'standard and reward' accounts. The results are very similar if we restrict the analysis to GB and standard and reward accounts.

most dissatisfied customers: the difference in prices between those ‘very satisfied’ and ‘very dissatisfied’, for example, is statistically significant at the 1% level.

5.132 These findings show that higher prices are not in general reflective of higher quality. They also undermine the view that satisfaction ratings simply reflect expectations: if that were the case, we would expect satisfaction scores to be roughly the same at all price levels. Instead, we find that those paying higher prices are significantly less likely to be satisfied with their account.

Table 5.11: Satisfaction levels from the GfK PCA survey and average prices

Reported satisfaction	*Percentage of respondents (%)*	*Average price per month (£)*
Very satisfied	52	1
Fairly satisfied	39	3
Neither satisfied nor dissatisfied	5	5
Fairly dissatisfied	2	7
Very dissatisfied	2	9

Source: CMA analysis of Runpath price outputs and GfK PCA survey. Price estimates are without benefits.

5.133 We also analysed for these customers whether those customers who were paying above-average prices were also receiving above-average quality. We found that there was a significant proportion of customers that pay above average prices and are not ‘very satisfied’ with their account, suggesting that these would benefit from switching their account. In addition, customers may not be aware of alternatives available to them and therefore be unable to verify whether indeed they have the best product and service for them. We discuss this in Section 6.

Summary on price-quality outcomes

5.134 In our updated analysis of price and quality we find that many providers have above-average prices but below-average satisfaction ratings. We conducted analysis matching individual customers’ reported satisfaction with the price they are currently paying and how this price compares to the average. This analysis confirms that there is a substantial proportion of customers currently paying above-average prices yet receiving relatively lower quality.

5.135 In undertaking this analysis, we are only looking at a snapshot in time and so are not capturing the potential dynamics of customers shifting between providers. However, as we set out above, market shares are broadly stable. Taken together, this therefore indicates that, in general, customers are not switching to ‘low-price high-quality’ providers and is evidence of a weak customer response to variations in prices and quality. Further, the customer-level information indicates that the price paid by customers is heavily linked to customer satisfaction with the product, which underlines the importance of considering price outcomes in this market.

Estimated gains from switching

5.136 We estimated how much customers could save by switching to cheaper available products. While we would not expect all financial gains from switching to be realised in a well-functioning market, evidence that a large proportion of customers would gain substantially from switching is indicative of poor market outcomes.

5.137 To estimate potential gains from switching products, we calculated the difference between the price per month of the customer's existing product and the price per month of the lowest priced products for that customer. We did this separately for GB and NI. The results for NI are less robust, because the underlying customer transactions data for NI customers was incomplete in some respects and so we have had to make further assumptions in order to produce price estimates.

5.138 Our gains from switching analysis is a static assessment, in the sense that we assume no changes in customer behaviour or provider prices. For example, we assume that customers do not change their usage patterns upon switching, and that customers would be able to obtain the same level of arranged and unarranged overdraft from other banks as they obtain from their own bank.[49] Providers may also change their pricing as switching increases. Therefore the gains from switching that we estimate should not be interpreted as the gains that all customers could achieve in the market if all customers switched to the best alternative product. Further, the potential gains from switching focus only on the monetary gains, and do not take into account aspects of quality.

5.139 For each customer, we calculate a monthly gain from switching to each of the five cheapest products for which the customer is eligible. This is calculated as the difference between the price of the customer's current product and the price of the alternative cheaper product. The customer has a gain from switching of zero to any product that is more expensive than their current product. We then calculate the average gains each customer could make across the five cheapest products and average this across the

[49] Except when product features do not allow such levels (eg control accounts).

population to calculate average market gains.[50] We focus on the average gains from switching to one of the five cheapest products to ensure that our results are not overly sensitive to the existence of any particularly cheap product.

5.140 We use year five prices to calculate gains and then average this in order to derive a monthly gain from switching. We consider that this measure is a good indicator to assess gains from switching: it has the advantage that it takes into account any one-off switching incentives and temporary discounts, but smooths their effect by averaging over a longer time period.

5.141 Before publication of the second iteration of the price analysis, in the analysis of average prices we corrected the year five measure to take into account the incorrect omission of unpaid and paid items fees. Nationwide submitted that the exclusion of unpaid and paid item fees could also be affecting the gains from switching analysis. Since publication of the working paper, we have implemented a correction to the gains from switching analysis to include these fees appropriately.

5.142 In order to test the sensitivity of our results to the methodological assumptions used, we undertook various sensitivity tests and found that our assumptions did not substantially alter the estimates. We consider the gains presented are lower bounds due to the issue surrounding the representativeness of the sample.

5.143 We find that in GB for standard/reward product customers, around 90% of customers could gain by switching to a cheaper product, and the average gain from switching to one of the five cheapest products for these customers is around £8 a month. For NI around 90% of customers could gain by switching to one of the five cheapest products, and the average gain from switching to one of the five cheapest products for these customers is around £6 a month.

5.144 Gains from switching for customers holding packaged accounts tend to be higher, but these estimates are subject to the limitation that we made assumptions on the value to customers of the benefits which are offered with these products,[51] which may not be reflective of the true value customers place on the benefits and their usage of them. We also assumed that customers may switch to products that have different benefits. We find that

[50] For example, if a customer is already on the very cheapest product, their average gain from switching to one of the five cheapest products will be zero. For a customer on the second cheapest product, they will have a positive gain from switching to the first cheapest product, but zero gains from switching to each of the other four products, so that there will be four zeros in the average calculation.
[51] See Appendix 5.2.

for packaged product customers in GB, 50% of customers could gain by switching to one of the five cheapest products within that category, and the average gain from doing so is around £14 a month. For NI around 70% of customers could gain by switching to one of the five cheapest products within that category, and the average gain from doing so is around £17 a month.

Table 5.12: Average gains from switching to five cheapest products, (five years including switching incentives and benefits) and proportion of customers that would gain, £ per month

	Average gains from switching (per month)	*Annual average gains from switching (per year)**	*Percentage of each product type customers that could gain if they switched to each of the cheapest products (%)*
	GB		
Standard/reward			
Cheapest product	11	134	96
2nd cheapest	9	104	92
3rd cheapest	7	85	90
4th cheapest	6	73	89
5th cheapest	5	66	89
Average of 3 cheapest	9	108	
Average of 5 cheapest	8	92	
Packaged			
Cheapest product	24	288	87
2nd cheapest	18	215	85
3rd cheapest	14	164	78
4th cheapest	9	108	57
5th cheapest	6	74	50
Average of 3 cheapest	19	223	
Average of 5 cheapest	14	170	
	NI		
Standard/reward			
Cheapest product	8	95	96
2nd cheapest	6	76	92
3rd cheapest	5	61	89
4th cheapest	4	53	89
5th cheapest	4	47	88
Average of 3 cheapest	6	77	
Average of 5 cheapest	6	66	
Packaged			
Cheapest product	31	373	99
2nd cheapest	23	276	99
3rd cheapest	16	193	93
4th cheapest	10	121	79
5th cheapest	7	80	67
Average of 3 cheapest	23	281	
Average of 5 cheapest	17	209	

Source: CMA analysis of Runpath price outputs.
* Annual gains differ from (monthly gain x 12) due to rounding of monthly gains to the nearest pound.

5.145 In general, gains are highest for those in overdraft and increase with the number of days in overdraft. We found that the lowest gains from switching are for those users who either do not use any overdraft, or are very light users of arranged overdrafts (1 to 3 days a year). The largest potential average gains from switching are for those using unarranged overdraft, particularly for those with higher average days in unarranged overdraft and for those without arranged overdraft usage. We interpret this cautiously as we have had to assume that upon switching these customers are offered the same size overdraft, which may not be the case as banks have different policies.

5.146 For customers in credit, we find a relatively consistent pattern whereby gains from switching tends to increase with the average credit balance.

5.147 There is no clear pattern for overdraft users or in-credit customers of packaged accounts, nor across users for NI customers.

Table 5.13: Average gains from switching to average cheapest products, by account type and customer segment based on average credit balance and average number of days in overdraft, five years (switching incentives), GB

	Characteristics											
	Overdraft users				*Non-overdraft users*							
Average gains from switching (£ per month)	*15+ days in overdraft*	*8–14 days in overdraft*	*4–7 days in overdraft*	*1–3 day(s) in overdraft*	*Less than £500*	*£500 to less than £2,000*	*£2,000 to less than £3,000*	*£3,000 to less than £5,000*	*£5,000 to less than £7,500*	*£7,500 to less than £10,000*	*£10,000 to less than £20,000*	*£20,000 or more*
Standard and reward PCAs compared to:												
Cheapest product	£25	£18	£14	£9	£5	£5	£7	£10	£13	£15	£17	£24
2nd cheapest product	£22	£16	£12	£7	£4	£4	£6	£7	£9	£12	£10	£11
3rd cheapest product	£20	£14	£11	£6	£3	£3	£4	£6	£7	£7	£6	£7
4th cheapest product	£19	£13	£10	£5	£2	£3	£4	£5	£5	£5	£4	£5
5th cheapest product	£18	£12	£9	£4	£2	£2	£3	£4	£5	£5	£4	£4
Average 3 best	£22	£16	£12	£7	£4	£4	£6	£8	£10	£11	£11	£14
Average 5 best	£21	£15	£11	£6	£3	£4	£5	£6	£8	£9	£8	£10
Share of standard and reward PCAs	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Packaged PCAs compared to:												
Cheapest product	£27	£21	£25	£25	£29	£23	£22	£20	£20	£21	£19	£11
2nd cheapest product	£22	£16	£19	£18	£23	£17	£16	£13	£14	£16	£11	£8
3rd cheapest product	£18	£12	£15	£13	£17	£12	£12	£10	£12	£15	£6	£7
4th cheapest product	£13	£6	£10	£9	£13	£7	£7	£4	£6	£11	£4	£6
5th cheapest product	£11	£5	£7	£6	£7	£4	£5	£3	£4	£10	£4	£5
Average 3 best	£23	£16	£19	£19	£23	£17	£16	£14	£15	£17	£12	£9
Average 5 best	£18	£12	£15	£14	£18	£13	£12	£10	£11	£14	£9	£8
Share of packaged PCAs	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis of Runpath price outputs.

Table 5.14: Average gains from switching to average cheapest products, by account type and customer segment based on overdraft usage (arranged/ unarranged), five years (switching incentives), GB

	Overdraft usage											
Average gains from switching (£ per month)	*No overdraft*	*Overdraft*	*Unarranged overdraft (with arranged) 1–3 days*	*Unarranged overdraft (with arranged) 4–7 days*	*Unarranged overdraft (with arranged) 8+ days*	*Arranged only overdraft, 1–3 days*	*Arranged only overdraft, 4–7 days*	*Arranged only overdraft, 8–14 days*	*Arranged only overdraft, 15+ days*	*Unarranged only overdraft, 1–3 days*	*Unarranged only overdraft, 4–7 days*	*Unarranged only overdraft, 8+ days*
Standard and reward PCAs compared to:												
Cheapest product	£9	£14	£21	£35	£40	£6	£9	£11	£17	£12	£31	£50
2nd cheapest product	£6	£12	£17	£32	£37	£5	£8	£9	£15	£9	£28	£47
3rd cheapest product	£5	£10	£15	£30	£35	£4	£6	£8	£14	£8	£26	£44
4th cheapest product	£4	£9	£14	£29	£34	£3	£5	£7	£13	£7	£25	£44
5th cheapest product	£3	£9	£13	£26	£32	£3	£5	£7	£12	£7	£24	£41
Average 3 best	£7	£12	£18	£32	£37	£5	£7	£9	£15	£10	£28	£47
Average 5 best	£5	£11	£16	£30	£35	£4	£7	£8	£14	£9	£27	£45
Share of standard and reward PCAs	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Packaged PCAs compared to:												
Cheapest product	£23	£25	£27	£33	£56	£23	£20	£16	£26	£28	£27	£31
2nd cheapest product	£17	£19	£19	£30	£55	£16	£15	£12	£22	£21	£23	£29
3rd cheapest product	£12	£15	£15	£29	£53	£12	£11	£8	£18	£16	£22	£27
4th cheapest product	£8	£10	£11	£28	£52	£7	£5	£3	£9	£13	£20	£27
5th cheapest product	£4	£7	£9	£26	£51	£4	£3	£1	£7	£9	£20	£26
Average 3 best	£17	£19	£21	£31	£55	£17	£16	£12	£22	£22	£24	£29
Average 5 best	£13	£15	£16	£29	£54	£12	£11	£8	£16	£17	£22	£28
Share of packaged PCAs	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis of Runpath price outputs.

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5.148 In general, for GB there are higher average gains for customers who hold an account with one of the higher market share banking groups. For NI we see no apparent trend.

Table 5.15: Average gains from switching to average of five best or to average of three best for all observations by account type and current provider, GB

	Average gains from switching to average of 5 best (£ per month)	*Average gains from switching to average of 3 best (£ per month)*
Standard and reward PCAs		
Lloyds Bank	£9	£11
Halifax	£8	£9
Bank of Scotland	£10	£11
NatWest	£9	£11
Royal Bank of Scotland	£9	£10
Barclays	£9	£11
HSBC	£8	£9
first direct	£7	£8
M&S Bank	£4	£5
Santander	£8	£9
Nationwide BS	£1	£2
TSB	£3	£4
Clydesdale Bank	£4	£5
Yorkshire Bank	£4	£5
smile	£4	£5
Co-op Bank	£4	£5
Metro	£0	£1
Packaged PCAs		
Lloyds Bank	£23	£29
Halifax	£11	£15
Bank of Scotland	£31	£36
NatWest	£13	£15
Royal Bank of Scotland	£13	£16
first direct	£19	£25
Nationwide BS	£6	£10
Clydesdale Bank	£3	£6
Yorkshire Bank	£18	£25

Source: CMA analysis of Runpath price outputs.

Table 5.16: Average gains from switching to average of five best or to average of three best for all observations by account type and current provider, NI

	Average gains from switching to average of five best	*Average gains from switching to average of three best*
Standard and reward PCAs		
Ulster Bank	£3	£4
Royal Bank of Scotland	£30	£31
NatWest	£10	£11
Danske Bank	£5	£6
Santander	£8	£9
Halifax	£9	£10
Bank of Scotland	£7	£8
Post Office	£4	£5
Nationwide BS	£1	£1
Barclays	£9	£10
Co-op Bank	£3	£4
HSBC	£6	£7
first direct	£6	£8
M&S Bank	£2	£3
TSB	£3	£4
Packaged PCAs		
Ulster Bank	£24	£31
Royal Bank of Scotland	£0	£0
Lloyds Bank	£26	£32
Halifax	£10	£15
Nationwide BS	£6	£10

Source: CMA analysis of Runpath price outputs.

5.149 When we restrict the switching options to the cheapest product within the same brand or to the cheapest product within the same group (that is, internal switching), the average gains from switching are substantially lower but, nevertheless, switching within banking group still leads to around £33 saving annually (around £3 per month) for standard and reward account holders (the equivalent annual figure for NI is around £13).

Table 5.17: Average gains for all observations by account type considering internal switching (to the best within brand/group product) only (excluding switching incentives)

	Average gains from switching when switching to cheapest product (£ per year)	
	GB	**NI**
Within brand		
Standard and reward PCAs	£16	£7
Packaged PCAs	£71	£6
Within group		
Standard and reward PCAs	£33	£13
Packaged PCAs	£112	£259

Source: CMA analysis of Runpath price outputs.

5.150 Considering aggregate gains from switching, we find that if customers switched to the average of the five cheapest products there could be around £4.6 billion gains for standard/reward customers in GB (£87 million in NI). We would not expect all gains from switching to be realised in a competitive market; but the magnitude of overall potential gains from switching confirms that there are substantial gains for a large proportion of PCA customers.

Table 5.18: Average market annual gains from switching, (five years including switching incentives and benefits), £m per year

	Sum of gains from switching (£m per year)	
	GB	**NI**
Cheapest product		
Standard and reward PCAs	£6,625	£125
Packaged PCAS	£1,967	£68
Average of 3 cheapest		
Standard and reward PCAs	£5,313	£102
Packaged PCAS	£1,519	£51
Average of 5 cheapest		
Standard and reward PCAs	£4,561	£87
Packaged PCAS	£1,160	£38

Source: CMA analysis of Runpath price outputs.
Note: Based on:

- Total number of active GB PCAs in 2014: 65,778,454. Total number of active NI PCAs in 2014: 1,754,016.
- Since we do not have data on the split by account type for GB and NI separately, we assume the split to be in proportion to the UK split for 2014.
- Share of standard/reward PCAs in the UK in 2014: 75%.
- Share of packaged PCAs in the UK in 2014: 10%.

Summary on estimated gains from switching

5.151 We find that there are substantial potential gains from switching that are available to a significant number of customers which go unexploited. In general, gains are highest for those in overdraft and increase with the number of days in overdraft, particularly for those with higher average days using unarranged overdraft for those without arranged overdraft usage. We interpret this cautiously, however, as we have had to assume that upon switching these customers are offered the same size overdraft, which may not be the case as banks have different policies.

5.152 For customers in credit, we find a relatively consistent pattern whereby gains from switching tends to increase with the average credit balance.

5.153 There is no clear pattern for overdraft users or in-credit customers of packaged accounts, nor across users for NI customers.

Innovation in PCAs

5.154 Innovation can be a useful indicator of the level of competition in a market. In a well-functioning market investment in innovation can bring benefits to customers in the form of diversity of choice, cost efficiencies and enhanced service levels. Conversely, a lack of innovation may suggest that firms are not subject to competitive pressure and therefore, have reduced incentives to innovate, or that there are barriers to innovation present in the market. See Appendix 5.4 for a more detailed discussion of the evidence on this subject.

5.155 We discuss in turn: (a) product innovation; (b) service innovation; and (c) new business models.

Product innovation

5.156 Product innovation in the PCA market over recent years has primarily taken the form of the development of reward accounts, which offer benefits to customers such as credit interest or cashback on transactions; and the introduction of switching incentives, typically in the form of cash payments, in order to attract new customers. Such product innovation, which incentivises customers to make regular transactions and hold credit balances in their PCA, appears to have been driven by competition among banks for main banking relationships. For more details see Section 6.

5.157 Examples of reward accounts include the Halifax Reward Current Account (launched in February 2009), which pays £5 per month to customers who remain in credit throughout the month, and Santander's 123 account (launched in March 2012), which offers up to 3% interest on credit balances up to £20,000, and up to 3% cashback on household bills paid by direct debit. More recently introduced reward offers include Barclays Blue Rewards in April 2015, HSBC Advance relaunched in November 2014, Club Lloyds in April 2014, and TSB's Classic Plus account in April 2014.

Service innovation

5.158 Service innovation in the PCA market has been primarily driven by the digitalisation of retail banking. Many of the banks have made and continue to make significant investments in this area.

Internet and mobile banking

5.159 Internet banking has been commonplace for some time, and has developed into a significant distribution channel, driven by increasing access to broadband and high-speed internet connections, and mobile banking is also increasing at a rapid pace. For example, the BBA estimates that customers log into their mobile banking applications 11 million times a day[52], and were used to transfer £2.9 billion each week in 2015.[53]

5.160 Many banks have made and continue to make significant investment in this area, as part of their wider digital banking offer. For example:

[52] BBA The Way We Bank Now Report (2016).
[53] See Deloitte innovation report, p4.

(a) In June 2014, RBSG announced that it would be investing more than £1 billion into its digital services for personal (and small business) banking in the next three years.

(b) LBG told us that it had invested over £750 million in digital technologies over the past three years and it would invest £1 billion over the next three years.

(c) HSBCG told us that its Retail Banking and Wealth Management business was investing [✂] to improve its UK multi-channel offering and digital services.

5.161 The UK has one of the highest rates of mobile banking adoption in the world: around one-third of customers use mobile banking applications[54] and mobile banking is now available to PCA customers of all of the major banks. While there are differences in the sophistication and functionality of the mobile banking applications offered by the established banks in the UK (see Appendix 5.6, Table 1), customers are typically able to check their balance, set up personalised alerts, send payments to another account using a mobile number, and locate their nearest branch or ATM.

5.162 The development of mobile banking and the wider digitalisation of banking has also led to a number of other service innovations in the PCA market, such as contactless payment technology, mobile payment systems (Paym) and SMS alerts and notifications.

5.163 However, while the rate of adoption of mobile banking in the UK has been high, overall only 27% of adults were using mobile banking in 2014,[55] and traditional distributional channels, particularly branches, continue to play an important role in the acquisition and retention of customers (see Section 9).

5.164 Much of a customer's transactional activity is undertaken using digital channels, and the ease with which customers can access their accounts through these channels appears to be increasing customer engagement with their PCA, evidenced by increased customer interaction with internet banking platforms and mobile banking applications.

5.165 As mobile banking adoption is largely driven by smartphone adoption, which is greater among the younger population, mobile banking adoption is likely to increase over time, and is likely to be further enhanced by the greater functionality and broader integration of banking services within mobile

[54] ibid, p9.
[55] ibid, p9.

applications. For example, the BBA estimates that by 2020, customers will use their mobile phone to manage their current account 2.3 billion times, which will be more than internet, branch and telephone banking combined.[56]

Aggregators

5.166 Aggregators (also known as account information services) are services that collect and collate information from a number of sources. There are two main types of aggregators:

(a) comparison aggregators (eg PCWs, which we consider in more detail in Section 6); and

(b) account aggregators.

5.167 The use of account aggregators in the UK has had limited penetration to date, although emerging services are being provided by banks, such as HSBCG, Barclays and LBG, and third parties, such as OnTrees. In contrast, they have developed at a faster pace in the USA, where existing market participants, such as Mint, Moven and Simple, allow customers to track their spending and saving patterns and manage bills and payments, and make use of the detailed financial data that they hold on customers to recommend new products and services.

5.168 To the extent that aggregation services become more widely used, they could raise financial awareness, increase customer engagement and provide an additional channel to reach customers, but there are a number of potential barriers to the development and uptake of account aggregation services. See Section 13 for a full discussion of these services.

'Big data'

5.169 'Big data' is a term broadly used to describe data that is especially large in volume, highly complex or frequently updated to the extent that traditional desktop computers and software (such as spreadsheets) are no longer capable of processing it. The growth of the digitalisation of activities and processes, which means there are vast increases in the amount of data being generated along with developments in data storage, management and analytics, have the potential to promote greater use of this information.

5.170 The utilisation of 'big data', either in the form of proprietary transaction data held by banks or other third party sources, has the potential to facilitate

[56] ibid, p15.

increased competition in the provision of PCAs. Big data, for example, could be used by banks to:

(a) better differentiate between customers, which can be used for both customer acquisition and customer retention strategies;

(b) analyse patterns in large data sets, in order to rapidly identify security breaches and predict future violations;

(c) make use of centralised information, in order to ensure that regulatory reporting requirements are fulfilled while protecting customer privacy; and

(d) simulate future events, in order to become more capable of managing risk.

5.171 We have found evidence of banks using data on their customers to target customers and to develop and cross-sell products. We consider in Section 9 whether access to such data is a barrier to entry and/or expansion. More generally, while the evidence suggests that 'big data' has the potential to facilitate increased competition, it is still in the early stages of development by banks and other providers.

New business models

5.172 We have observed entry into the PCA market by firms with an established presence in other areas of retail banking. For example, Tesco Bank, M&S Bank[57] and the Post Office[58] have expanded their financial product offerings to include PCAs. See Section 9 for further information.

5.173 We are also aware of a number of prospective entrants that are planning to enter the PCA banking market with online models and no (or very limited) branch presence. For example, Atom launched in 2015 as the UK's first full-service digital-only bank. Starling is entering with a purely digital business model, although with a niche PCA offering rather than as a full-service bank.

5.174 In contrast to this trend, Metro has entered on a more traditional model of branch-based banking.

[57] M&S Bank is a wholly owned subsidiary of HSBCG.
[58] The Post Office offers retail banking services under BoI's banking licence.

Digital wallets

5.175 A digital wallet is a service that facilitates the storage of payment (and possibly other) credentials and enables users to make payments, either online or via a mobile device. It can take a number of forms, encompassing different technologies, channels and providers. Digital wallets have grown in prominence in recent years, and are generally split into two categories:

(a) Online digital wallets allow customers to store the payment details of one or more cards online for use in repeat purchases. For example, PayPal first appeared in the late 1990s, and now provides a variety of services including online payment services, mobile payment services, account services, deferred payment systems, money (including cheques) transfer services into PayPal accounts and in-store payment systems.

(b) Mobile digital wallets allow customers to make in-store payments with their mobile device. For example, in July 2015, Apple introduced Apple Pay to the UK market. Apple Pay allows newer iPhone models and Apple Watch owners to use their devices to make payments at near-field communication (NFC)-equipped terminals. As of June 2015, 19 high street stores and all of the major UK banks had signed up to Apple Pay.[59]

5.176 Online digital wallets have been around for some time, however adoption remains relatively low and credit and debit cards still account for a significantly larger proportions of online payments.

Summary of evidence on innovation

5.177 The evidence set out above shows that there have been a number of innovations in the PCA market in recent years with respect to products (such as the introduction of reward accounts), service (as part of the wider digitalisation of retail banking); and new business models (for example by firms with only an online presence).

Summary conclusions on structure and outcomes in PCAs

Market structure and concentration

5.178 The PCA markets in both GB and NI are concentrated. In 2015 the four largest providers in GB had a combined market share of approximately 70% and an estimated HHI of around 1,600. In NI in 2015, the combined share of

[59] See Deloitte innovation report, p23.

the four largest main PCA providers is around 70% and an estimated HHI of around 1,500.

5.179 Since 2005 the combined market share of the largest four banking groups in GB has increased as a result of merger, but market shares have otherwise remained stable. While we find evidence of high rates of net account opening among smaller PCA providers such as Metro, Nationwide and Santander,[60] the absolute increase in their market share remains small and has not translated into a significant impact on the concentration of PCAs.

Financial performance

5.180 Banks take different approaches to assessing the performance of PCAs, but the evidence we have seen from several banks suggests that PCAs are profitable across a five-year period.[61] An important source of banks' revenues is the net value of funds, accounting for around 50% of net revenue in 2014. This illustrates that banks earn considerable revenues from the accounts of customers who maintain positive credit balances. The remainder of bank revenue from PCAs is from charges and overdraft interest.

Price and quality outcomes

5.181 Most banking groups offer a number of different products, and there are often substantial differences between the prices of these products. For overdraft users, the product prices are substantially higher than for non-overdraft users.

5.182 Our comparison of average banking group prices shows variation between banking groups. In GB the results suggest that banks whose customers have had their accounts for longer periods and with larger market shares tend to have higher average prices. For NI, there is no clear relationship between average product prices and market shares of banking groups.

5.183 We interpreted the price and quality outcomes together as we would expect customers to be making a trade-off between price and quality in choosing their account. We find that that there is a substantial proportion of customers currently paying above-average prices yet receiving relatively lower quality.

[60] This is also reflected in the net switching data.
[61] [✂] and [✂] provided stand-alone profit and loss forecasts for their PCA propositions, whereas [✂] and [✂] provided forecasts for their personal banking businesses, which includes the provision of PCAs and other personal banking products.

Alongside broadly stable market shares, this indicates that customers are not responding to differences in price and quality across banks by switching.

Estimated gains from switching

5.184 Estimates of gains from switching provide a measure of customer engagement in the market, although we would not expect all financial gains from switching to be realised in a well-functioning market. The estimates should be interpreted carefully, since it is a static assessment that assumes no changes in customer behaviour or provider prices so should not be interpreted as the gains that all customers could achieve in the market if all customers switched to the best alternative product. The estimates focus only on monetary gains, and do not take into account aspects of quality.

5.185 We find that there are substantial potential gains from switching that are available to a significant number of customers which go unexploited, which provides evidence of weak customer engagement of a considerable scale.

5.186 In general gains are highest for those in overdraft and increase with the number of days in overdraft, assuming that these customers are offered the same size overdraft, which may not be the case as banks have different policies.

Innovation

5.187 There have been a number of innovations in the PCA market in recent years with respect to products (such as the introduction of reward accounts), service (as part of the wider digitalisation of retail banking); and new business models (for example by firms with only an online presence). When assessed individually, there is a considerable degree of variation in the development of each innovation and the extent to which each innovation has impacted (or is likely to impact) the PCA market. Both the introduction of reward accounts and mobile banking (as part of the wider digitalisation of retail banking) are well established. In contrast, other innovations, such as the use of account aggregation services, big data, and digital wallets, are in the early stages of development, particularly when considering their application to the PCA and wider retail banking market.

Overall conclusion on PCA outcomes

5.188 We find that the PCA markets are concentrated and the GB market has become more so following recent mergers. Excluding the impact of mergers and divestments, market shares have remained stable since 2005. We find evidence of innovation, and we find also considerable variation in price and quality of products. However, banks offering lower average prices and/or better quality tend to have gained market share only slowly. We find that there are substantial potential gains to be made by a large number of customers switching PCA to the lowest priced products for them.

5.189 We interpret the above as evidence of markets that are not well-functioning: there are weak customer responses to variations in prices and quality, and the substantial potential gains to be made by a large number of customers switching PCA suggests that the scale of weak customer engagement is considerable.

5.190 We consider the implications of these findings further in Section 6 on how banks compete for PCA customers, in Section 9 on new entrants and the ability of smaller banks to expand, and in Section 10 in our assessment of market structure and market power.

6. PCAs: competition and customer behaviour

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Introduction

6.1 In light of the evidence in Section 5 of PCA outcomes indicative of weak customer engagement, we examine this further. We look at the extent to which PCA customers drive competition between banks, whether anything prevents them from doing so (ie barriers to searching and switching), and how this affects the way providers compete for PCAs.[1,2]

[1] Our analysis that follows proceeds on the basis of the markets identified in Section 4: we have defined PCAs (with and without overdraft facilities) as a relevant product market, and concluded that GB and NI should be considered as separate geographic markets. However, in this section we consider both geographic markets together as our analysis is similar for both GB and NI, and we did not identify any significant differences.
[2] Appendices 6.1–6.9 support the analysis described in this section.

6.2 As a starting point we first set out different measures of customer engagement and how this varies by type of customers such as overdraft users.

6.3 We then consider the following aspects of customer behaviour that are important for driving effective competition:

(a) Customers having sufficient **awareness** to consider it worthwhile shopping around for PCAs.

(b) Customers being willing and able **to access** information about the various products available in the market and **assess** the products available to identify the product that provides the best value for them.

(c) Customers being willing and able to **act** by switching to their preferred product.

6.4 In doing so, we look at a number of explanations for low engagement. In more detail:

(a) We look at a number of factors that could affect customers' awareness and searching and switching in the PCA market including whether:

(i) they may lack natural trigger points to prompt initial engagement (ie to consider searching and switching) because PCAs are products with no contracted end date; and

(ii) they may perceive that there are limited or no gains from switching because **PCAs are free or low cost** or because they perceive that there is **no or little difference** between PCA providers.

(b) We look at whether customers may face barriers to access or assess information on PCA offers as they may have difficulty identifying their favoured account if they are unable to easily combine information on account charges with a detailed knowledge of their usage, or lack information on service quality; and

(c) We look at whether customers may have real or perceived issues that prevent them from carrying out a switch, such as concerns that there is too much 'hassle' in opening a new account or concerns around the risk of error when switching account.

6.5 In carrying out the above analysis we also look at whether or not there are additional or more specific issues among overdraft users and unarranged overdraft users in particular, representing around 45% and 24% of all active accounts respectively.

6.6 We then consider how all these aspects of customer behaviour combine to affect their overall engagement with the PCA market.

6.7 We conclude by considering how competitive strategies contribute to low engagement levels. We also consider how developments in PCAs have increased engagement or contributed to lower levels of engagement. Specifically we looked at the impact of the main developments in:

(a) pricing, including providers' complex pricing strategies and the recent product innovation in reward accounts, which offer benefits to customers such as credit interest or cashback on transactions and may also offer cash switching incentives to attract new customers;

(b) service quality and innovation, including digital innovations where many providers have made substantial investments in digital banking services;

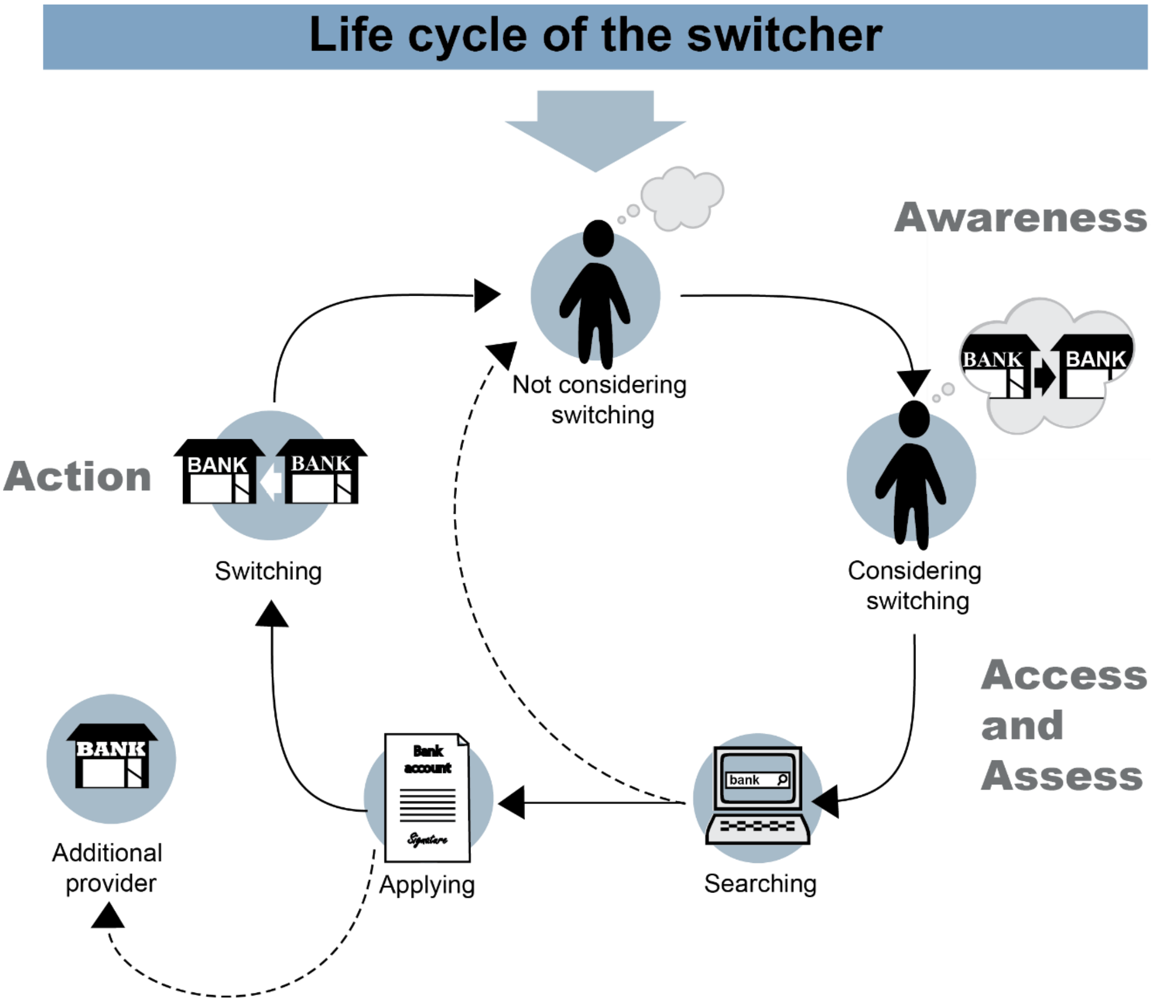
(c) marketing, including the new channels providers were using to attract new customers and the trends in advertising spend in recent years; and

(d) the FIIC pricing model in particular, focusing on cross-subsidisation and distributional effects across customers and extent to which it contributes to our observed levels of engagement.

Level of customer engagement

6.8 Customers may engage in various ways, from understanding the PCA product they currently hold (eg checking their balance or whether they are overdrawn), to engaging in the market by shopping around (ie accessing information on and comparing various PCAs) and eventually either staying with the current provider or applying for a new account and either switching providers or multi-banking. This is illustrated in Figure 6.1.

Figure 6.1: Customer engagement with PCAs



Source: CMA.

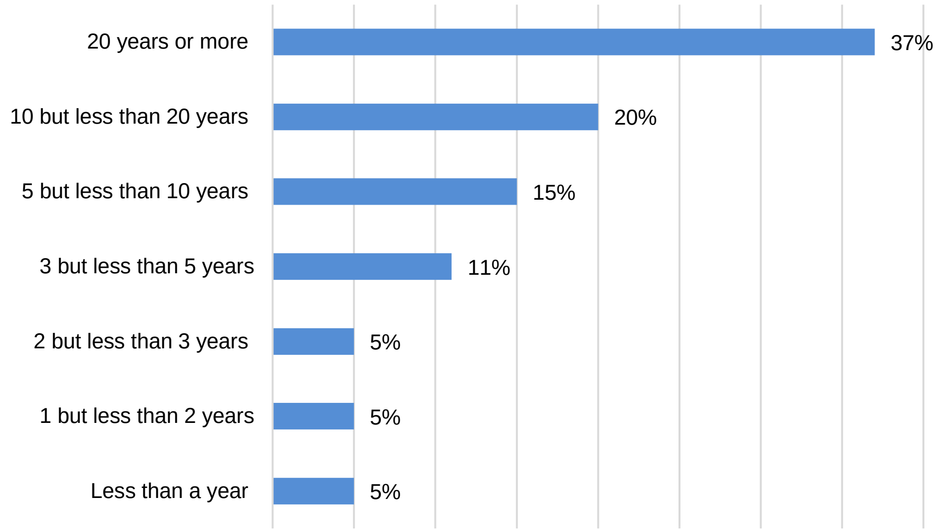
6.9 We first examine the main indicators of PCA customer engagement: length of relationships with banks; and searching and switching rates.[3]

Length of relationships with banks

6.10 PCA customers tend to stay with their banks for many years: the GfK PCA consumer survey found that 37% of respondents had been with their main PCA provider for more than 20 years and a further 20% for between 10 and 20 years[4] (see Figure 6.2 below).

[3] We also received evidence from the Greenfield Organisation on emotive intelligence and stimulating account switching towards the end of the investigation. However, since it did not provide a full explanation of the results and methodology used we have not been able to assess what weight to place on this evidence and have therefore not made use of it.
[4] GfK PCA consumer survey. Base = all (4,549). B1: 'For how long have you been using this account as your main current account?'

Figure 6.2: Length of time account used as main current account



Source: GfK PCA consumer survey.

Switching and searching rates

6.11 Consistent with this, we also found that rates of switching of a customer's main account between banks were low. Appendix 6.1 includes evidence on the annual rate of PCA switching based on volume and value measures, and all of these indicated annual switching rates of around 3%.

6.12 The GfK PCA consumer survey found that, over the past three years, 8% of PCA customers had switched banks. The annual switching rate between banks in 2014 was around 3%. As can be seen in Figure 6.3, the GfK PCA consumer survey found that, in 2014:

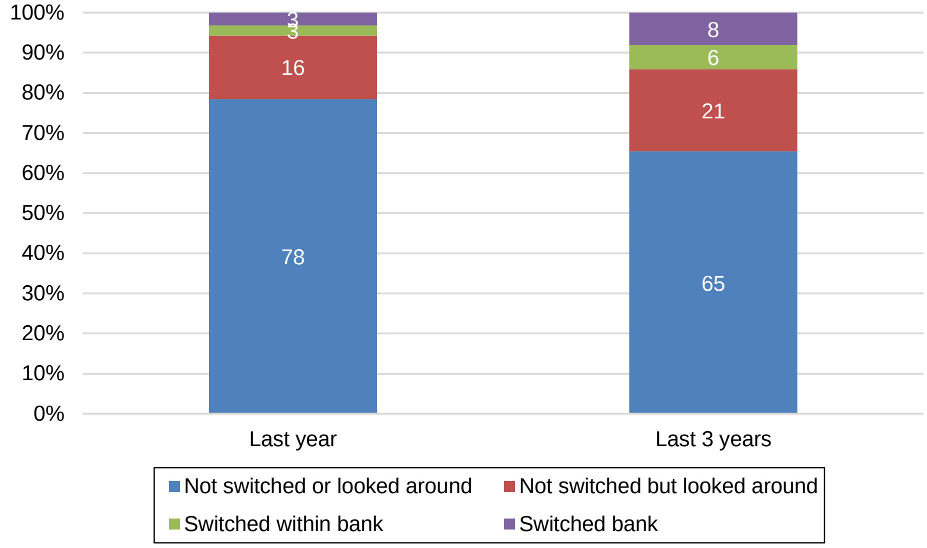
(a) 78% of PCA customers had neither searched around nor switched;

(b) 16% of PCA customers had searched but did not switch;

(c) 3% of PCA customers had switched PCAs within their existing bank;

(d) 3% of PCA customers had switched PCAs to a different bank.

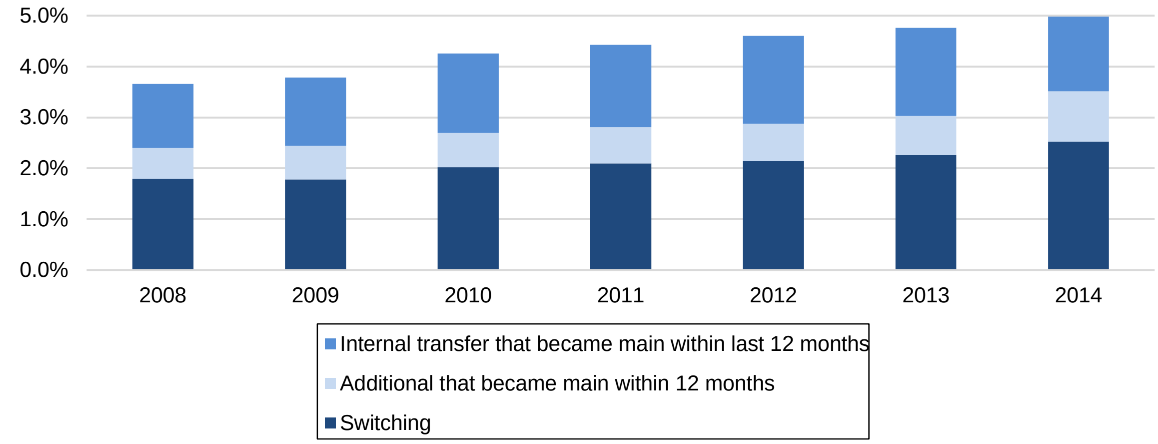
Figure 6.3: GfK PCA consumer survey – summary of searching and switching behaviour



Source: GfK PCA consumer survey.
Note: Figures calculated from F1–F4. Base=All (4,549).

6.13 The GfK FRS provides switching data in GB over time. As shown in Figure 6.4, the annual rate of switching for GB main accounts has increased over time, but at a slow pace. GfK FRS data shows that switching rates (not including internal transfers or opening additional accounts) increased from 1.8% in 2008 to 2.5% in 2014.

Figure 6.4: GfK FRS data: percentage of main accounts over time – GB



Source: CMA analysis based on GfK FRS data.
Note: GfK FRS asked customers who had a current account opened in the last 12 months which of these statements best describes what they did when they opened their account: (i) 'I switched my main current account from another bank or building society'; (ii) 'It replaced an existing account held with the same bank/ building society'; (iii) 'It was taken out as additional to my main current account'; (iv) 'It was my first ever current account'; (v) 'Although I had had a current account in the past I no longer held one at the time I opened my account'; (vi) 'Other'; 'Don't know'. Data is reported for all accounts and those which customers classify as their main account. We report figures in relation to customers' 'main' accounts.

6.14 Some banks submitted to us that:

(a) switching was naturally low, not as a result of disengagement but because customers were satisfied with the reliability and functioning of their account;[5]

(b) switching rates between banks underestimated the overall constraint imposed by customers on PCA providers, because internal switching should also be taken into account;

(c) many customers were multi-banking, defined as holding a number of PCAs with different banks, which often represents a form of 'hidden switching' and increases the competitive pressure on banks; and

(d) there was no benchmark against which to assess whether switching and searching rates were low.

6.15 These banks therefore argue that the switching rates we observe may nonetheless still be compatible with a well-functioning market. However, these explanations are not compatible with the evidence we have reviewed on PCA outcomes. If competition were effective, we would expect banks that deliver higher quality and/or lower prices to be rapidly gaining market share at the expense of banks who offer lower quality and/or higher prices. As noted in Section 5, despite positive developments in innovation and entry, we observed relatively stable market shares in response to differences in prices and quality across banks, with banks offering lower average prices and/or better quality tending to have gained market share but only slowly. This, combined with low switching rates, indicates that there is a lack of responsiveness and engagement by PCA customers, who would otherwise drive more significant changes in market shares.

6.16 We also consider each of these arguments in turn below.

Low switching levels as a reflection of customer satisfaction

6.17 Barclays submitted that switching rates were naturally low due to customers being satisfied with the reliability of their PCA. It argued that switching PCAs was not a priority for customers when their account was functioning well. Other banks also told us that the observed low switching rates should be seen in the context of high levels of reported customer satisfaction, and that the low switching rate was entirely consistent with a well-functioning market.[6]

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[5] Barclays response to provisional findings, paragraph 3.6. Also see HSBCG response to provisional findings, paragraph 3.10.
[6] However, Nationwide told us that undue emphasis should not be placed on high levels of reported customer satisfaction.

6.18 If customers do not switch because they are satisfied with their banks in an informed manner (ie because they have sufficient information to lead them to think that they are indeed getting good value from their bank), low levels of switching may not reflect a lack of customer engagement and may be consistent with a well-functioning market. In such a market the threat of switching (should customers find that they are not getting good value for money any more, or that they could get better deals elsewhere) is sufficient to impose a strong competitive constraint on banks.

6.19 A high proportion of respondents to the GfK PCA consumer survey said that they were satisfied with their main current account provider, with 52% and a further 39% stating that they were 'very satisfied' and 'fairly satisfied' respectively. Customers who had not switched were asked an unprompted question about the reason why they had not considered switching supplier. The most commonly mentioned reason was that they were happy with their current supplier (51%), while 'no reason to change' (22%) was mentioned as the second most common reason.[7]

6.20 These results could therefore suggest that customers are already getting good outcomes, and that the threat of switching is sufficient to impose a constraint on banks. However, as we explain above in paragraph 6.15, the evidence on outcomes we reviewed does not appear to be compatible with this: changes in market shares are low despite substantial gains from switching and differences in price and quality across banks.

6.21 Moreover, there is evidence that, even though many customers said that they did not switch because they were satisfied, they may simply not be aware of alternatives available to them and therefore be able to verify whether indeed they have the best product and service for them.

6.22 First, the low level of searching (with only 18% of searchers in the GfK PCA survey sample) suggests that many customers may not necessarily be aware of the alternatives that are available to them.

6.23 Second, and as set out in Section 5, our analysis of gains from switching found that many PCA customers could make substantial financial gains if they switched. For example, assuming a customer switched accounts to one

[7] GfK PCA consumer survey. Base = All those who have not changed accounts and not looked around (2,781). F9: 'You said that you have not changed your account. Why have you not considered changing your current account in the last three years?'

of the five cheapest products, the average annual gains from switching in GB[8] are:

(a) £92[9] for a standard or reward PCA; and

(b) £170[10] for a packaged PCA.

6.24 These financial gains from switching may overestimate the overall gains from switching banks if differences in prices between accounts reflect differences in service quality. However, our analysis in Section 5 shows that this is unlikely to be the case. This is due to there being a substantial proportion of customers who are currently paying above average prices and receiving relatively low quality who could thus gain from switching. The low switching levels are therefore not explained by the fact that customers are already using the best accounts for their needs.

6.25 We do not expect that all financial gains from switching would be realised in a well-functioning market. However, in a well-functioning market with low switching costs we would expect to see more switching in response to these gains given how substantial the gains are.

Internal switching

6.26 The GfK PCA consumer survey found that, in 2014, approximately 3% of customers switched internally. This internal switching may be indicative of competitive pressure if banks are improving their offers to existing customers in order to retain them. However, the survey indicated that the large majority of internal switchers did not search prior to doing so (73%), whereas the large majority of those who switched to another bank did search (72%). Since many of the customers will not have searched for the best deal before switching internally, and this switching does not result in banks losing customers, internal switching is likely to impose weaker competitive constraints on banks than switching to other banks. Furthermore, even taking into account internal switching, switching rates are less than 6%.

Multi-banking

6.27 Some banks submitted that many customers, rather than switching, were increasingly opting to 'multi-bank' and this should be taken into consideration

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[8] Assuming a customer switched accounts to one of the five cheapest products.
[9] Annual gains differ from (monthly gains x 12) due to round of monthly gains to the nearest pound.
[10] Annual gains differ from (monthly gains x 12) due to round of monthly gains to the nearest pound.

as it would often represent a form of 'hidden' switching.[11] The GfK PCA consumer survey found that a considerable proportion of UK customers (22%) hold more than one PCA with different providers and actively use them. GfK FRS data shows that multi-banking has increased since 2008 from 18% to 21% in 2014[12] (see Appendix 6.1, Figure 9), although the level of multi-banking has remained stable since 2010.

6.28 We agree that multi-banking is relevant in the context of understanding overall switching levels and customer engagement. Multi-bankers may exert a competitive constraint on banks if they are using this activity to shop around for the best deal and open new accounts to 'try them out' with a view to potentially switching in the future. Those GfK PCA consumer survey respondents who used at least one other account with a different bank were asked 'Why do you use more than one current account'. The most common reason given was 'to have different PCAs for different purposes' (62%) followed by 'to get better rates, products and deals' (16%) and to have a sole and joint account (15%).[13] When the same sample of GfK respondents were asked a subsequent question on 'Why do you have more than one bank for your current accounts',[14] 26% said it was to get better rates, products and deals.

6.29 The GfK PCA consumer annual switching rates of approximately 3% per year also capture some customers who may be classified as multi-bankers, such as those customers who have switched to move some of their personal banking requirements to a new account but still continue to use their old account for their remaining requirements. We asked whether a customer had switched their main account so the results include customers who operate both their new and old account.

6.30 Multi-banking was recently investigated by the Social Market Foundation (SMF report)[15] commissioned by LBG. The SMF report considered two types of multi-banking: narrow multi-banking where customers have more than one PCA at two or more banks; and broad multi-banking where customers buy

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[11] Barclays, BoI, HSBCG, Danske and RBSG. The volumes of switching must be considered in this context of increased multi-banking which will often represent a form of 'hidden switching'.
[12] GfK provided us with data from 2005 to 2014, but told us that there was a step change in the data between 2007 and 2008 as a result of a methodology change in the survey. Therefore, GfK suggested comparing data from 2008 to 2014.
[13] Sample base: All who actively use at least one other account with a different bank (1,009). B8a 'Why do you use more than one current account?' We interpreted the response 'to have different PCAs for different purposes' as meaning that customers have different accounts to hold money for different purposes, such as personal spending, household bills, or saving, such as holidays, mortgages, children or other big spending.
[14] Sample base: All who actively use at least one other account with a different bank (1,009). B8 'Why do you have more than one bank for your current accounts?'
[15] Social Market Foundation (July 2015), *Playing the Field: Consumers and Competition in Banking*, consulted 28 September 2015.

financial services from more than one provider.[16] The report recognises that narrow multi-banking can be expected to have a more immediate impact on levels of competition in the current account market.[17]

6.31 The results from this report on the prevalence and reasons for multi-banking were broadly similar to our own. The SMF report found that 25% of customers have current accounts with more than one bank and 20% of customers' use them actively, compared with 31% and 22% of GfK PCA consumer survey respondents.[18] The SMF report found that the most common (57%) reason for using more than one current account provider was to manage finances, compared with the GfK PCA consumer survey finding that 16% of active multi-bankers use more than one bank for their accounts, because they have accounts for different purposes.[19] The SMF report found that over a third of customers are using more than one account to seek value,[20] which compares to the GfK PCA consumer survey's 26% of active multi-bankers who were using multi-banking to take advantage of good offers.[21]

6.32 We agree with the SMF conclusions that multi-banking may lead to benefits for customers by allowing them to observe directly differences between the price and service levels of banks.[22]

6.33 Multi-banking also reduces barriers to searching and switching. When customers hold more than one account, it increases the transparency of the variation of price and service attributes across different banks. Customers will be more familiar with the products and services offered by other banks, particularly where these cannot be experienced without being a customer. Customers can also more easily move between different banks when they

[16] ibid, p8.
[17] ibid, p8.
[18] ibid, p9.
[19] ibid, p9. The collective term 'Managing finances' refers to consumers who use current accounts at multiple providers for at least one of the following reasons: to help keep track of payments or direct debits; to keep household and personal expenses separate; one is a shared account with a partner or housemates; one is for my business; one is for a club or charity; one is a betting account. This includes a wider range of possible responses from surveyed customers than the collective term used in the GfK PCA consumer survey. We interpreted the response 'to have different PCAs for different purposes' as meaning that customers have different accounts to hold money for different purposes, such as personal spending, household bills, or saving, such as holidays, mortgages, children or other big spending. The difference in defining these collective terms may explain the difference in the reported figures in the SMF report and the GfK PCA consumer survey.
[20] SMF report, p9.
[21] The statistics are based on active multi-bankers, who are customers that actively use at least one additional PCA with a different provider. The statistics of the SMF report are based on a wider sample of customers who have additional PCAs with more than one PCA provider.
[22] SMF report, p8.

already have a relationship with more than one provider. This is because identification verification and credit references may be reduced.

6.34 In summary, we have found some evidence that multi-banking can be used by customers to shop around for the best deals and to 'try before you buy' and is also likely to reduce some barriers to searching and switching. Insofar as customers use multi-banking as a prelude to switching their main account, this type of switching is taken into account in our estimates of switching rates. However, we also found evidence that multi-banking rates appear to have levelled off in recent years and that most multi-bankers have additional accounts in order to use them for different purposes rather than to take advantage of better deals.[23]

6.35 So although there is some evidence that multi-banking can help increase competition, further customer engagement is needed to bring about the full potential of the constraint from multi-banking. This is consistent with the evidence on PCA outcomes (in Section 5) not pointing towards a well-functioning market.

Lack of a benchmark

6.36 We have found that changes in market shares of PCA providers are small in light of the gains of switching and variation in price and service quality across PCAs (see Section 5). Regardless of whether or not there is a precise benchmark against which to compare switching rates in banking, this indicates that the current competitive constraint from switching and searching is lower than what we would expect in a well-functioning market.

6.37 In addition, we note that switching rates in the PCA market are low compared with other markets: the GfK PCA consumer survey showed that switching rates in the last three years in PCAs (8%) were low compared with other areas such as savings (13%) and energy (31%).[24,25]

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[23] GfK PCA consumer survey. Sample base: All who actively use at least one other account with a different bank (1,009). B8a: 'Why do you use more than one current account?'.
[24] See Appendix 6.1 for more details.
[25] Comparing switching rates in banking across Europe shows that the low switching rate is not unique to the UK. A European Commission study from 2012 asked customers how many had switched banks within the last two years and found that UK switching rates were in line with the EU average of 4%. Switching rates from this study (Directorate-General for Health and Consumers (2012), Bank fees behaviour study) are 4% in the UK, 3% in Germany, 5% in Italy, 6% in Spain, 3% in France, 4% in Ireland, 2% in Latvia, 2% in the Netherlands, 8% in Romania, and 4% in Sweden. It is important to note that different member states operate under different banking structures and markets may have changed since 2012.

Summary of evidence on the level of customer engagement

6.38 The overall level of PCA customer engagement, while having increased in recent years, remains low. The levels of switching and searching we observe do not appear consistent with a well-functioning market, in particular given the evidence on PCA outcomes set out in Section 5. This evidence includes the substantial gains PCA customers could make if they switched accounts, the variation in prices and service quality across PCAs, and the slow growth in market share of banks offering lower average prices and/or better quality.

Characteristics of engaged customers

6.39 We analysed whether there are any particular customer groups who are more or less likely to search, switch or multi-bank.

6.40 Using the results from the PCA survey, we conducted a quantitative analysis in order to compare the characteristics of searchers and non-searchers, and switchers and non-switchers, with the aim of understanding the relevant differences between these different groups of customers. We carried out this comparison through both a descriptive analysis of the data and an econometric analysis (details of the analysis are set out in Appendix 6.2).

6.41 We found the following:

(a) Customers who searched, whether they switched or not, had on average higher income and higher education levels than customers who did not. We found that having confidence in the use of the internet had a positive effect on the probability of searching. Moreover, customers who used internet banking were more likely to search than those who did not. We also found evidence that confidence in the use of the internet impacts switching but the results were less robust than for searching.

(b) Customers holding higher credit balances are more likely to search, while no significant effect is found on switching.

(c) PCA customers who also hold other financial products with a bank other than their main bank are more likely to search and switch.

6.42 We also examined the demographic profile of multi-bankers and found that multi-bankers are more likely to be middle-aged, have a degree and be in employment. More multi-bankers tend to have higher incomes or are financially literate in comparison with customers banking only with one bank. More details on the characteristics of multi-bankers can be found in Appendix 6.1.

6.43 Our analysis of the characteristics of customers who search, switch or multi-bank suggests that customers who are more likely to engage with PCAs tend to have higher income and higher education levels. They also tend to have higher credit balances. We find strong results on usage of internet banking and confidence with the use of the internet being associated with more engagement.

6.44 We also specifically looked at the characteristics of overdraft users and their propensity to switch.

6.45 Our quantitative analysis of searching and switching suggested that overdraft users were as likely to search, but less likely to switch, than others. However, as this result must be interpreted with caution due to limitations in the methodology used to analyse the impact of overdraft usage on switching rates,[26] we also used different approaches to assess the switching behaviour of overdraft users.

6.46 We therefore complemented our econometric analysis of switching rates with an analysis of data from banks of 2015 switching rates based on their PCA customers' overdraft usage in 2014.[27] Specifically, we used the data from banks to compare external switching rates between different overdraft subgroups, depending on whether they used arranged overdrafts, un-arranged overdrafts or both. We also looked specifically at two subgroups of overdraft user: those customers who only use arranged overdrafts and those who only use unarranged overdrafts. We found that accounts where customers use an unarranged overdraft facility are generally less likely to switch than accounts where the customer used only an arranged overdraft facility.[28]

6.47 We also looked at switching rates for customers with different frequency[29] of overdraft usage. We found that many lighter overdraft users were more likely to switch than non-overdraft users. However, for any type of overdraft usage, switching rates are generally lower for heavier overdraft users compared with lighter overdraft users.

6.48 The extent to which the heaviest overdraft users have lower switching rates than non-overdraft users depends on the type of overdraft usage (arranged or unarranged). Overall, the evidence shows that only the heaviest

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[26] See Appendix 6.2 for more details.
[27] To isolate customers' overdraft usage before they switched accounts.
[28] As set out in Appendix 6.1.
[29] We would also expect similar results in terms of amount borrowed given that frequency of overdraft usage is correlated with the amount borrowed (see Appendix 6.4).

unarranged overdraft users tend to have materially lower switching rates than those users who do not go into overdraft at all.

6.49 Differences in switching rates by overdraft usage may be explained by differences in the gains from switching as customers with a higher potential gain from switching should have stronger incentives to switch. We therefore conducted further analysis on the gains from switching for overdraft users.[30] See Section 5 for further details of the methodology of this analysis.

6.50 We interpreted the gains from switching cautiously for overdraft customers, as we have had to assume that upon switching these customers are offered the same size overdraft, which may not be the case as banks have different policies. We found that the lower switching rates of heavier overdraft users is not due to gains from switching being lower for these users, as we found the opposite relationship: the gains from switching increased with the frequency of overdraft usage (Table 6.1 shows the results for standard and reward account users[31]). This suggests that many heavier overdraft users[32] are relatively disengaged, or that they face high barriers to searching and switching, or both.

[30] As set out in Appendix 6.1.
[31] Corresponding results for packaged account overdrafts users are presented in Section 5.
[32] For example, 13%, 11% and 14% of all GB overdraft users respectively were in overdraft for 4 to 7 days, 8 to 14 days and 15 or more days (set out in Table 6.1 above). Due to their heavier usage, these customers are likely to account for a disproportionately higher spend on overdraft charges relative to lighter users. This means the engagement of these heavier overdraft users is likely to be a key driver of banks' overdraft revenues and therefore important for incentivising banks to set competitive overdraft charges.

Table 6.1: Average annual gains from switching for different types of GB overdraft users of standard and reward accounts

Type of overdraft usage	*Average days in overdraft per month**	*Annual gains from switching (£)***	*Proportion of all GB users§ (%)*	*Proportion of overdraft all GB users§ (%)*
No overdraft usage		60	56	
All overdraft usage		132	44	100
All overdraft usage	1–3	72	27	63
	4–7	132	5	13
	8–14	180	5	11
	15+	252	6	14
Unarranged overdraft usage (with an arranged overdraft facility)*** †	1–3	192	10	23
	4–7	360	1	3
	8+‡	420	1	2
Arranged-only usage	1–3	48	10	22
	4–7	84	3	7
	8–14	96	3	7
	15+	168	5	12
Unarranged-only usage***	1–3	108	8	18
	4–7	324	1	2
	8+‡	540	1	2

Source: CMA analysis based on pricing and usage data provided by PCA providers.
* The average number of days in overdraft is defined as an average over all months in the year, as opposed to the average over the months when the account was overdrawn.
** The ranges shown represent the average annual gains from switching to the five cheapest alternatives..
*** Based on an average unarranged overdraft balance of £100.
† The categorisation here is by average days in unarranged overdraft.
‡ Our data set contains insufficient accounts without an overdraft facility that were in unarranged overdraft for more than 15 days per month, on average, to make a separate estimate for that category. Instead, we present a single result for all accounts that had eight or more days, on average.
§ These percentages refer to proportions (rounded to the nearest percentage) of all GB overdraft users and not just those who used a standard and reward account. Please also note that for certain banks where we only received customer data over the last quarter of 2014 (Co-op Bank, Metro, Nationwide, Yorkshire Bank, Smile, Clydesdale and TSB). For these banks we estimate their usage in the first three quarters of 2014 based on customers' usage in the last quarter.

6.51 We also found that the annual gains from switching for overdraft users can be as much as three to four times as high as those for customers that do not use an overdraft, and higher still if the customer is a heavy user of unarranged overdrafts. Compared with annual gains of £65 for non-overdraft users of standard and reward accounts in GB:

(a) GB standard and reward customers in overdraft for 8 to 14 days a month could gain £180 per year;

(b) GB standard and reward customers in overdraft for over 14 days a month could gain £252 per year; and

(c) GB standard and reward customers with 8 or more days of unarranged overdraft usage (but no arranged usage) could gain £540 per year in GB. This is the highest gain from switching.

6.52 Overall, the above evidence suggests that engagement levels are low for overdraft users given that switching rates are low when accounting for the substantially greater gains from switching over non-overdraft users. This is particularly the case for heavier users of overdrafts, and even more so for the heaviest users of unarranged overdrafts.

6.53 The low customer engagement of unarranged overdraft users is a particular issue for the following reasons:[33]

(a) Unarranged overdrafts are used outside a credit limit that a customer has agreed in advance with a PCA provider. Some customers may therefore not want to exceed this limit and would avoid doing so if they were informed on a timely basis when they exceed this limit or are about to.

(b) Unarranged overdraft usage is more likely to be inadvertent than arranged usage. Without alerts it is difficult for customers to be aware of when they have used and incurred charges on an unarranged overdraft. Many PCA providers do not inform all their customers on a timely basis of when they exceed a pre-agreed overdraft limit or are about to (see Appendix 6.6 and Appendix 15.1). The FCA's findings in its Occasional Paper on banking behaviour show that text alerts alongside mobile banking reduced unarranged charges by 24%.[34] [35]This points to substantial inadvertent usage of unarranged overdraft facilities. Our evidence on patterns of unarranged overdraft suggests that it occurs over shorter periods relative to arranged usage and is therefore more likely to be temporary and therefore inadvertent. More details on this analysis are set out in Appendix 6.4.

(c) Exceeding a credit limit involves a significant increase in charges that can build up over time, especially for heavier unarranged overdraft users.

6.54 Lastly, we examined the demographic profile of PCA customers based on the type of overdraft they used, namely non-users, arranged-only overdraft

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[33] Similar concerns apply in relation to facilities such as Barclays' emergency borrowing facility, which in contrast to other PCA providers' unarranged overdrafts specifies a borrowing limit of the facility. Barclays has stated its views that its emergency borrowing facility is not an unarranged overdraft facility. Whether or not such emergency borrowing facilities are unarranged overdraft facilities, they are alternatives to other PCA providers' unarranged overdraft facilities. They are all lending facilities that are offered to PCA customers after they have exceeded an initial pre-agreed credit limit. As with other PCA providers' unarranged overdraft facilities, customers may underestimate their likelihood of using such facilities on top of any initial pre-agreed credit limit. Customers can also accumulate higher charges in using such facilities in the same way that customers can accumulate higher charges from using other PCA providers' unarranged overdraft facilities. For convenience, we use the term unarranged overdraft in this document to refer to Barclays' emergency borrowing facility and other PCA providers' unarranged overdraft facilities (or unplanned or unauthorised overdraft facilities).

[34] Based on data from a sample of customers from one bank analysed by the FCA.

[35] FCA (2015), Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.

users and unarranged overdraft users.[36] We explain further in paragraph 6.41 that overdraft users do not tend to have lower income, and nor are they less educated, than non-overdraft users.

Summary of evidence on characteristics of engaged customers

6.55 Our analysis of the characteristics of customers who search, switch or multi-bank suggests that the customers who are more likely to engage with PCAs tend to have higher income and higher education levels; they also tend to have higher credit balances. We found that confidence in usage and the intensity of usage of internet banking are associated with greater engagement.

6.56 In relation to overdraft users, we found that:

(a) light overdraft users are on average more likely to switch than non-overdraft users, but the differences are small and switching rates remain low for light overdraft users.

(b) heavier overdraft users (both unarranged and arranged), are generally less likely to switch than lighter users;

(c) the heaviest unarranged overdraft users typically have the lowest switching rates compared with other overdraft users and non-overdraft users; and

(d) overall, overdraft users have much greater gains from switching, with the gains increasing with usage, and especially unarranged usage.

Explanations for low customer engagement

6.57 In paragraphs 6.14 to 6.38 we assessed a number of arguments banks submitted to explain why the low levels of PCA switching may be compatible with strong customer engagement and a well-functioning market. As we found that this did not appear to be the case, we look further at possible explanations for the low levels of customer engagement including the low

[36] We define the following PCA customer groups: *(a)* non-users – customers who did not use an overdraft in 2014; *(b)* arranged only – customers who only used arranged overdrafts in 2014; and *(c)* unarranged – customers who used unarranged overdrafts in 2014 including both those who used unarranged only and those who used arranged and unarranged overdrafts. Further details are provided in Appendix 6.5. We have also compared characteristics of heavy overdraft users (those who used overdrafts for nine or more months) with light overdraft users (those who used overdrafts for eight or fewer months). Apart from regular users being less likely to receive low inflows, we do not find any other substantial differences.

levels of searching and switching. Customers may be less engaged with PCAs because they:

(a) lack natural trigger points to prompt initial engagement;

(b) believe that there is not much to be gained from switching as:

(i) PCAs are free or low-cost for many customers;

(ii) customers have limited awareness of the potential gains, as they lack awareness of their own usage of PCAs and have limited engagement with their account; or

(iii) they believe that there is no or little difference between banks;

(c) are unable to compare different accounts due to a lack of transparency on prices or service quality and/or a lack of information on and understanding of their own usage; and/or

(d) encounter issues that prevent them from executing a switch.

6.58 The first two of these explanations relate to customers having a **low level of awareness and initial engagement**, the third relates to **barriers to accessing and assessing information** and the fourth relates to **barriers to switching**.

Low levels of awareness and initial engagement

Lack of natural trigger points

6.59 PCAs are 'evergreen' products (ie there is no contract end date), which means that there are few, if any, natural trigger points for customers to consider searching for and switching PCAs. Some parties have submitted that life events – such as moving house and getting a mortgage – are potential triggers increasing the probability for customers to search and switch.[37] Our quantitative analysis of searching and switching behaviour (presented in Appendix 6.2[38]) found no evidence that such life events had a significant effect on customers' propensity to search and switch.

[37] [✂]
[38] We used anonymised customer information from two sources: the results of the GfK PCA consumer survey and current account usage data provided by the banks. We also used information on branch locations provided by the banks. This information allowed us to compare searchers and switchers with non-searchers and non-switchers on a variety of dimensions including their demographic characteristics, their beliefs and perceptions, and their use of their PCA.

Perception of limited or no gains from switching

6.60 As noted above, there are a number of factors that may limit customers' incentives to engage in the market and stop them considering searching and/or switching. We consider them in more detail below.

PCAs are free or low-cost

6.61 PCAs are a low-cost product for many customers: the majority of PCA providers operate an FIIC pricing model and do not charge for a variety of common transactions. Based on the anonymous transaction data from the banks we estimated that 54% of PCA customer accounts did not incur charges in the last quarter of 2014 and 46% incurred charges.[39,40] The most common source of charges were overdraft charges: 28% of accounts paid for an overdraft in the last quarter of 2014.[41] The second most common source were monthly fees, with these being incurred on 18% of customers' accounts. Such monthly fees are, for example, charges for some packaged accounts. Some reward accounts also charge monthly fees.

6.62 Figure 6.5 shows the proportion of customers' accounts that have incurred different types of charges.[42]

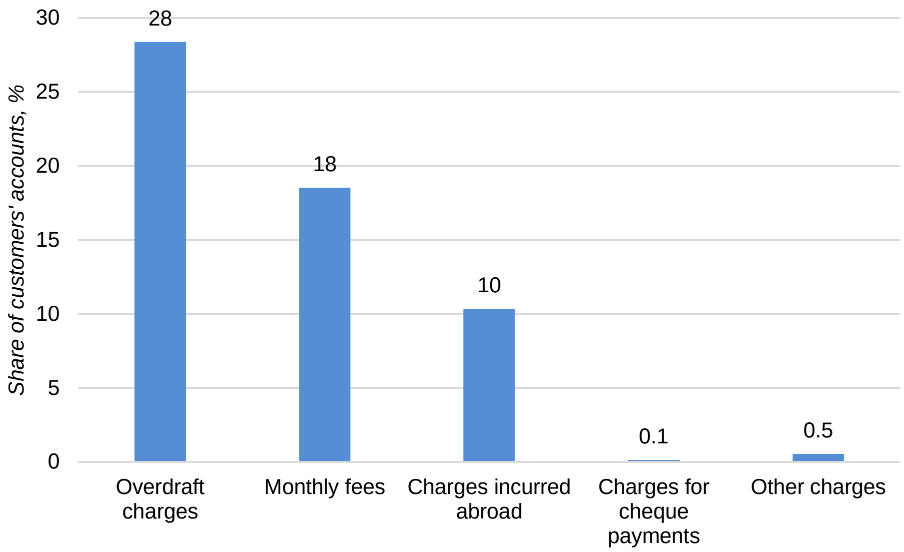
[39] CMA analysis based on banks' transaction data (sample base: 70,798) in Q4, 2014. The estimate includes interest and non-interest charges paid for an overdraft, interest and non-interest charges paid for usage of debit cards and ATMs abroad, charges relating to cheque payments, charges relating to other payments, and monthly account fees as at the end of 2014. The point in time when charges have been paid may differ from the point in time when charges have been incurred. We excluded observations where the account was opened past December 2013 and observations with missing values for any of the charges in the transaction data. Banks for which a full data set of charges was available include BoI, BoS, Clydesdale, first direct, Halifax, HSBC, Lloyds, Nationwide, RBS, Santander, TSB, NatWest, Yorkshire, and M&S Bank. We refer here to 'customers' for simplicity when considering transaction data. However, transaction data contains a sample of accounts rather than customers. Therefore, for customers who hold more than one PCA, we do not observe all their activity but only that associated with the account included in our sample. For example, a customer may have two accounts and only incur charges on one of them, while the chances for any of the two accounts being in the sample are the same. As the transaction data includes accounts that are used as secondary accounts, we sensitivity-checked the results by considering only the main accounts as indicated by surveyed customers. The sensitivity results were broadly the same as the results in the main analysis.

[40] We could only conduct this analysis for Q4 2014 due to data limitations. On an annual basis, the percentage of consumers incurring charges would be higher, as some consumers will make fee paying transactions (eg overdrafts, use of debit card abroad) only in certain months. For instance, some banks have provided us with data on overdraft charges for the whole of 2014. Using the whole year data for this sample of banks we find that 41% of customers incurred overdraft charges in 2014 in contrast to 29% in the last quarter. Therefore it is likely that, over a whole year, the overall proportion of consumers incurring some charges would be substantially higher than 46%.

[41] CMA analysis based on banks' transaction data (sample base: 71,093) in Q4 2014.

[42] We have excluded forgone interest from this analysis but this is considered in 'The costs of banking to PCA customers' and 'Cross-subsidies and distribution effects' later in this section.

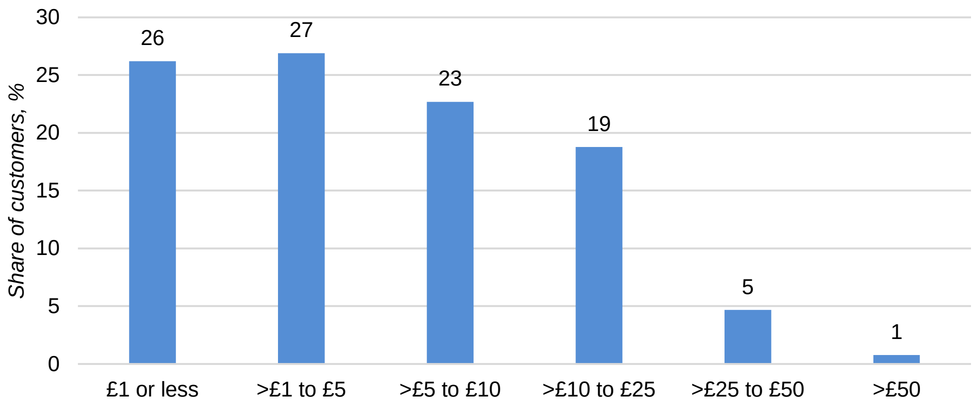
Figure 6.5: Distribution of customers' accounts that incurred different types of charges in Q4 2014



Source: CMA analysis based on banks' transaction data.
Sample base: Overdraft charges (71,093); monthly fees, charges incurred abroad, charges for cheque payments, other charges (70,823).

6.63 Figure 6.6 below shows the distribution of the 46% of accounts where customers incurred charges[43] in the last quarter of 2014. For most of these accounts (76%), customers paid low or very low charges, of less than £10, to use their PCA in the analysed three-month period.

Figure 6.6: Distribution of customers who incurred charges in Q4, 2014



Source: CMA analysis based on banks' transaction data (sample base: 32,379).

6.64 Given that for many customers these charges will be a small proportion of their total expenditure on goods and services, PCAs may not typically be

[43] Again, excluding forgone interest.

perceived as a significant purchasing decision. This is also a potential factor that contributes to the overall lack of engagement.

6.65 Some parties submitted to us that the perception that PCAs were low-cost to customers was exacerbated by the FIIC pricing model, and that this pricing model reduced engagement and transparency. We examine evidence on the impact of the FIIC pricing model on engagement, and more broadly on how FIIC impacts outcomes in the market, in our discussion of the 'Assessment of the impact of the free-if-in-credit pricing model' later in this section.

Awareness of own usage as a barrier to initial engagement

6.66 Even for those who do pay for PCAs, such as overdraft users, reward and package account holders and customers incurring foreign exchange fees, a lack of awareness of usage means that it is harder for them to gauge the overall value for money they achieve in using their current account. This in turn may limit incentives to shop around and make it more difficult to appreciate the potential gains from doing so. For example, some overdraft customers may believe they do not need to shop around because they believe that they use their overdraft much less than they actually do or not at all. They may therefore not even think about searching for a product offering better overdraft charges and terms.

6.67 PCA providers told us that among certain customer groups the increasing digitalisation of banking had already increased levels of customer engagement with their own account.[44] Customers can currently access information on their account transactions, and therefore assess their usage, using different distribution channels including internet and mobile banking.

6.68 Appendix 6.3 provides details on the development of internet and mobile banking. In 2014, 27% of British adults were using mobile banking, [45] although usage is increasing. For example, the BBA estimated that there were 9.6 million daily logins to internet banking services in March 2015.[46] This rose to 11 million logins for the full year 2015, which was said to be a 50% rise since 2014.[47]

6.69 Mobile banking applications are provided by all of the largest banks in the UK (Barclays, HSBCG, LBG, RBSG, Santander, TSB and Nationwide). The core services provided by mobile banking applications (apps) typically

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[44] Barclays, HSBCG, Danske, LBG, RBSG, TSB.
[45] See Deloitte innovation report, p9.
[46] ibid, p4.
[47] BBA (25 July 2016), *The Way We Bank Now: Help at Hand*.

include account checking services; money transfer and payment services; ATM location services; personalised alerts; and loan and service requests.

6.70 We conducted an analysis comparing overdraft users' perceptions of their usage of overdraft with their actual usage, a summary of which is discussed in detail in paragraph 6.94, and a full analysis included in Appendix 6.4. This analysis indicates that 52% of overdraft users underestimated their usage by two or more months and 38% of them did not believe that they had gone into overdraft. This discrepancy between actual and perceived usage suggests that there is a lack of understanding and initial engagement among overdraft users. With limited awareness of the fact that they use overdrafts or alternatively their level of usage, many customers will have limited incentives to shop around. More generally they will be less able to assess the value for money they obtain in using their overdraft even though they may have strong financial gains from switching (see Appendix 6.4 for more details).

6.71 We found that these issues around awareness of usage are particularly acute for unarranged overdraft users. Our analysis indicates that 55% of unarranged overdraft users underestimated their usage by two or more months and around half of unarranged overdraft users did not believe that they had gone into unarranged overdraft.[48]

6.72 We consider further awareness of overdraft usage in relation to comparing PCAs later in paragraph 6.94.

Perception of no or small difference between banks

6.73 Along with the lack of awareness of potential gains from switching, the perception by customers that there is no differentiation between banks may also reduce incentives to initially engage. PCA customers, in order to consider switching, need to expect benefits from switching, either by receiving a better quality of service or a cheaper service (or a combination of both).

6.74 The GfK PCA qualitative research found that some respondents viewed PCAs as generic products that had little differentiation.[49] Tesco research found that 43% of current account holders thought that PCAs were all the

[48] Appendix 6.4.
[49] The GfK PCA qualitative research was intended to amplify the quantitative findings, and in particular to get in-depth opinions from groups of particular interest. It was not designed to represent the whole population of PCA holders in the way that the GfK PCA quantitative survey was, but instead to concentrate on a small number of key demographic and behavioural groups. Forty-three 1-hour face-to-face interviews were conducted.

same, and a further 42% saw only small differences between them. Research undertaken for RBSG in 2013 also stated that [✂].

6.75 In the GfK PCA consumer survey[50] 49% of respondents agreed with the statement that 'There are real differences between banks in the current accounts that they offer',[51] with the other half of respondents either disagreeing or being indifferent. In 2012 the European Commission found that 'there is low awareness of the potential savings to be made by switching.'[52] [✂]

Barriers to searching (accessing and assessing information)

6.76 Low levels of searching and switching may also be caused by actual barriers to shopping around and switching. In this section we consider:

(a) transparency of PCA pricing;

(b) information on customers' own account usage;

(c) transparency of PCA service quality;

(d) past initiatives aimed at improving PCA transparency and comparability; and

(e) current and future initiatives that enhance the role of PCWs.

Transparency of PCA pricing

6.77 We assess the transparency of PCA pricing by considering:

(a) customer views from the PCA consumer survey;

(b) accessibility of pricing information;

(c) transparency of account charges; and

(d) transparency of account rewards.

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[50] GfK PCA consumer survey. Base = all (4,549). H1: 'I am going to read out a number of statements, and I'd like you to tell me how much you agree or disagree with each using the following scale?' Just under half of respondents agreed with the statement (21% agreed strongly and 28% tended to agree) while 22% disagreed (7% disagreed strongly and 15% tended to disagree) with a further 17% neither agreeing nor disagreeing.
[51] This result was similar for overdraft users: 17% neither/nor and 22% disagreed.
[52] Bank fees behaviour study conducted by TNS at the request of Directorate-General for Health and Consumers, p6.

Customer views from the PCA consumer survey

6.78 The GfK PCA consumer survey asked customers how easy it was to *(a)* find information about the features of different accounts; *(b)* understand the different current account options available; and *(c)* make comparisons between accounts.[53] Between 65% and 78% of respondents who had not looked around said they expected that it would be very or fairly easy, indicating that consumers considered the searching process to be relatively easy.[54] These particular results should be interpreted with some caution, as we asked consumers to speculate about something that they did not have any experience of.

6.79 The GfK PCA qualitative research provided somewhat different insights stating that when asked about comparability between PCAs 'it became clear that some participants would not know how to go about comparing PCAs (this was discussed theoretically as so few participants had compared PCAs).'[55] Research by Tesco also found that PCA comparisons proved really difficult.

Accessibility of pricing information

6.80 We carried out a review of the websites of PCA providers to understand the availability of pricing information, and found that in general information on overdraft charges, interest rates, monthly fees and rewards was available. Information on other charges such as foreign transaction charges was less prominent and we had to search for these in leaflets and terms and conditions. Information on unarranged overdraft charges was also less prominent and could be difficult to find.

6.81 In its response to our provisional findings, Barclays commented that we had underestimated the ability of customers to access and assess information on charges and service quality. In particular, it felt that ongoing innovations (such as mobile banking) had increased the ability of customers to access

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[53]Those who had not looked around were asked how easy or difficult they thought it would be to find out about the features of different accounts, to understand the differences between them, and finally to make comparisons between accounts. F11: 'I am now going to read out different aspects of shopping around for current accounts, and I'd like you to tell me how easy or difficult you think each aspect would be if you were to shop around for banks (IF NOT LOOKED AROUND)/you expected it would be before you started looking around to compare different accounts (IF LOOKED AROUND IN LAST 3 YEARS)?'
[54] Between 75% and 78% of respondents who had looked around said they expected that it would be very or fairly easy.
[55] GfK PCA consumer survey report, p61.

information and assess offers.[56] Similarly Virgin Money stated that it believed that new technologies could help build customer engagement.[57]

6.82 We agree that these innovations may have improved the accessibility of information on other accounts and helped customers understand their own account charges.[58] However, customers' ability to access this information and identify the best-value PCA for their needs is likely to be impaired by the complexity involved in comparing different PCA pricing structures and the limitations of tools such as Midata (as explained in more detail in paragraphs 6.113 to 6.116) to help overcome this complexity. We consider the evidence for this conclusion below.

- *Transparency of account charges*

6.83 The main PCA charges are overdraft fees, monthly account fees and foreign transaction fees. We discuss each of these in turn below. Appendix 6.3 provides further detail of all PCA charges.

- *Overdraft fees*

6.84 Overdraft fees have a complex structure:

(a) Overdraft fees can take a number of different forms which may hinder a customer's ability to calculate the cost. Banks levy a package of charges which may include daily fees, monthly fees and debit interest charged on daily balances. In addition banks may charge an unpaid and/or paid item fee.[59]

(b) PCA providers apply different pricing structures, making a like-for-like comparison across providers difficult. Providers have different approaches to their overdraft charging and different combinations of fees. This variation across providers applies to both arranged and unarranged overdrafts structures.

(c) PCA providers have different fee policies in place, adding further complexity. Providers vary in the provision of buffer zones, whereby charges are only incurred once a customer has become overdrawn by a

[56] Barclays response to provisional findings, paragraph 1.5.
[57] Virgin Money response to provisional findings, p3.
[58] Albeit it is unclear how these innovations help customers access some information that is less prominently displayed.
[59] Charged for each item that is paid by the PCA provider that leaves the customer in, or extends the overdraft.

certain amount; grace periods to balance the account before a set deadline to avoid charges; and fee caps.

(d) When customers are searching for a new account there is a lack of clarity or certainty around the arranged overdraft limit offered, so there is no easy way for a customer to find and compare the credit limits an alternative PCA might offer them. Most notably, heavier unarranged overdraft users, whose credit scores may be becoming impaired, face additional search costs due to the increased uncertainty over what, if any, credit they will be offered.

6.85 The complexity of overdraft charges is reflected in the FCA Consumer Credit research.[60] It found that, despite the introduction of transparency initiatives, the terms set by PCA providers for overdrafts can be so complex and opaque that 'even the most astute customer could struggle to understand what they are paying for.' Qualitative consumer research commissioned by the FCA as part of that work found that there was a lack of understanding about overdrafts and widespread confusion about what happens when customers exceed their arranged overdraft. It found that there was a widespread perception that, as long as customers remained within the agreed limit, then the overdraft was free, with little or no understanding of interest being charged on any balance. It also found that there were specific issues in that overdrafts were rarely seen as debt among consumers and that this was driven in part by the way providers often included the overdraft in 'available funds'.[61]

6.86 We also looked at PCA providers' unarranged overdraft charge caps and found that the differences in what is covered under each provider's cap make it difficult to make like-for-like comparisons between accounts. And we found that, even with these caps, unarranged overdraft users could still incur high unarranged charges (as noted in Appendix 6.3).

6.87 More detail on the complexity of providers' different overdraft charging structures and information on how overdraft charges have changed over time is provided in Appendix 6.3.

- *Monthly account fees*

6.88 A relatively small proportion of PCAs charge a fee. Packaged accounts typically charge monthly fees for additional benefits such as travel insurance, breakdown cover and mobile phone insurance. Some reward accounts also

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[60] FCA press release (10 April 2014): FCA research shows many customers paying too much for overdrafts.
[61] FCA (7 April 2014), Consumer Credit Qualitative Research: Credit Cards & Unauthorised Overdrafts, pp20–21.

charge a monthly fee, some of which are waived if the customer meets specific conditions. Table 5 in Appendix 6.3 provides details on these charges. Our research showed that monthly fees were relatively transparent and well-advertised.[62]

- *Foreign transaction fees*

6.89 Foreign transaction charges comprise cash and transaction fees, with different banks levying different minimum and maximum charges (see Appendix 6.3). Foreign transaction charges are not prominently advertised, which hinders comparability.

- *Transparency of account rewards*

6.90 The number of reward accounts being launched on the market has increased and the GfK PCA consumer survey showed that 28% of respondents stated that benefits were an important feature of their account. Customer rewards can take different formats, including higher rates of interest, joining incentives and cashback. Table 12 in Appendix 6.3 provides a comparison of some reward accounts on offer and a comparison of different incentives in place.

6.91 Although rewards appear to be well advertised, we found that there were three main factors that could hinder comparisons between PCAs offering rewards:

(a) Eligibility criteria for rewards differ between banks. For example, some accounts require customers to have minimum inflows into the account and a minimum number of direct debits.

(b) Where interest rates apply, the rate received can vary for different income ranges and different size account balances.[63] In addition a minimum balance may be required. The variation in interest rate thresholds and rates makes it particularly difficult for customers to compare. This feature is particularly relevant for customers with high credit balances.

(c) There is a wide range of other offers available such as switching incentives, cashback on various items and interest on balances.

[62] While the initial price is transparent customers may not necessarily know whether these will change. For example, Santander's 123 account monthly fee increased from £2 to £5 in January 2016. Santander announced this change in September 2015. Santander announcement, consulted 19 October 2015.
[63] Interest rates can also vary in relation to the length of time applicable. For example, high interest rates are sometimes only introductory offers.

Switching incentives are changed by banks over time and may be only applicable for a full account switch when using CASS. In regard to cashback incentives, their levels vary depending on the third party (eg utilities) and such variation can make it difficult to calculate expected benefits.

6.92 We also note that a comparison between reward accounts requires complex calculations on account usage to work out which PCA offers the best value for the customer.

Information on customer's own usage

6.93 In order for a customer to choose the best-value PCA product they need not only to understand the account charges and rewards that will be applied, but also to be able to access and assess their expected account usage. For example, customers who use overdrafts will often need to assess the expected likelihood, length and size of future overdrafts (and the extent to which such overdraft use may be arranged or unarranged). Customers who travel abroad will often similarly have to make assumptions to assess their expected foreign exchange charges.

6.94 We looked at whether customers were able to assess their account usage and the associated charges and benefits using the same actual vs perceived analysis mentioned in paragraph 6.70 (further details are provided in Appendix 6.4). We found the following:

(a) A large minority of overdraft users and the majority of unarranged overdraft users were not aware that they had gone into overdraft and unarranged overdraft respectively (as noted in paragraph 6.70).

(b) Many customers did not assess their usage of overdrafts correctly and more often underestimated than overestimated their usage. Approximately half of the customers who used overdrafts correctly estimated the number of months they used overdrafts; 38% correctly estimated the average number of days in overdraft; and 27% correctly estimated the range within which their debit balance lay.[64]

(c) 50% of customers estimated their overdraft charges correctly within +/- £5, with a slight tendency, for the 50% of customers who did not estimate overdraft charges correctly, towards underestimating their

[64] The reported share of customers who correctly estimate the number of months and average number of days in overdraft is within a margin of error of two months and three days respectively. The bands were: £50 or less, £51–£100, £100–£200, £200–£500, £500–£1,000 and £1,000 or more.

charges. Only a small percentage of customers, however, stated that their charges were considerably different (more than £20 away) from what they actually were.[65]

(d) Most customers (approximately 90%) knew whether they had an over-draft limit, and 57% of overdraft users who had an arranged overdraft limit knew exactly what their limit was. Customers who did not know their limit tended to underestimate rather than overestimate their limit.

(e) 60% of customers correctly knew whether they received any revenues on their credit balances, while over one-third falsely thought that they received revenue while they actually did not.

(f) There was no evidence to suggest that customers with particular characteristics were consistently better at evaluating their usage, limits, charges and credit interest.

6.95 There is also evidence that it is difficult for customers to access information on usage through banks' statements. According to recent research undertaken by the Money Advice Service (MAS), 22% of customers cannot read a bank statement and 36% of the UK population have difficulty calculating the impact of a 2% interest gain on a £100 balance.[66] It is likely that overdraft customers have greater difficulty in this respect due to the more complex charging structure for overdrafts.

6.96 The increasing digitalisation of banking, through internet and mobile banking noted in Section 5 has facilitated access to information on customers' account usage for them to make comparisons, albeit with significant scope for improvement. However this trend, provided it continues, will help to enhance customer engagement with their account.

Transparency of PCA service quality

6.97 The GfK PCA consumer survey found that customers value service attributes, with approximately 80% of respondents citing 'quality of staff and customer service' and 'handling problems' as essential or very important features of their account.[67]

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65 Due to a larger measurement error in responses to the survey question about charges, the findings on charges are less reliable than other findings. See further details in Appendix 6.4.
66 As highlighted by TSB in response to our provisional findings.
67 GfK PCA consumer survey. Base = All (4,549). E3: 'You've told me about satisfaction with various features. Now can you tell me how important each feature is to you personally, using the following scale. Other service attributes reported as essential or very important. Internet banking = 62%; Branch = 60%; Mobile banking = 32%.'

6.98 However, our research showed that there was limited readily available information on this topic beyond reports from Which?[68] and MoneySavingExpert.com, for example.

6.99 In addition, 85% of respondents to the GfK PCA consumer survey told us that they trusted their own bank to treat people in a fair and honest way, while less than half trusted other banks.[69] This suggests that the perception of a bank's trustworthiness stems mainly from direct experience of the bank as a customer. Further, this perceived lack of trustworthiness of other banks, relative to own banks, could suggest that customers indeed lack awareness or information on service quality at other banks.

Previous transparency and comparability initiatives

6.100 Several UK initiatives have raised and tried to address the issues of relative complexity of PCA pricing structures and their overall lack of transparency. A brief overview of these initiatives is provided below. (Details on EU directives aimed at improving transparency are provided in Section 3 and Appendix 3.1).

6.101 The OFT's 2009 report recommended initiatives to help customers understand and control their own PCAs.[70] The initiatives were to introduce an annual summary of the cost of their account for each customer; make charges more prominent on monthly statements; provide average credit and debit balances; and produce illustrative scenarios showing unarranged overdraft charges.

6.102 The FCA Occasional Paper on banking behaviour (2015) showed that annual summaries, as designed by the banks, had no effect on consumer behaviour when considering whether they incurred overdraft charges, altered balance levels or switched to other current account providers.[71]

6.103 The OFT unarranged overdraft charging scenarios have been introduced by most PCA providers. The 2014 CMA PCA market study found that the charging scenarios did not give a full picture of how charges could be applied, and relatively few consumers used these scenarios to choose

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[68] Which? Has produced a report on customer service.
[69] GfK PCA consumer survey. Base = All (4,549). J2 'To what extent do you trust or distrust the following types of organisation to treat you in a fair and honest way?'
[70] These were intended to help consumers: better understand the costs of their PCA, enabling them to make informed choices about how to use their existing PCA more efficiently; and better understand the potential costs of other competing PCAs against the benefits offered, allowing them to assess which provider is the best one for them.
[71] FCA (2015), Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.

between PCAs.[72] Further, our current research has found that some banks' information on the OFT profiles is easier to locate online than others.

6.104 The Consumer Credit and Insolvency Review (2011) recommended initiatives to help customers control their PCAs. This resulted in voluntary commitments to *(a)* provide customers with text or email alerts; *(b)* increase customers' awareness of grace periods;[73] and *(c)* introduce a small buffer zone.[74]

6.105 The CMA 2014 market study stated that all major PCA providers and a number of smaller providers offered some form of text alert service.[75,76]

6.106 The FCA Occasional Paper on banking behaviour found that signing up to text alerts or mobile banking apps reduced the amount of unarranged overdraft charges incurred by 5% to 8%, and signing up to both services had an additional effect, resulting in a total reduction of 24%. In addition, text alerts and mobile banking apps decreased average current account balances by 17% to 24%.[77]

6.107 As shown in Appendix 6.3 most banks had implemented the buffer zones (within which unarranged overdraft charges were not levied).

6.108 The Lending Standards Board (2011) report considered opt-outs from unarranged overdraft facilities.[78] It set standards for those banks that provide this opt-out. However, at present, although many banks provide this facility several of them also apply a monthly charge for doing so.[79]

6.109 The OFT super complaint (2011) on travel money looked into charges for the use of debit and credit cards abroad. The OFT secured the following: consistent terminology; improved presentation of foreign use charges in credit card and PCA summary boxes; clearer presentation of when charges were cumulative; changes to call centre processes; improvements to website travel pages;[80] clearer presentation of the sterling amount of the exchange

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[72] PCA market study update, pp67 & 68.
[73] Where customers can avoid charges by transferring money to balance the account before a set deadline.
[74] Where charges are only incurred once a customer has become overdrawn by a certain amount.
[75] PCA market study update, p57.
[76] Our research covers this in more detail in Appendix 6.6.
[77] FCA (2015), Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.
[78] The Lending Code is a voluntary code of good practice overseen by the Lending Standards Board, which endeavours to monitor credit products.
[79] For example, Barclays: has a control feature available for £8 per month to prevent customers incurring unpaid transaction fees. Clydesdale: 'Current Account Control' offers this facility and a £7.50 monthly fee is applicable to the Current Account Control; LBG: 'Control' facility £10 monthly fee; and TSB: 'Control' facility £10 monthly fee.
[80] Such as accessible links to foreign use charges, worked examples of how foreign use charges apply, and links to historic exchange rate information.

rate fee on monthly statements; and annual statements to show the GBP amount of foreign use charges that had been applied.

6.110 We consider that many of these initiatives are positive developments in the market. However, as explained above, we have still found that barriers remain for customers to access or assess information on pricing, service quality and their usage.

Current and future initiatives that enhance price comparison websites

6.111 The most recent initiatives have focused on giving customers better access to their personal data in particular to enhance the role of PCWs and their ability to aid consumers with accessing and assessing the relevant information to identify the best PCA for them.

6.112 The evidence we have collected indicates that so far the use of PCWs has been limited, compared with other sectors such as motor insurance. We reviewed the PCWs that do feature current accounts, and it appeared difficult to make an accurate comparison of both account rewards and charges, especially overdraft charges.[81] Further, the ability to incorporate service attributes into the comparison appears more limited. Appendix 6.3 summarises the variables by which products can be ranked in the comparison tables and highlights what information is displayed.

6.113 In an attempt to address this issue, the UK government launched its Midata initiative[82] in 2015 to give consumers more control over, and better access to, personal data that companies hold about them. Customers can download their own transaction data (eg list of transactions, interest paid, charges incurred) from the previous 12 months for their current account in a single file. This gives customers access to their personal data in a portable, electronic format which can then be uploaded to a PCW, to compare PCAs and identify the best-value account for them, given their usage. The aim is for individuals to be able to use this data to make more informed choices about products and services, and to manage their financial lives more efficiently.

6.114 Currently, only Gocompare.com provides a Midata comparison tool, which it launched in March 2015.[83] Customers can upload their Midata file on to

[81] Only headline overdraft charges (debit interest charged and/or daily fee) are typically advertised on PCWs while exact charges are generally contained within 'more detail' links or linking through to providers' websites.
[82] Midata.
[83] [✂]

Gocompare.com's website to compare current accounts using a customer's PCA usage profile.[84]

6.115 Barclays told us that existing transparency initiatives such as Midata and the development of APIs might give rise to innovations that would enhance the transparency of PCA charges.[85] However, PCWs cannot currently use APIs and a number of limitations to the Midata initiative have been reported to us. For example, Midata files do not present reward and service quality dimensions.[86] LBG told us that Midata did not offer a seamless customer journey as it required customers to download a CSV file and upload to a third party, and had limited compatibility with some tablet and mobile devices. It also told us that there were several issues around the data security risks.[87] Finally, some of the transaction data download is currently redacted to address confidentiality concerns arising from the technology being used. This, for example, prevents the PCW's systems from identifying payments, such as to utility companies, which would qualify for rewards from some current account providers. For these reasons, although we believe Midata to be a positive development, we consider that many limitations around its current implementation have meant that it has not been used by many customers or third parties, and therefore has had limited effectiveness in enhancing price transparency.

6.116 We therefore welcome that the government in 2015 announced[88] its intention to deliver an open API standard in UK banking (as set out in Section 3), which can address some of the implementation issues of Midata. The aim of this standard is not just to increase consumer engagement by making it easier for customers to see where they could get a better deal as was the case for Midata. The standard also aims to increase competitive intensity by supporting the growth of technology that can be adopted by banks and non-bank providers to compete to offer new products. In Section 13 we explain how our remedies involve open API standards and data sharing.

Barriers to switching

6.117 Once a customer has decided to switch there are two separate processes to act on this decision, namely the account opening process and the account

[84] More details on the initiative are included in Appendix 3.1.
[85] Barclays response to provisional findings, paragraph 3.25.
[86] Barclays, LBG, Nationwide, AIB, Metro.
[87] LBG's submission 'An explanatory summary on APIs and Midata', paragraph 2.5.
[88] HMT (18 March 2015), Call for evidence on API in banking. Also see HM Treasury: Data sharing and open data in banking and The Open Banking Standard.

switching process (although we note that customers often view this as one and the same process).[89] In this section we consider separately:

(a) barriers to account opening;

(b) barriers in the switching process; and

(c) specific issues for overdraft users.

6.118 Similar to the transparency initiatives, there have recently been developments in the switching process, most notably the introduction of CASS.[90] We have considered the impact of CASS below in our analysis of barriers to switching as appropriate. While there has been discussion of other initiatives that could facilitate switching, including account number portability (ANP), we do not consider these in this section as they have not been implemented.[91]

Account opening

6.119 In September 2014, the FCA launched a review of the effectiveness of CASS.[92] The FCA's CASS report identified the perception of a 'hassle' around the account opening process as impacting customers' perception of switching and specifically found that this perceived hassle was related to issues such as 'a need to go to a branch'.

6.120 In relation to the application process itself we have also seen some survey evidence of customer dissatisfaction with this process.[93] We note that the process varies by application channel. For example, the online application process is quicker, approximately 10 minutes,[94] compared with the branch process, which ranges from 15 to 40 minutes.[95] We have been told,

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[89] FCA CASS report, paragraph 1.8.
[90] CASS was launched in September 2013. It is a voluntary scheme set up as part of an industry-wide programme by the Payments Council and owned and operated by Bacs. It makes switching current accounts simpler and quicker for customers. Some 40 bank and building society brands participate, accounting for over 99% of the current account market. Customers using CASS to switch accounts are covered by the 'Switch Guarantee', which includes the automatic closure of their original account. More details can be found in Appendix 6.1.
[91] Further detail on ANP is provided in Appendix 3.1.
[92] FCA CASS report.
[93] [✂] survey found that [✂]% of customers agreed with the statement that the process of opening would be complicated, and [✂].
[94] LBG.
[95] Metro only accepts branch applications, which it told us could take as little as 15 minutes to complete. LBG told us – supported by internal documentation – that it took around 40 minutes to open an account in the branch. Nationwide's research found that, [✂]. Santander [✂].

however, that a high proportion of online applicants fail to complete the process.[96]

6.121 We note that UK providers must comply with AML regulations aimed at preventing money laundering and combating terrorist financing.[97] Providers are required to put in place policies and procedures, including the carrying out of customer due diligence (CDD) to prevent and detect money laundering.[98] A number of parties, such as Yorkshire Building Society, considered that the 'hassle' of needing to complete CDD in order to open an account in particular deterred customers from shopping around and switching.[99] Some consumer groups attending a CMA roundtable in June 2015 raised similar views, also noting that customers may not have the necessary ID to meet banks' CDD criteria.[100] LBG told us that failed or referred identification and verification checks contributed to the high refusal level of online applications.

6.122 We therefore looked further at information provided by providers on their PCA opening processes:

(a) We found that PCAs are generally opened quickly (within one or two days).

(b) We found that a wide range of CDD approaches are seen in the market and account opening processes, at the more efficient end, do not appear to be unduly onerous given the timing outcomes noted above. Assuming firms are generally compliant, this implies that it is individual firms' policies and processing capabilities (such as IT capabilities or how approvals are internally organised) rather than the content of the regulation itself, that contributes to additional complexity or time required to complete the account opening process. However, we note that it is not possible to assess the extent to which process complexity or delays arise solely due to the CDD element of the process (as opposed, for example, to credit risk assessment).

(c) Firms' ability to support account opening via different channels varies and is a significant factor in customers' account opening experience.

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96 LBG told us that currently over 50% of all online applicants could not complete their online journey and were referred to the branch for identification and verification. Of these only 20% actually visited the branch. HSBCG [✂].
97 These are enacted in the UK through the Money Laundering Regulations 2007. See Section 3 and Appendix 3.1 for more detail.
98 As providers are by their very nature relatively high-risk for money laundering so the policies and procedures adopted will reflect this.
99 Yorkshire Building Society response to updated issues statement.
100 Consumer roundtable summary.

Online account opening times can be the quickest but depend on whether the provider conducts electronic ID verification checks and, if so, whether customers pass these or have to undergo supplementary checks in-branch, or by posting the relevant documentation to the provider. If these supplementary checks are required, in-branch account opening is generally the quickest route so long as all documentation is ready to hand.

6.123 We found that the speed and efficiency of the account opening process can in itself be an aspect of competition. One bank, for example, promotes its ability to swiftly open accounts in branch and another told us that it was launching a project to allow customers to submit photo identification and verification documents online or via a smartphone.[101] We also found that providers are increasingly investing in enhancements to their account opening processes, including their handling of CDD checks, with online account opening and electronic verification becoming more widespread.

6.124 Work by the UK government (for example the ongoing Cutting Red Tape Review of the impact on business of AML regulation) and upcoming legislative changes (the Fourth Money Laundering Directive)[102] are moving in the same direction, towards streamlining processes in a risk-proportionate manner (as discussed in Section 3)

6.125 The evidence suggests that the account opening process is perceived by some customers to be inconvenient, yet we are aware that AML regulations are a necessary part of conducting business as a retail bank and are a critical measure to combat financial crime. We are also aware that account opening may be an aspect of competition as providers are increasingly investing in enhancements to their account opening processes, including their handling of CDD checks, with online account opening and electronic verification becoming more widespread. Nevertheless, to the extent that customers perceive there is an issue, it will have a detrimental effect on customer engagement although this may reduce in the medium to long term as providers' account opening processes continue to evolve.

The switching process (including CASS)

6.126 The account switching process can be another potential barrier to switching. This is the process by which payments in and out of one account are transferred over to a new account. Customers can switch accounts manually

[101] LBG.
[102] See Appendix 3.1.

by handling all the arrangements themselves (for example, by changing direct debits and standing orders), or through CASS.

6.127 55% of respondents to the GfK PCA consumer survey either ‘agreed’ or ‘strongly agreed’ that ‘Switching current accounts is too much hassle’. 42% of respondents either ‘agreed’ or ‘strongly agreed’ with a statement ‘I worry that if I switch my current account that things will go wrong’.[103] Customers interviewed as part of GfK’s qualitative research also indicated that one of the key reasons for not switching providers was ‘a fear that a problem could arise in the process of switching PCAs’.

6.128 Providers’ research supported the view that the ‘hassle’ factor was prevalent. Research undertaken for RBSG in 2013 stated that [✂]. A survey undertaken for LBG examined attitudes to switching, and found that [✂]% of respondents agreed that switching would be too much hassle. Research undertaken for [✂] in 2013 found that ‘the biggest barrier to switching is the “hassle factor” meaning most stick with their bank for 16 years on average.’

6.129 The risk of error in the switching process was also raised as a significant concern from customers, as noted in the FCA CASS report.[104]

6.130 The FCA CASS report also found that CASS addressed the main concerns expressed by customers about switching;[105] however, customers lacked awareness of CASS and confidence in the service remained low. While figures published by the Payments Council reflected fairly high levels of awareness of CASS (69% of consumers aware of CASS in December 2014), the FCA research found much lower levels of awareness, with only 41% of consumers having heard of CASS prior to completing its survey. These results were lower than the target of 75% awareness set by HMT for June 2015. The FCA CASS report also found that consumers’ confidence in CASS was also currently below HMT’s target of 75% of consumers confident by June 2015. The FCA report states that the Payments Council regularly reports a score for consumer confidence that reflects survey responses to five measures of confidence (ease of switching, effort, speed, control and risk of error). The average score in December 2014 was 65%. However, the FCA consumer research found that consumers’ biggest fear when switching was something going wrong and that, in line with Payments Council findings, the measure for confidence in an error-free process was much lower than the average score. For example, in December 2014, when the average

[103] GfK PCA consumer survey. H1: ‘I am going to read out a number of statements, and I’d like you to tell me how much you agree or disagree with each using the following scale?’
[104] FCA CASS report, p34.
[105] FCA CASS report.

score was 65%, the Payments Council reported that less than 50% of consumers were confident CASS would complete their switch without error. The FCA said that, given that an error-free switch was the biggest concern for consumers, confidence in CASS was likely to be better reflected by this measure and was therefore still relatively low.

6.131 There were also a small number of operational issues associated with CASS, for example:

(a) the risks arising when the redirection service ended;

(b) access to CASS to providers offering alternatives to traditional current accounts;

(c) issues with using CASS for customers requesting overdrafts or with overdrafts that they were unable to repay through a debt management company; and

(d) the non-transfer of continuous payment authorities. These are recurring payments attached to customers' debit cards, which could be disrupted as customers change debit card during the switching process.

6.132 Almost all banks supported the view that CASS was a positive development. Nationwide, for example, considered that CASS made switching 'as easy as possible'. In contrast, TSB told us that the limitations of CASS, including the loss of customers' transaction histories, lack of customer awareness, the fact that it compelled the switcher to close their old account in order to benefit from guarantees, and a lack of functionality around overdrafts were still a concern. Some banks also told us that more should be done to increase awareness of and confidence in the service.[106] In particular, HSBCG stated that increasing awareness of and confidence in CASS would remove discrepancies between perceived and actual costs of switching.

6.133 Further, the CASS process requires an old account to be closed and as such does not facilitate multi-banking. If a customer would like to keep their old account open they do not receive the switching guarantee.[107] In addition, not all banks will transfer payments for a customer if their previous account

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[106] Barclays, Clydesdale, Nationwide, LBG, RBSG and Santander.
[107] The Switch Guarantee: It will only take seven working days. The service is free to use and customers can choose and agree a switch date; the bank will take care of moving all payments going out and those coming in; if money is in an old account, the bank will transfer it to the new account on the switch date. For 36 months, the bank will arrange for payments accidentally made to the old account to be automatically redirected to the new account. The bank will also contact the sender and give them the new account details. If there are any issues in making the switch, they will contact the customer before the switch date. If anything goes wrong with the switch, they will refund any interest (paid or lost) and charges made on either the old or new current accounts as a result of this failure.

remains open. However, customers can open a new account, and at a later stage, make a full switch using CASS, if they were satisfied with their new account. This facilitates switching as customers do not need to commit to closing an old account before they have experienced using their new account.

6.134 We consider that CASS eases the switching process for full account switching as it provides a guarantee to the customer. Nevertheless we agree with concerns raised by the FCA and some banks that there is a lack of awareness and confidence in the service which may hinder its success. We consider that CASS provides a useful guarantee for customers, including those that wish to switch immediately and those wishing to use their new account before switching.

Overdraft users

6.135 The FCA rules require banks to assess the creditworthiness of a customer before entering into a credit agreement.[108] The FCA rules specify that a PCA provider offering an arranged overdraft needs to consider any adverse impact on the customer's financial situation and the ability of the customer to make repayments as they fall due or within a reasonable period.

6.136 We found that this requirement may give rise to specific additional barriers for overdraft users, relating to both account opening and account switching. In particular, some overdraft customers could be deterred from applying to open a new account because they may fear that the same overdraft facility as they currently hold would not be offered to them by a new provider.

6.137 In more detail, the GfK PCA qualitative research[109] found that some heavy users of arranged overdrafts[110] felt that PCA choice would be constrained by their overdraft. The following issues were raised:

(a) Perceptions that customers were 'locked' into their current bank until the overdraft was paid off.

(b) Perceptions that a new bank would want to see the PCA in credit, ie no overdraft usage.

(c) Concerns that a new bank may not offer the same overdraft amount.

[108] FCA Consumer Credit sourcebook 5.2.1.
[109] GfK PCA consumer survey, pp64 & 65.
[110] Where heavy overdraft users are taken to be those customers who use overdrafts in at least nine months of the year, and make up just over 5% of the sample.

(d) PCA providers would not say in advance of the application whether they will offer the same overdraft conditions as the current bank.

6.138 Similarly, the FCA CASS qualitative research also suggested that there was a lack of clarity about whether it would be possible to move accounts when the account is in overdraft but this did not emerge as a primary concern.[111]

6.139 We asked PCA providers whether their overdraft users would be offered the same overdraft limit if they applied as a new customer today. Evidence showed that the percentage of overdraft customers who would not be offered the same overdraft terms if they applied as a new customer varied between 3% and 29%.[112] One bank noted that customers with higher overdraft limits were less likely to be offered the same overdraft limit.[113] One potential reason for this was a change in the customer's personal circumstances, for example a reduction in income. Another potential reason was the lack of access to historical customer transaction data, since the banks assessed the overdraft limit assuming the customer was new to the bank.

6.140 We also considered reasons why PCA providers may not be able to match an existing customer's overdraft facility. In the main, a provider's creditworthiness assessment must be based on sufficient information obtained from the customer or, where necessary, from a credit reference agency. Consequently, any bank offering an overdraft has to assess the borrower's creditworthiness before concluding a credit agreement and therefore an acquiring bank cannot automatically guarantee to match existing overdrafts.

6.141 We also found that in some circumstances a customer who had applied to a new provider would not know whether they would be granted overdraft facilities until a later stage of the application process,[114] by which time their old account may have been closed.[115] Furthermore, some overdraft

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[111] Optimisa research (March 2015), *Engagement with current accounts and the switching process*, p36 ('FCA CASS qualitative research').
[112] LBG told us that as many as [✂]% of its overdraft customers and as many as [✂]% of its full facility PCAs were credit-constrained. LBG provided analysis segmented by overdraft balance which demonstrated that the proportion of credit-constrained customers increased with the size of the overdraft balance. Santander told us [✂] would be account inactivity or a change in circumstances, for example the customer becoming bankrupt or accruing adverse credit information. This analysis was based on the observed customer account usage (for example, credits to the account and conduct of the account) and external customer data which will be different to that when the overdraft was originally allocated. HSBCG told us that [✂]% of existing HSBC customers, [✂]% of existing first direct customers and [✂]% of M&S Bank customers utilising their overdraft would be offered the same or a higher credit limit if they applied as a new customer today. In order to try to replicate any decision HSBCG would make at account opening, it has compared the average value of overdraft limits provided to its new customers against existing customers with the same risk score and the actual overdraft limit these customers held with it in May 2015.
[113] LBG.
[114] [✂] it is not possible to apply for an overdraft online at the account opening stage.
[115] The FCA CASS report found evidence of a problem experienced by some consumers requesting an overdraft on a new current account to which they planned to switch. CASS is designed so that a switch starts once the

customers may be referred to branches. Both factors increase the time and inconvenience of the switching process for overdraft users.

6.142 Finally, certain customers, such as heavier overdraft users and particularly those in financial difficulties, may actually be impaired by their low credit score and in turn may have fewer options either for switching PCAs, or switching to other forms of credit.

Summary of parties' views

6.143 In its response to our provisional findings report, HSBCG questioned the evidence base for specific barriers to account opening and switching for overdraft users.[116] It told us that the concerns raised by the GfK PCA qualitative research were based on the 'perceptions' of a very small sample. It also told us that our results on the monetary gains from switching for overdraft users were too high and that the conclusions based on the quantitative analysis were not robust. We recognise that the GfK PCA qualitative research was not designed to represent the whole population of PCA holders, however it was designed to concentrate on a small number of key demographic and behavioural groups, which included overdraft users. We recognise that there are caveats on the interpretation of the evidence on propensity to switch and search by overdraft users in our econometric analysis of switching, see Appendix 6.2. Our view, however, is that there is sufficient corroborating evidence in that overdraft users had concerns that if they switched accounts either their new account may not be able to match their current overdraft facility, or they may only know about the overdraft offered at their new account until after they closed their old account and their low credit score may actually prevent them from doing so to suggest there are additional difficulties for overdraft users to switch accounts.

Summary of evidence on barriers to initial engagement, searching and switching

6.144 We analysed whether there are any barriers to initial engagement and for customers to access and assess information about available PCA products. We found the following:

account opening process is complete, hence once the consumer has been informed whether their application for an overdraft on the new account has been successful. However, the FCA found that at some banks this did not happen and a switch could be initiated before a decision on an overdraft was made.

[116] HSBCG response to provisional findings, paragraph 3.13.

(a) Information on PCA pricing is easily accessible but difficult to assess and understand due to the complexity of charging structures. This is particularly true for overdraft charges.

(b) Our actual versus perceived analysis demonstrated that many overdraft users lack awareness of their overdraft usage. The lack of awareness makes it more difficult for them to assess which PCA offers the best value for them given their overdraft usage. However, we consider that the increasing digitalisation of banking through internet and mobile banking has facilitated customer engagement with their own account.

(c) Information on the quality of service provided by different banks is difficult to access and compare, despite the fact that service quality is very important for many PCA customers.

(d) The availability of PCWs to ease comparisons has been limited and underdeveloped. One exception is the Gocompare.com Midata initiative which we consider to be a positive development.

6.145 We considered barriers to switching and found that customers perceive the application and switching process to be ‘a hassle’ and there are issues relating to the uncertainty and timing of overdraft acceptance. CASS has improved the switching process but there are still concerns relating to awareness of and confidence in the system, and a number of operational issues.

How banks compete in the PCA market

6.146 Our analysis of customer engagement set out above has found that there are low levels of customer engagement with PCAs, due to various factors including the existence of barriers for customers to access and assess information and barriers to switching.

6.147 The low customer engagement means that the discipline imposed by customers on banks through switching and the threat of switching is not as strong as it would be if more customers were engaged, and this in turn weakens banks’ incentives to compete to gain new customers and retain existing customers.

6.148 We have found that one of the factors that makes it difficult for customers to engage is the complexity in pricing structures and the difficulties of comparing the offers of different banks. In this section, we briefly summarise the main developments in pricing, service and innovation and marketing, and whether these developments are likely to increase engagement by customers, or rather contribute to the low levels of engagement observed.

6.149 We then present our analysis of PCAs as a gateway product, and finally present our assessment of the FIIC pricing model, focusing on the extent to which it contributes to the low levels of engagement we observe, and its distribution effects.

Pricing strategies

6.150 As we discuss in Section 5, product innovation in the PCA market over recent years has primarily taken the form of the development of reward accounts, which offer benefits to customers such as credit interest or cashback on transactions, and the introduction of switching incentives, typically in the form of cash payments, in order to attract new customers. There has been an increase in the number of such accounts launched in recent years, with many banks now offering some accounts which deliver benefits to customers in the form of cashback or credit interest, in some cases these accounts also charge monthly fees though these may be waived if certain conditions apply.

6.151 The main developments in PCA pricing and examples of these are summarised below;[117]

- **Arranged overdraft fees**. Banks have made changes to their arranged overdraft fees. For example, Barclays updated its charging structure in June 2014, moving from charging interest on the overdraft amount to a tiered daily amount of 75 pence per day for overdrafts up to £1,000, £1.50 per day for £1,000 to £2,000 and £3 per day for £2,000 to £5,000.[118]

- **Unarranged overdraft fees**. There have also been changes to unarranged overdraft fees, although we recognise that regulatory intervention has played an important role in this area, for example the OFT unarranged overdraft charging scenarios. Appendix 6.3 provides more detail on this topic. Some of the banks told us that they had reduced unarranged fees in response to competition. For example, Santander told us that following [✂], a review was undertaken of San UK tariffs. Changes were introduced in August 2014 for 123, Everyday, Premier and Premier Direct Current Accounts.

[117] Further evidence on price competition is provided in Appendix 6.6.
[118] Barclays PCA overdraft fees, consulted 12 August 2015.

- **Financial switching incentives**. Some of the banks offer switching incentives. For example, Clydesdale and Yorkshire Bank offering £150 for switching.[119]

- **Interest rates**. Interest rates on credit balances has also been an area of competition, with banks introducing new accounts paying higher interest rates. For example, Santander's 123 account paying interest of 3% on balances up to £20,000.[120]

- **Rewards**. Some of the banks offer financial rewards to customers.[121] For example, Tesco's bank account offers Tesco Clubcard points.[122]

- **Other financial benefits**. Some banks have begun offering other financial benefits. For example, Metro offers fee-free use of its debit card for purchases or withdrawals in Europe.[123]

6.152 This evidence indicates that PCA providers are changing their pricing offers, and increasingly offering accounts that provide rewards and switching incentives. However, rather than making comparisons between accounts easier, PCA providers still set complex pricing structures for overdraft charges, and the reward structures of the different accounts are also difficult to compare across accounts. For example, the fact that certain reward accounts – such as Clydesdale's Signature account – offer benefits in the form of insurance[124] and cashback along with a £150 cash switching incentive whereas other reward accounts – such as Club Lloyds – primarily offer lifestyle benefits[125] can make a value-for-money comparison challenging. We also note that there has been less active competition on aspects such as arranged and unarranged overdraft fees, with many of the changes being driven by regulation.

6.153 Our analysis of PCA pricing shows that some of the new reward accounts that have been launched are relatively cheap compared with more standard accounts; however, by diversifying their product offering, and by making specific offers to new-to-market customers and to switchers, banks are able to price discriminate to some degree between existing customers, and new or switching customers (the evidence for this is presented in Section 10). Although the introduction of these products suggests that competition has

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[119] Clydesdale Bank current accounts consulted 18 August 2015.
[120] Santander 123 current account, consulted 12 August 2015. 3% interest is paid when the account contains more than £3,000.
[121] Further evidence on the development of reward accounts is provided in Appendix 6.3.
[122] Tesco Bank rewards, consulted 18 August 2015.
[123] Metro Bank, using your card abroad, consulted 18 August 2015.
[124] Including Worldwide travel insurance, UK car breakdown cover.
[125] Such as cinema tickets, magazine subscriptions and gourmet society membership.

increased for new customers and switchers, we find that switching rates remain low so there is a large proportion of customers on older, more expensive products.

Service quality and innovation

6.154 The banks provided us with examples of improving the quality of service, and examples of digital innovations. Many banks have made substantial investment in digital banking services. For example, Danske told us that it was investing to improve customer service through its digital banking offer, including apps, an improved registration process for eBanking, web chat functions and budgeting tools. It also told us that in 2012 it had increased the range of PCA services that customers could undertake in over 400 Post Office outlets across NI.

6.155 Many of these improvements have been made to the potential benefit of all customers, some of which have been supported by regulatory intervention (eg such as text alerts).

6.156 As discussed in Section 5, we consider that the increased digitalisation of banking with their own account has helped customers engage with their account. We also consider that this development reduces customers' searching and switching costs as it eases customers' ability to access and assess their expected account usage, and therefore facilitates choosing the best-value PCA.

Marketing

6.157 Many of the banks told us that they were advertising through different channels to attract new customers. For example, HSBCG told us that it had invested around £[✄] on marketing HSBC Advance until the end of February 2014. It had advertised in many formats, including branch posters, cinema, digital content, emails, London Underground, press, social media and on television. Tesco Bank told us it spent heavily promoting its PCA at launch, and television advertising was the most effective and wide-reaching channel. It expected its marketing budget to normalise at around £[✄] million per year.

6.158 We found that PCA advertising spend had increased in recent years, but the increase had been small. However, some banks – particularly Halifax, Lloyds and Santander – are spending considerable sums on advertising their

PCAs in an attempt to attract customers. Branches still appear to play a role in attracting customers, with PCWs and referral schemes less important.[126]

6.159 We saw no evidence that banks were specifically targeting overdraft users with their marketing, but some of the banks told us that they were taking specific actions to facilitate switching by overdraft users.

PCAs as a gateway product

6.160 As part of the PCA market competition analysis, we also considered the ability of banks to use PCAs as a gateway to cross-sell other products to either retain or acquire customers. Such cross-selling may increase customer acquisition costs for new entrants and particularly benefit incumbent banks.

6.161 Most PCAs are individually profitable and therefore banks do not need to sell additional products to ensure PCAs are profitable, but it may benefit their overall business performance. Marketing additional financial services to existing PCA customers is a strategy adopted by most banks. Appendix 6.6 presents evidence on banks' strategies in relation to cross-selling and evidence from the GfK PCA consumer survey on cross-holding rates.

6.162 Overall, the evidence indicates that selling additional products to PCA customers, while an important source of revenue for banks, is not a fundamental driver of PCA competition. In particular, there is no evidence that PCAs are a loss-leader used to attract customers, who can then be sold other financial products, and no evidence that banks were tying or bundling other products with their PCAs in a way that could lead to AECs in PCAs.

Assessment of the impact of the free-if-in-credit pricing model

6.163 PCA products that do not charge customers for a variety of common transactions are commonly referred to as being 'free-if-in-credit' (FIIC) (see Section 4 for examples).

6.164 However, FIIC is something of a misnomer as customers using FIIC PCAs pay for banking services in the following ways:

(a) Interest forgone: FIIC customers do not pay directly for their PCA or for common transactions, although customers are not generally credited

[126] More evidence on this issue is set out in Appendix 6.6.

with interest on their credit balances and do not receive other payments or rewards.

(b) Non-core transactions/services: FIIC products usually feature charges for additional services, such as foreign exchange transactions.

(c) Overdraft services: customers pay for overdrafts either through a daily fee or interest and incur charges for example for unpaid items.

6.165 For the purposes of this analysis, we refer to FIIC accounts as standard accounts (which do not deliver credit interest, cashbacks or benefits).[127] On this basis, FIIC accounts are the most commonly used PCAs: in 2015, 63% of PCAs in the UK were FIIC accounts. However, in 2015 11% of PCAs in the UK were packaged accounts (which charge a monthly or annual fee in exchange for additional benefits), and 16% were reward accounts (ie accounts which pay interest rates on credit balances and/or significant rewards[128]; usually subject to eligibility conditions and sometimes against payment of a monthly fee).[129]

6.166 We were told of two main areas of concern arising from the FIIC model of pricing for PCA products.

6.167 First, we were told that the FIIC pricing structure reduces customer engagement because:[130,131,132,133,134]

(a) FIIC distorts customers' perceptions of the cost of banking, making them less sensitive to the costs of their PCAs, and/or

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[127] More specifically, a standard account is defined as any account with up to 0.01% or no credit interest, no cashback, no benefits, and which is not a basic account.
[128] The data on share of standard accounts for 2015 is not comparable to data presented elsewhere in this section for 2011-2014 due to different treatment of student and youth accounts
[129] Our definitions of standard, reward and packaged accounts are set out in Section 4.
[130] RBSG told us that the FIIC model reduced the incentive to switch by giving rise to the perception that there was little to gain from switching; in its response to our provisional findings (p4) it further submitted that the FIIC model 'is distortive of customer perceptions of the cost of banking'.
[131] TSB, in its response to our provisional findings (paragraph 24), stated that 'customers do not currently have the tools to compare and contrast the true costs and benefits of different banking services easily, meaning that they see little benefit in switching accounts – and this is exacerbated by the myth that banking is "free".'
[132] The Financial Services Consumer Panel (FSCP) told us, in response to our provisional findings (p1), that the lack of differentiation between banks was exacerbated by the FIIC model and that 'cross-subsidisation, coupled with murky pricing structures and contingent charges, obscured the true cost of having a banking account.
[133] Virgin, in its response to our provisional findings (p1), stated that: 'The complexity and opacity of pricing under the FIIC model makes it very hard for customers to assess the true cost of their PCA banking, for charges made and interest forgone and even harder to assess the cost of PCAs of other banks. This leads to a negative impact on customers' incentives and ability to search and switch PCAs. The market would work better if firms competed on headline prices and service quality.'
[134] Santander told us that free banking potentially perpetuated lower customer engagement as customers might not perceive the cost of forgone interest as an expense in the same way as paying a monthly fee.

(b) the opacity of the FIIC pricing structure makes it challenging for customers to compare the cost of PCAs.

6.168 We were also told that as a result of this reduction in customer engagement, the FIIC pricing model makes it more difficult for banks to acquire customers.

6.169 Second, we were told that it results in cross-subsidies between different groups of customers. Specifically, we were told that:[135,136]

(a) overdraft users subsidise the cost of PCA banking for other customers; and/or

(b) customers with high credit balances subsidise those with low credit balances.

6.170 We investigate these claims in this section. We first present some recent trends in FIIC and evidence on how FIIC impacts on customer engagement. We then present evidence on the total costs of PCAs to customers when charges for additional services and interest forgone are also taken into account. Finally, we examine evidence on cross-subsidies and the distribution of costs between customers.

Impact of FIIC on engagement

6.171 As set out above, we were told that the FIIC pricing structure reduces customer engagement because it makes the true cost to customers of banking opaque, making customers less sensitive to the cost of PCAs and making it difficult to compare PCAs.

6.172 Against this, Barclays told us that the FIIC model promoted multi-banking, which might increase consumer engagement, and LBG told us that FIIC might give customers an ability to ‘try before you buy’ and so remove some of the uncertainty about different providers, which could encourage switching.

6.173 To assess the impact of FIIC on engagement:

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[135] Virgin, in its response to our provisional findings (p2) stated that the CMA’s analysis had shown that the FIIC model continued to lead to significant cross-subsidies between different groups of PCA customers and that it was unfair that customers who enjoyed genuinely free banking should be cross-subsidised by users of overdrafts, as this group was likely to include customers who were less affluent, less educated, less likely to switch and vulnerable to price discrimination.
[136] The Financial Services Consumer Panel (FSCP) told us, in response to our provisional findings (p1), that it had commissioned research on cross-subsidisation in 2014 which concluded that among the biggest losers in the PCA market were those with high balances not earning interest; and people who used overdrafts.

(a) We discuss some recent trends in PCA markets and product offerings.

(b) We present survey evidence on whether customers of FIIC products are less engaged.

(c) We look at engagement in other countries or other markets which do not operate FIIC pricing of products.

Recent trends in PCA product offerings

6.174 Over the past few years a number of banks have started introducing new PCA products which are moving away from the traditional FIIC pricing model. We have seen an increase in the offer of reward accounts which either offer interest on credit balances, cashback or financial benefits – in some cases conditional on some minimum requirements or against payment of monthly fees. Santander launched the Santander 123 account in 2012 (which offers credit interest against payment of a monthly fee); many banks have since then introduced rewards accounts, such as for example the launch of Club Lloyds by LBG in 2014, and Barclays Blue in 2015 see Appendix 6.6 for further details. As we set out in Section 10, banks are primarily targeting more affluent customers with high credit balances through these products.

6.175 Reward accounts have greatly increased their share of new account openings: 34% of new PCAs that were opened were reward accounts in 2015, against only 8% in 2011. Reward accounts have also gained overall market share, albeit at a slower pace: from only a 6% share of active accounts in 2011 to 16% in 2015.

6.176 At the same time, FIIC accounts have lost share: the proportion of new PCAs opened that are FIIC products has decreased from 50% in 2011 to 43% in 2014, and FIIC products' share of all active PCAs decreased from 64% to 62% in the same period.[137]

6.177 Therefore, FIIC accounts remain the most common type of product held by customers, but are slowly losing share. This is a result of banks introducing reward accounts targeting the more affluent customers with high credit balances, and as customers are increasingly opening reward accounts rather than traditional FIIC accounts. Despite the increase in the offer of

[137] The data on share of standard accounts for 2015 is not comparable to the data for 2011–2014 due to different treatment of student and youth accounts.

reward accounts by banks, some of which are substantially better value for money for customers (see Section 5), levels of switching remain low.

Are customers with non-FIIC accounts more engaged?

6.178 We compared searching and switching rates depending on whether customers were using FIIC accounts or non-FIIC accounts (reward and packaged accounts) to compare measures of engagement. The results from the GfK PCA consumer survey show a limited tendency for more customers on a reward or packaged product to have looked around for a PCA compared with customers on an FIIC product: in the previous three years 26% of customers on an FIIC product searched the market compared with 29% on reward or packaged.[138]

6.179 Fewer customers with FIIC products switched banks compared with customers with reward and packaged products: In the last year, 2% of customers on FIIC PCAs switched current account from another bank compared with 4% of customers on reward products and 3% on packaged products. In relation to packaged PCAs, we note that the switching rate may be influenced by negative publicity surrounding these accounts, as evidenced for instance by the volume of complaints – complaints regarding packaged PCAs increased by 278% between 2014 and 2015.[139]

6.180 There is a limited tendency for more customers on FIIC products to find it difficult to compare products than customers on reward products: around 24% of customers with FIIC products report finding it difficult to compare between PCAs compared with 20% of customers with reward products, a statistically significant difference.[140,141]

6.181 Fewer customers on FIIC products agree that there are real differences between banks in the PCA products they offer relative to customers on other products. 45% of customers on FIIC products perceived differences between bank PCA product offerings compared with 51% for those on reward products, a statistically significantly difference. The remainder of

[138] Appendix 6.9.
[139] Appendix 6.3 shows that the majority of the most common fee-paying accounts per bank are packaged accounts. According to data from the Financial Ombudsman Service (FOS), complaints in relation to packaged accounts have increased from 5,667 in March 2014 to 21,348 in March 2015 by 278%. In comparison, complaints about all types of current accounts increased by only 78% from 19,878 in March 2013 to 35,344 in March 2014 (Financial Ombudsman (2015), Annual review of consumer complaints, p46).
[140] Appendix 6.9.
[141] Appendix 6.9

respondents either disagreed there were differences, did not know or reported neither agreement nor disagreement.[142]

6.182 Overall, therefore, we find higher search and switching rates for customers on non-FIIC accounts. We would expect higher switching rates for customers on non-FIIC products given that reward accounts are relatively new and so customers using these accounts have switched relatively recently. We also find that customers on FIIC accounts are more likely to find it difficult to compare accounts, and less likely to agree that there are real differences between banks. The latter differences are very small, however, and likely to be a result of customers with reward accounts having engaged with the market recently: we found more generally that those customers who had experienced searching and switching had found it easier to compare accounts than those who had not.[143]

International comparisons and comparison with other markets

6.183 We have looked at the extent of customer engagement in other countries, some of which have different pricing models to FIIC, and also looked at the BCA market, where SMEs are directly charged monthly fees and/or pay per transaction.

6.184 A European Commission study from 2012 found that the percentage of UK customers switching within the last two years was close to the average of 4% for the EU member states included in the survey, despite other EU countries not operating an FIIC model.[144]

6.185 We undertook a detailed case study of the Dutch retail banking market (see Appendix 6.8). We focused on the Netherlands because there have been a number of recent regulatory reviews of retail banking in the Netherlands, and the Dutch retail banking market displays many similar characteristics to the retail banking market in the UK, such as high levels of concentration in the PCA market. One aspect in which the Netherlands differs from the UK is that PCAs in the Netherlands require the account holder to pay a monthly fee. This can vary from €15 to €160 per year, but averages at around €70 per year.[145] However, switching rates do not appear to be higher in the Netherlands compared with the UK. The Authority for Consumer and

[142] Appendix 6.9.
[143] See GfK PCA report.
[144] Bank fees behaviour study conducted by TNS at the request of Directorate-General for Health and Consumers. The EU10 average was based on the following switching rates across the previous two years: Germany (3%), Ireland (4%), Spain (6%), France (2%), Italy (5%), Latvia (2%), Netherlands (2%), Romania (8%), Sweden (4%) and UK (4%). Sample size of around 1000 respondents per country.
[145] See Appendix 6.8 for further details.

Markets (ACM)[146] commissioned a survey, which found similarly low engagement levels in the Netherlands. For example, 73% of all Dutch consumers who are 18 years old or older have never voluntarily switched banks, while 24% have done so only once.[147]

6.186 Research submitted by Barclays conducted in 2013 states that the UK was unique in offering FIIC standard current accounts in 2012; only US credit unions and one major player in Australia offered FIIC PCAs. It concluded that switching rates in the UK were 'amongst the lowest in the world' in 2012.[148] Barclays' cross-country comparison relied on the results of a number of different surveys whose methodologies may not be fully comparable. For instance, the UK switching rate of 3.1% quoted in the paper is based on the GfK survey for 2012 which asked about switching within the previous 12 months whereas [✂].[149] The switching rates for other countries appear very high compared to other data we have. [✂] Also, we note that the Barclays study found that average revenue per PCA in UK was among the lowest of the countries studied. Overall, therefore, Barclays' research does not provide clear evidence that FIIC results in lower switching rates in the UK.

6.187 Barclays told us that the FIIC model promoted multi-banking, which might increase consumer engagement. LBG told us that FIIC might give customers an ability to 'try before you buy' and so remove some of the uncertainty about different providers, which could encourage multi-banking. Consistent with this, we found that multi-banking levels are lower in the Netherlands, where customers typically pay a fee for their account, than in the UK.[150] This is consistent with multi-banking being facilitated by the FIIC pricing model.

6.188 BCA products do not adopt the FIIC pricing model, and we find that switching rates in the UK are as low as those observed in the PCA market (see Section 8). Further, in the BCA market, pricing structures (where SMEs pay directly for common transactions and/or a monthly fee) are very complex, making it very difficult for SMEs to compare prices across BCAs. It is therefore not the case that direct charging models are necessarily more transparent than FIIC pricing models.

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146 ACM is the primary competition authority in the Netherlands, providing consumer protection and market oversight.
147 ACM (2014), p76. See Appendix 6.8 for more details.
148 [✂] This conclusion was based on the following switching rates: UK (2012: 3.1%), [✂], USA – small banks and credit unions (2012: 0.9%), [✂].
149 [✂]
150 In the Netherlands there are 1.16 PCAs per adult whereas the level of multi-banking in the UK, as indicated by the GfK PCA consumer survey, is 1.8 per adult.

Summary on impact of FIIC engagement

6.189 Overall, the evidence does not suggest that the FIIC pricing model reduces engagement in the PCA market:

(a) We have not found that the FIIC pricing model is contributing significantly to lower switching rates. Evidence from other countries which do not operate an FIIC pricing model does not point to customer engagement being higher under different pricing models; similarly, the BCA market, which does not operate an FIIC pricing model, has similar rates of switching.

(b) Our survey evidence shows small differences between customers on FIIC and reward accounts in terms of measures of engagement; these most likely reflect the fact that customers on reward accounts will generally be among the more engaged customers, as such products are relatively recent and hence their customer base is more likely to consist of recent switchers. It would therefore be incorrect to interpret this to mean that the FIIC pricing model is a material cause of lack of engagement. Alternative pricing models to FIIC such as reward products are not necessarily any more transparent than FIIC products. For instance, we found that pricing structures for BCAs (where SMEs pay for common transactions) are very complex, making it difficult for SMEs to compare prices across BCAs. We have also found that reward accounts, particularly where rewards are dependent upon personal usage, are difficult to compare.

(c) There has been a move away from FIIC with the increase in the number of banks offering reward products and customer take-up of reward products has meant that they have gained market share. Switching rates, however, remain low. This suggests that the main barrier to engagement is not FIIC but the complexity for customers in comparing offers and assessing best value and the barriers to switching accounts.

6.190 We note the findings from the Barclays study that average revenues per PCA were among the lowest of the countries studied; suggesting that FIIC is not necessarily associated with low overall costs of banking when comparing to other countries with different pricing models. In addition, to the extent that FIIC facilitates multi-banking, it may make it easier for some customers to switch through trying new accounts before switching their main account.

6.191 This is not to deny that there are real problems with the PCA market. We have found that there is a lack of transparency about the cost of PCAs, and that this makes it difficult for a consumer to compare PCAs and select the best one for them. However, we find that the underlying reason it is difficult to compare and select the best PCA is not FIIC in itself, but the overall complexity of fees, in particular overdraft charges and the lack of tools available to consumers to combine various charges with their individual account usage to make comparisons.

6.192 We see a shift away from FIIC pricing model as banks have increasingly introduced new types of accounts with a different pricing structure and which deliver financial benefits to customers in the form of interest on credit balances, cashback or financial reward, in some cases also charging monthly fees. We expect that, as customers are prompted to switch, and their ability to compare products and switch increases as a result of our remedies, and as customers get prompted to switch, this will incentivise banks to improve their range of offerings and offer products which may be more attractive to customers than standard FIIC products.

The costs of banking to PCA customers

6.193 In the last quarter of 2014, 46% of PCA customer accounts of large banks incurred direct charges of one form or another, and overdraft charges were the most common charges incurred (28% of customers). 76% of the customer accounts that incurred charges paid less than £10 in the last quarter of 2014.

6.194 Half of banks' revenue from supplying PCAs in 2014 was from the interest earned by banks from lending out customers' credit balances (see Table 5.6). We used transaction data to estimate the total costs to customers when charges for additional services and interest forgone are included. We calculated the revenue banks receive from each customer, looking separately at customers with FIIC products,[151] reward products and packaged products. This gives an estimate of the total costs to customers of PCAs, including both direct charges and indirect costs due to interest forgone, and net of any financial benefits to customers (in the form of credit interest or rewards).

6.195 Figure 6.7 shows that:

(a) in 2014 all groups of PCA customers generated positive revenues to banks. There were almost no PCA customers incurring no cost of

[151] Throughout this analysis, we define FIIC accounts as standard accounts.

holding a PCA, and therefore effectively paying negative prices, once interest forgone is accounted for.[152]

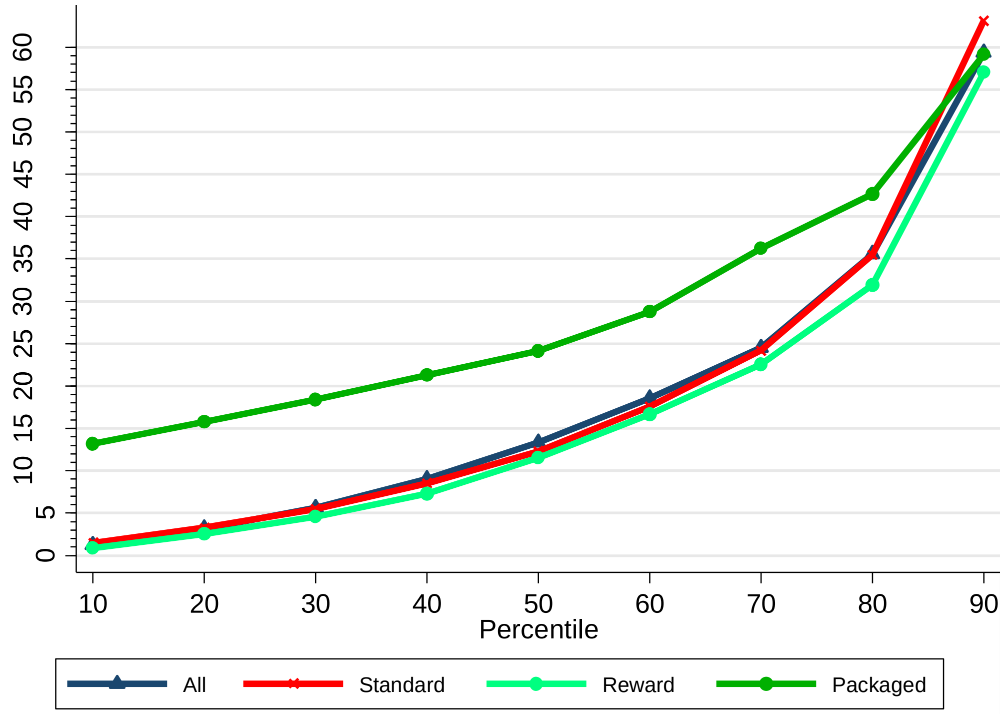
(b) There is considerable variation in total revenue generated across customers – 10% of accounts in our sample generated less than £1.26 per month in total average revenue whereas the highest 10% of PCA holders generated over £59.37 in revenue per month.

(c) The distribution of average total cost to customers is broadly similar for FIIC and reward accounts.

(d) Average total cost to customers for packaged accounts tends to be higher than for FIIC and reward accounts.[153]

(e) The average cost to customers of a main PCA in 2014 was of the order of £14.75 per month including interest forgone (as set out in Table 5.6).

Figure 6.7: Monthly average costs of PCAs to consumers, including interest forgone, by product type (£ per main PCA), UK 2014



Source: CMA analysis of transaction data supplied by banks.
Note: Base size (unweighted base) is 3,709 (all products), 1,748 (standard), 1,164 (reward), 297 (packaged). Average revenue includes interest forgone. Forgone interest calculated as BoE base rate on average credit balances less interest and non-interest payments to customers, monthly average across Q4 2014.

[152] We find that only 2% of customers were effectively paying negative prices taking into account forgone interest.
[153] Average total cost to customers of packaged and rewards accounts are net of any financial benefits that customers receive on these accounts

6.196 We find considerable variation across customers in the amount of interest forgone, ranging from under £0.61 per month for the lowest 10% of customer accounts to over £42.66 for the highest 10% of accounts. The range in interest forgone is broadly similar for FIIC and reward accounts but is lower for packaged accounts.[154]

Cross-subsidies and distribution effects

6.197 Cross-subsidies occur when firms sell some products or to some customers at a price below incremental costs, and fund this through higher prices on other products or customers. FIIC involves an element of cross-subsidies between services offered for any given customer, as common transactions (for which banks incur some incremental costs) are provided for free in exchange for access to customers' credit balances.

6.198 As submitted by some parties, cross-subsidies could occur between different groups of customers (for example, high to low credit balance customers; or overdraft users to non-overdraft users), or across products (for example, some types of PCAs being subsidised by others). However, if we observe different groups of customers making differential contributions to common costs, this does not necessarily imply that banks are making losses on some customers that are being cross-subsidised by others.

6.199 These different types of cross-subsidies are not mutually exclusive, and different banks (depending on how they allocate costs and their strategy) may be cross-subsidising in several ways. Rather than attempting to assess the extent of cross-subsidies empirically, we have focused on evidence of cross-subsidies across groups of customers in light of the representations made by some parties and also the potential distributional effects arising from the FIIC pricing model.

6.200 We note that nine banks have entered into commitments to offer basic bank accounts free of all charge to anyone who does not already have a bank account or who cannot use their existing account due to financial difficulty.[155] Basic bank accounts do not provide any overdraft facility, or a cheque book usually. Because basic bank accounts do not have any charges (including overdraft charges), and also do not generate large revenues to banks from interest on positive credit balances (due to these being attractive to those with low credit score, see Section 4), a degree of cross-subsidisation may be occurring. The evidence from banks is that basic bank accounts are the least

[154] Appendix 6.9.
[155] Basic bank accounts represented approximately 11% of all UK PCAs (and 7% of main PCAs) in 2014; see Section 4.

profitable of accounts and some banks have stated that such accounts are loss-making based on their data. To the extent that there are cross-subsidies from other PCA products to basic bank accounts, however, this will benefit those who use basic bank accounts, who would tend to be customers in more vulnerable financial situations.

Cross-subsidies between customers

6.201 We were told that FIIC may result in overdraft users cross-subsidising credit-only users, or high-credit-balance users cross-subsidising others.

6.202 Banks may be able to extract higher margins from certain categories of customers: those for whom competitive pressure is weaker; for instance, overdraft customers, as well as more generally for less engaged customers. As a result of this, some customers are likely to contribute more to banks' common costs than others. However, as we explain above, this does not necessarily imply that certain customers are cross-subsidising others, in the sense that banks are making a loss on some customers that is funded by higher prices to others.

6.203 We analysed whether there were any customer groups who were effectively generating zero or negative revenues for banks. If this were the case, this would imply that these are being cross-subsidised by other customer groups. As set out above, our analysis shows that nearly all PCA customers generate positive revenues for banks (once interest forgone is taken into account). That analysis does not take account of banks' costs of serving customers or any differences in costs in serving particular customer groups. Therefore, it does not mean that all PCA customers are profitable. However, it does not constitute strong evidence that banks are cross-subsidising across customers.

6.204 This is consistent with our comparison of average revenues generated by products with and without overdraft use. This analysis suggests that there is no strong evidence that overdraft users are effectively cross-subsidising other users. Table 6.2 shows that:

(a) both overdraft and credit-only users generate a positive revenue for banks;

(b) on average both overdraft users and credit-only users generate positive revenues for banks, once interest forgone is accounted for; and

(c) average revenues from overdraft users are very similar to those from credit-only users (£26 per month on average for both overdraft users, and credit-only users).

6.205 This is also consistent with our analysis of aggregate banks' revenues, which shows that interest forgone accounts for a greater proportion of banks' revenue than income from overdraft charges (50% and 34% respectively).

Table 6.2: Monthly average revenue by source separately for non-overdraft users and overdraft users

		£
	Non-overdraft	*Overdraft*
Total revenue	25.82	25.94
Forgone interest	24.20	3.55
Overdraft charges	0.20	19.06
Other	1.42	3.33

Source: CMA analysis of transaction data supplied by banks.
Note: Analysis for reward and standard accounts only. Revenue monthly average is across Q4 2014. Overdraft based on average monthly number of days in overdraft across Q4 2014. Values are non-zero for some non- overdraft users; this is likely to be because of timing of overdraft charges relative to overdraft occurrence. Base size (unweighted base) is 3,414 (all), 2,480 (non-overdraft) and 934 (overdraft).

Distributional effects

6.206 As set out above, the fact that some customer groups may contribute more to common costs does not necessarily imply cross-subsidies. However, in light of the submissions we received on the potential distributional effects of FIIC, and in particular concerns that poorer customers may be paying more for PCAs than wealthier customers, we conducted analysis to understand which categories of customers were incurring the highest costs for their PCAs. In particular, whether there is evidence that less wealthy customers (on various measures) are effectively paying more for PCAs than wealthier customers under the FIIC pricing model, and/or whether heavy overdraft users pay the highest costs.

6.207 Overdraft users generally pay more in direct charges for PCAs than non-overdraft users; we therefore looked at the characteristics of PCA customers and differences in income levels, education levels and financial literacy between those who use overdrafts and those who do not. Our analysis[156] found that:

(a) Arranged-only overdraft users are generally more likely to have a high income, and less likely to have a low income, than customers who do not use any overdrafts and those who use unarranged overdrafts. A larger proportion of customers who do not use any overdrafts tend to have low income than those who use any type of overdraft.

[156] See Appendix 6.5.

(b) Our analysis shows that customers who use arranged overdrafts only are more likely to have a degree-level education compared with non-users and unarranged overdraft users. They are also more likely to be financially literate.

(c) When we look at demographics by intensity of use of overdrafts, we found that customers in the heavy users group are less likely to have a low income (27%), compared with light users (34%).

6.208 Overall, our analysis does not find large differences in demographics between customers who do not use an overdraft and those who use unarranged overdrafts. There are, however, differences between those who use arranged overdrafts only and the other two groups: customers who only use arranged overdrafts tend to be wealthier, more likely to have a degree and more likely to be financially literate. We do not find that heavier overdraft users have a lower income than lighter users, rather the reverse holds. Therefore, overdraft users (who pay more in direct charges than credit-only users) do not have lower incomes, nor are they less educated, than credit-only customers.

6.209 We also looked at how total costs varied across customers depending on their income level taking into account interest forgone. Figure 6.8 below shows the average cost per account (including interest forgone) ranked by the customers' average monthly income. It shows that:

(a) for FIIC accounts, customers with low incomes (lowest and second lowest income deciles) paid the lowest average costs (£17 per month for those in the lowest income[157] decile, and £15 for those in the second lowest income decile);

(b) customers in the highest income decile paid the highest average cost (£63 per month);

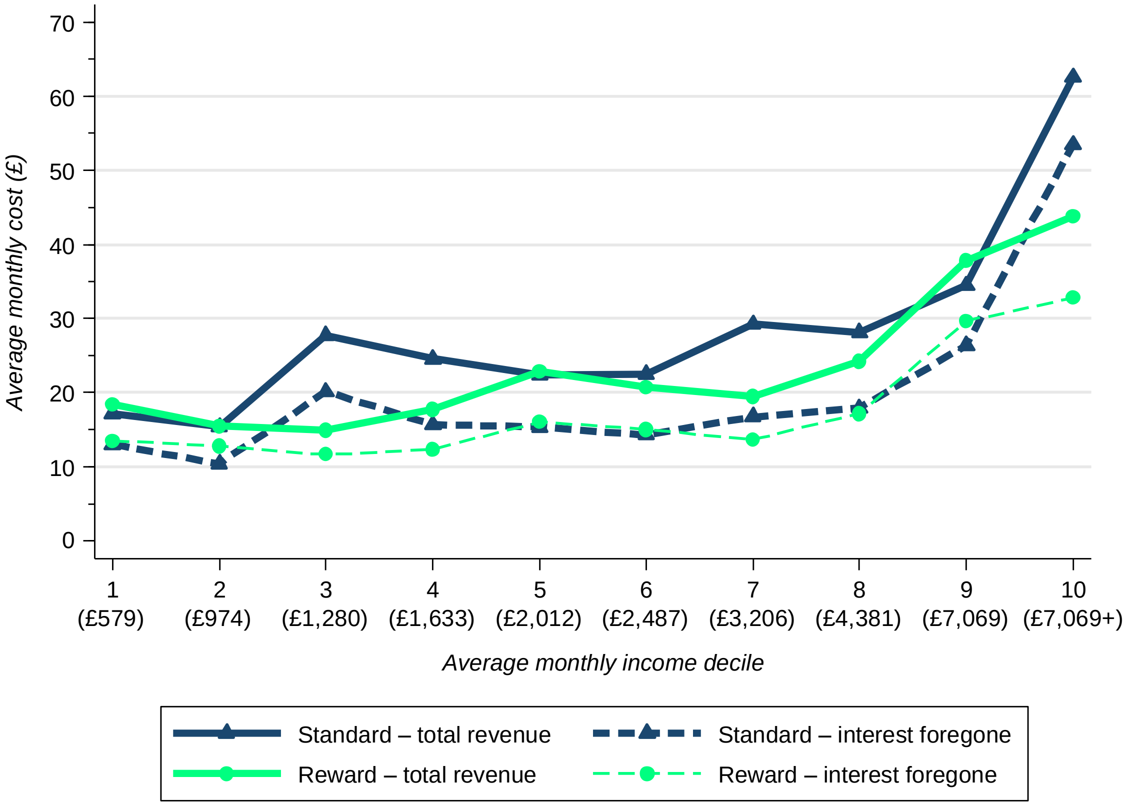
(c) most of this cost is interest forgone – ranging from around £13 per month for those in the lowest income decile to £53 for those in the highest income decile; and

(d) the pattern for reward accounts is broadly similar.

6.210 The evidence therefore does not indicate that lower income customers contribute more than higher income customers under the FIIC pricing model.

[157] Total value of payments and transfers into the PCA.

Figure 6.8: Monthly average cost (including forgone interest) per account ranked by monthly income decile in the last quarter of 2014, UK



Source: CMA analysis of data provided by banks.
Notes:
1. Analysis of main accounts.
2. Forgone interest calculated as BoE base rate on average credit balances less interest and non-interest payments to customers.
3. Average monthly income decile across reward and standard PCAs. Income is total payments and transfers into the account, monthly average across Q4 2014.

6.211 We also looked at how total costs including interest forgone varied across customers depending on their credit balance. Customers with high credit balances pay more than customers with low credit balances – average costs varied from under £10 for the 10% of accounts with the lowest credit balance to over £142 for the highest 10% of accounts. Interest forgone represents a greater proportion of these costs for accounts with higher credit balance and we also see that high credit balance customers would on average pay less with reward accounts.[158]

6.212 We also examined the average cost per account depending on intensity of overdraft usage and credit balances. Figure 6.9 shows average cost per month according to the number of days the customer was overdrawn (for customers who went into overdraft) and according to credit balance (for those who did not use overdrafts). It shows that:

[158] Appendix 6.9.

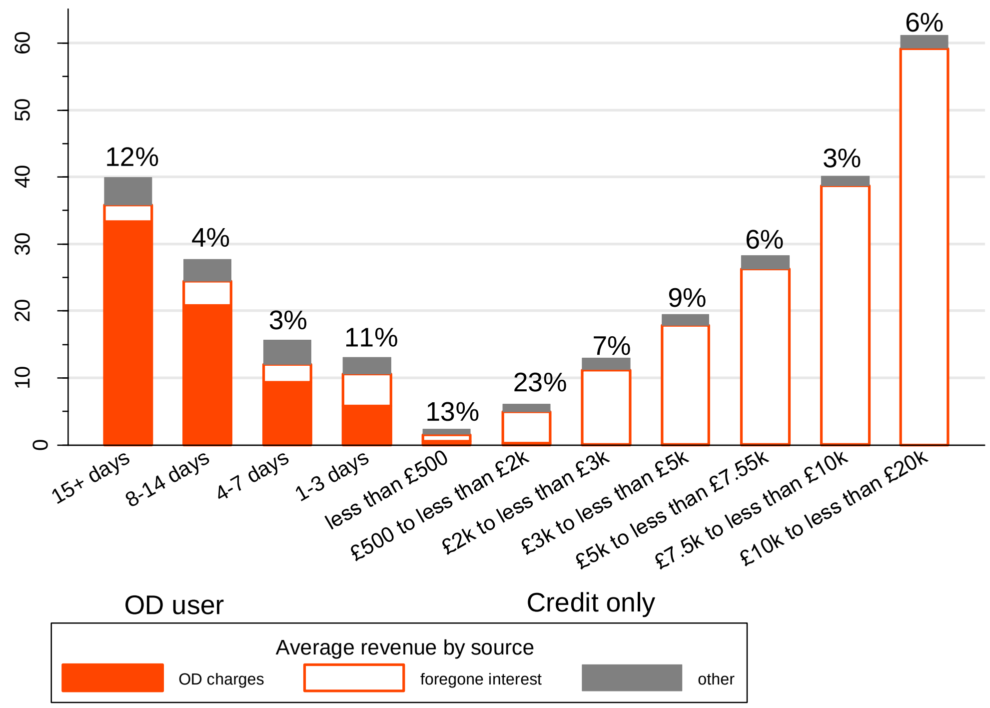
(a) For customers in credit only, costs increase with credit balance (£2 for credit balances of less than £500 compared with over £60 for credit balances of £10,000 or more).

(b) For customers who use overdrafts, costs increase with the number of days overdrawn (£13 for accounts 1 to 3 days overdrawn compared with £40 for accounts more than 15 days overdrawn).

(c) Customers with high credit balances (over £7,500) contribute more than customers with heavy overdraft usage (more than 15 days), when interest forgone is taken into account. We note that similar proportions of customers are heavy overdraft users (12%) compared with customers with credit balances above £7,500 (13%).

(d) Customers with no overdraft and low credit balances pay the lowest costs.

Figure 6.9 Average revenue per month (£) by number of days on overdraft and credit balance



Source: CMA analysis of data provided by banks.
Notes: Analysis of main accounts. Percentages in the graph denote the proportion of main accounts in this category. Overdraft based on average monthly number of days in overdraft across Q4 2014. Analysis for reward and standard/FIIC accounts only. Values are non-zero for some non-overdraft users; this is likely to be because of timing of overdraft charges relative to overdraft occurrence. Data for main accounts with credit balance exceeding £20,000 (representing 4% of main accounts) is not shown in order to improve readability of the graph. Average total revenue for main accounts for this omitted category is £196.06 of which £194.13 is forgone interest, 0.11 is overdraft charges and 1.82 is other revenue.

Summary on the costs to customers of PCAs, cross-subsidies and distributional effects

6.213 We examined evidence on the costs of a PCA to different customers, and on the extent of cross-subsidies across customers and potential distribution effects arising from FIIC.

6.214 We find that the costs of FIIC PCAs to almost all customers are positive once interest forgone is taken into account. This holds regardless of income group and credit balance.

6.215 Overall, the evidence on cross-subsidies and distributional effects suggests that:

(a) While overdraft charges are high, this is not a consequence of FIIC but a result of a lack of competitive pressure on overdraft charges for the reasons set out in Section 11. This does not necessarily mean that other customers are being provided PCAs below incremental costs. We find that all customer groups generate positive revenues for banks when interest forgone is taken into account, and that interest forgone accounts for a larger proportion of banks' revenues than overdraft charges.

(b) The costs to customers of PCAs increase with credit balance and number of days overdrawn (taking into account both direct charges and indirect charges through interest forgone).

(c) It is not the case that customers with lower income are paying more for PCAs:

(i) Basic bank account users are likely to be cross-subsidised to some extent by other users; however to the extent that this is occurring this benefits customers in more vulnerable financial situations.

(ii) Our analysis of the demographics of overdraft users shows that these are not less wealthy, or less educated, than those who do not use overdrafts; if anything, we find that arranged overdraft users tend to have higher income and higher education levels than both non-overdraft users and those who use unarranged overdrafts; we also do not find that heavier overdraft users are poorer than lighter users.

(iii) When we take into account interest forgone as well as direct charges including overdraft charges, again we find that the costs of PCAs are highest for customers in the highest income deciles, and this is particularly the case for FIIC accounts.

(iv) Customers with no overdraft and low credit balances pay the lowest costs. This suggests that customers with large credit balances are making a higher contribution to banks' costs than customers with low credit balances and who do not use overdrafts.

Conclusions on PCA competition and customer behaviour

6.216 Evidence on the outcomes in the PCA markets of GB and NI set out in Section 5 suggests that competition in these markets is not fully effective:

(a) Both markets are concentrated and market shares have remained stable excluding the impact of mergers and divestments.

(b) There is considerable variation in price and quality of products, but banks offering lower average prices and/or better quality tend to have gained market share only slowly.

(c) There are substantial potential gains to be made by a large number of customers switching PCA to the lowest priced products for them.

6.217 We therefore considered the extent to which PCA customers drive competition between banks, whether anything prevents them from doing so (ie barriers to searching and switching), and how this affects the way providers compete for PCAs.

6.218 The overall level of PCA customer engagement, while having increased in recent years, remains low, as demonstrated by levels of searching and switching and the existence of substantial gains if customers were to switch PCAs.

6.219 We also found that heavy overdraft users are less likely to switch than lighter overdraft users, even though they had much greater gains from switching (as noted in paragraphs 6.50 to 6.51). Of these heavy overdraft users, those with the heaviest unarranged overdraft had both the highest gains from switching and the lowest switching rate of any customer group.[159] More generally unarranged overdraft users also had greater gains from switching than those users who only used an arranged overdraft.

6.220 We also considered internal switchers and multi-bankers:

(a) Internal switching may indicate that banks are encouraged to improve offers to existing customers in order to retain them; however, it has limitations as a competitive constraint as the propensity to search by this

[159] Including non-overdraft users.

group of customers is lower and the primary bank still maintains the relationship (as noted in paragraph 6.26).

(b) There is some evidence that multi-banking can help increase competition, for example it can increase the transparency of the variation of price and service attributes across different banks. However, further customer engagement is needed to bring about the full potential of the constraint from multi-banking. This is because the main reason for holding multiple accounts is to manage finances rather than to take advantage of better deals (as noted in paragraphs 6.27 to 6.35).

6.221 We also found that customers who searched had higher balances than those who did not (as noted in paragraph 6.41).

6.222 We consider that there are a number of reasons for the weak customer engagement we observed:

(a) A lack of trigger points because PCAs have no contract end date (as noted in paragraph 6.59).

(b) For many customers, PCAs are low-cost products and they perceive that there are few gains from switching; however, our analysis of the benefits of switching indicates that many customers would gain financially from switching PCAs (as noted in paragraphs 6.61 to 6.65).

(c) Barriers to accessing and assessing information on PCA charges and service quality contribute to low customer engagement. In particular, in order to identify the best account for them, customers need to combine the information on the different account charges, including complex overdraft charges, with a detailed knowledge of their own account usage. PCWs play a limited role and while the Midata initiative is a positive development, there are issues around its current implementation.

(d) Barriers to switching accounts still remain. Customers perceive that switching accounts is burdensome and there is still fear that something may go wrong. Awareness of and confidence in CASS is still low.

6.223 We have also found specific concerns regarding the engagement of overdraft users:

(a) Overdraft users tend to be those who would potentially gain most from switching, however they generally have limited awareness of and engagement with their overdraft usage. Many overdraft users believed

they did not use an overdraft when they did and/or underestimated their usage.

(b) Overdraft charges are particularly complex to compare across banks, due to both the complexity and diversity of the charging structures and customers' difficulties in understanding their own usage.

(c) There are additional barriers to switching for overdraft users due to uncertainty surrounding the acceptance and timing of an overdraft approval.

6.224 Further, we note that unarranged overdraft users are likely to have the most difficultly effectively engaging with the market. There is a low level of awareness of unarranged overdraft usage, with around half of unarranged overdraft users believing that that they had not gone into an unarranged overdraft (as noted in paragraph 6.70). Without alerts it is also difficult for unarranged overdraft users to be aware of when they have exceeded an arranged limit and become liable to the charges associated with doing so. Many PCA providers do not alert all their customers on a timely basis of when they exceed a pre-agreed overdraft limit or are about to (see Appendix 6.6). This is of particular concern as this low engagement is also generally coupled with a significant increase in charges when a customer transitions from arranged overdraft usage to unarranged overdraft usage.

6.225 There are some developments that are reducing barriers to engagement. As discussed in Section 5 we consider that the increasing digitalisation of banking, through internet and mobile banking, has facilitated customer engagement with their own account. This development reduces customers' searching and switching costs as it eases customers' ability to access and assess their expected account usage, and therefore facilitates choosing the best-value PCA.

6.226 Lastly, we have also specifically considered whether the FIIC pricing model contributes to low customer engagement and low switching levels. While FIIC may reduce to some extent the awareness of the costs (direct and indirect) that customers are incurring for PCAs, we have not found that the FIIC model is contributing significantly to lower switching rates. Evidence from other countries which do not operate an FIIC pricing model does not point to customer engagement being higher under different pricing models; similarly, the BCA market, which does not operate an FIIC pricing model, has similar rates of switching.

6.227 We find that FIIC works well for many customers, who are not charged directly for a variety of banking services. In addition, to the extent that FIIC facilitates multi-banking, it may also make it easier for some customers to switch through being able to try new accounts before switching their main account.

6.228 Banking can be expensive, particularly for those who are not in credit: banks have an incentive to set high overdraft charges due to the low customer engagement by overdraft users, as described above. This, we considered, would be the case whether or not banks operated an FIIC model. We also see a move away from FIIC in recent years through the increased uptake of reward accounts which deliver some financial benefits to those who switch, though switching rates remain low. We expect more of this as a result of our remedies prompting customers to switch, and improving their ability to compare products and switch.

6.229 We also analysed the distributional effects of FIIC. We found that it is not the case that customers with lower income are paying more (directly, through charges, or indirectly, through interest forgone) for PCAs.

Impact of weak customer engagement on PCA competition

6.230 The general lack of customer engagement in the market affects banks' incentives to compete and how they compete.

6.231 Pricing is an important aspect of competition between banks, particularly switching incentives and interest rates on balances. Recent years have seen an increase in the number of accounts that provide rewards and switching incentives. However, rather than making comparisons between accounts easier, PCA providers still set complex pricing, including through the reward structure, which makes it difficult to compare across accounts. There has also been less active competition on aspects such as arranged and unarranged overdraft fees, with many of the changes being driven by government or regulatory initiatives. This less active competition on arranged and unarranged overdraft fees is consistent with our analysis of the levels of engagement, searching and switching by overdraft users. In particular, there is a lack of competitive pressure on overdraft charges, especially for unarranged overdraft charges (as noted in Section 5).

6.232 The low customer engagement means that the discipline imposed by customers on banks through switching and the threat of switching is not as strong as it would be if more customers were engaged. This in turn weakens banks' incentives to compete to gain new customers and retain existing customers.

6.233 Overall we therefore found that competition in the PCA markets is not working well. A combination of factors mean that there is a weak customer response to differences in prices and service quality. As a result banks have limited incentives to compete for PCA customers. We consider further the impact of this weak customer response on barriers to entry and expansion in Section 9 and the market power of banks in Section 10.

6.234 In Section 11, we set out how this gives rise to an AEC in the provision of PCAs, in each of GB and NI respectively.

7. Structure and market outcomes: SME banking

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7.1 To develop our findings on whether or not features in the markets for SME banking products are harming competition, we have analysed the main characteristics of the markets, including market shares and concentration, and the outcomes of the competitive process.

7.2 This section is structured as follows:

- **Market structure and concentration**: analysis of the market structure for BCAs, business deposit accounts and SME lending products.

- **Financial performance**: analysis of revenues by source, impairment margins and the available evidence on profitability.

- **Price outcomes:** a comparison of BCA pricing for small SMEs using pricing profiles.

- **Quality outcomes:** analysis of quality of service metrics across SME banking providers.

- **Price-quality outcomes**: analysis of price and quality outcomes together, as we expect SMEs to make trade-offs between price and quality in choosing their products.

- **Innovation**: an assessment of the degree of innovation within and around the SME banking markets, and the potential impact on competition.

- **Summary conclusions**: we set out our summary conclusions on structure and outcomes in the markets for SME banking and the implications for our assessment of competition in these markets.

7.3 In formulating our findings in this area we have paid particular attention to the strength of customer response to variations in pricing and quality outcomes, and separately whether there is evidence of a relationship between outcomes and market share.

Market structure and concentration

7.4 The market shares presented in this section have been calculated mainly using data submitted by the banks in response to our information requests.[1] In some cases data is not available for all banks in all years. We have cross-checked our findings against those obtained from the Charterhouse BBS and find that the results are generally very similar. However we recognise that particular caution should be exercised in interpreting market shares where data on a market participant(s) is not available. Also, in some cases data limitations mean we have used UK-wide data.

7.5 We have defined separate product markets for each of (see Section 4):

[1] An information request was sent to the following banking groups: AIB, Aldermore, Barclays, BoI, Clydesdale, Co-op Bank, Danske, Handelsbanken, HSBCG, LBG, Metro, Santander, Shawbrook, TSB and RBSG. In the case of Aldermore, Co-op Bank, Handelsbanken, Metro and Shawbrook a shorter version of the information request was submitted to reflect the relative size of these banking groups' operations and the disproportionate resource impact that a full information request may have created.

(a) BCAs;

(b) business loans; and

(c) business deposit accounts.

7.6 For each product market we identified geographic markets for GB and NI.

7.7 Appendix 7.1 contains more detailed evidence on market structure.

BCAs

7.8 The total size of the GB BCA market has remained broadly constant since 2012 at around 5.5 million accounts (see Table 7.1), of which approximately 89% were active in 2015.[2] In 2015 about 12% of BCAs were opened in GB and a similar percentage closed.

Table 7.1: Summary of GB BCA market

	2012	*2013*	*2014*	*2015*
Total accounts (000s)	5,517	5,511	5,459	5,500
Active accounts (%)	86	87	88	89
Accounts opened (000s)	733	699	642	674
Accounts closed (000s)	748	780	652	605
Net account opening (%)	0	–1	0	0

Source: CMA calculations based on data submitted by the banks.

7.9 Similarly, the size of the BCA market in NI has remained broadly constant since 2012. In 2015 it had approximately 193,000 BCAs, around 88% of which were active (see Table 7.2). The rate of account opening and closure in 2015 was slightly lower than in GB at about 11%.[3]

Table 7.2: Summary of NI BCA market

	2012	*2013*	*2014*	*2015*
Total accounts (000s)	189	190	190	193
Active accounts (%)	n/a	86	85	88
Accounts opened (000s)	16	17	16	21
Accounts closed (000s)	17	16	17	19
Net account opening (%)	0	1	0	0

Source: CMA calculations based on data submitted by the banks.
Notes:
1. Active accounts data not available for Danske in 2012.
2. N/A = not available.

[2] Where an active account is defined as one which has had at least one customer-generated payment or transfer (including standing orders and direct debits, but excluding charges and interest on the account) coming into, or leaving, the account in the last 12 months.
[3] Calculated from the accounts opened and total accounts data in Table 7.2.

7.10 Smaller SMEs (with annual turnover below £2 million) account for the vast majority of BCAs held. In 2014, over 90% of GB active BCAs were held by SMEs with annual turnover of less than £2 million.[4] The equivalent figure for NI was around 85%. Smaller SMEs accounted for a smaller proportion of revenue than of number of accounts, but this was still nearly two-thirds (based on BCA revenue earned from interest and charges).[5]

7.11 In GB, the four largest banking groups for BCAs are RBSG, LBG, Barclays and HSBCG, and these had a combined market share of just over 80% in 2015 in terms of number of active BCAs (see Table 7.3).[6]

7.12 Figures in the CC's 2002 report[7] suggest that the GB share of BCAs of the four large banking groups has declined from 87% in 2000, although the data is not directly comparable.[8] Since 2005 (see Figure 7.1), [✂] has experienced a marked decline in market share, whilst [✂] has gained market share noticeably. Santander also gained market share following its acquisition of Alliance & Leicester in 2008. Market shares for all banks have remained broadly stable since 2012, including LBG's despite its divestment of TSB.

7.13 With respect to net account opening, which nets off any BCAs closed during the year, smaller providers such as [✂] received amongst the highest volumes in 2015.[9] Nevertheless, the number of net accounts opened relative to the size of the market is small, such that this has had little impact on their overall market shares of active BCAs.

Table 7.3: GB market share of active BCAs (by number) 2012 to 2015

				%
Banking group	*2012*	*2013*	*2014*	*2015*
Barclays	[10–20]	[10–20]	[10–20]	[20–30]
Clydesdale	[0–5]	[0–5]	[0–5]	[0–5]
Co-op Bank	[0–5]	[0–5]	[0–5]	[0–5]
Handelsbanken	[0–5]	[0–5]	[0–5]	[0–5]
HSBCG	[20–30]	[10–20]	[10–20]	[10–20]
LBG	[20–30]	[20–30]	[20–30]	[20–30]
Metro	[0–5]	[0–5]	[0–5]	[0–5]
RBSG	[20–30]	[20–30]	[20–30]	[20–30]
Santander	[5–10]	[5–10]	[5–10]	[5–10]
TSB	N/A	[0–5]	[0–5]	[0–5]

Source: CMA calculations based on data submitted by the banks.

[4] CMA calculations using data submitted by the banks. We have not updated these figures with 2015 data as we considered that it would be disproportionate to have required the relevant banks to provide the revised data.
[5] CMA calculations using data submitted by the banks.
[6] CMA calculations based on data submitted by banks.
[7] CC (2002), *A report on the supply of banking services by clearing banks to small and medium-sized enterprises within the UK*.
[8] Figures in the CC's 2002 report relate to liquidity management services (BCAs plus instant access deposit accounts) but the figures for BCAs are likely to be similar. 2015 figures use data submitted by the banks on active BCAs. Though not directly comparable the two figures indicate a general trend.
[9] See Appendix 7.1, Figure 7.

Figure 7.1: GB market shares of BCAs (by number) 2005-2014

[✄]

Source: CMA calculations using OFT 2007 'Review of the Undertakings given by banks following the 2002 CC Report', for 2005 shares and Charterhouse BBS for 2010 onwards.

7.14 We calculated market shares on the basis of the number of all new BCAs opened (see Table 7.4), which includes new-to-market customers as well as switchers. In 2015 the four largest banking groups accounted for around 75% of all new BCAs opened. Since 2012, [✄] and [✄] have experienced a slight increase in new accounts in terms of market share, [✄] a slight reduction, and [✄] a more marked reduction.

Table 7.4: GB market share of new BCAs (by number) 2012 to 2015

%

Banking group	*2012*	*2013*	*2014*	*2015*
Barclays	[20–30]	[20–30]	[20–30]	[20–30]
Clydesdale	[0–5]	[0–5]	[0–5]	[0–5]
Co-op Bank	[0–5]	[0–5]	[0–5]	[0–5]
Handelsbanken	[0–5]	[0–5]	[0–5]	[0–5]
HSBCG	[20–30]	[10–20]	[10–20]	[10–20]
LBG	[20–30]	[20–30]	[10–20]	[10–20]
Metro	[0–5]	[0–5]	[0–5]	[0–5]
RBSG	[10–20]	[10–20]	[20–30]	[20–30]
Santander	[5–10]	[5–10]	[10–20]	[10–20]
TSB	N/A	[0–5]	[0–5]	[0–5]

Source: CMA calculations based on data submitted by the banks.

7.15 Concentration levels in GB for 2015, as measured by Herfindahl-Hirschman Indices (HHIs), are just over 1,800 for active BCAs, which according to our guidelines indicates that the market is concentrated.[10,11] Comparison with figures in the CC's 2002 report suggests there has been a reduction in concentration since 2000 from a reported HHI of 2,050 (although the data is not directly comparable), which seems to be largely due to the reduction in market share of [✄].[12]

7.16 We have also estimated market shares and the associated concentration measures for the markets segmented between SMEs with turnover above £2 million and those below £2 million in GB.[13] While we observe variation in

[10] See Guidelines, Annex A.
[11] We cross-checked this and found that for 2014 data (which was the latest available on both measures), similar levels of concentration are obtained if concentration is calculated using the number of active accounts or the number of unique BCA customers. Unique BCA customers refers to the number of BCA customers held by each bank, such that a customer holding multiple BCAs at the same bank would be counted as a single unique BCA customer. Due to data limitations we have not been able to update our estimates of the HHI based on the number of unique BCA customers for 2015 but we do not expect any notable changes to have occurred.
[12] The figures in the CC's 2002 report suggest an HHI based on the number of accounts for GB liquidity management services of about 2,050. 2015 figures are based on data submitted by banks on the number of accounts. Although not directly comparable the two figures communicate a general trend.
[13] See Appendix 7.1, Figure 5.

the share of certain banking groups across each of these segments of the GB BCA market,[14] estimated levels of concentration are similar across the two size segments.[15]

7.17 In NI, the four largest active BCA providers are RBSG, Danske, BoI and AIB, which have a combined market share of around 90% in 2015 (see Table 7.5). Since 2000, the share of the four largest active BCA providers has reduced by around 10 percentage points (although this data is not directly comparable).[16] According to our calculations based on data submitted by the banks, since 2013 their combined share has been stable.

Table 7.5: NI market share of active BCAs (by number) 2012 to 2015

			%
Banking group	*2013*	*2014*	*2015*
AIBG	[10–20]	[10–20]	[10–20]
Barclays	[0–5]	[0–5]	[0–5]
BoI	[10–20]	[10–20]	[10–20]
Danske	[20–30]	[20–30]	[20–30]
HSBCG	[0–5]	[0–5]	[0–5]
LBG	[0–5]	[0–5]	[0–5]
RBSG	[20–30]	[20–30]	[20–30]
Santander	[5–10]	[5–10]	[5–10]

Source: CMA calculations based on data submitted by the banks.

7.18 The flow of new BCAs in NI is less concentrated than the stock (see Table 7.6): the four largest active BCA providers had a combined market share of around 78% in 2015, which is broadly the same as that in 2012. The most noticeable change in market share of new BCAs since 2012 is for [✂], which has increased its share by approximately [✂] percentage points, and has similar volumes of new BCAs to some of the largest NI banking groups.

[14] For example, in 2014 [✂] and [✂] had a notably larger share of the GB BCA market for SMEs with annual turnover above £2 million, compared to SMEs with turnover less than £2 million, while the opposite was true of [✂] and [✂].
[15] For example, the HHI for BCAs for SMEs with annual turnover less than £2 million was 1,933 in 2014, compared to an equivalent figure of 1,923 for SMEs with annual turnover above £2 million. Equivalent data is not available for NI.
[16] Based on figures for the number of liquidity management accounts in the CC's 2002 report.

Table 7.6: NI market share of new BCAs (by number) 2012 to 2015

				%
Banking group	*2012*	*2013*	*2014*	*2015*
AIBG	[10–20]	[10–20]	[10–20]	[10–20]
Barclays	[0–5]	[0–5]	[0–5]	[0–5]
BoI	[20–30]	[20–30]	[20–30]	[20–30
Danske	[10–20]	[10–20]	[10–20]	[10–20]
HSBCG	[5–10]	[0–5]	[0–5]	[0–5]
LBG	[0–5]	[0–5]	[0–5]	[0–5]
RBSG	[20–30]	[10–20]	[10–20]	[20–30]
Santander	[10–20]	[10–20]	[10–20]	[10–20]
Other	[0–5]	[0–5]	[0–5]	[0–5]

Source: CMA calculations based on data submitted by the banks.

7.19 In 2015, the HHI based on active BCAs in NI is 2,015, which according to our guidelines, is on the threshold of being a highly concentrated market.[17]

7.20 To test the sensitivity of our estimates to the definition of market share used, we calculated market shares using the gross revenue earned by banking group, on a UK basis (excluding the internal value to the banks of positive credit balances).[18] While we are unable to replicate this calculation on a GB and NI basis, we note that resulting measures of concentration for the UK market are similar to those obtained using the number of UK accounts.

Business loans

7.21 For the purposes of this market investigation, business loans include general-purpose business loans and commercial mortgages, credit cards, asset finance, invoice finance and alternative lending platforms (see Section 4).

7.22 We have data from the largest banks and several smaller banks, but certain types of business loans are offered by a wider range of providers (see Sections 4 and 8). We have therefore considered separately the different SME lending products, commenting as appropriate on the presence of other providers.[19]

7.23 Due to limited data availability, we have estimated UK market shares, which we expect to be broadly applicable to the GB and NI markets. We report market shares and HHIs for the four largest provides for each lending product, but these are not the same four providers for each lending product.

[17] See Guidelines, Annex A.
[18] See Appendix 7.1, Figure 4.
[19] Data for these products (except for credit cards) is not available separately for the GB and NI geographic markets and we have therefore estimated market structure indicators at a UK level.

General-purpose business loans (including commercial mortgages)

7.24 A total of £21 billion worth of general-purpose business loans (including commercial mortgages, but excluding residential property loans)[20] were granted in the UK in 2015, with an average loan value of £237,496.[21,22] The total stock of outstanding balances at year end stood at approximately £96 billion.

7.25 Smaller SMEs (with annual turnover less than £2 million) accounted for around three-quarters of new loans granted in the UK in 2014 by volume but less than half the value of these loans. Approximately two-thirds of general-purpose business loan revenues from interest and charges were earned on loans to SMEs with annual turnover less than £2 million.

7.26 The combined share of the four largest banks of the value of outstanding loans was similar to that for BCAs, at around 80%.The HHI was about 1,750.

Table 7.7: UK general-purpose business loan market shares in 2015 (by value)

		%
Banking group	*Value of loans at year end*	*Value of new loans granted*
AIBG	[0–5]	[0–5]
Aldermore	[0–5]	[0–5]
Barclays	[10–20]	[20–30]
BoI	[0–5]	[0–5]
Clydesdale	[0–5]	[5–10]
Co-op Bank	[0–5]	[0–5]
Danske	[0–5]	[0–5]
Handelsbanken	[5–10]	[10–20]
HSBCG	[5–10]	[10–20]
LBG	[20–30]	[20–30]
Metro	[0–5]	[0–5]
RBSG	[20–30]	[5–10]
Santander	[0–5]	[0–5]
Shawbrook	[0–5]	[0–5]
TSB	[0–5]	[0–5]
Ulster	[0–5]	[0–5]

Source: CMA calculations based on data submitted by the banks.
Notes:
1. Figures include commercial mortgages and are exclusive of residential property lending.
2. Loan data excluding residential property lending not available for LBG and AIB. Shares for these banking groups have been calculated by applying the industry average proportion of residential property lending (in total lending) to the total lending data submitted by these banks.
3. RBSG shares only take into account RBS and NatWest.

[20] Residential property loans are loans to SMEs for the purposes of residential buy-to-let, residential property development or investment in finished residential properties. Due to differences between banks in how these loans are reported, and in particular how they are classified as either personal or SME lending, we have asked all banks to exclude such loans from the submitted business lending accounts and value data. On the basis of the data provided by the banks, we estimate such loans to account for approximately 3% of business loan volumes and 8% of business loan values.
[21] See Appendix 7.1, Table 3.
[22] We provide more details on the distribution of loans by size and at a greater disaggregation of products in Appendix 16.1.

7.27 The market for general-purpose business lending to smaller SMEs (turnover less than £2 million) is more concentrated than that of business loans for larger SMEs: the HHI for the former is around 2,660 compared to around 1,680 for the latter.

7.28 The combined share of flow of the four largest lenders with respect to the value of new loans has remained stable at around 70% since 2012 (excluding the impact of the TSB divestment). Smaller banks such as [✂] and [✂] have experienced very high rates of growth in their share of new loans granted, but the absolute changes in share remain very low.[23]

7.29 These figures do not include peer-to-peer lending which is another source of general-purpose business loans. Figures from Nesta indicate that the value of such lending in 2015 was about £1.49 billion,[24] around 1.5% of the outstanding general-purpose business loans to SMEs from banks. However, peer-to-peer lending is growing rapidly and accounts for a larger share of the flow of new general-purpose business loans (about 7%).

Invoice finance

7.30 Data from the Asset Based Finance Association (ABFA) show that there were approximately 42,000 SMEs with invoice finance agreements in place at the end of the first quarter of 2015, with total outstanding balances of around £9 billion.[25]

7.31 Larger SMEs account for the majority of invoice finance lending. Data from ABFA shows that SMEs with annual turnover less than £2 million accounted for around 50% of SME invoice finance customers at the end of the first quarter of 2015, but less than 15% of outstanding balances. Similar proportions for the end of 2014 are obtained from accounts and lending data submitted by banks to the CMA.[26]

7.32 Based on data from banks, we estimate similar levels of concentration in invoice finance to those observed for general-purpose business loans (including commercial mortgages). The combined share of UK outstanding balances of the four largest providers was approximately 80% at the end of

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[23] See Appendix 7.1, Figure 15.
[24] See Nesta (2015), *Pushing boundaries: the 2015 UK alternative finance industry report*, p37. The great majority of peer-to-peer lending is to SMEs.
[25] These figures may include a limited number of SMEs holding import and/or export factoring, stock finance and asset-based lending facilities.
[26] Specifically, SMEs with annual turnover less than £2 million accounted for around 45% of SME asset finance customers but only 15% of the value of outstanding balances.

2014.[27] The corresponding HHI was around 2,000. However, these are likely to be over-estimates as we are aware of invoice finance providers that are not captured in the data used to estimate these concentration measures.[28]

7.33 The ABFA figures do not include invoice trading on alternative finance platforms. Figures from Nesta indicate that the value of invoice trading in 2015 was about £325 million.[29] In 2014 this was £270 million, making up around 4% of the value of conventional invoice finance.[30] Like other types of alternative finance, invoice trading is growing rapidly.

Asset finance

7.34 According to figures from the Finance & Leasing Association, over £25 billion worth of new asset finance loans (excluding high-value items)[31] were made in the 12 months to June 2015, representing growth of around 15%. Data on new asset finance lending submitted by BCA providers shows a similar rate of growth for 2014.

7.35 The majority of asset finance lending by BCA providers is to larger SMEs. SMEs with annual turnover below £2 million account for less than 15% of the value of new asset finance loans in 2014.[32]

7.36 The provision of asset finance lending appears less concentrated than of general-purpose business loans: the four largest asset finance providers had a combined share of around 65% of outstanding balances at the end of 2014[33] and the HHI was 1,550 (compared with around 1,780 for general-purpose business lending).

Business credit cards

7.37 On the basis of the Charterhouse BBS, we estimate there were over 1.7 million business credit card or charge card accounts in GB in 2014. Over 90% of these accounts were held by SMEs with an annual turnover of less than £2 million. Estimated levels of concentration have remained constant

[27] We did not request 2015 data from banks as we considered that this would be disproportionate, in particular it would not capture other providers.
[28] The ABFA membership list includes over 30 providers for which customer and balance volumes were not available to the CMA. See membership list on the ABFA website.
[29] See, Nesta (2014), *Pushing boundaries: the 2015 UK alternative finance industry report*, p40. The great majority of invoice trading is in relation to SMEs.
[30] 2014 is the last year for which we have full data available on conventional invoice finance.
[31] Data on the value of lending specifically to SMEs is not available. We have therefore sought to proxy this using asset finance lending excluding high value items.
[32] CMA calculations using data submitted by the banks.
[33] See Appendix 7.1, Figure 17.

since 2011 with HHIs of around 2,000 and a combined market share of the four largest providers of 87%.[34]

7.38 According to the Charterhouse NI BBS, there were approximately 44,000 business credit or charge card accounts in 2015. Over 95% of business credit or charge card accounts were held by SMEs with annual turnover less than £2 million in 2014.[35] Estimates calculated using the Charterhouse NI BBS suggest lower levels of concentration than observed in GB. The combined market share of the four largest banking groups was around 75% in 2015[36] and the HHI was around 1,700.

Total business loan market

7.39 As a result of data constraints, we have not been able to calculate market shares and HHI for all business loans. Although we would expect that market shares of the largest four banks and HHI would be lower than for general-purpose business loans, since their market shares of invoice and asset finance are lower than of general-purpose business loans. Furthermore the identity of the four largest providers also differs between products. We expect this to be the case both at the UK level as well as separately for the GB and NI geographic markets.

Bank business deposit accounts

7.40 On the basis of data submitted by banks, we estimate that approximately 1.7 million bank business deposit accounts were held with UK BCA providers at the end of 2014, containing a total of £82 billion worth of deposits. We note, however, that there are a number of participants in the business deposit account market that are not also BCA providers, and as such will not be captured in our market share estimates. While the total number of accounts held by BCA providers has remained broadly constant since 2012, the value of deposits has risen by around 15%. Smaller SMEs account for nearly 90% of these accounts but only 50% of the value of funds deposited.[37]

7.41 On the basis of the subset of business deposit accounts held with BCA providers, the combined share of the four largest providers of the total value of UK deposits was approximately 85% in 2014,[38] with a corresponding HHI

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[34] See Appendix 7.1, Figure 18.
[35] CMA calculations using data submitted by the banks.
[36] See Appendix 7.1, Figure 19.
[37] Equivalent data on a GB and NI basis is not available.
[38] See Appendix 7.1, Figure 20.

of around 2,100. However, given the exclusion of a number of providers, these figures will overestimate the level of concentration.

Summary of evidence on market shares and concentration

7.42 The combined share of active BCAs of the four largest banking groups in GB is around 80% in 2015. The equivalent combined share in the flow of new BCAs is lower (around 75%). Whilst market shares have changed somewhat since 2005 for RBSG, Barclays and Santander (the latter's market share largely increased due to acquisition), the GB market for BCAs in 2015 is concentrated as measured by an HHI of just over 1,800.

7.43 In NI the combined market share of the four largest banking groups in terms of their year-end stock of active BCAs was around 90% in 2015. The market is on the threshold of being highly concentrated in 2015 according to our guidelines, with an HHI at around the threshold for a high concentration of around 2,000.

7.44 While we do not have sufficient data on revenues for each of the GB and NI BCA markets separately, our analysis of data for the UK produces similar levels of concentration whether calculated using either the number of BCAs or gross revenue earned from BCAs.

7.45 Due to limited data availability, we have estimated UK market shares for separate SME lending products. We report market shares and HHIs for the four largest provides for each lending product, but these are not the same four providers for each lending product.

7.46 The combined share of the four largest banks in the value of outstanding general-purpose business loans in 2014 was similar to that of BCAs at around 80%. The share of the four largest banks in the value of new loans granted is similar and the absolute change in the market share of smaller banks since 2012 remains low.

7.47 We estimated similar levels of concentration in invoice finance to those observed for general-purpose business loans, although not all invoice providers are captured in our data set which means this is likely to be an overestimate.

7.48 For asset finance we find evidence of lower levels of concentration than observed for general-purpose business loans, invoice finance and BCAs. The four largest asset finance providers had a combined share of around 65% of outstanding balances at the end of 2014 and the HHI was 1,550 (compared with around 1,800 for general-purpose business lending).

7.49 For business credit cards we have been able to estimate market shares separately for the GB and NI geographic markets. In GB the combined market share of the four largest providers was around 87% in 2014 and the HHI was around 2,000. We observed slightly lower levels of concentration in NI where the combined market share of the four largest banking groups was around 75% in 2015 and the HHI was around 1,700.

7.50 We have been unable to calculate market shares and HHI for all business loans due to data constraints. Nevertheless, we expect that overall market shares of the largest four banks (and HHIs) would be lower than for general-purpose business loans (which is around 80%) as the shares of these banks in invoice and asset finance are lower.

7.51 We have only been able to estimate business deposit account market shares for UK accounts held with BCA providers. On the basis of this subset of data we find that the share of the four largest providers of the total value of UK deposits was approximately 85% in 2014 with a corresponding HHI of around 2,100. However, given the exclusion of a number of providers, these will be overestimates.

Financial performance

Revenues

7.52 In our analysis of revenues we sought to gain an understanding of the primary sources of revenue by product market, how this has evolved over time, and the degree of variability between banking groups.

7.53 Using data submitted by the banks[39] we have calculated net revenue from BCAs as:

(a) receipts from fees and interest charged on overdrafts;

(b) **plus** receipts from other charges and sources of BCA revenue including interchange fees;

(c) **less** any interest paid to customers on credit balances together with any other payments made to customers (eg cashback);

[39] A data request was sent to Barclays, Clydesdale, HSBC, LBG, Santander, TSB, RBS (RBS and NatWest branded accounts), Ulster (RBSG submitted a separate return for Ulster), AIB, BoI and Danske. As part of our targeted and proportionate approach to evidence gathering, smaller banks were sent a shorter version of the market questionnaire, which did not include revenue data.

(d) **plus** the value that banks obtain from net credit balances (ie the value of funds from credit balances less the cost of funding overdrafts).

7.54 We have normalised net revenue by the number of active BCAs held so as to obtain net revenue numbers that are comparable between banks and overtime (as all else being equal, a bank with many customers will have greater revenue than one with few customers). We use active accounts as the basic unit of analysis.[40]

7.55 Our revenue analysis relates to banks' UK revenue from BCAs and other SME banking products. It includes banks operating across the UK (eg RBSG and Santander); banks whose UK operations are primarily in GB (eg Barclays, HSBCG and LBG); and banks whose UK operations are primarily in NI (AIB, BoI and Danske). As such, we consider that the results are broadly applicable to both of the geographic markets we identified (GB and NI).

7.56 Further details on the analysis can be found in Appendix 7.2.

BCAs

7.57 In interpreting this analysis, we note the following:

(a) The net value of funds is an important source of BCA revenue but banks differ in the way in which they value funds.

(b) There may be differences between banks in how they have defined revenue and how or when they recognise revenue. The overall quality of response also differs between banks.

(c) We are unable to control for the volume of transactions carried out by SMEs which may impact the interpretation of changes in revenues from transaction charges over time (for example if trends over time are partly driven by an overall reduction/increase in SME activity).

7.58 Our analysis of aggregate net revenue per active BCA shows that the most important sources of revenue in 2014 were the value of funds from net credit balances (accounting for about half of net revenue, or 45% if interest paid to customers is subtracted), arranged overdraft fees (accounting for around 20% of net revenue) and transaction charges (accounting for around 15%).

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[40] An active account is defined as an account that has had at least one customer-generated payment or transfer (including standing orders and direct debits, but excluding charges and interest on the account) coming into, or leaving, the account in the last 12 months.

Table 7.8: Analysis of BCA revenue (£ per active BCA,* 2014 prices)

Type of revenue	*2012 (£)*	*2013 (£)*	*2014 (£)*	*2014 (%)*	*Decomposition of change in net revenue since 2012 to 2014 (%)¶*
Transaction charges	143	124	112	15	–28
Arranged overdraft	219	171	156	21	–58
Unarranged overdraft & unpaid item fees	54	42	36	5	–17
Interchange fees (debit card)	4	5	5	1	1
Monthly account fees	30	28	32	4	2
Other receipts (net)‡	83	75	67	9	–15
Total receipts from charges & interest	**535**	**444**	**408**	**55**	**–117**
Interest payments to customers	–23	–24	–25	–3	–2
Other payments to customers	0	0	–3	0	–3
Net value of funds§	334	398	356	48	20
Net revenue	**845**	**818**	**736**	**100**	**100**

Source: CMA calculations based on data submitted by banks in response to aggregate data request.
*Aggregate revenue is divided by the average of number of active accounts at start and end of year (except for Danske data in 2013, when only number of accounts at end of year is available).
‡Other receipts consists of revenue from charges for failing to meet account criteria, revenue from occasional charges relating to cheques, revenue from occasional charges relating to payments, revenue from account management charges, other revenue from account holders and other revenue which is not from account holders.
§Banks' own assessment of value of funds from BCA credit balances less cost of funding BCA debit balances (except for Danske, where the weighted average for the other banks has been used).
¶Numbers do not sum due to rounding.
Note: Excludes AIB, HSBCG and RBSG, for which a full revenue breakdown is not available. Data is not available for Clydesdale and LBG in 2011, and for Danske and Santander for 2011–2012.

7.59 There has been a decline in net revenue per active BCA since 2012. This has been driven by a reduction in revenues from the following sources:

(a) arranged overdrafts (arrangement, renewal and day-to-day usage);

(b) transaction charges;

(c) unarranged overdrafts (but to a lesser extent); and

(d) other receipts[41] (primarily as a result of a reduction in revenue from occasional charges relating to payments).

7.60 There has, however, been an increase in the net value of funds. We find that the value assigned by banks to BCA credit balances in 2014 (industry-weighted average of 2.16%) remained significantly higher than the prevailing short-term interest rate (which was approximately 0.5%).

7.61 We have also considered how net revenue per account differs by the size of SME served (see Table 7.9). Total net revenue per account is found to be substantially greater for BCAs held by larger SMEs with annual turnover in excess of £2 million, in comparison to smaller SMEs. This is likely to reflect the more complex needs of larger SMEs, including the greater volume of

[41] While revenue per active account from other receipts appears to have increased in 2014 relative to 2011, this is due to the absence of [✂] (which attributes around [✂]% of total net revenue to this source) from the sample in 2011. When measured over the entire period for which [✂] is present in the sample (ie 2012–2014), revenue per active account from other receipts declined by around 20%.

transactions carried out, and in relation to overdrafts, the larger levels of borrowing. These are partially offset by greater payments to customers on credit balances held.

Table 7.9: Comparison of net BCA revenue (excluding value of funds) by size of SME, 2014

	SMEs with annual turnover <£2m		*SMEs with annual turnover >£2m*	
Type of revenue	*£ per active account*	*% of net revenue per account*	*£ per active account*	*% of net revenue per account*
Transaction charges	98	35	726	35
Arranged overdraft	93	33	832	41
Unarranged overdraft and unpaid item fees	35	13	83	4
Interchange fees (debit card)	4	1	3	0
Monthly account fees	37	13	49	2
Other receipts (net)	22	8	599	29
Total receipts from charges and interest	**290**	**102**	**2292**	**112**
Interest payments to customers	–7	–2	–243	–12
Other payments to customers	–2	–1	–9	0
Net revenue excluding value of funds	**283**	**100**	**2,049**	**100**
(% average annual turnover)	0.16%	-	0.03%	

Source: CMA calculations based on data submitted by banks in response to aggregate data request.
Notes:
1. Excludes HSBC, for which a full revenue breakdown is not available.
2. Breakdown by SME size is not available for AIB, Danske and TSB.
3. Average annual turnover calculated using midpoint of turnover bands in 2014 for GB SMEs from the Charterhouse BBS.

General-purpose business loans (including commercial mortgages)

7.62 Table 7.10 summarises our analysis of aggregate gross revenue by source from general-purpose business lending. Revenues are expressed as a proportion of average loan balances to control for differences in the size of lending.

Table 7.10: Analysis of general-purpose business loans (including commercial mortgages) revenue (% average loan balance)

					%
Type of revenue	*2011*	*2012*	*2013*	*2014*	*Percentage in 2014*
Interest received from SMEs	2.55	2.62	2.70	2.57	92
Arrangement fee revenue received from SMEs	0.10	0.10	0.10	0.10	4
Other revenue (including fee received from SMEs)	0.13	0.12	0.12	0.11	4
Total revenue from interest and charges	2.78	2.84	2.92	2.78	100

Source: CMA analysis of data submitted by banks.

7.63 We find that total revenue from interest and charges has largely remained unchanged since 2011.

7.64 However, in interpreting this result, we note that we are unable to account for loan impairments (ie costs for credit and first party (customer) fraud losses) and changes in the quality of banks' loan books over time. Similarly, we are also unable to include the revenue impact of differences in the cost of funding between banks.

Other SME lending products

7.65 A similar analysis of gross revenue has been undertaken for asset and invoice finance products (see Table 7.11 and Table 7.12, respectively). While total revenue has increased since 2011 for asset finance (due to an increase in interest received from SMEs), there has been a decrease in total revenue for invoice finance products.

7.66 Arrangement fee revenue has remained relatively stable over the period for both asset and finance products although there has been a reduction in other revenue from fees and charges. This is most notable in the case of invoice finance for which other revenue is the most important source of income, accounting for over half gross revenues in 2014.

Table 7.11: Analysis of asset finance revenue (% average loan balance)

Type of revenue	*2011*	*2012*	*2013*	*2014*	*%* *Percentage in 2014*
Interest received from SMEs	3.46	4.08	4.37	4.53	89
Arrangement fee revenue received from SMEs	0.22	0.24	0.22	0.20	4
Other revenue (including fee received from SMEs)	0.69	0.52	0.40	0.34	7
Total revenue from interest and charges	4.38	4.84	4.99	5.07	100

Source: CMA calculations based on data submitted by banks in response to aggregate data request.
Note: Revenue data not available for Santander in 2011 and 2012 and Lloyds for 2011 to 2014. Revenues for Clydesdale and Ulster not included due to problems with the underlying data.

Table 7.12: Analysis of invoice finance revenue (% average loan balance)

Type of revenue	*2011*	*2012*	*2013*	*2014*	*%* *Percentage in 2014*
Interest received from SMEs	2.98	2.92	2.89	2.77	30
Arrangement fee revenue received from SMEs	0.21	0.19	0.17	0.17	2
Other revenue (including fee received from SMEs)	6.90	6.62	6.48	6.40	68
Total revenue from interest and charges	10.09	9.74	9.55	9.34	100

Source: CMA calculations based on data submitted by banks in response to aggregate data request.
Note: Revenue data not available for Santander in 2011 and 2012.

Business deposit accounts

7.67 Net revenue from business deposits remains positive in 2014, at approximately £740 per account, despite the decrease of over a third since 2011 (see Table 7.13). The value of funds has driven this reduction, which is the main component of revenues.

Table 7.13: Analysis of business deposit account revenue (£ per account, 2014 prices)

	£				%
Type of revenue	*2011*	*2012*	*2013*	*2014*	*Percentage in 2014*
Fee revenue received	1	1	1	1	0
Interest paid to SMEs	–226	–272	–301	–197	–26
Net revenue from interest and charges	**–226**	**–271**	**–300**	**–196**	**–26**
Standardised value of funds	1,417	944	1,112	942	126
Net revenue*	**1,191**	**673**	**812**	**746**	**100**

Source: CMA calculations based on data submitted by banks in response to aggregate data request.
*Calculated by applying standardised % value of funds for BCA credit balances to the annual average business deposit account balance of each bank. Data for Danske excluded from calculation of standardised % cost of funding. BCA credit balances data not available for RBS, Co-op Bank, Metro and Handelsbanken.

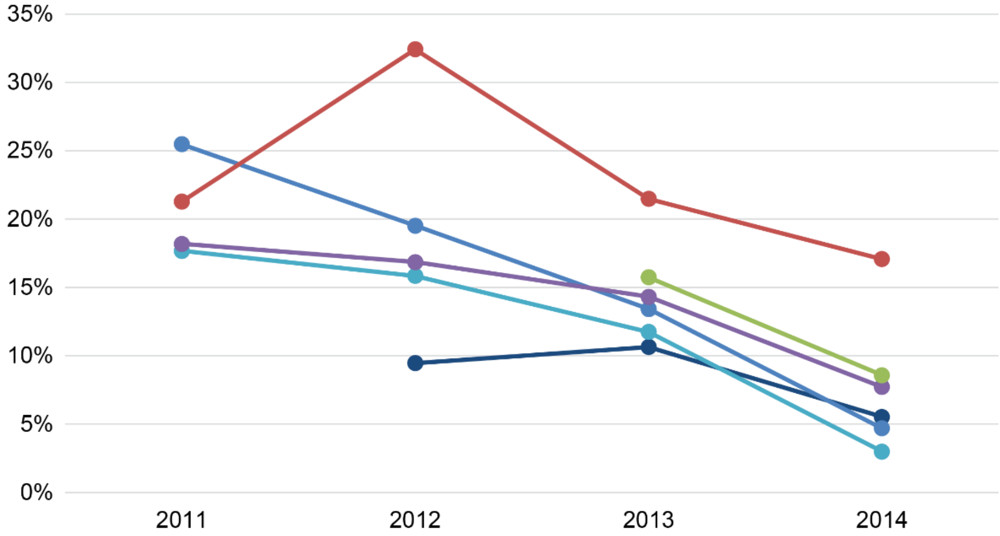
Impairments

7.68 The comparability of banks' revenues may be affected by impairments. To understand the impact of impairments on banks over time, we looked at impairments as a percentage of revenues, including value of funds.

7.69 Figure 7.2 shows the impairment rate for five banks, for 2011 to 2014.[42] There is an overall reduction in impairment rates, which appears to track the recovery of the UK economy. [✂] told us that the peak in impairment rate in 2012 mainly related to the loss crystallisation on loans arising from the prolonged downturn. It told us, in particular, that 2012 impairments were reflective of losses from loan vintages written before the financial crisis for 2008 which, typically, had an effective term of five years. Impairment losses in the years following 2012 have been lower, reflecting the actions taken by [✂] to work out, exit or restructure substandard and non-performing loans.

[42] [✂] (2012): data excluded as not representative; [✂] (all years): data unable to be reported due to business reporting limitations; [✂]: 2011 data not provided to CMA as only one of the two underlying businesses had data for that period.

Figure 7.2: SME impairments as a proportion of total revenues, 2011 to 2014



Source: CMA analysis based on data provided by the parties.

Profitability of SME banking by customers and products

7.70 As noted in Section 2, our ability to conduct our own analysis of the profitability of BCAs and other SME banking products is complicated by the difficulty and subjectivity of allocating a significant proportion of common or shared costs (eg branch costs, HR costs and marketing spend) to individual products and/or customers.

7.71 We have nevertheless collected information from the five largest UK banks (Barclays, HSBCG, LBG, RBSG and Santander)[43] on ways in which they assess the profitability of their SME operations, and to the extent possible, the profitability of individual products and customers. The details of our findings are included in Appendix 7.3 and can be summarised as follows:

(a) Over the course of a five-year period, for [✂], BCAs are profitable, and for [✂], SME banking, including the provision of BCAs, is profitable.[44]

(b) The main drivers for BCA profitability are: number of active customers, level of fees charged for BCA usage; level of credit balances; income from overdraft fees and interest; and net interest margin.[45] The impact of these drivers varies over time reflecting both the macroeconomic

[43] We focus our analysis on the SME banking activities of the five largest banks in the UK, as together they had a combined GB market share (by number of active BCAs) of over 90% in 2014 and 2015. Our assessment is based on financial data provided by the banks in 2014 and generally reflects accounting (and not economic) profits.
[44] [✂] provided stand-alone profit and loss forecasts for their BCA businesses, whereas [✂] provided forecasts for their SME banking businesses, which includes the provision of BCAs and other SME banking products.
[45] By which we mean the difference between the interest income generated from the use of their BCA customers' credit balances to fund banks' lending businesses and the amount of interest paid out to those same customers, relative to the amount of their interest-earning assets.

environment, such as the base rate, and customer behaviour (eg transactional volume and channel usage).

(c) The volume and type of transactional activity undertaken by the customer is particularly important in the case of BCA customers. For example, [✂] told us that it made a loss on serving charities, clubs, associations and societies, because these customers were typically provided core banking services (eg BCAs and key payment services) free of charge and were relatively high cost to serve because they were particularly likely to use cheques (rather than process transactions electronically) and frequently required changes in mandates.

(d) Start-ups or new BCA customers often receive free core banking services for a limited period (typically 12 to 18 months) and therefore generate less income in the early stages of their operation. [✂] told us that BCAs provided to start-ups or switchers, which were introductory products, were not expected to cover their incremental costs in the short term. However, it expected these customers to make a contribution in excess of incremental costs over the lifetime of their relationship with [✂]. Therefore, it considered that the provision of free banking for a limited period was effectively a cost of customer acquisition.

Summary of evidence on financial performance

7.72 There has been a decline in net revenues per active BCA since 2012 as a result of reductions in revenues from arranged overdrafts, transaction charges, unarranged overdrafts and other receipts[46] (primarily from occasional charges relating to payments).

7.73 By contrast, for general-purpose business loans, we find that total revenue from interest and charges has broadly remained the same since 2011. While total asset finance revenue has increased since 2011, invoice finance revenue has declined. Net revenue from business deposits has also declined. Overall, impairment rates have reduced over the period.

7.74 Banks take different approaches to assessing the performance of SME banking, but the evidence for the five banks we have assessed (Barclays, HSBCG, LBG, RBSG and Santander) suggests that BCAs are profitable over the course of a five-year period.[47]

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[46] [✂] (which attributes around [✂]% of total net revenue to this source) is absent from the sample in 2011.
[47] [✂] provided stand-alone profit and loss forecasts for their BCA businesses, whereas [✂] provided forecasts for their SME banking businesses, which includes the provision of BCAs and other SME banking products.

Price outcomes

7.75 Comparisons of prices between banks can provide information on the competitive conditions in a market. For example, the existence of a wide range of prices between banks for a similar product alongside stable market shares could indicate that customers are not switching to better value products, and therefore be evidence of a weak customer response. A comparison of prices between banks may also provide information on the existence of a relationship between market share and price outcomes.

7.76 Variations in price between banking groups may reflect differences in the quality of BCA service provided. We have therefore also undertaken comparisons between banks based upon a number of indicators of service quality. We have considered these, together with the price analysis, in drawing our conclusions about market structure and outcomes.

7.77 We undertook a comparative analysis of BCA pricing between banks by applying banks' BCA tariffs (as of January 2015) to a set of representative SME customer profiles. We obtained the customer profiles from banks in response to an information request.[48] We have undertaken the analysis for 17 profiles in total (three banks provided four profiles each, and one bank provided five profiles).

7.78 SMEs with annual turnover greater than £2 million were excluded from the analysis because of the prevalence of negotiated pricing among this segment of larger SMEs. Similarly, we have not undertaken a formal analysis of SME loan pricing, given the variation in types of lending and the more tailored nature of loan pricing reflecting the nature of the SME, the size of the loan, the term of the loan and the nature of any security. In particular, SME loan pricing typically reflects the specific risk associated with a given customer and in the absence of external data on credit risk for all SMEs we would need to estimate the default risk of each SME by controlling for a range of characteristics. As a result, any analysis would be significantly more data intensive and complex, and the inferences we could draw from it would be limited.

7.79 The BCA pricing data was obtained from the Business Moneyfacts website in January 2015. The analysis includes the most important transactions for which pricing data was readily available. According to one bank ([✂]),

[48] Five usable customer profiles were received from Barclays and four each from RBSG, HSBCG and Santander. LBG did not submit any customer profiles as it did not consider that any meaningful representative profiles could be derived given the diversity in cost-to-serve, risk, balance holdings, transaction volumes and channel preferences amongst its SME customers.

approximately 93% of all transactions (by volume) were covered by those included in the analysis.

7.80 In applying the tariffs to the transaction profiles we assumed that SMEs choose the cheapest tariff available given their pattern of transactions, making the price estimates for each profile a lower bound, and we only applied tariffs that apply to the turnover band of the SME profile.

7.81 The results of this analysis need to be interpreted carefully for the following reasons:

(a) There are a number of pricing dimensions that are not taken into account such as overdraft charges, interest on credit balances and other rewards such as switching incentives.[49]

(b) The analysis is limited to SMEs with annual turnover less than £2 million and even within this segment customer profiles may not be fully representative of the diversity of SMEs' BCA usage. Nevertheless, we note the similarity in results (in terms of relative prices) across the range of customer profiles submitted by the banks and have weighted the customer types using the actual proportion of customer accounts in each category.

(c) Differences in banks' prices may reflect differences in the quality of service provided to SME customers.

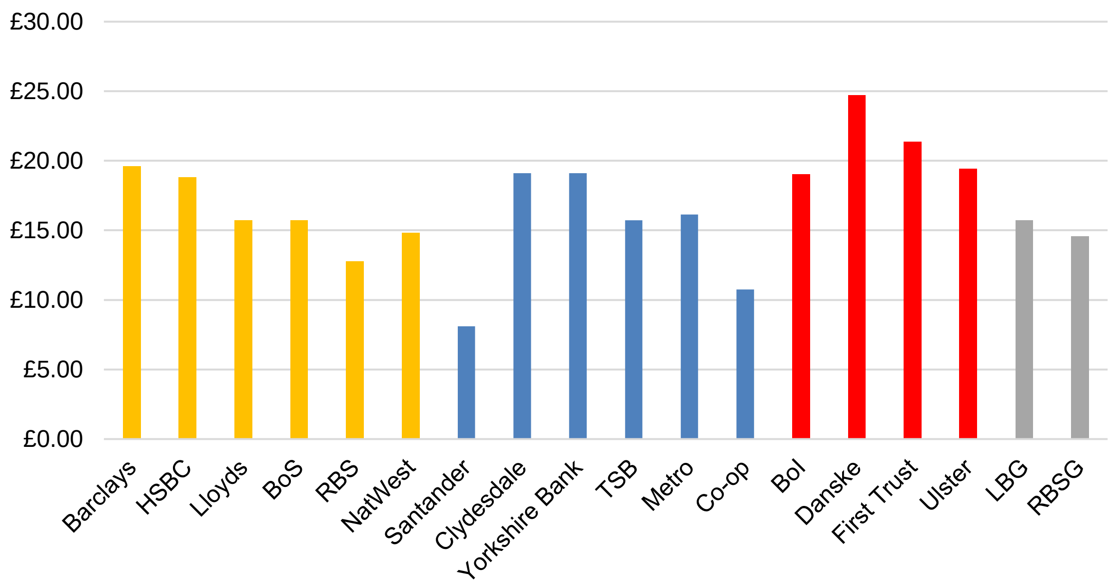
7.82 A fuller discussion of the methodology and results is contained in Appendix 7.4.

7.83 We observe significant variation in monthly charges between banks. For GB BCA providers, the difference between the highest and lowest monthly cost was over 100% for nine out of 17 customer profiles. For three of the customer profiles, the highest monthly cost was over three times as large as the lowest monthly cost. Similar results were observed for the NI BCA providers.

7.84 Figure 7.3 shows each bank's weighted average prices calculated by weighting the individual profiles submitted by Barclays. The variation in charges and relative position of each bank are broadly similar under the other available profiles (those submitted by HSBCG, RBSG and Santander).

[49] The impact of these exclusions is discussed in Annex A of Appendix 7.4. Exclusion of overdraft charges is likely to understate the prices of products. Given that credit interest rates are low, this is unlikely to have a major effect on the overall results. The exclusion of switching incentives means that our analysis tends to overstate the relative prices of banks offering the most generous incentives, particularly for prices in the first year of switching.

Figure 7.3: Weighted average monthly price by bank

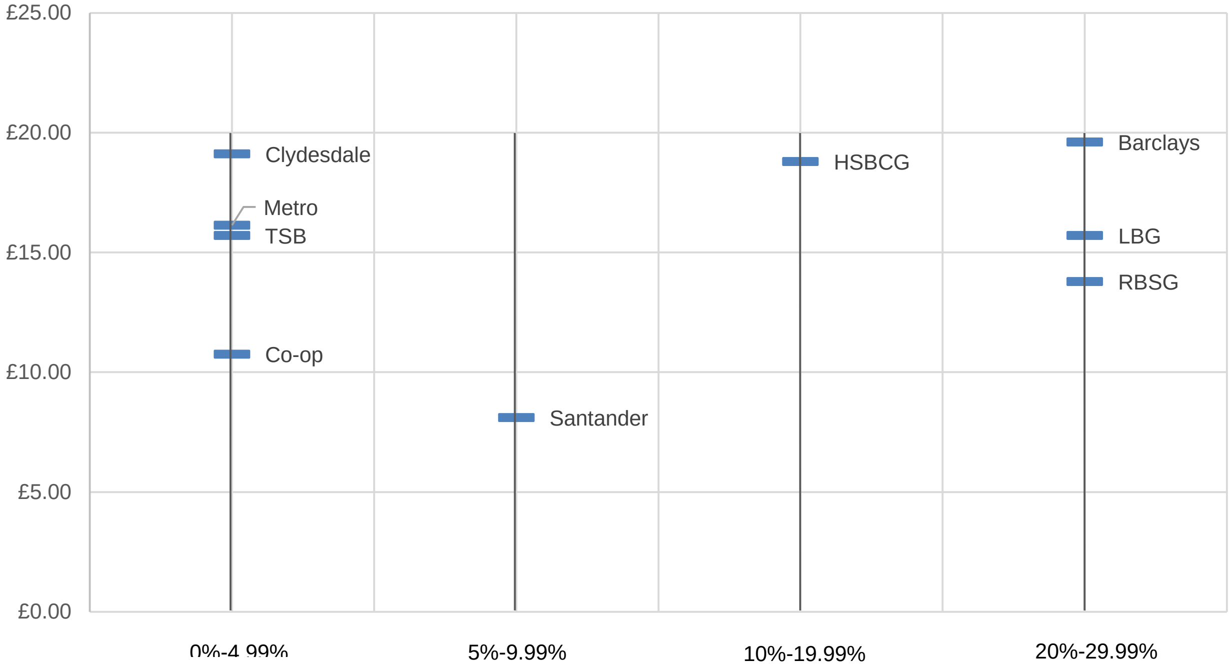


Source: CMA analysis.
Notes:
1. Bars 1–6 (yellow) show larger banks, bars 7–12 (blue) show smaller banks, bars 13–16 (red) show NI banks and the final two bars (grey) show weighted averages for the two banking groups whose constituent banks have different weighted average prices.
2. Monthly prices calculated using customer profiles submitted by Barclays.

7.85 We found that the monthly prices of the NI banks are generally higher than those of the GB BCA providers.

7.86 We did not find evidence of a clear association between price and market share (as demonstrated in Figure 7.4 for GB providers using the Barclays customer profiles; a similar result is observed for NI).

Figure 7.4: Weighted average monthly price and market share by bank, 2015 prices and market shares



Source: CMA analysis.
Note: Monthly prices calculated using customer profiles submitted by Barclays. The RBSG price is an unweighted average across RBS and NatWest.

Summary of evidence on price outcomes

7.87 We observe significant variation in monthly charges between banks in GB and NI, with the difference between the highest and lowest monthly cost between providers for a certain customer profile being over 100%.

7.88 We did not find evidence of a clear association between price and market share in GB or NI.

7.89 Variations in price between banking groups may reflect differences in the quality of PCA service provided. We therefore interpret the price analysis alongside analysis on quality in drawing our overall conclusions about market structure and outcomes.

Quality outcomes

7.90 We have sought to identify: *(a)* whether there is a relationship between market structure and quality outcomes; and *(b)* how and to what extent customers respond to variations in quality outcomes.

7.91 A more detailed discussion of the methodology and results is contained in Appendix 7.5.

Indicators of overall service quality

7.92 Customer experience metrics such as customer satisfaction and advocacy ratings, can be useful as indicators of the overall quality of service received by customers, and are widely used as a measure of overall service quality, by both private companies and regulators.[50]

7.93 We have used the following indicators of overall quality of service:

(a) satisfaction ratings (from BBI survey);

(b) net promoter score (NPS) (from Charterhouse BBS); and

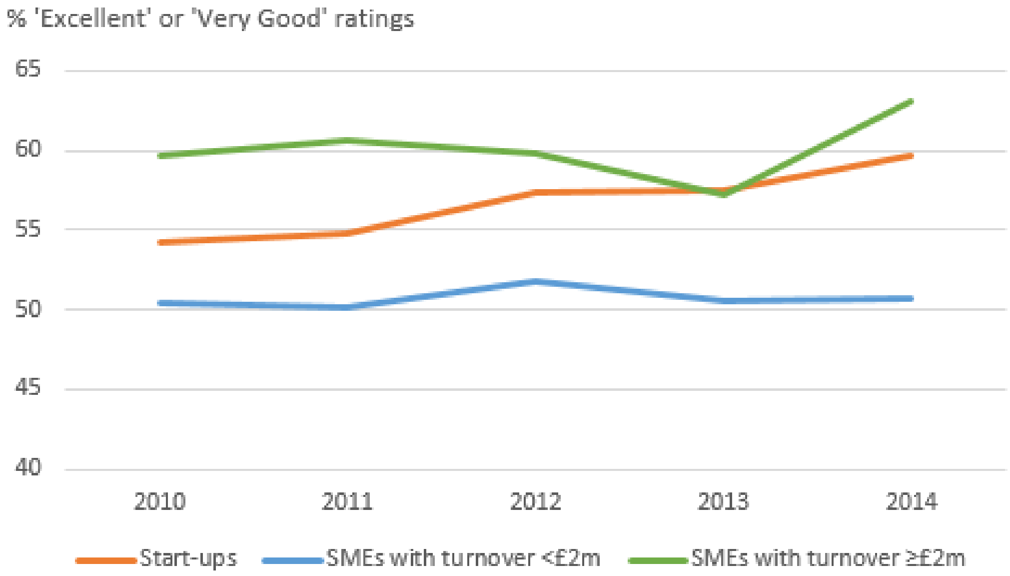
(c) satisfaction ratings (from Charterhouse BBS).

7.94 We recognise that there are limitations to the use of these measures as a proxy for quality, and for this reason the results of such analysis should be interpreted carefully, especially when considering absolute levels of satisfaction (see Section 5 for discussion on this).

7.95 Overall satisfaction for GB customers (as indicated by the proportion of customers rating their bank as either 'very good' or 'excellent') has remained at around 50%[51,52] throughout the period 2010 to 2014. We find some evidence that smaller SMEs (ie those with annual turnover less than £2 million) are less satisfied than start-ups or larger SMEs (see Figure 7.5). The overall proportion of NI SME banking customers with positive satisfaction ratings in 2015 was around 56%.[53]

[50] For example since 2010/11 Ofwat has used customer satisfaction as one of its key metrics to compare and incentivise improvements in the service quality delivered by regulated water companies. Since 2009 Ofcom has used customer satisfaction surveys to quantify and monitor the customer service experience delivered by the main communications providers in the UK. Similarly, customer satisfaction forms part of the Broad Measure of Customer Service (BMCS) used by Ofgem in its Distribution Price Control Review 5 and RIIO-ED1 price control to incentivise improvements in the customer service delivered by electricity distribution network operators.
[51] Note that SMEs with turnover less than £2 million (excluding start-ups) account for nearly 85% of the weighted number of SMEs in the Charterhouse sample, therefore the overall results are similar to those for SMEs with turnover above £2 million.
[52] Respondents to the Charterhouse BBS were asked to select a rating on a five point scale of 'excellent', 'very good', 'good', 'fair' or 'poor'. HSBC, in its response to the provisional findings, highlighted that customers selecting the middle rating of 'good' should be included in the satisfaction level. The analysis presented follows the interpretation adopted in the phase 1 market study which considered a rating of 'excellent' or 'very good' to indicate that banks were satisfying their SME customers; a rating of 'fair' or 'poor' as indicating that SMEs were dissatisfied; and a rating of 'good' (ie the midpoint on the five point scale) as neutral. We think this remains a valid approach.
[53] Satisfaction ratings before 2015 are not available for NI and there are insufficient observations in the Charterhouse NI BBS to segment the results by size of SME.

Figure 7.5: Rating of GB overall quality of service for main bank, by size of SME



Source: Charterhouse BBS.

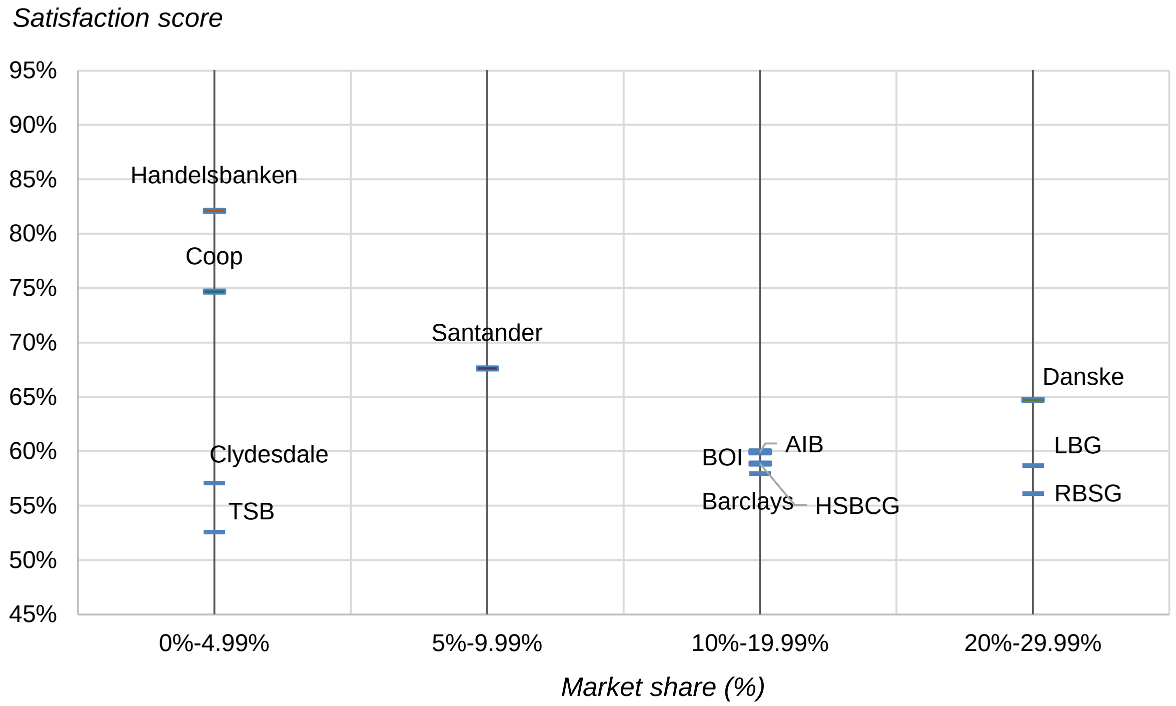
Comparisons of overall quality

7.96 In general we find that there is little variation in the performance of the four largest banking groups in GB, which are rated average or below average under each of the indicators (for example, see Figures 7.6 and 7.7 below).

7.97 Some banking groups such as Handelsbanken and Co-op Bank appear to deliver considerably higher levels of satisfaction than other providers in our analysis. While Handelsbanken has experienced an increase in market share, which is consistent with customers responding to this variation in service quality, [✂]. Furthermore Co-op Bank, in comparison, has experienced a [✂] reduction in market share over the same period despite relatively higher levels of satisfaction.

7.98 We do not find evidence of a clear relationship between BCA market share and satisfaction with overall service quality for GB (see Figures 7.6 and 7.7 below). While we observe that Handelsbanken and Co-op Bank, which have relatively low market shares, receive above average ratings for each of the three indicators, the relationship between satisfaction and market share in the remainder of the sample is relatively flat.

Figure 7.6: Comparison of satisfaction with BCA provider in 2014



Source: BBI 2014 and CMA calculations using data submitted by banks.
Notes:
1. Data for Metro not displayed as sample fewer than 30 respondents.
2. Market shares relate to NI for AIB, BoI and Danske, and GB for all other banking groups.
3. Satisfaction score calculated as weighted average of the overall satisfaction score for each SME size segment.

Figure 7.7: Comparison of GB NPS by banking group in 2014

[✂]

Source: Charterhouse BBS and CMA calculations using data submitted by banks.
[✂]

7.99 Equivalent results for SME banking customers in NI can be found in Appendix 7.5. Due to small sample sizes for some banks it is more difficult to interpret the results of the analysis. Notwithstanding these limitations, the relationship between market share and the indicators of overall service quality appears relatively flat.

Comparison by 'quality of relationship management' metrics

7.100 The Charterhouse BBS shows that concerns with the quality of relationship management is one of the primary reasons cited by SME switchers for moving away from their previous BCA provider.

7.101 To analyse variations in the quality of relationship management, we have undertaken comparisons of customer satisfaction with their relationship manager, as well as comparisons of the proportion of each banking group's customers that receive a relationship management service (segmented by size of SME).[54]

7.102 Almost universally across the banking groups, close to 100% of larger SME customers with annual turnover greater than £2 million receive a relationship management service.[55] It was more mixed across banks for smaller SME customers. There appears to be no correlation between offering relationship management service and market share of the banking group. For example, of the smaller banks, Handelsbanken has an above-average proportion of relationship-managed customers, while TSB does not offer a face-to-face relationship management service to any of its BCA customers.

7.103 We recognise the difficulties in interpreting such comparisons as observed differences between banks reflect differences in the customer base of the banks. For example, banks with a higher proportion of smaller SME customers (and therefore with less complex needs) may have lower rates of relationship management. Differences in the definition of a relationship manager, and the number of customers each relationship manager is assigned, also limit our ability to compare between banks.

7.104 As with relationship manager coverage, we do not find evidence of a clear relationship between market share and satisfaction with relationship managers (for example, see Figure 7.8).

Figure 7.8: GB satisfaction with relationship manager in 2014

[✂]

Source: Charterhouse BBS and CMA calculations using data submitted by banks.
[✂]

Summary of evidence on quality outcomes

7.105 Some banking groups appear to deliver considerably higher levels of satisfaction than other providers in our analysis, but such providers are either losing market share or gaining market share at a slow pace.

7.106 We do not find evidence of a clear relationship between BCA market share and satisfaction on various measures for GB or NI.

[54] See Appendix 7.5, Figures 11, 12 & 13.
[55] CMA calculations using data submitted by the banks.

Price-quality outcomes

7.107 The existence of large variations in prices across banks might indicate that customers of worse-performing banks would be better off switching away from their existing bank. However, it might also be reflective of differences in service quality, with customers making a trade-off between price and quality in choosing their account. We therefore interpret the results of the pricing and quality analysis together.

7.108 Below we present the results of our analysis of the price and quality offerings by provider.[56] In the figures, we consider four possible outcomes:

(a) Customers pay **above**-average prices for **above**-average quality.

(b) Customers pay **below**-average prices for **below**-average quality.

(c) Customer pay **above**-average prices for **below**-average quality.

(d) Customers pay **below**-average prices for **above**-average quality.

7.109 Outcomes *(a)* and *(b)* are consistent with customers making rational trade-offs between price and quality. However, evidence that customers pay above-average prices for below-average quality (outcome *(c)*) suggests that these customers would be better off switching product.

7.110 The analysis is based on satisfaction ratings in 2014, and market share changes between 2013 and 2014. We present the location of each brand within a ‘bubble’, providing its general location within the price-quality plane so as not to focus on the exact positioning of providers given that the average prices are estimates.

7.111 We find that some banks appear to offer a combination of above-average performance on both the quality and price indicators (eg Danske), while others appear to offer below average on both indicators (eg RBSG).

7.112 There are banks with a combination of above-average prices and below-average satisfaction. In this case we would expect customers to be better off by switching from the ‘high-price low-quality’ providers to ‘low-price high-quality’ banks. We find examples of ‘high-price low-quality’ banks gaining market share (Barclays and BoI), or losing market share slowly: Clydesdale and AIB have experienced a reduction in market share of [✂] since 2012.

[56] Appendix 5 presents the detailed analysis and results.

7.113 The banks that are ‘low-price high-quality’ have either not increased market share (Co-op Bank) or have increased only slowly (Santander).

Figure 7.9: Comparison of BCA satisfaction and weighted average prices using Charterhouse data

[✂]

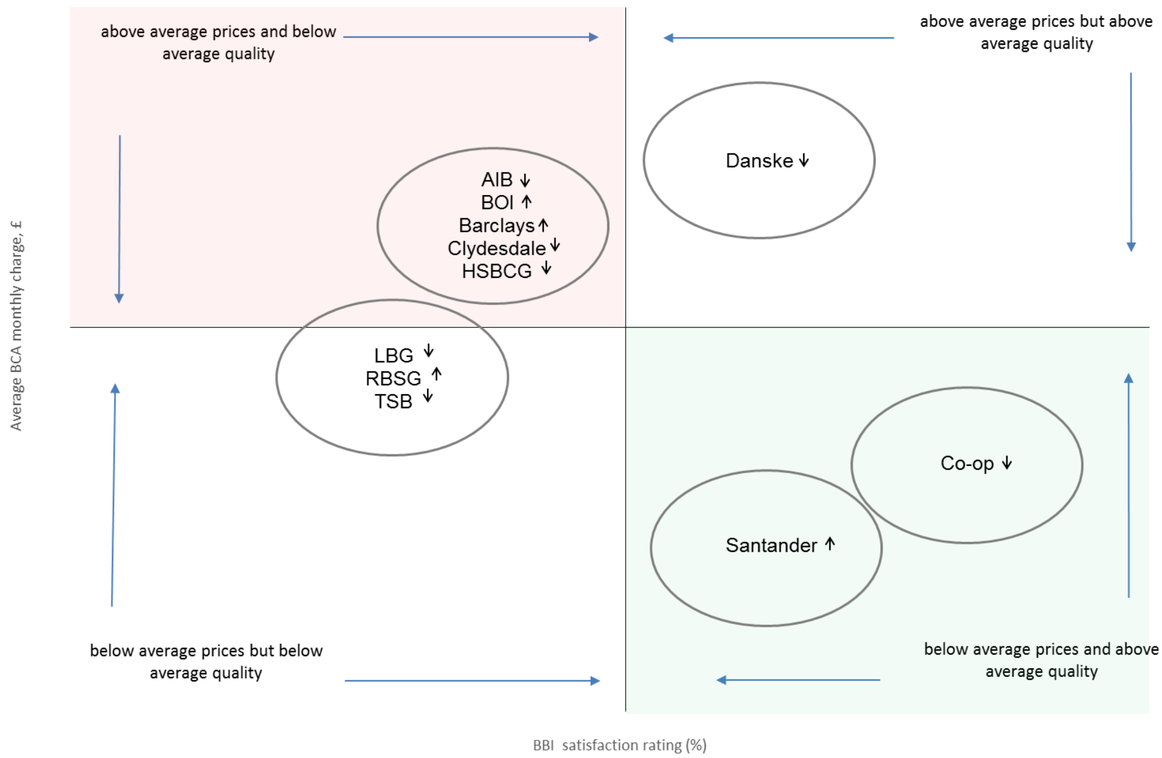
Source: CMA analysis, Charterhouse BBS and Charterhouse NI BBS.
[✂]

Figure 7.10: Comparison of BCA NPS and weighted average prices using Charterhouse data

[✂]

Source: CMA analysis, Charterhouse BBS and Charterhouse NI BBS.
[✂]

Figure 7.11: Comparison of BCA satisfaction using BBI data and weighted average prices



Source: CMA analysis of data submitted by banks, BBI survey.
Note:
1. ↑ denotes increase in bank’s market share in 2014 and ↓ denotes decrease.
2. Pricing data not available for Handelsbanken.

Summary of parties’ views

7.114 In its response to our provisional findings, Barclays told us that the suggestion that it offered a ‘high-price low-quality’ combination was inconsistent with its investment in continuous innovation and routine monitoring and reaction to NPS and other customer satisfaction measures.[57]

7.115 Barclays also stated that the interchangeable use of the phrases 'quality' and 'BBI satisfaction rating' was problematic because satisfaction levels did not necessarily always reflect an awareness of whether SMEs were indeed best served by their bank. LBG similarly noted that customer satisfaction was not the same as quality.[58]

7.116 Whilst we acknowledge this as one of the weaknesses of satisfaction measures, customer experience metrics are the best available indicator of the extent to which banks are meeting customers' expectations of service for the dimensions that are most important to them.

7.117 HSBCG made similar comments in relation to our analysis of SME outcomes as to those made with respect to our analysis of PCA outcomes. Our response to these also applies to their comments on the SME price and quality analysis (see Section 5).

Summary of evidence on price-quality

7.118 We find that some banks are gaining market share despite appearing to offer a combination of below-average quality and above-average prices. Conversely there are banks offering below-average prices and above-average quality that are either losing market share or gaining market share at a slow pace.

Estimated gains from switching

7.119 We estimated how much customers could save by switching to cheaper available products. While we would not expect all financial gains from switching to be realised in a well-functioning market, evidence that customers would gain substantially from switching is indicative of poor market outcomes.

7.120 To estimate potential gains from switching accounts, we calculated the difference between the price per month of the customer's existing product and the price per month of the lowest priced products for that customer. We did this separately for GB and NI.

[57] Barclays response to provisional findings, paragraph 2.11.
[58] LBG response to provisional findings, paragraph 18.

7.121 The estimates should be interpreted carefully, since the underlying prices are subject to some limitations, including that we have not been able to take into account all components of price in the price calculations (see ‘Price Outcomes’ section above).

7.122 Our gains from switching analysis is a static assessment, in the sense that we assume no changes in customer behaviour or provider prices.

7.123 There are four “profile sets” which each contain profiles of SMEs. We estimated gains from switching as follows for each “profile set”:

(a) For each SME profile, we have prices for banks across the market, which we used to calculate the difference between each bank’s price and the price of the cheapest bank in the market for that profile.

(b) We aggregate across the profiles to find the average gain across SMEs at each bank. We do this by weighting the profiles according to the estimated proportions of corresponding SMEs in the market, and multiply by the total number of SMEs at the bank in question.

(c) To find the average gain across all banks in the market, we take an average of the gains across the banks.

7.124 The results for each of the “profile sets” are presented in Table 7.14 below. We find that the results are broadly consistent across each set. We therefore consider the average of these four sets.

7.125 We find that in GB, SMEs could save around £80 per year on average by switching to the bank which was cheapest given their transaction behaviour.[59] In NI, the equivalent figure is around £112 per year.

Table 7.14: Average difference between monthly cost of BCA and cost of cheapest BCA

	“Profiles sets”					
	Barclays set	*HSBCG set*	*RBSG set*	*Santander set*	*Average of all profiles*	*Annual average of all profiles*
GB £ per BCA*	8	5	6	6	6	77
GB %†	104	56	78	75	79	
NI £ per BCA*	12	9	8	10	9	112
NI %†	136	101	91	119	112	
UK £ per BCA*	9	5	6	6	7	78
UK %†	105	57	79	77	80	

Source: CMA analysis.
*Weighted average across banks and profiles.
†% of charge for cheapest BCA (weighted average across banks and profiles).

[59] At provisional findings we round the intermediate figure downwards resulting in a lower estimate of gains. Here we round at the end of the calculation.

Note: the figures are rounded to zero decimal places in the table. Differences between the last two columns are due to rounding.

Summary of evidence on estimated gains from switching

7.126 The estimates of gains from switching should be interpreted carefully: the underlying prices are subject to some limitations; it is a static assessment that assumes no changes in customer behaviour or provider prices; and the estimates focus only on monetary gains so do not take into account aspects of quality.

7.127 We find that there are substantial potential gains from switching. In GB, SMEs could save around £80 per year on average by switching to the bank which was cheapest given their transaction behaviour. In NI, the equivalent figure is around £112 per year.

Innovation

7.128 Innovation can be a useful indicator of the level of competition in a market, as, in a well-functioning market, investment in innovation can bring benefits to customers in the form of diversity of choice, cost efficiencies and enhanced service levels. Conversely, a lack of innovation may suggest that firms are not subject to competitive pressure and therefore, have reduced incentives to innovate, or that there are barriers to innovation present in the market. See Appendix 7.6 for a more detailed discussion of the evidence on this subject.

7.129 We discuss in turn: *(a)* product innovation; *(b)* service innovation; and *(c)* new business models.

Product innovation

7.130 Recent product innovation in the PCA market has primarily taken the form of rewards accounts and switching incentives. However, there do not appear to have been similar levels of product innovation in the SME banking market, where recent activity has reflected price competition rather than product innovation. Further details on SME product innovation is contained in Section 8.

Service innovation

7.131 Service innovation in SME banking has primarily taken the form of the digitalisation of banking.

Mobile banking

7.132 Mobile banking was initially developed in the PCA market and then expanded into SME banking. Usage of this channel has grown considerably in recent years, but mobile banking usage in the SME banking market has not yet reached the levels observed in the PCA market. For example, LBG's mobile banking service for business customers currently attracts [✂]% to [✂]% of its base of SME internet banking customers. This is in contrast to the PCA market where we observe rates of mobile banking adoption of close to 30%.[60] Some banks, such as TSB, do not currently offer a mobile banking application for their BCA customers.

7.133 The development of mobile banking and the wider digitalisation of banking has also led to a number of other service innovations in the SME banking market. Many of these innovations, such as Paym, and online account opening, have first been initiated in personal banking and then developed in the SME banking markets.

7.134 As mobile banking adoption is largely driven by smartphone adoption, which is greater among the younger population, mobile banking adoption is likely to increase over time.

Aggregators

7.135 Aggregators are services that collect and collate information from a number of sources. The use of account aggregators in the UK is limited, particularly when compared to their development in other countries. For example, Commonwealth Bank in Australia recently launched Daily IQ, which gives its business customers access to information about their cash flow, sales and the market in which they operate,[61] and Bode Tree, a US company, provides specific financial services, such as forecasting, access to a network of banks and alternative bank lenders, on top of general account aggregation.[62]

'Big data'

7.136 The use of 'big data' for the purposes of credit and risk assessment could facilitate the entry of new SME lending providers by reducing the informational asymmetry between them and the established banks, which would also improve customer access to credit.

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[60] Expressed as the proportion of UK adults that used mobile banking in 2014 (see Deloitte innovation report, p9).
[61] See Deloitte innovation report, p42.
[62] See Deloitte innovation report, p76.

7.137 In the UK, the vast majority of lending to SMEs is based on traditional credit assessment checks using primarily transactional data. There are international examples of the use of big data in this area, particularly by non-banks, which are not inconvenienced by inflexible legacy systems and can potentially integrate such data into their systems more easily and at a lower cost. For example, Kabbage, an SME lender with operations in both the UK and the USA,[63] applies big data analysis techniques to data from both social media pages and online market places, such as eBay, to determine the credit score of a small business.[64] We have also seen evidence of established companies, such as Amazon and PayPal, beginning to enter the lending market on this basis.

7.138 Overall 'big data' is still in the nascent stages of development in the UK.

New business models

7.139 There have been a number of recent new entrants to the SME banking market, many of whom, such as Atom, Civilised Bank and OakNorth, have entered as online banks with no or very limited branch presence.[65]

7.140 Metro has entered with the more traditional distribution model of branches. Some digital banks provide counter services to their customers through agency banking relationships; Inter-Bank Agency Agreements (IBAAs); use of the Post Office network; and/or cash collection and delivery services agreements.

7.141 The development of digital wallet products such as PayPal, Apple Pay and Google Wallet cannot be used to effectively substitute for the full set of features of a BCA (see Section 4). Digital wallets compete in the payment systems market. For example, PayPal increasingly competes with banks in merchant acquiring[66] for SMEs and may be impacting on banks' BCA income. However, we have not seen evidence that digital wallet providers have yet had a significant impact on banks' BCA supply or of a competitive response from BCA suppliers.

[63] Kabbage launched in the UK in 2013 and remains relatively small scale. In the USA, where it has operated since 2009, it was lending $1 billion a year within four years of launch.
[64] See Deloitte innovation report, p52.
[65] See further case studies in Appendix 9.2.
[66] That is, providing retailers with services associated with collecting card based payments, such as terminals, and collecting card payments which have been accepted by retailers.

Summary of evidence on innovation

7.142 Mobile banking has progressed in recent years but usage in the SME banking market has not yet reached the levels observed in the PCA market. Other innovations – such as the use of account aggregation services, 'big data' and digital wallets – are in the early stages of development.

7.143 In relation to SME-specific innovations, these have tended to focus on the digitalisation of banking and reducing customer reliance on branches.

Summary of conclusions on structure and outcomes in SME banking

Market structure and concentration

7.144 We find that the BCA market in GB in 2015 is concentrated with the four largest providers having a combined market share of over 80% of active BCAs and an HHI of around 1,800. Excluding the impact of mergers and divestments, shares in the GB and NI BCA markets have remained relatively stable for the majority of providers since 2005.

7.145 In NI the combined market share of the four largest banking groups in terms of active BCAs was around 90% in 2015. The market is on the threshold of being highly concentrated in 2015 according to our guidelines, with an HHI of around 2,000.

7.146 We find that levels of concentration in general-purpose business lending (including commercial mortgages) in the UK are similar to that of the BCA market. Concentration in business loans as a whole is expected to be lower than in BCAs, reflecting the lower share of the largest banks in invoice finance.

Financial performance

7.147 Net revenues per active BCA has decreased since 2012. We find for general-purpose business loans total revenue from interest and charges has broadly remained the same since 2011, total asset finance revenue has increased, and invoice finance revenue has declined. Net revenue from business deposits has also declined. Overall, impairment rates improved over the period.

7.148 Banks take different approaches to assessing the performance of SME banking, but the evidence we have seen for five banks suggests that BCAs are profitable over the course of a five-year period.[67]

Price and quality outcomes

7.149 We have considered to what extent variations in pricing and quality are associated with banks gaining and losing market share. We find evidence of some banks gaining market share despite appearing to offer a combination of below-average quality and above-average prices. Conversely there are banks offering below-average prices and above-average quality that are either losing market share or gaining market share at a slow pace. This suggests that there is a weak customer response to variations in price and quality across providers.

Estimated gains from switching

7.150 Estimates of gains from switching provide a measure of customer engagement in the market, although we would not expect all financial gains from switching to be realised in a well-functioning market. The estimates should be interpreted carefully, since the underlying prices are subject to some limitations. It is a static assessment that assumes no changes in customer behaviour or provider prices, so should not be interpreted as the gains that all customers could achieve in the market if all customers switched to the best alternative product. The estimates focus only on monetary gains, and do not take into account aspects of quality.

7.151 Our finding of substantial potential gains from switching although subject to caveats is consistent with the evidence above of a weak customer response.

Innovation

7.152 When the various innovations in the SME banking markets are assessed individually, there is a considerable degree of variation in the development of each innovation and the extent to which each innovation has impacted (or is likely to impact) the SME banking markets. In contrast to mobile banking, which has progressed significantly in recent years, other innovations – such as the use of account aggregation services, 'big data' and digital wallets – are in the early stages of development.

[67] [✄] provided stand-alone profit and loss forecasts for their BCA businesses, whereas [✄] provided forecasts for their SME banking businesses, which includes the provision of BCAs and other SME banking products.

7.153 In relation to SME-specific innovations, these have tended to focus on the digitalisation of banking and reducing customer reliance on branches.

7.154 When these individual innovations are considered in aggregate, our view is that the extent of innovation in the SME banking markets has lagged behind the levels observed in the PCA markets. This is perhaps best represented by the slower adoption of mobile banking and penetration into the SME banking markets.

Overall conclusion on SME banking outcomes

7.155 We find that the markets for SME banking are concentrated, and excluding the impact of mergers and divestments, shares have remained broadly stable since 2005. We find that on the whole, innovation has lagged behind that in PCAs. We find considerable variation in price and quality of products, however banks offering lower average prices and/or better quality have lost market share or have gained market share only slowly. We find that there are substantial potential gains to be made by customers switching BCA to the lowest priced products for them.

7.156 We interpret the above as evidence of markets that are not well-functioning: there are weak customer responses to variations in prices and quality, and the substantial potential gains to be made by customers switching BCA suggests the scale of weak customer engagement is considerable.

7.157 We consider the implications of these findings further in Section 8 on how banks compete for SME banking customers, in Section 9 on new entrants and the ability of smaller banks to expand, and in Section 10 in our assessment of market structure and market power.

8. SME banking: competition and customer behaviour

Contents

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Introduction

8.1 In this section we examine the way competition works in SME banking services. We look at the extent to which SMEs drive competition between banks, whether anything prevents them from doing so (ie barriers to searching and switching), and how this affects the way banks compete for SMEs.

8.2 We first provide some background information on the market for SME banking services, and then separately assess competition for BCAs and SME lending. At the end of this section we draw together our analysis and our findings on SME market structure and outcomes from Section 7, before concluding on the extent of competition in SME retail banking services.

8.3 Further information on BCAs is set out in Appendix 8.1 and on SME lending in Appendix 8.2.

8.4 Our separate assessment of BCAs and SME lending is consistent with our market definition for SME banking services set out in Section 4.[1] We have

[1] We found separate product markets for BCAs (with or without overdraft facilities), business loans and deposit accounts. While we consider overdrafts as part of the BCA market for the purpose of our market definition, for most of this section overdrafts are analysed and reported alongside other SME lending products, as they share a

not given further consideration to competition for business deposit accounts because we have not received evidence to suggest that further analysis should be undertaken.[2]

8.5 Access to finance for SMEs has been the subject of much government focus throughout the UK, in particular since the financial crisis. Whilst there is clearly a link between competition and access to finance, the focus of our investigation has been on assessing the nature of competition in SME retail banking. Where relevant we have considered the impact of schemes such as the British Business Bank (BBB) and the Funding for Lending Scheme (FLS) on our assessment (see Section 9) but we have not considered wider access to finance issues.

Background to SME retail banking services

8.6 SMEs are extremely important to the UK economy. They employ around two-thirds of the private sector workforce and produce just under half of all UK private sector turnover. In the last few years, there has been a large expansion in the number of people starting up and growing a business. At the start of 2015 there were just under 5.4 million SMEs in the UK (an increase of 1.9 million since 2000).[3] This growth has come from the self-employed but also among employing SMEs and is evident across all sectors of the economy. This includes highly innovative, high-tech start-ups to more traditional businesses in the construction industry, manufacturing and retailing. However, despite this rise, the total number of SMEs actively using a BCA has remained broadly stable over time at around 4.9 million[4] since 2012.[5]

8.7 BCAs are an indispensable service for the vast majority of SMEs and perform broadly the same functions as a PCA for personal customers. SMEs need a reliable banking service as the potential impact on an SME's business of payments to and/or from customers, suppliers and employees can be significant. For many SMEs, banks are also an important source of finance both during critical periods of growth when businesses are seeking

number of similarities. We recognise, however, that an overdraft cannot be obtained without a BCA and we make reference to overdrafts where relevant to SMEs' decisions and behaviours regarding BCAs.

[2] Similarly, we note that the SME market study did not identify any concerns regarding SME deposit accounts.

[3] See Appendix 8.1, Table 1 and Figure 1.

[4] See Table 7.1. This figure refers to active accounts.

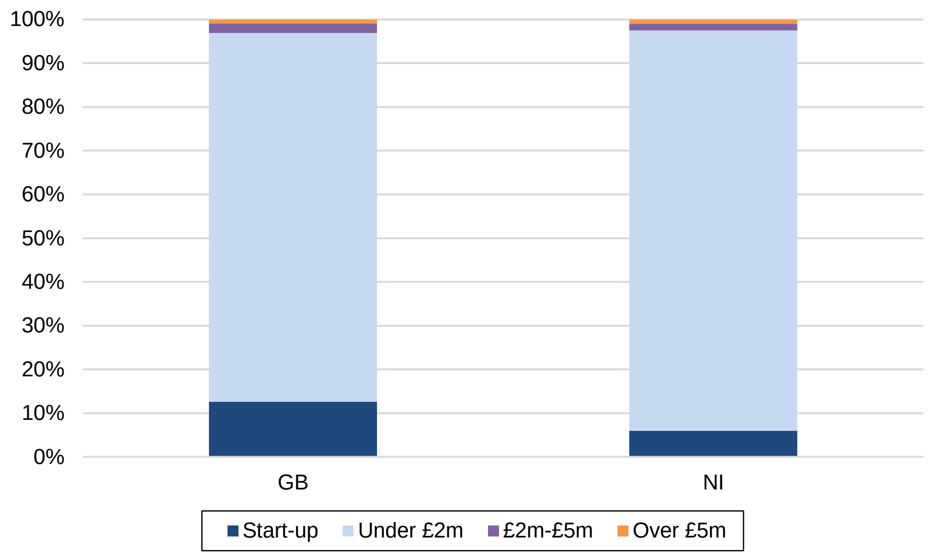
[5] The difference in the total number of SMEs and the total number of active BCA accounts can partially be explained by some SMEs using a PCA for business purposes. The SME Finance Monitor estimates the proportion of SMEs using PCAs to be approximately 14%. SMEs that are most likely to use a PCA for business purposes include low turnover SMEs and sole traders as PCAs tend to lack the functionality needed for the majority of larger SMEs. For instance, paying wages and authorising multiple payments from one account.

to expand, as well as during difficult periods when a business may need short-term financial assistance (for example to manage cash flow). A total of £21 billion worth of general-purpose business loans[6] were granted in the UK in 2015 and the use of external finance by SME has remained constant over the last few years with over 50% of SMEs holding some form of external finance (excluding credit cards) – see Appendix 8.2 for further details.

SME characteristics

8.8 The vast majority of SMEs are small in terms of turnover (see Figure 8.1) and number of employees[7] – 97% of SMEs with BCAs in GB have a turnover less than £2 million, including 13% that are start-ups.[8,9] Less than 1% have a turnover above £5 million. This is broadly similar in NI.

Figure 8.1: Turnover profile of SMEs in GB and NI using BCAs 2014



Source: Charterhouse BBS 2014 and Charterhouse NI BBS.
Base: All SMEs 2014 (14,239).
Notes: Some SMEs use a PCA rather than a BCA so the number of businesses may be higher. However, the Charterhouse survey only asks about the SME with a BCA account.

8.9 Each year a number of new businesses will start trading and a number of businesses will cease to trade.[10] In 2014, approximately 14% of the total business population in the UK were new businesses and 10% exited.[11] This

[6] Includes commercial mortgages, but excludes residential property loans.
[7] Approximately 75% of the SME population have no employees – see Appendix 8.1.
[8] Charterhouse BBS. Start-ups in this are defined as businesses that began trading within the 12 months prior to the questionnaire.
[9] We provide details of the Charterhouse BBS in Appendix 8.1. In general results from the Charterhouse BBS are for GB only, unless NI is specifically noted.
[10] In addition, businesses can expand beyond the size of an SME.
[11] See Figure 4, Appendix 8.1. This includes all businesses not just SMEs, however, large SMEs account for a relatively small proportion of the overall SME population.

natural business turnover is partially reflected in the level of churn[12] in BCAs (approximately 12% of BCAs were opened in 2014 and a similar proportion were closed[13]).

8.10 Start-ups have the highest failure rates. After the first year of trading approximately 90% of SMEs are still in business. However, by year 3 this has dropped to 60% and by year 5 less than half (around 40%) are still operating.[14] At the other end of the spectrum just under half of SMEs (46%) are over ten years old and just over a quarter (26%) are over 20 years old.[15] The natural level of entry and exit or 'churn' has implications on how banks compete for SME customers, which will be discussed later in this section.

SMEs' usage of BCAs and other banking products

8.11 Demand for SME banking services is affected by the demographics of the SME population. For example, microbusinesses tend to have simpler banking requirements than larger SMEs which may trade over more than one site and internationally.

8.12 BCAs are core payment accounts, generally used to make and receive payments and to manage cash flow. The types of transactions that SMEs make via their BCA and the services and products they use from their bank, will vary significantly depending (among others) on the size of the SME, the type of business and the sector they operate in. For example, a retail cash handling business that primarily makes and takes cash payments is likely to require access to branch services, whereas an online business is more likely to need access to online banking services.

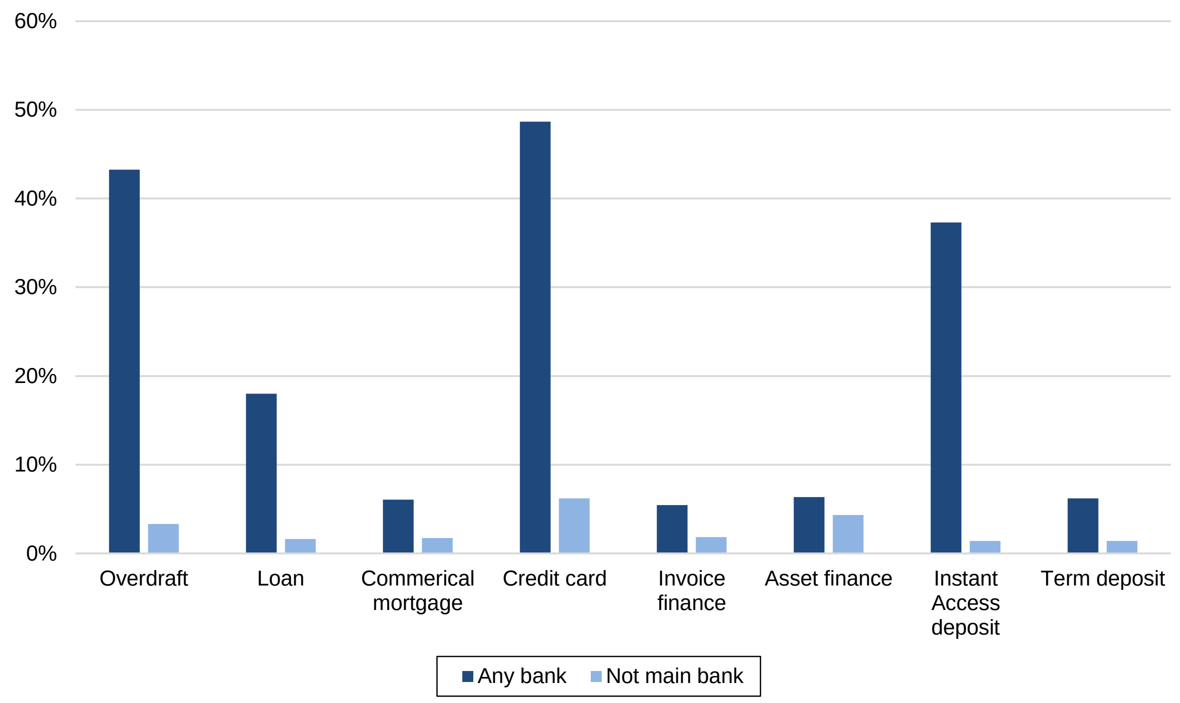
8.13 BCAs need to support a variety of different transactions and requirements. In relation to SMEs, banks typically charge per transaction or more recently charge a monthly fee which will include a specific volume of transactions within the monthly fee or at a reduced fee. Anything not covered by this monthly fee is paid per transaction at the banks' standard rates. Examples of transaction charges for SMEs include direct debits, standing orders, depositing cash and taking cash out at ATMs.

8.14 Alongside this many banks also provide additional services with a BCA. This may include overdrafts, and access to a relationship manager to provide advice and support to SMEs.

[12] Churn refers to the rate of entry and exit by SMEs.
[13] See Section 7.
[14] See Appendix 8.1.
[15] Figure 6, Appendix 8.1.

8.15 As shown in Figure 8.2 SMEs will generally hold more than one product with their main bank. Larger, more complex businesses will hold more products than their smaller counterparts. Credit cards account for the greatest proportion of lending including overdrafts (in 2014, 48% of SMEs had credit cards and 43% held overdrafts) while only 18% held a loan. Few SMEs use invoice or asset finance and those that do are predominantly larger SMEs.[16]

Figure 8.2: Proportion of SMEs holding banking products (GB)

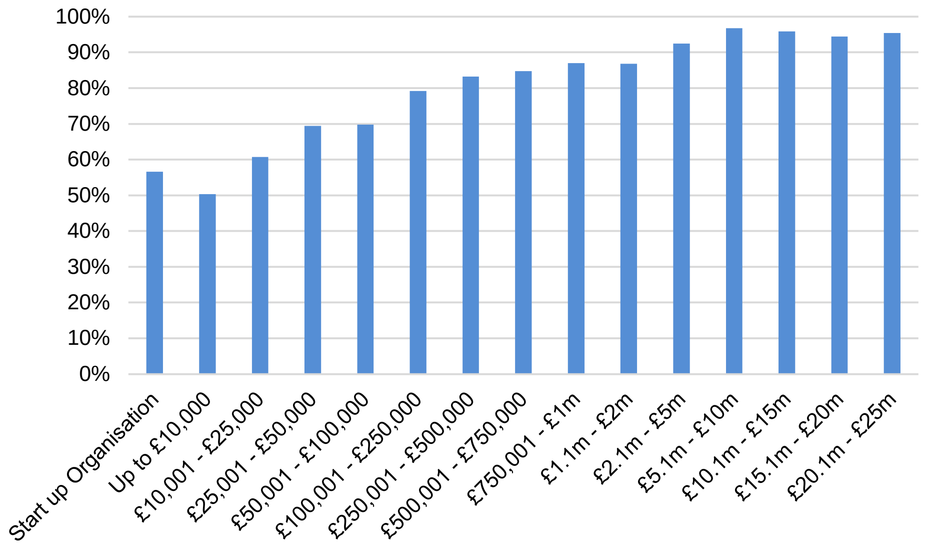


Source: Charterhouse BBS 2014.
Base: All SMEs asked about other products (4,993).

8.16 Lending facilities are not used by all SMEs. Some SMEs do not require finance, and others are more suitable for or may prefer other types of finance such as personal equity.[17] Larger SMEs are more likely to take out lending (see Figure 8.3).

[16] In response to our provisional findings, Barclays said that we had undertaken insufficient analysis on other lending products, in particular asset finance and commercial credit cards (Barclays response to provisional findings, paragraph 4.1). It has not been possible to undertake analysis of asset finance pricing due to the bespoke nature of pricing for this product. We also note that only a small proportion of SMEs use asset finance, particularly amongst SMEs with turnover below £2 million (see paragraph 8.146). We have, however, considered asset finance specifically in our analysis of revenue, concentration and search behaviour. With regards to commercial credit cards, we did not receive evidence from parties that credit cards were a specific area of concern (over and above the issues identified in the provision of BCAs). As such we have focused our analysis on BCAs and general purpose business lending.
[17] See Section 4 and Appendix 8.2 on types and suitability of types of finance.

Figure 8.3: Proportion of SMEs who held finance in last 12 months by SME turnover (GB)



Source: Charterhouse BBS 2014.
Base: All SMEs asked about banking products other than their BCA.

Banks' segmentation of SMEs

8.17 Banks will typically segment customers based on the turnover or the value of the business.[18] This segmentation influences the products available and the degree of negotiation on tariffs and terms as well as the level of support and quality of relationship management SMEs receive. The largest five banks generally serve SMEs across two business units: business banking and commercial banking.[19]

(a) Business banking is where the majority (around 95%) of SMEs lies and is generally for smaller businesses with turnover up to around £2 million.[20] These SMEs, particularly those at lower turnovers, will tend to have simple banking needs, often requiring only a transactional relationship with their bank (eg making payments, cash handling). Some will get access to relationship managers, albeit as part of a large portfolio. Negotiation of prices and terms is limited. Start-ups and to a lesser extent switchers will tend to get a period of free banking.

[18] This is a proxy for the complexity of the business and the types of services it is likely to require.
[19] Some banks also segment on turnover or sector and some provide specific accounts for charities, clubs or societies. In response to our provisional findings, Barclays questioned whether these accounts were in scope of the investigation (Barclays response to provisional findings, paragraph 4.2). We confirm that charity, clubs or societies accounts are in scope of the investigation, but as they are a relatively small proportion of business bank accounts (in 2014 they accounted for less than 0.5% of revenue from charges and interest, and 6% of total net revenue (including the net value of funds)) no separate analysis has been undertaken for these accounts.
[20] Names of organisational units and exact turnover splits vary by bank (see Appendix 8.1).

(b) Commercial banking serves the remaining SMEs (around 5%). It generally includes SMEs with a turnover of over £2 million. These SMEs will often have a greater degree of financial sophistication (including employing specialist financial management staff) and are more likely to require a wider range of products and services than those required by smaller SMEs. These SMEs will generally also be provided with an individual relationship manager by their bank. They also tend to generate more revenue for banks and are more likely to be able to negotiate on price and other terms (see Appendix 7.2, Table 5).

8.18 In the remainder of this section in relation to competition for BCAs, we first look at how and when SMEs engage in the market to consider further evidence on the nature and level of SME engagement. We then examine possible explanations for low engagement such as barriers to searching and switching preventing SMEs from identifying and acting on better offers. Finally we consider how this impacts on banks' incentives to compete in the supply of BCAs. We then separately consider those issues in relation to competition for SME lending. Finally we then draw together our overall conclusions on competition in SME banking with reference to our analysis on SME outcomes set out in Section 7.

BCAs

Level of SME engagement

8.19 SMEs are highly diverse and what they look for and demand from their bank will vary depending on factors such as the stage and life cycle of the business, the sector they operate in, the complexity of the business, whether they employ staff or are self-employed, the growth ambition of the business's owners and whether they trade internationally.

8.20 BCAs are 'evergreen' products (ie there is no contract end date), which means there are few natural trigger points for customers to consider searching for and switching BCAs (see also Section 6 in relation to PCAs and trigger points). There are, however, several key stages in the life of an SME that will impact on an SME's demand for banking products and the nature of their engagement:

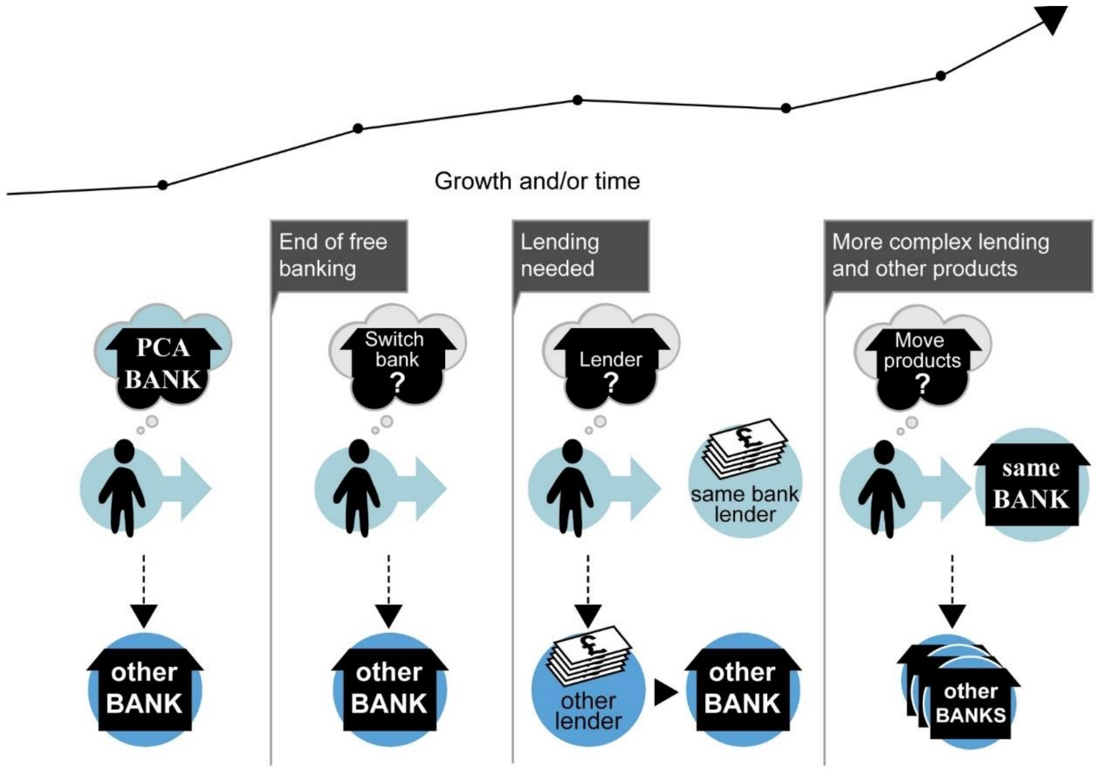
(a) The start-up phase: when first opening a BCA and establishing a business banking relationship for the first time.

(b) The end of the free banking period: usually after 12 to 24 months when an SME will have a more established relationship with its business banking provider and it starts paying for transactions.

(c) More established SMEs: as an SME grows and becomes more established, the need for other business products and services, including in particular lending, may increase and, as a result, the relationship aspects of banking become potentially stronger.

8.21 Figure 8.4 below displays a stylised journey of an SME through the key stages in its life that impact on its banking decisions. At start-up an SME chooses whether to open a BCA with its current PCA bank, or go elsewhere. Then, once free banking has finished, it may consider switching to a different bank. At some stage, should the SME require lending, it may go directly to the bank it holds its BCA with, or try a different provider. If it takes out lending at a different bank it may consider whether to move its BCA as well. As the lending needs get more complex or the SME requires other products, the SME may consider moving at least some products to another bank or alternative lender.

Figure 8.4: SME journey in relation to banking



Source: CMA.

8.22 As set out earlier, each year a large number of new SMEs will be established or will cease to trade. The level of churn in SMEs and how SMEs engage in the market at each stage affects how banks compete for SMEs. For example, at start-up SMEs may be more focused on other priorities than their banking relationship.

8.23 In addition, having chosen a banking provider, an SME's needs may change over time and it may then find it more difficult to switch provider. Or, having established a relationship with one provider, an SME's ability or incentive to change bank may be constrained.

8.24 We now look at the key points in the journey when SMEs might engage with their BCAs: the point in which SMEs initially choose a BCA provider and then their behaviour after they have chosen, where we also assess their level of engagement for example through switching rates. Finally we consider parties' views on our analysis of SME customer engagement.

SMEs' initial choice of BCA provider

8.25 One of the first opportunities for SMEs to actively engage with business banking products is when they first open a BCA.

8.26 The Research Works SME qualitative research shows that SME owners will often start by using their PCA but when they consider themselves more established, they will then open a BCA account.[21] It also found that those opening their first BCA were more likely to look around for alternative providers than when looking for their original PCA.

8.27 The Charterhouse follow-up survey with start-ups showed that 54% of SMEs did some searching before opening a BCA, although 36% went straight to their PCA provider.[22,23] When asked whether they compared different providers against each other, 58% said that they did not compare other providers and a further 23% did so in a superficial way.[24]

8.28 We find that in GB, overall, just over half of start-ups open a BCA with their PCA provider, although this varies by bank (see Figure 8.5).

Figure 8.5: Proportion of start-up SMEs in GB opening a BCA with their PCA provider (by brand) (2010 to 2014)

[✂]

Source: Charterhouse BBS, 2010–2014.
[✂]

[21] See Research Works SME qualitative research, p14. Research Works qualitative research covered the UK.
[22] SME follow-up surveys, p9. The remaining 9% were SMEs that did not go to their PCA bank, but did not compare banks either. Results from the Charterhouse SME follow-up surveys cover the UK.
[23] In its response to our provisional findings, HSBCG said that our assessment did not place sufficient weight on the HSBCG 2015 survey (HSBCG response to provisional findings, paragraph 3.15). As outlined in Appendix 8.1, we have concerns about the sampling and methodology of this survey which means that whilst it brings some helpful insights we do not place undue weight on its findings.
[24] SME follow-up surveys, p16.

8.29 We do not have equivalent data for NI due to the small number of start-up SMEs in Charterhouse's survey sample.

8.30 For start-ups that did not compare banks, the most important reasons given for choosing a BCA provider were it being the personal bank (25%), branch location (20%), and free banking (17%). For those that did compare providers, free banking was the most important reason given (39%), followed by attractive charges and fees (12%) and the branch location (12%).[25]

8.31 The survey suggests free banking was a significant driver for SMEs that were considering different banks. Most banks offer initial free banking periods so the differentiating factor is likely to include the length of free banking offered.[26]

8.32 The follow-up survey also provides evidence that many SMEs do not consider the lifetime cost of banking. We found that 28% of start-ups did not consider future fees when choosing their initial BCA. Even though 72% of all start-ups said they considered future fees, of these, 12% then went on to say that they did not look into the fees at all, 24% did not spend much time looking at fees and 14% looked at the fees of the provider they chose without comparing between banks.[27] This means that only 36% considered and compared future fees.

8.33 Many SMEs do not compare across banks the fees that they will pay after the end of the free banking period. This means that the ability of SMEs to search and switch BCA providers once their free period of banking has ended, is particularly important for the competitive process.

SME behaviour after they have chosen a BCA provider

8.34 Once an SME has made an initial choice of BCA, the suitability of the product may change over time. This will particularly occur at the end of the free banking period, when the charging structure of its current provider may not suit the SME. But this will also arise if its needs change, as its business evolves and/or it requires additional banking products such as access to lending. Equally, an SME may become dissatisfied with its bank if the service does not meet its expectations. These changes could cause an SME to reassess its banking needs and which provider is best suited, and potentially switch BCA provider. We have assessed levels of switching and

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[25] See Appendix 8.1. The chart displaying the results for all start-ups can be found at p11 of the SME follow-up surveys.
[26] Further information on length of free banking periods is presented in Appendix 8.1.
[27] SME follow-up surveys, p18.

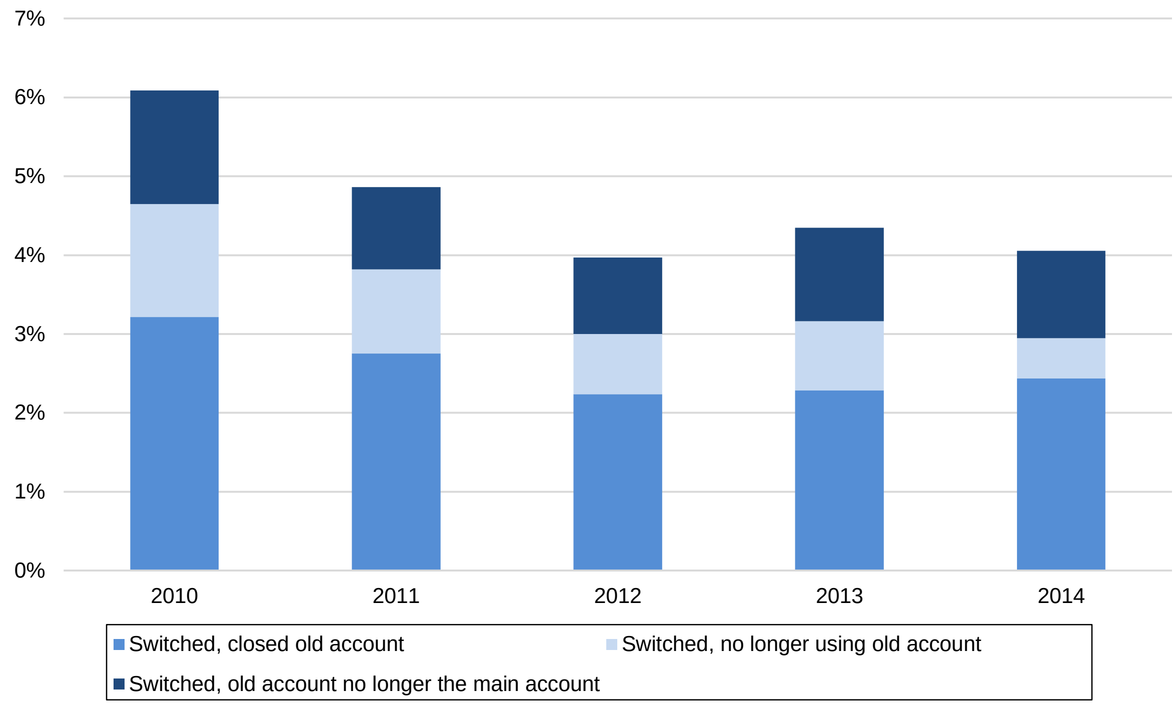
searching to understand levels of customer engagement after having chosen a BCA provider.

- *Switching and searching rates*

8.35 We have found that, similar to PCAs, rates of switching for BCAs are low.

8.36 The annual switching rate for BCAs in GB was around 4% in 2014 (see Figure 8.6).[28] This compares with around 3% for PCAs.[29] In addition, around 4% of SMEs hold more than one BCA.[30] In NI, only 2.6% of SMEs switched BCAs in 2015.[31]

Figure 8.6: SME BCA switching rates in GB (2010 to 2014)



Source: Charterhouse BBS, 2010–2014.
Base: 2010 (15,866), 2011 (16,188), 2012 (15,746), 2013 (15,838), 2014 (14,239).
Note: The Charterhouse BBS asked respondents 'Have you changed your main bank over the past 12 months?' While the main bank does not necessarily mean the BCA provider, 96% of businesses named their main bank as their BCA provider.

[28] This followed a decline in switching after the recession, when switching rates fell from 6% in 2010 to just under 4% in 2012. These rates include partial switching where the SME retains its old account.
[29] This excludes internal switching. We do not consider that internal switching is a reliable indicator of engagement, especially where SMEs come to the end of their free banking period and are simply moved on to a different tariff at this stage.
[30] This does not suggest there are a significant number of SMEs that are engaging in partial switching between existing BCAs (see Appendix 8.1, Figure 29).
[31] Charterhouse BBS NI. In addition, around 4% of SMEs use more than one BCA in NI.

8.37 We found that older SMEs have a particularly low inclination to switch BCA providers.[32] 70% of SMEs in GB that have been in business for over ten years have been with their main bank for at least ten years, and 79% of SMEs that have been in business for at least five years have been with their main bank for at least five years.[33] Similarly in NI, 77% of SMEs that have been in business for over ten years have been with their main bank for at least ten years, and 88% of SMEs that have been in business for at least five years have been with their main bank for at least five years.[34]

8.38 We also found indications of limited searching by SMEs once they have chosen a BCA: 77% of businesses between two and five years old said that that they never compared the costs of their BCA with those of other providers.[35]

8.39 When SMEs do switch, the main drivers for switching appeared to be dis-satisfaction with an element of service and the costs of banking.[36] For younger SMEs (between two and five years old) costs were particularly important: the main reasons for considering switching were the current service being too expensive and the offer of free banking from another provider. Service issues appeared to be a much less significant factor.[37]

8.40 Even at the end of the free banking period, the majority of SMEs did not consider switching (67%) and only six of the 78 respondents who considered switching actually switched banks.[38] Of those who did not consider switching, the main reason stated by respondents was satisfaction with their main bank (45%).[39] However, over a quarter reported not considering switching because it was 'too much hassle' or thought it would take too long[40] with others citing existing payment arrangements/continuity of payment arrangements (9%) and products linkages (6%) with their BCA. 12% cited the charges being too small to warrant switching.

8.41 Whilst we would not necessarily expect those customers satisfied with their current service to want to switch, in a competitive market we would still

[32] See Appendix 8.1, Figure 23. Due to the sample size of the Charterhouse NI BBS, there are few SMEs that have been in business for less than two years. Therefore all SMEs under five years old are grouped together. Switching rates for this group were higher than for those SMEs over ten years old (see Figure 24).
[33] Charterhouse BBS 2014.
[34] Charterhouse BBS NI.
[35] SME follow-up surveys, p32.
[36] The drivers of switching are discussed in Appendix 8.1.
[37] SME follow-up surveys, p30.
[38] SME follow-up surveys, p29.
[39] SME follow-up surveys, p29.
[40] Further results are in the SME follow-up survey results.

expect a higher proportion of the least satisfied customers to consider switching.

8.42 Evidence from Charterhouse BBS shows that while businesses that were least satisfied with their bank are more likely to switch, around 35% of those who considered their banking service to be poor were still not considering switching. Of those customers who only considered their banking service to be fair, an even larger number (61%) were not considering switching. The pattern in NI was similar, although there were more customers considering switching among those who were least satisfied.[41]

8.43 This is broadly consistent with evidence from Research Works' qualitative research[42] and FCA qualitative research,[43] which found examples of SMEs that had been unhappy with their bank, yet they remained disinclined to switch. Typically, these respondents were 'tolerating' their situation. Some felt that a change to an 'unknown' provider might lead to a worse outcome.

8.44 In addition, given the difficulties in comparing offers across banks which we identify below, and the low levels of searching, satisfaction levels do not necessarily always reflect an awareness of whether SMEs are indeed best served by their bank.[44]

8.45 In summary, we find there are low levels of switching and searching by SMEs at the end of the free banking period. We do not consider that such low levels can be explained solely by customer satisfaction. We also found that although there are higher rates of searching by SMEs at start-up, few start-ups spend time comparing future fees when considering their choice of bank.

Summary of parties' views on customer engagement

8.46 A number of parties disagreed with our assessment of SME customer engagement in BCAs.

8.47 In response to our provisional findings Barclays commented that the presence of multi-banking and multi-sourcing indicated that the market was more competitive than suggested by switching rates alone.[45] We consider multi-banking in Appendix 8.1. We found that the level of narrow multi-

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[41] See Appendix 8.1 Figure 46.
[42] See Research Works SME qualitative research.
[43] See Optimisa Research for the FCA (March 2015), *Engagement with current accounts and the switching process* ('FCA CASS qualitative research').
[44] Satisfaction levels are examined further in Appendix 8.1.
[45] Barclays response to provisional findings, paragraph 3.35.

banking (where an SME holds a BCA at more than one bank) is less than 5%, which does not suggest high levels of SME engagement in BCAs.

8.48 Barclays disagreed that there are insufficient triggers for switching.[46] It considered that an almost doubling in switching rates at the end of the free banking period indicated, alongside start-up, that this was a choice point. It also cited changes to prices and products as a potential trigger point. While we acknowledge that switching is higher at the end of an SME's free banking period, the absolute rate of switching still remains low. Furthermore, there are few trigger points for SMEs no-longer in a free banking period, consequently SMEs are not required to consider whether their BCA is the best available or appropriate product for them.

8.49 Barclays also said that little analysis had been undertaken in relation to businesses with a turnover of above £6.5 million.[47] We were unable to include larger SMEs in our analysis of BCA pricing. This is due to the bespoke nature of pricing for larger SMEs which is usually the result of bilateral negotiation. As such published prices are neither available nor relevant for this segment of customers. However, we note that SMEs of this size account for less than 1% of all SMEs with a BCA.[48] Larger SMEs (including those with turnover up to £25 million) are nevertheless included elsewhere in our analysis including that of concentration, revenue, quality, customer engagement and switching, and competition between banks.

8.50 HSBCG stated that as two-thirds of dissatisfied SMEs were looking to change bank, we may not be comparing against a realistic benchmark.[49] However we note that 35% of dissatisfied SMEs are not even considering changing bank, which indicates that the market is not functioning well.

8.51 HSBCG also questioned the reliability of the Research Works' qualitative research,[50] given this was based on a small sample.[51] We have taken into account the sample size of the Research Works research in how we have used it to inform our analysis. We have used it alongside the FCA CASS qualitative research[52] which we consider provides corroborating evidence of SMEs 'tolerating' their current bank.

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[46] Barclays response to provisional findings, paragraph 3.31.
[47] Barclays response to provisional findings, paragraphs 1.5 & 4.1.
[48] Charterhouse BBS.
[49] HSBCG response to provisional findings, paragraph 3.8.
[50] See Research Works SME qualitative research.
[51] HSBCG response to provisional findings, paragraph 3.9.
[52] See Optimisa Research for the FCA (March 2015), *Engagement with current accounts and the switching process* ('FCA CASS qualitative research').

8.52 RBSG submitted that, based on analysis of the CMA's research, levels of customer engagement were not indicative of low levels of SME engagement given that 22% of SMEs between two and five years old had compared costs of their BCA with other providers and 33% of SMEs had considered switching at the end of their free banking period.[53] Similarly, Barclays said that customers were not inactive and switched only when they were dissatisfied. It argued that previous SME surveys indicated high levels of customer satisfaction and that as such the market was working well with engaged customers making informed choices.[54]

8.53 Although there is no set benchmark, in evaluating the evidence on customer engagement and other outcomes we are concerned that rates of searching and switching are relatively low given the observed levels of customer satisfaction.

Explanations for low customer engagement

8.54 In this section, we consider possible explanations for the evidence we have found of low levels of SME engagement in the markets for BCAs; which includes:

(a) SMEs' attitudes to banking.

(b) Perception of lack of differentiation between banks.

(c) Perception that the financial gains from switching are limited.

(d) Barriers to searching (ie accessing and assessing information).

(e) Barriers to switching BCAs.

SMEs' attitudes to banking

8.55 Various research on SME attitudes to banking suggest that SMEs' propensity to search and switch BCAs is low.

8.56 The FCA conducted qualitative research on SMEs' attitudes to banking.[55] Four key themes emerged from this research:

(a) low maintenance, where reliable current accounts are taken for granted with few customers having experienced problems;

[53] RBSG response to provisional findings, section 4.2.
[54] Barclays response to provisional findings, paragraph 3.27.
[55] See FCA CASS qualitative research.

(b) low priority, because current accounts are not generally perceived as being costly to customers;

(c) long term, because customers may feel they receive benefits from being loyal; and

(d) convenience, especially for customers who need access to a certain channel such as a branch, and have become used to using that channel.

8.57 Similarly, the Research Works SME qualitative research found that some SMEs would not consider switching BCA if they felt existing arrangements were working well. Their attitude tended to be one of ‘if it’s not broken, don’t fix it’, particularly amongst younger businesses.[56]

8.58 Both the FCA CASS qualitative research and Research Works found that there is a perception amongst some SMEs that staying loyal means ‘you get a better deal’, which again may reduce SMEs’ propensity to search and switch.

Perception of limited differentiation between banks

8.59 For SMEs to consider searching and/or switching, they need to expect benefits from searching, either a better-quality service or a cheaper service (or a combination of both). Their perception that there are differences between providers and between products are therefore likely to be key drivers in their willingness to engage and shop around at the outset and search once they have a BCA.

8.60 Our analysis of outcomes found that there was very little difference between the largest four banks on quality[57] although there were differences between providers on both price and free banking periods for start-ups and switchers.[58]

8.61 The FCA CASS qualitative research noted that SMEs did not think other providers would be any different to their current provider. This was identified as part of a wider distrust in the banking industry and was more evident among smaller SMEs that felt they were ‘just a number’ to the larger banks.[59] The Research Works SME qualitative research found similar results, in particular it found that the perception of a lack of differentiation was based on assumptions rather than a factual understanding of the range

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[56] Research Works SME qualitative research.
[57] See Section 7.
[58] See Appendix 8.1, Table 2.
[59] FCA CASS qualitative research, p32.

of BCA banking offers. This perception of a lack of differentiation between banks is likely to be a factor which reduces SMEs' propensity to search and switch.

Perception that the financial benefits from switching are insufficient

8.62 The annual average cost for a BCA was around £379 in 2014.[60] The relatively low cost of BCAs for many SMEs, compared with other costs they incur (such as supplier bills or energy and telecoms bills), means that SMEs may have low incentives to consider switching BCAs.

8.63 There is evidence from several sources suggesting that the financial benefits from switching may be perceived to be insufficient by some SMEs to switch.

8.64 In the Charterhouse follow-up survey with SMEs between two to five years old, although 'satisfaction' and 'hassle' were the primary reasons given for SMEs not considering switching at the end of the free banking period, 12% said it was because the differences in charges were too small, 5% mentioned banks being the same and 5% said that switching banks was not a priority.[61]

8.65 The HSBCG survey 2014[62] found that 94% of SMEs considering switching accounts in the last five years ('considerers') and 75% of 'non-considerers'[63] felt there was a lack of incentive to switch provider, with 46% of considerers and 41% of non-considerers mentioning other offers being too similar to the existing offer and 43% of considerers and 36% of non-considerers saying there was not enough price benefit. 67% of considerers (and 88% of non-considerers) did not think they could save enough to make switching worthwhile. Further evidence from this survey is set out in Appendix 8.1.

8.66 The FCA CASS qualitative research supported the HSBCG survey 2014 in suggesting that businesses considered that there was very little differentiation between the banks, and there was little being offered by other banks to induce switching.[64] In addition, qualitative research conducted by LBG on customer retention noted that the market was not dynamic and there

[60] See Appendix 8.1.
[61] SME follow-up surveys, p29.
[62] HSBCG survey 2014. See Appendix 8.1 for a discussion of this survey.
[63] Analysis of the survey was broken down by three groups of SMEs: SMEs that have switched BCA providers in the past five years ('Switchers'); SMEs that have considered switching BCA providers in the past five years, but did not switch ('Considerers'); and SMEs that have not considered switching in the past five years ('Non-Considerers').
[64] FCA CASS qualitative research, pp32 & 33.

were few ‘pull’ factors evident with little evidence of competitors seeking to incentivise switching behaviour.

8.67 This perception that the financial gains from switching are insufficient is likely to be a factor explaining low switching rates for some SMEs.

Barriers to searching (accessing and assessing information)

8.68 In order for an SME to understand and compare BCA features, it needs to understand the offers (including charges and levels of service) from the different banks and to understand its own likely transactional behaviour so it can understand how the transaction charges would impact on it. If it is difficult or too time-consuming for SMEs to identify the best offers in the market, then they are unlikely to search in the first place. This is particularly true of smaller SMEs, which tend to be more time-poor and consider banking less important than other more immediate business priorities.

- *Transparency and comparability of account charges and rewards*

8.69 Parties submitted to us that information on account charges were accessible across a number of channels, including the banks’ websites. This was the most frequently mentioned source of information in the Charterhouse follow-up survey with start-up SMEs.[65] Our analysis of banks’ websites showed that much of the basic information on costs can be found fairly easily.[66] Getting detailed information on the exact charges for each account requires slightly more searching on some banks’ websites but is generally visible.[67]

8.70 Information from our start-up survey suggests that the majority (73%) of start-ups that had considered the fees after the free banking period found it easy to find information on these (see Figure 8.7), although 9% found it quite or very difficult.

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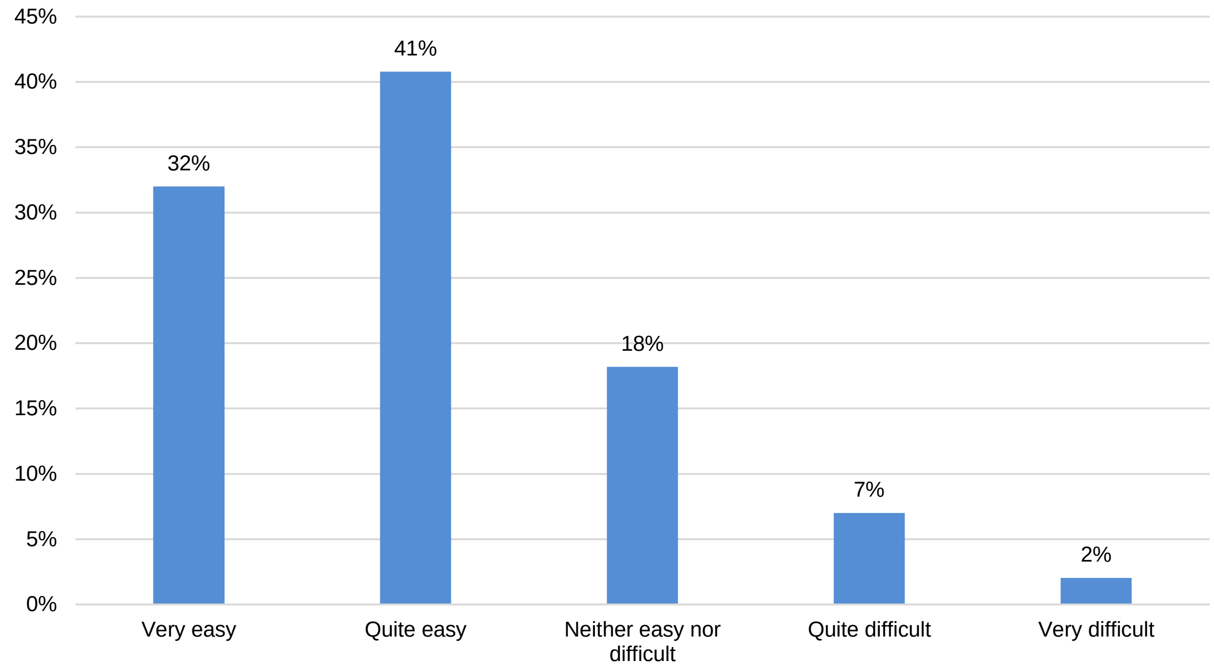
[65] SME follow-up surveys, p16.
[66] The type of information that is displayed on each bank’s web pages varies from bank to bank, but basic information includes monthly account fees, whether interest is paid, maximum transactions or cash paid in or out, or basic information on overdrafts.
[67] For example HSBC has a publicly available Business Banking Price List. Appendix 8.1 contains more information on the sources of information SMEs use and the ways of accessing account charge information.

Figure 8.7: How easy is it to find information on post free banking prices (UK)



Source: Charterhouse follow-up survey of start-ups, Question C6.
Base: All offered free banking and considered future fees (129).

8.71 The HSBCG survey 2014 asked SMEs how difficult it was to access pricing information, but also the length of time needed to assemble the information to make comparisons. It found that 15% of switchers and 27% of 'considerers' thought it was difficult to access pricing information from other banks. A third (34%) of 'considerers' also thought it took a large amount of time to assemble the relevant information to make a comparison.[68] Moreover, some SMEs felt they lacked information to assess offers, (54% of considerers and 28% of non-considerers). This suggests that, while accessing the information is not generally considered to be difficult, there are more difficulties for SMEs to assemble the information and compare this information across banks.

8.72 Larger SMEs are more likely to receive bespoke pricing through negotiation.[69] Naturally a negotiation process involves speaking with business or relationship managers to come to an agreement on charges (and terms and conditions). This potentially reduces transparency of prices, although we recognise this is a natural part of the process of negotiation.

[68] HSBCG survey 2014. As discussed in Appendix 8.1 we have some reservations about the robustness of this survey, but find it useful to give an indicative sense of the ease with which SMEs can find information on prices from other banks.
[69] Banks have different turnover criteria necessary for offering bespoke prices. Table 2 in Appendix 8.1 shows at what turnover SMEs are able to start negotiating on BCA pricing at each bank. [✂]

- *Transparency and comparability of service attributes and quality*

8.73 While price is an important factor for SMEs when choosing who to bank with, there is significant evidence to suggest that non-price elements of business banking offers – namely service attributes and service quality – are also very important. While price was mentioned by more start-ups as the most important reason for choosing a BCA, a significant proportion also mentioned branch-related factors and staff or service-related factors.[70]

8.74 The Research Works SME qualitative research suggested that the following service aspects were important to SMEs:

(a) branch opening times and the availability of a relationship manager;

(b) speed of access/establishment of services; and

(c) characteristics of customer services (eg UK-based call centres, dedicated customer handling staff, no automation).

8.75 Evidence from the Charterhouse follow-up survey of start-ups and the Charterhouse BBS supports the qualitative research. At least 80% of SMEs had visited a branch counter service over the past year and around a quarter of SMEs (23%) reported that this was their most used method of banking.[71] The vast majority (84%) of start-ups mentioned that branches were important in their choice of BCA, with 84% of those SMEs saying this was because they needed to pay in cash or cheques and 19% needed to meet a relationship manager face to face.[72]

8.76 Information on branch locations and opening hours is generally readily accessible. The Business Banking Insight website[73] helps SMEs to collect and compare information on both service attributes and banks' quality of service. It allows SMEs to leave comments as well as rate the quality of service on a number of aspects. However, the Research Works SME qualitative research suggests that SMEs are more likely to place weight on experiences from their known SME peers, rather than from comments on a website (if they do not have their own experience of using a BCA with a particular provider).[74]

[70] SME follow-up surveys, p11.
[71] Charterhouse BBS 2014.
[72] SME follow-up surveys.
[73] Jointly driven by the FSB and British Chambers of Commerce (BCC), BBI was originally initiated by HMT and is supported by an advisory group that includes the BBA, RBSG and BEIS. It is operated by ICM Unlimited and TMW.
[74] Research Works SME qualitative research, p31.

8.77 Beyond information on branch location and opening hours, there is a general lack of comparative information in the public domain on service quality, including the performance of relationship managers[75], customer service and errors or complaints.[76] We have further assessed service quality (eg. which service quality data is currently available to and used by customers) in our assessment on remedies regarding the ability of both PCAs and SMEs to make comparisons between providers on their service quality (see Section 13 and Appendix 13.2).

- *Assessing BCAs*

8.78 Assuming that SMEs can access key information on BCAs, they still need to be able to assess the different product offerings to make an informed decision. This involves understanding and comparing prices, charges and quality. SMEs may be unable to do this because:

(a) their own account usage data is difficult to access;

(b) they lack information or awareness on the costs of their BCA;

(c) charges are complex;

(d) they lack financial sophistication;

(e) comparison tools are insufficient; and/or

(f) there is a lack of other support, such as advisers.

8.79 We consider these issues in turn below.

- *Access to account usage data*

8.80 For SMEs to compare the costs of using different BCAs they need to have some understanding as to their likely future usage. In many cases their previous transaction history may be a good proxy for future usage and hence a good basis from which to calculate the likely cost of using a particular BCA.

8.81 Established SMEs have some experience and track record of using a BCA and therefore will typically have a much better idea of their own transaction

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[75] We note in this context that banks requested confidentiality in respect to the level of relationship management service they provide to different SMEs (see Table 2 in Appendix 8.1).
[76] However, RBSG submitted to us that on its website it presented its service level agreements (SLAs) and the performance against those for particular products.

history. However, there is no equivalent to Midata[77] for SMEs at present that could be used in conjunction with a price comparison tool, to make comparisons using transaction history easier to do.

8.82 We note that BCA transaction history may be less useful or non-existent for start-up SMEs. Start-ups will either have been using a PCA for their business up to the point of opening the BCA (and as such may have some transaction history from their PCA to assess the likely costs of their BCA) or may not have any transaction history.

- *Awareness of costs of existing BCA*

8.83 To compare the costs of different BCAs, SMEs that are considering switching will need to have information on the costs of their existing BCA against which to compare an alternative provider. The Charterhouse follow-up survey results suggest that SMEs have relatively high awareness of the costs of their BCA: 66% of start-ups and 77% of two to five year old businesses monitor the cost of using their BCA.[78] The follow-up surveys also found that charges on SMEs' own BCAs were transparent. For instance 83% of two to five year old SMEs that had compared the cost of using their BCA with other banks said the charges on their own account were either very or quite transparent.[79]

8.84 At least one bank told us that it provided new start-up or switcher SMEs with summaries of BCA charges and interest in the form of a pre-notification advice statement every month during their free banking period.[80] This gives those SMEs on free banking an idea of the likely costs of their BCA once they start paying charges.

- *Complexity of charges*

8.85 A wide variety of transactions are made through BCAs. By way of illustration, NatWest has a summary document which lists 19 different charges for each standard tariff and business plus tariff.

8.86 Due to the nature of BCAs and the number of different charges and transactions that can arise, it can take some time to compare costs. While an SME will wish to keep its costs down, the relative size of the charges of running a BCA compared with other costs the business faces may mean that

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[77] See Section 3 and Section 7 for more information on Midata.
[78] SME follow-up surveys.
[79] SME follow-up surveys.
[80] This letter shows the amount they would have been charged had they not been on free banking.

an SME would rather spend time on other tasks than calculating the best BCA for its needs. For example, the main reason given by both start-ups and two to five year old SMEs for not comparing costs was that they did not have the time to compare the current level of charges (see Appendix 8.1, Figure 11).

8.87 Furthermore, the Research Works SME qualitative research suggested that comparing information was far more difficult than obtaining it in the first place. Salient issues were the high number of different charges making calculations difficult (particularly when calculated mentally), and trying to understand the different charges and how they correlate across banks.[81] For instance one SME said: 'It's difficult to hold everything in your head as you go through them.'

8.88 Some parties also submitted to us that comparing accounts could be challenging for some SMEs. This view was also held among some SME advisers:[82] 'Charges are visible, but not transparent.' (Independent Financial Advisor). 'I think charges are complex because they can differ so much across different products and you have to know how many transactions you do.' (Accountant).

8.89 The HSBCG survey 2014 also suggested that some SMEs found calculating and assessing which product was best for them a difficult task.

- *Financial sophistication*

8.90 Where charges are complex, understanding them may be difficult. SMEs with lower levels of financial sophistication may struggle to compare products or fully understand the different charges and when they might occur. This in turn may either lead to SMEs making poor decisions, or being entirely put off searching and comparing.

8.91 Evidence suggests that few SMEs have staff solely responsible for financial decisions. Smaller SMEs are substantially more likely to have the owner or director responsible for finance matters (see Appendix 8.1, Figure 12).

- *Comparison tools*

8.92 Considering the complexity of comparing BCAs and the limited time that SMEs have to make these comparisons, tools that help simplify and shorten the process may encourage comparisons and improve decision-making,

[81] Research Works SME qualitative research, pp30 & 42.
[82] Research Works SME qualitative research.

particularly if they include service quality elements and the ability to take into account past usage. We assess the role of PCWs, calculators and BBI.

Price comparison websites

8.93 Business Finance Taskforce and the BBA have created a comparison tool (the Business Account Finder) that allows SMEs to compare accounts on a range of factors.[83] This has the most comprehensive information on BCAs in terms of the number of different charges and costs it covers,[84] as well as the range of providers covered.

8.94 We are also aware of four commercial PCWs that offer some ability to compare BCAs. There is some variation in the level of detail and coverage they provide, but none is as comprehensive as the Business Account Finder. However, none of these sites has a facility for selecting transaction usage (including the Business Account Finder), as there is no equivalent to Midata for business accounts. This means SMEs would need to be aware of their future transaction usage and calculations need to be done manually.

8.95 Many parties have also acknowledged that PCWs are not comprehensive enough. HSBCG noted that there were limited tools available to SMEs to compare the prices and services offered by different providers, and in particular that PCWs for SME customers lagged behind those available for personal customers in terms of coverage and detail.[85]

8.96 Major PCWs active in other sectors told us that they had no plans to enter the SME banking comparison market, with either BCAs, loans or other SME products in the foreseeable future.[86]

8.97 The lack of PCWs offering SME product comparisons could potentially be explained by a current lack of commercial viability. Revenues in the SME banking price comparison market are currently low due to limited usage (see Appendix 8.1). The limitations described above (eg. lack of comprehensive comparison services and that SME transaction history is not available), may also have an impact. Business Moneyfacts told us that it only offered best buy tables and not a full search function of all accounts because it did not believe it was commercially viable to build a full search facility for

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[83] SMEs can specify certain criteria such as whether they need an overdraft, want interest paid, or a branch-based account.
[84] This includes transaction charges such as paying in and taking out cheques and cash, direct debits, standing orders, the amount of interest paid on credit balances, and whether overdraft facilities are available.
[85] Similarly LBG and RBSG, as well as some other banks, either noted that PCW tools were more limited for SMEs or that SMEs were under-served in having a one-stop-shop portal or online comparison.
[86] We received responses noting this from: [✂]

the revenues available in this market.[87,88] This is turn may explain low usage and therefore reduced revenue.

8.98 We found that few SMEs currently use PCWs. According to the Charterhouse follow-up survey of start-ups only 9% of SMEs used PCWs when first considering which BCA to use.[89] However there is some evidence that customer awareness of SME product comparison is low. For instance, many SMEs in our qualitative research had used price comparison sites when choosing personal financial products, but few had realised that business banking products could be compared in the same way. We discuss further in Section 16 the obstacles to PCWs and the measures we are taking to bring about the creation of one or more comparison sites, which will make it easier for SMEs to undertake comparisons of price and service quality.

8.99 There is also evidence suggesting that there was some interest amongst SMEs in using PCWs for BCA comparisons. The HSBCG survey 2014 found that 51% of those that had considered switching in the last five years were more likely to switch if they could use a PCW to compare quotes, reducing to 23% for those that had not considered switching in the last five years.[90] In the Research Works SME qualitative research some SMEs thought that PCWs were a good 'starting point'.[91]

BCA tariff calculators

8.100 Several banks have price comparator tools such as BCA tariff calculators.[92] These allow SMEs to compare a range of accounts at an individual bank assuming they have some idea of their future usage or transactional behaviour (usually by using past statements as an indication of future use).

8.101 These tools can be helpful, but they do not allow for an easy comparison across providers as separate calculators would need to be used on each banks' website. An exception is Santander's calculator which compares the cost of its own tariff (that best meets the SMEs' usage criteria) against that of tariffs at the largest four banks and TSB, by showing how much could be

[87] Moneyfacts noted that it had no immediate plans to enhance its business best buys into a full search in the SME market, but it constantly reviewed plans so this might change in the future.
[88] Also, the most comprehensive website, Business Account Finder, is not intended to generate revenue or profit.
[89] SME follow-up surveys, B5.
[90] HSBCG survey 2014. As discussed in Appendix 8.1 we have some reservations about the robustness of this survey, but find it useful to give an indicative sense that some SMEs would find a price comparison tool useful.
[91] Research Works SME qualitative research, p30.
[92] For instance Lloyds Tariff Calculator, Santander BCA Calculator, HSBC Banking Cost Calculator and Barclays Price Plan Selector.

saved over a year. It does not, however, show where this money is saved (ie on which specific transactions).

8.102 During the Research Works qualitative research, SMEs were shown some of these calculators. In general they were perceived as a useful 'starting point' for comparisons, however some expressed a degree of scepticism about the results, especially as the provider brand used for calculating always appeared most cost-effective.[93]

Business Banking Insight

8.103 The only quality comparison tool that we are aware of is the Business Banking Insight website.[94] The website allows SMEs to rank providers on their overall service rating as well as their performance under a number of different service attributes. The website also shows feedback in the form of quotes from the SMEs interviewed in the survey. Users can then view results by SME size (both number of employees and turnover), location and industry sector among other attributes.[95]

8.104 However both awareness and use of the website is currently low. Less than 2% of SMEs mentioned this website as an information source when considering which bank to choose.[96] SMEs were also shown the Business Banking Insight website as part of the Research Works SME qualitative research. No SMEs were aware of the website before being shown it during the interview. SMEs that were concerned about service quality perceived the website as a potential 'final layer' of assessment. However, for most, the website was seen as akin to Trip Advisor, and as such, it was not a credible enough measure of service quality for business purposes.[97] Instead factual information such as branch opening hours, UK-based call centres and the availability of a relationship manager were seen as more helpful.

8.105 Despite these concerns, considering the importance of service quality to SMEs, the Business Banking Insight website is nevertheless a helpful tool pending the development of 'one stop shop' tools which include price and quality comparisons, and the availability of standard publically accessible

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[93] Research Works SME qualitative research, p30.
[94] The website allows SMEs to rank providers on their performance under five attributes (fairness and clarity, value, tailoring, availability, and being informative) as well as on their overall service rating, based upon a weighted average of all five attributes, with scores out of five also given for a range of other products. SMEs are also able to view feedback from the SMEs interviewed in the survey.
[95] Although sample sizes for some providers are low, scores are still presented along with information on how many ratings were used to calculate these scores, leaving it to the SME to decide on how much weight to place on the information presented.
[96] SME follow-up surveys, question B5.
[97] Some SMEs did not trust the reviews from other SMEs as they did not know who they were. Many would place far more weight on peer SMEs than ones they did not know.

indicators on quality. The HSBCG survey 2014 found that 47% of 'considerers' and 25% of 'non-considerers', were more likely to switch if there was an independent website that rated the quality of service of each bank. This is discussed further in Sections 13 and 16.

- *Role of third parties*

8.106 Given the complexity of BCA charging and the lack of tools to help compare charges, we considered whether SMEs are turning to advisers such as accountants to assist and advise them on their choice of bank.

8.107 The Research Works SME qualitative research indicated that advisers tended to simply suggest different banks or banking strategies to SMEs, rather than helping with calculating comparisons. In general accountants were more influential than independent financial advisers, but views varied. Some were more conservative and traditional, suggesting that SMEs should stay with the banks they knew, while others suggested a more active approach of shopping around for the best deals.

- *Summary on barriers to searching*

8.108 For smaller SMEs, information on price is generally available but there are more difficulties in assembling the information and comparing this information across banks. Comparable information on quality is less readily available publically, partly because some aspects of SME banking quality only become evident once used. This makes it difficult for SMEs to trade off price and quality.

8.109 There are a number of further factors which make comparisons difficult:

(a) Information about usage is not really available for start-ups, and whilst established SMEs will typically have more information on their usage, there is no equivalent of Midata to make comparisons easier by using transaction history. This is likely to impact on how easy it is to compare banks.

(b) The extensive and complex charging structure of BCAs and number of different transactions, makes it more difficult to compare providers and it takes more time.

(c) There is a lack of comprehensive tools (eg. PCWs) available to SMEs to allow for effective comparisons between providers on price/quality.

(d) Many SMEs also lack the financial sophistication to compare providers in a comprehensive fashion and lack assistance from financial advisers.

8.110 This means that, overall, it is difficult for many SMEs to compare and assess BCA offers effectively.

Barriers to switching BCAs

8.111 Even if SMEs have the information and tools to compare different products and providers, there may still be barriers to them acting on this information in terms of the process for opening and switching BCAs.

- *Account opening process*

8.112 When seeking to move BCA, an SME has two separate processes to engage in, namely the account opening process and the account switching process. Although these can sometimes be conflated, they are separate and distinct processes.

8.113 For SMEs, the account opening process can be lengthy, onerous and time-consuming depending on the complexity of the businesses. This also reflects in part banks' processes in implementing AML regulations (as set out in Appendix 3.1).[98] This involves carrying out CDD checks to prevent and detect money laundering.

8.114 Data collected from banks shows that while smaller SMEs were often able to open their accounts within 48 hours, ten days or more was not uncommon and this could extend to months in complicated cases (ie those with more complex ownership structures or cross-border business). Some banks provided an indication of how long it takes to open a BCA. In particular two banks noted it took around 48 hours for smaller businesses (which are more likely to involve simpler AML checks). For larger SMEs the time to open an account was at least two weeks.

8.115 A number of banks have indicated that there is room for industry improvement in account opening processes. For example, Santander suggested there was scope to improve CDD checks for larger SMEs.[99] Also RBSG observed that more could be done to simplify AML procedures.[100]

[98] For further details see Appendix 3.1.
[99] Santander hearing summary, paragraph 96.
[100] RBSG response to the updated issues statement, pp 18 & 23.

8.116 The Research Works SME qualitative research found that some SMEs considered that the account application and administrative process dissuaded them from switching banks (see Appendix 8.1).[101]

8.117 Similarly, the FCA CASS qualitative research found that:

> The effort involved in opening a new account was identified as a major barrier for considerers[102] across all audiences. It was recognised that there would be some hassle involved in organising a change-over of accounts, and finding the time to do this was felt to be challenging. This was particularly true for SMEs and charity organisations that may have more complex banking arrangements or multiple stakeholders involved.[103]

8.118 As noted in Section 7 where we consider account opening for PCAs, speed and efficiency of opening an account can in itself be an aspect of competition and one where new entrants and smaller banks appear well placed to compete. There is also some evidence that both banks and the UK government are looking for ways to streamline processes, which might improve experiences of account opening.

8.119 Nevertheless it appears that for SMEs, account opening for some can be lengthy, onerous and time-consuming, and there may be ways to simplify and improve the procedures in place.

- *Account switching process (including CASS)*

8.120 Once an SME has chosen a bank and opened an account with it, it must also organise for balances and payments details to be transferred to their new bank. SMEs can either do this manually or use CASS. We considered whether the account switching process raises further barriers to switching.

8.121 Like PCA customers, account switching for almost all (99%) of BCA customers[104] can be done through CASS. However, many of those who are eligible for CASS are not aware of CASS and/or the service it provides. Evidence from the Payments Council suggested that only half of SMEs that had not switched knew assistance was available (and the majority of these

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[101] Research Works SME qualitative research, pp17 & 18.
[102] Optimisa defined 'considerers' as those who had actively considered switching and either decided not to do it or not got round to it.
[103] FCA CASS qualitative research, p35.
[104] Since April 2015 an SME with an annual turnover that does not exceed £6.5 million and employs fewer than 50 people can use CASS. Before the change, use of CASS was limited to SMEs with turnover or assets up to €2 million (this is in accordance with the EU definition of a microbusiness). This covered about 95% of SMEs.

knew little or nothing about what the assistance consisted of). While the FCA CASS qualitative research found that CASS had been more visible to consumers than SMEs (see further detail in Appendix 8.1).

8.122 The levels of account switching through CASS by SMEs also suggest a lack of awareness and understanding of CASS. Only approximately 10% of BCAs are switched through CASS.[105] If CASS is not used, an SME needs to manually transfer all payments in and out of its old account to its new account and inform all suppliers and customers of its new account. For some SMEs this will involve significant time and resource with the risk that some payments in and out are at best delayed.

8.123 There are a number of aspects of the CASS service which are potentially of concern to SMEs:

(a) Loss of historical account data: the CMA's qualitative research found that one potential barrier to switching is that SMEs will lose access to their previous transaction history following a switch through CASS. This could potentially affect businesses' ability to apply for financial products in the future as they would not have proof of their transaction history.

(b) Period of redirection: SMEs tend to have multiple payments coming in from more than one source. Although, payments are redirected for 36 months by CASS, SMEs still need to contact their customers to ensure they update their payment details so that at the end of the automatic redirection period payments are made to the new account.[106]

8.124 The FCA CASS qualitative research also noted that the risks and effort of switching accounts were felt to be heightened among business and charity audiences, where mistakes were felt to potentially have an even greater impact than among PCA customers, and the changeover was felt to involve more administration.[107]

- *Access to lending and multi-product holdings*

8.125 Research found that customers perceived that staying with their current bank meant they were more likely to get access to lending. This was because they believed that having an established relationship with a bank gave the business credibility. There was an underlying assumption that

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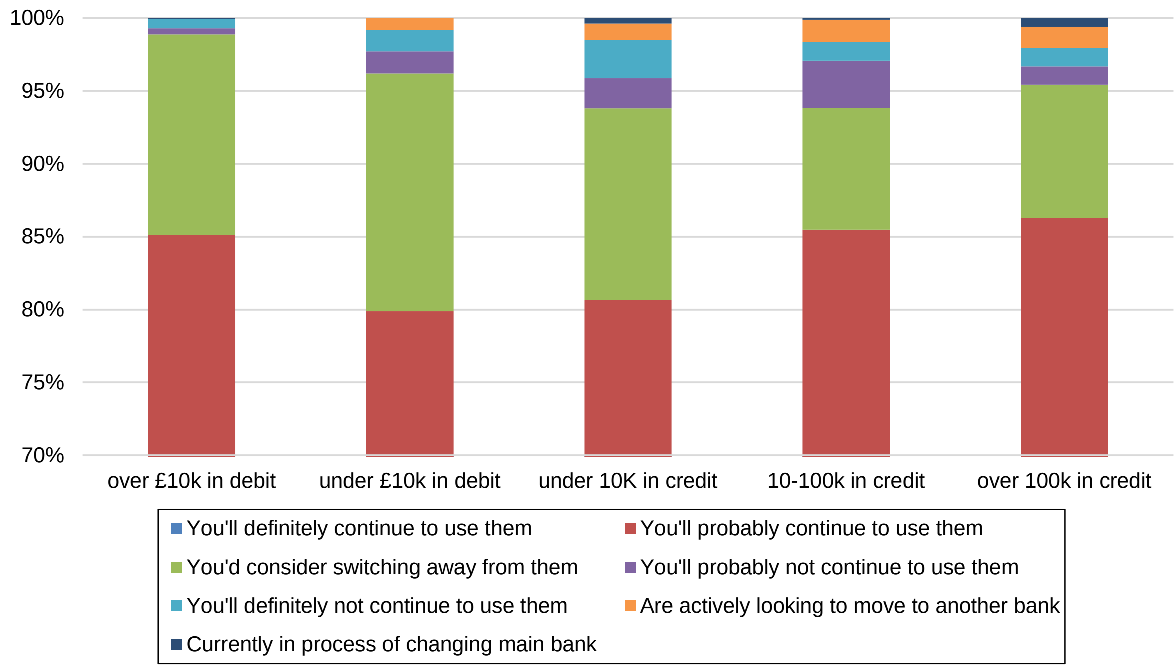
[105] In total 22,452 SMEs switched their BCA through CASS in 2014, around 0.4 % of the total number of active BCAs. Given that switching rates are around 4%, 90% of SME switchers are not using CASS to switch.
[106] This was noted by some SMEs in Research Works SME qualitative research (see pp17 & 18).
[107] FCA CASS qualitative research, pp36 & 37.

banks would look more favourably on businesses which had had multiple interactions with that bank in the past.[108]

8.126 Similar to PCAs, another concern expressed in the FCA CASS qualitative research was whether customers could move their overdraft facilities. SMEs mentioned that they would want to negotiate with their new provider if they were to move.[109] Given that banks can charge arrangement fees for overdrafts as well as holding collateral, this could potentially slow down the switching process. However, this did not emerge as a primary concern.

8.127 Data suggests that the customers most likely to consider switching are those with low credit or debit balances (see Figure 8.8). We would expect SMEs to be less likely to consider switching if they have a high debit balance. However even though we see differences between these groups, they are not statistically significant.

Figure 8.8: Proportion of SMEs in GB considering switching by credit/debit balances



Source: Charterhouse BBS.
Base: All SMEs asked about account balances 2014: over £10,000 in debit (337), under £10,000 in debit (330), under £10,000 in credit (1,836), £10,000–£100,000 in credit (1,168), over £100,000 in credit (662).
Notes: Balances are for BCAs only (including overdrafts) but do not include loans.

8.128 The FCA CASS qualitative research also found that 'having multiple products linked to the account was a potential barrier to switching.'[110] The

[108] Research Works SME qualitative research, p16.
[109] FCA CASS qualitative research, p36.
[110] FCA CASS qualitative research, p32.

Charterhouse BBS data also showed that switching consideration fell as the number of products rose (see Appendix 8.1, Figure 18).

- *Summary on barriers to switching*

8.129 We have identified a number of barriers to switching. In respect of account opening, the process can be difficult and lengthy, in particular due to banks' differing requirements for complying with AML regulations. In addition, SMEs consider the switching process itself to be time-consuming, difficult and potentially risky. Awareness of CASS was low among SMEs, despite most being eligible. SMEs also have other concerns about switching, such as loss of historical data, disruptions to payments and changing arrangements with customers. These issues can be considered a 'hassle' which deters switching.

8.130 In addition, for some SMEs access to finance played a key role in deterring them from switching, with fears that moving would make it less likely that they would be able to access finance in the future.

How banks compete on BCAs

8.131 In this section we look at the way in which banks compete in the supply of BCAs. Evidence in Section 7 and Appendix 7.3 suggests that, BCA's are profitable over the course of a five-year period. However, we also found that there are low levels of customer engagement and barriers to searching and switching BCAs. These factors, together with the levels of churn in the market, affect banks' incentives to compete.

Start-up SMEs

8.132 A key point when competition takes place is when SMEs are starting up (or being established). The SME follow-up survey with start-ups showed that free banking was one of the most important reasons given for their initial choice of bank.[111] The free banking period enables start-up SMEs to use 'core' transactions free of charge for a set period of time. Most banks offer start-ups a period of free banking of between 12 and 24 months (see Table 8.1).

[111] This is particularly true of SMEs who compared different banks against one another. However, we note that most banks offer initial free banking periods, so it is not a clear differentiating factor beyond the different lengths of free banking offered.

Table 8.1: BCA incentives offered by banks to start-ups and switchers, as at January 2015

Bank	*BCA incentives*	
	Start-ups (period with no monthly/ standard transaction charges)*	*Switchers (period with no monthly/ standard transaction charges or cash payment)*
Barclays	12 months	†
HSBC	18 months‡	6 months§
Lloyds	18 months¶	6 months¶
BoS	18 months	6 months
RBS, NatWest	24 months#	£150–£250~
Santander	12 months★	None
Clydesdale	24 months♦	18 months♦
Yorkshire Bank	24 months♦	18 months♦
TSB	18 months	6 months▲
Metro	None	None
Handelsbanken	None	None
Co-op Bank	Special offer to members of Federation of Small Businesses✷	
BoI	No transaction charges for 12 months and a 50% discount for a further 12 months⅄	■
Danske Bank	12 months◇	6 months□
First Trust	For those with certain loan types, 12 months' free banking	
Ulster Bank	24 months	None

Source: Banks' responses to Question 11 in SME MQ (January 2015), supplemented by bank websites.
*Typically businesses in first year of business, setting up their first BCA.
†Possible [✄].
‡£2 million turnover or below (start-ups with annual turnover above £2 million are offered bespoke terms that are negotiated with their relationship manager and may include a period of free banking).
§Turnover up to £500,000 (increased to 12 months). Switchers with turnover of £500,000 to £2 million may be offered a period of free banking following a discussion with their relationship manager and those with annual turnover above £2 million are offered bespoke terms that are negotiated with their relationship manager and may include a period of free banking.
¶Also offers fee-free overdrafts.
#Up to £1 million turnover. Also offers a fee free overdraft facility of £500 for the first 12 months.
~For customers with turnover of up to £2 million, accounts are credited £150 (or £250 if the customer also switches an overdraft) by the end of the fourth full month after account opening.
★Additional six months if customer has PCA with Santander, or switches to it.
♦Increase to 25 months for start-ups and switchers with effect from 4 May 2015.
▲Changed from 6 to 18 months effective from 15 June 2015.
✷Co-op Bank offers FSB Business Banking Account customers free banking, £25 annual loyalty reward and a fee free overdraft.
⅄Except for cash deposits greater than £10,000 per quarter.
■No free banking offer for switchers, but a three-year package for growing businesses.
◇Extended to 24 months if the business owners/directors have/switch to a PCA with Danske.
□Extended to 12 months if the business owners/directors have/switch to a PCA with Danske. Also offers 12 months' free Business e-Banking (payments module) and no arrangement fees on certain products during the first 12 months.

8.133 Introductory offers in the form of free banking for start-ups (and indeed switchers) have been a common feature since at least the 1990s. Prior to this, most banks charged start-ups for their banking services. HSBC was the first bank to introduce free banking for start-ups and for switchers in 1986 and 1998 respectively, with other banks soon following. See Appendix 8.2 for further detail on the history and rationale of free banking for start-ups.

8.134 The banks told us that the rationale for offering free banking to start-up SMEs was:

(a) to minimise the cost of banking during the start-up phase;

(b) a profitable strategy in the long run as a means of acquiring and establishing a relationship generating greater revenue as the SME grew; and/or

(c) as a response to competitive pressures, in order to improve customer acquisition.

8.135 We asked banks whether there had been changes to their free banking offers to start-ups. Responses show that there have been few changes in the length of the free banking period offered to start-ups since 2011.

8.136 With the exception of Metro and Handelsbanken, which focus on the quality aspects of their service offering rather than price, free banking periods continue to be an important focus for most banks in attracting start up SMEs.

8.137 There is variation between banks in the free banking period although in more recent years there is little evidence of dynamic competition between banks on free banking periods for start-ups or on service/quality.

8.138 We have not received evidence from banks of targeted advertising and marketing to start-up SMEs.[112] Nor does there appear to be a clear correlation between market share and free banking periods. For example Barclays' market share of new BCAs in GB increased [✂] between 2012 and 2014, notwithstanding it offering shorter periods of free banking relative to its competitors in this period.[113] We note that in 2015 its share of new BCAs in GB [✂].

Established SMEs

8.139 We looked at how banks compete for established SMEs, both in terms of attracting new established SMEs and retaining existing SMEs.

- *Switching incentives*

8.140 Some banks offer free banking periods as an inducement to switch. As shown in Table 8.1, the majority of larger established bank brands – Lloyds,

[112] See Appendix 8.2.
[113] See Table 7.4 for further details. [✂]

BoS and Barclays[114] – offer free banking to switchers for six months.[115,116] Many of the newer and smaller banks do not offer free banking to switchers, for example, Handelsbanken, Metro[117] and Santander. The exceptions are Clydesdale and Yorkshire Banks which currently offer 25 months' (increased from 18 months and 24 months respectively) free banking to switchers[118] and TSB which increased its free banking period from six months to 18 months for switchers in June 2015.

8.141 Banks told us that the rationale for offering free banking to switchers was to compensate SMEs for the cost of switching banks, and in particular the costs attributed to the transfer of lending facilities. [✂][119]

8.142 We have observed some changes by banks in the free banking periods for switchers. Some banks (LBG and HSBCG) have adjusted or increased the length of the period of free banking to switchers, while RBSG have removed the free banking periods to switchers. Both HSBCG and LBG submitted information on the impact of free banking offers to switchers on their customer acquisition rates. This is considered further in Appendix 8.1.

- *BCA tariffs after free banking periods*

8.143 Most banks have at least two tariffs for smaller SME customers: one tariff for customers who use branches and a lower tariff for customers who use online channels.

8.144 In the last few years, there have been a number of adjustments made to these tariffs, but there have not been significant changes in tariffs or other aspects of pricing of BCAs, such as credit interest. According to several banks the key driver for tariff changes has been simplification of tariffs and the introduction of lower tariffs for electronic bank usage to encourage non-branch channel usage by SMEs (which is also less costly to the banks). For example, in 2011 LBG introduced a monthly price plan which, for a fixed fee, included a certain number of transactions per month, with extra charges for

114 For Barclays, this is subject to the discretion of the business manager.
115 RBSG withdrew its offer of free banking for switchers in 2014 as part of RBS's and NatWest's strategy to end teaser rates across all brands for personal and business customers. It replaced the offer with a flat rate cash contribution of between £150 and £250 to cover SME switching costs for customers with a turnover less than £2 million.
116 In relation to Lloyds and BoS, the free banking to switchers offer is only available to RBB customers (SMEs with turnover below £1 million).
117 Metro does waive the monthly charge for business banking customers with balances of £5,000 and above, and customers receive 50 free transactions.
118 Some banks also link their free banking periods to other products. For example [✂] and LBG offers to waive lending arrangement fees and security fees for switchers taking out a new term loan or overdraft.
119 [✂]

off plan transactions. Similarly in October 2011 Santander introduced a fixed fee BCA allowing unlimited transactions included within a monthly account maintenance fee. HSBCG told us that as of March 2016 it offers SMEs in its Business Banking segment (i.e. SMEs with annual turnover less than £2 million) an "all inclusive" fee plan of £5.50 per month for a 12 month period following the end of their free banking period, and that during the fixed price period all standard account services will be free (with limited exceptions).[120]

- *Quality/relationship management*

8.145 One of the principal factors motivating SMEs to switch away from their bank is poor quality of service. The proportion of SMEs reporting that they switched away from their bank due to poor quality of service was broadly similar to the proportion switching away due to price.[121] This would suggest that quality of service is as important as price for established SMEs.

8.146 A distinctive feature of SME banking compared with the PCA markets is that SMEs are typically provided with access to advice and sometimes relationship management services. For smaller SMEs with turnover below £250,000, this will typically be provided through a call centre and/or business centre; whereas small to medium and larger SMEs (above £500,000) will generally be provided with a relationship manager. However, even then the level of service and support of their relationship manager will typically vary depending on size of SME. As the turnover size of the SME increases, the more likely the SME will receive more personalised support from its relationship manager. Given that only 5% of SMEs have a turnover above £2 million, few SMEs benefit from more dedicated and personalised relationship management services.

8.147 In recent years there have been changes by some banks to their offering of relationship management services. HSBCG told us [✂]. HSBCG told us it had since made efforts to improve its relationship management offering to ensure a greater number of meetings between relationship managers and relationship management-managed SMEs.

8.148 Banks have used a variety of sources to measure customer satisfaction and quality of service, ranging from surveys and benchmarking reports to internal metrics and complaints data. The parties, provided some examples of improvements they have made to services based on results from these

[120] HSBCG response to provisional findings, paragraph 3.19 footnote 62.
[121] See Appendix 8.1.

quality and service measures (see Appendix 8.2). However, these generally appear to be aimed at retaining existing customers, although we do note some instances of trying to acquire new customers.

- *Customer targeting*

8.149 Banks can target customers either through the use of advertising and marketing or through relationship managers. We found little evidence of banks engaging in mass media advertising for SME products; evidence shows that advertising expenditure in the UK by the largest five banking groups on SMEs was £24.7 million in 2013. Most banks confirmed that their focus for mass media advertising was on brand awareness rather than for specific products. This is likely to be a consequence of the disparate nature of SMEs and the fact that, compared to the PCA market, the number of potential new customers in the BCA market is relatively small.

8.150 Relationship managers can have a significant role in attracting new SMEs (as well as in the retention of existing customers).[122] Some banks have told us that as part of their role, relationship managers will have shadow portfolios of SME customers who currently bank elsewhere and will have targets to attract a certain number of SMEs to switch banks.[123] For example [✂].[124] [✂][125]

8.151 We note, however, that on the whole these policies are mainly targeted towards larger SMEs (turnover above £2 million), as relationship managers are typically seeking to attract SMEs of commensurate size to their current portfolio.

8.152 Therefore, it does not appear that relationship managers are being used to attract and retain the vast majority of SMEs. Relationship managers are typically offered to larger SMEs and these currently represent only 5% of the SME population.

BCA churn

8.153 Some banks have indicated that, because of the high churn in BCAs, they continually need to compete for new business in order to maintain their

[122] In its response to provisional findings, Barclays told us that [✂]. Barclays response to provisional findings, Annex 1 paragraph 6.
[123] For instance, this was noted by several banks [✂]
[124] [✂]
[125] [✂]

market share, and therefore switching rates are not the relevant indicator of customer engagement.[126]

8.154 As set out in Tables 7.1 and 7.2 in Section 7, approximately 12% of BCAs were opened and closed in GB and 11% in NI in 2015. The death and attrition rates of start-ups is likely a major contributor to the closure rates of BCAs.[127] However, we also found that, despite the large level of business closures in the first few years of a business's life, once a business is more established and has survived this initial period, many businesses continue to operate for long periods of time.

8.155 As noted earlier, banks compete for start-ups, in particular through offers of free banking periods, but we found little dynamism in competition for start-up SMEs with few changes to free banking periods since 2011.

8.156 However, while banks may compete for start-ups, this does not necessarily guarantee that all customers will benefit from this competition. In order for competition for start-up SMEs to benefit other SMEs we would need to find that either:

(a) there was no price discrimination between start-ups and established businesses; or

(b) SMEs considered the entire cost of their banking relationship over the lifetime of the product holding.

8.157 If there is no price discrimination, then intense competition for new business could mean that lower prices to attract start-ups may benefit all SMEs. If there was price discrimination but SMEs considered the entire cost of banking over the lifetime of their relationship with the bank, then banks would be competing over the whole life cost of their products (including the costs of BCAs after the free banking period) rather than just for the start-up period.

8.158 As we have set out, most banks offer periods of free banking to start-ups, and many also offer, albeit shorter, free banking periods to switchers. Therefore banks can and do price discriminate between start-ups and established SMEs.

[126] See Appendix 8.1.
[127] See Appendix 8.1.

8.159 As outlined earlier we found that just over half of SMEs do not compare different providers against one another at start-up and some evidence that SMEs did not consider the lifetime cost of banking.

8.160 Therefore, because start-up SMEs are not fully engaged, with many SMEs either not searching or not comparing fees across banks, we do not consider that competition for start-up SMEs is likely to be particularly intense. All SMEs will benefit to an extent from the initial free banking periods they are offered. However for those SMEs that stay in business for a long time, the benefits of that initial competition will be limited, especially considering the low switching rates.

SME lending

8.161 As SMEs grow they are more likely to seek additional products from their bank (or other financial institution). An SME may have a wider portfolio of products to consider than simply its BCA. Some SMEs may require credit, others may require a deposit account.[128] Further description of the types of finance available to SMEs, why SMEs need finance and trends in lending is set out in Appendix 8.2.

8.162 In particular there are a number of reasons why an SME may require credit. The business may be seeking to grow, but require some funding to do so, whether for immediate expansion of the business or an investment in future expansion. Alternatively it could be to deal with a shortfall in cash flow, late payments from customers or an unexpected cost. The Charterhouse follow-up survey of start-up SMEs showed that the most common reasons for seeking finance were for investment to expand the business (30%), purchasing new equipment (22%) or shortfalls in cash flow (28%). SMEs may then turn to their bank for lending products.

8.163 As described in Sections 2 and 4 banks provide a range of debt finance products. Different types of finance aim to address the differing needs of SMEs. SMEs may consider a number of different types of products, but equally only certain products may be suitable for a particular need. The product suitability may depend on:

- whether short-term capital is needed or longer-term finance;

[128] SMEs may also require other products such as insurance, merchant acquiring, hedging and foreign exchange. However, these products are not part of our ToR and therefore not considered in this section.

- whether security is available and/or the finance is to purchase an asset; and
- the urgency of the need for finance.

8.164 In particular, overdrafts and credit cards may be suitable for cash flow issues, while loans and asset finance may be more suitable for investments and business expansion.

8.165 As noted in paragraph 8.15, credit cards and overdrafts are the most common forms of lending for SMEs. Larger SMEs are more likely to take out finance than smaller SMEs (see Appendix 8.2, Figure 3). In GB the vast majority (94%) of SMEs with turnover above £2 million took out finance, compared with 72% of SMEs with turnover less than £2 million and 57% of start-ups. Very few SMEs with annual turnover under £2 million take out commercial mortgages, invoice finance or asset finance.

8.166 We first examine the nature and extent of SME engagement and their behaviour when obtaining credit. We then look at whether there are barriers to searching and applying for credit or switching providers. Finally we consider how banks compete for SME lending.

Level of SME engagement

Search levels: consideration of providers

8.167 The Charterhouse follow-up survey of SMEs applying for finance found that more than half (60%) of SMEs only considered one provider when seeking finance.[129] HSBCG survey 2015 suggested that the proportion that did not search was lower: 45% of SMEs that considered taking out a new loan in the last five years spoke only to their main bank.[130]

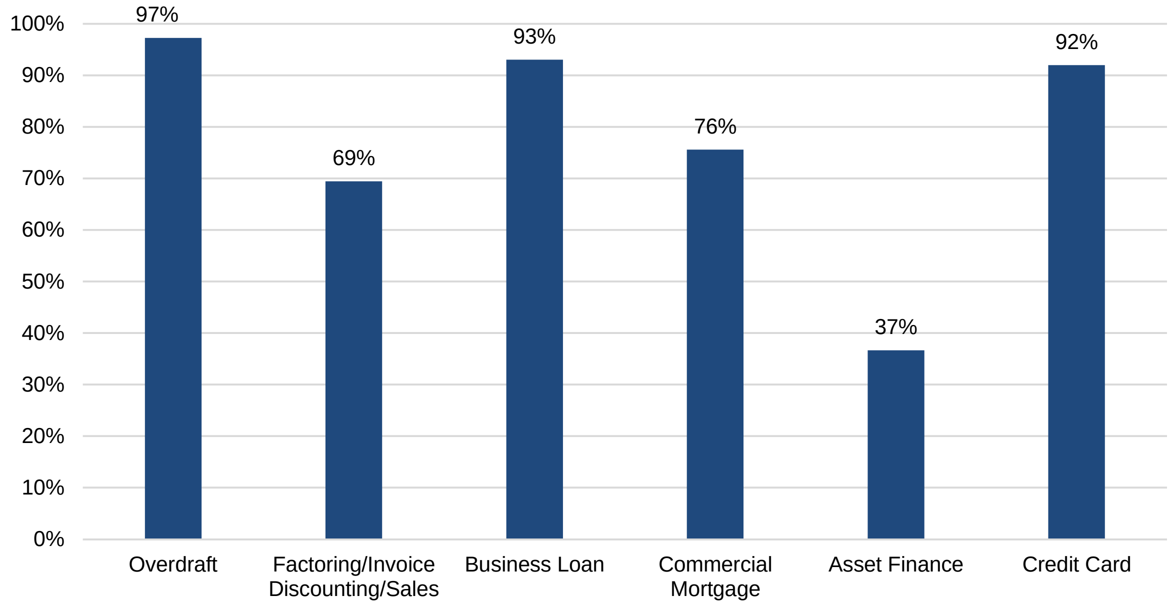
8.168 Of those that did consider more than one organisation (40%), nearly two-thirds (64%) made some comparison between providers to help them make a decision. Although the majority of these were done superficially without comparing each factor one at a time.[131]

[129] Of those that only considered one provider, only 5% did not consider their main bank.
[130] HSBCG survey 2015.
[131] SME follow-up surveys, p43 & p49.

Choice of provider

8.169 The vast majority of SMEs seeking finance go to their BCA bank, despite 40% considering other lenders. This is consistent across all types of core bank finance except asset finance. Figure 8.9 shows that for example over 90% of SMEs in GB went to their main bank for overdrafts, loans, and credit cards. While the sample sizes are small, it appears that this is very similar in NI.

Figure 8.9: Proportion of respondents saying they used their main bank for each product in GB



Source: Charterhouse BBS 2014 and Charterhouse BBS NI.
Base: All SMEs who held product in last 12 months: asset finance (633), company credit/charge card (2,802), business loan (1,062), overdraft (2,219), factoring/invoice discounting (469), commercial mortgage (461).

8.170 The Charterhouse follow-up survey with SMEs applying for finance suggests that there are two primary reasons why SMEs go to their main bank for finance: the relationship the SME has with its main bank; and the time, effort and convenience associated with going to their main bank rather than elsewhere. We now look at each of these in turn.

- *Relationship with their main bank*

8.171 A considerable amount of evidence pointed to the importance of the SME's relationship with its main bank when choosing a finance provider. Research Works SME qualitative research, BBB/BMG's Journey Towards Raising Finance survey,[132] and the Charterhouse follow-up survey of SMEs applying

[132] Please see BBB/BMG, 2014 'SME Journey Towards Raising Finance' Survey, where information about this survey can be found. This survey only covers GB.

for finance, suggested that the relationship with their bank was a primary reason for SMEs going to their main bank for finance.[133]

8.172 Some SMEs in the Research Works SME qualitative research noted the importance of a trusted relationship with their bank and their loyalty to their bank might help them get finance should they suffer some financial distress (ie the bank would still lend to them despite their current financial situation).[134] SMEs also noted that the bank where they held their BCA had knowledge of their financial and transaction history.[135] When a bank decided whether to lend, and at what price, the bank needed to assess the risk of the SME defaulting on its repayments. This required assessing certain credit information.

8.173 Considering that an SME’s BCA bank holds more information on its financial performance, the BCA bank is in a position to better assess the risk, more accurately price credit, and potentially make a lending decision more quickly than other finance providers. While of benefit to the SME, this would also suggest that the informational advantages that the BCA bank holds over other potential lenders is a real barrier to searching for credit, rather than simply a perception of SMEs.[136]

8.174 This was mentioned by a number of parties. Santander noted that ‘Incumbent banks have an advantage as they are likely to have had an existing relationship with the SME, and will therefore have more data and a richer understanding of that business’. During the ‘challenger banks’ roundtable Secure Trust noted that a bank holding the BCA or PCA had an advantage when it came to credit decisions, but also that many SMEs would simply go to their main bank as the first thing any other lenders would ask for was details of their accounts.

- *Time, effort and convenience*

8.175 The entire process of applying for finance can take some time. Beyond the search process, SMEs need to gather material for their application and fill in forms, then wait for the bank(s) to make a decision and submit an offer(s). Finally, the SME needs to review all offers.

8.176 Debt finance may be required for a number of different reasons and quite often at short notice (see Appendix 8.2). Where finance is required to help

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[133] See Appendix 8.2, Figure 10 and SME follow-up surveys, p50.
[134] Research Works SME qualitative research, p37.
[135] Research Works SME qualitative research, p37.
[136] We note this is an adverse selection problem for banks that do not provide the SMEs BCA.

with cash flow, timing may be particularly important (for example, if a customer pays late). The Charterhouse follow-up survey of SMEs applying for finance shows that 24% of SMEs applied for finance at the time it was needed, and a further 12% within two weeks of needing the finance.[137]

8.177 The time spent filling in an application and gathering documents can vary greatly. The BBB/BMG Journey Towards Raising Finance suggests that of all applications (the majority of which are to the SME's BCA bank), just under half (46%) took less than 1 hour to complete but 9% took over 20 hours.[138]

8.178 The time it takes for banks to subsequently make a decision on lending also varies. Banks told us that smaller loan decisions were generally made within a few days, while for larger loans the decision could take a couple of weeks (particularly if security was required). It usually took a few days to get a decision on asset finance and decisions on invoice discounting or factoring could take quite some time (potentially months). A number of banks noted that it could take longer to reach a decision for a new customer to the bank.

8.179 When SMEs were asked why they went to their main bank or why they did not consider other providers, ease of application, hassle and time constraints were all some of the reasons mentioned most often. Ease of application was the second most common reason given for going to the SME's main bank in the BBB/BMG's Journey Towards Raising Finance survey.[139] Over a quarter of SMEs that applied for finance at their main bank in the Charterhouse follow-up survey did not consider other organisations because of the hassle or time associated.[140]

8.180 Similarly, the Research Works SME qualitative research found that faster and easier access and less initial paperwork were some of the main reasons for SMEs going to their main bank for finance.[141]

8.181 The amount of time and effort to apply to banks other than the SME's BCA/main bank lead SMEs simply to choose their main bank. Their bank already holds information about them (including credit information for assessing risk) and they believe this will be a quicker, simpler process.

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[137] SME follow-up surveys, p52.
[138] BBB/BMG, 2014 'SME Journey Towards Raising Finance' Survey, A20b. This survey only covers GB.
[139] See Appendix 8.2, Figure 10.
[140] SME follow-up surveys, B10b, p44.
[141] Research Works SME qualitative research, p37.

Summary on SME engagement in lending

8.182 Overall, we find low levels of searching amongst SMEs looking for lending and a high proportion of SMEs that take out a loan with their BCA provider. This is the case for all lending products except asset finance, a product predominantly used by larger SMEs. The main reasons for this linkage between BCAs and SME lending products, appear to be the relationship SMEs have with their main bank (in particular the information asymmetry between the SME's main bank and other providers), and the time and effort involved in applying and awaiting responses from other providers.

Barriers to searching

8.183 For an SME to understand how good a deal it can get with a particular lender it needs to understand all the costs and terms and conditions of the finance product.

Interest rates and arrangement fees

8.184 There are two main prices that make up a lending product. The interest rate and any arrangement fees.[142] To be able to understand and compare lending products an SME needs to be able to collect information on these costs for each product.

8.185 When setting prices lenders will consider various factors:

- the size of the loan;
- whether (and how much) security is held against the loan;
- the term (length) of the loan;
- the SME's business sector; and
- the risk band of the SME.

8.186 The combination of all these factors can result in a large range of potential prices for SME lending.[143] As a result, some banks have told us that they do

[142] Arrangement fees are not the only fees for some products. In some cases where security is needed there will be a fee for valuing the security, but also potentially for the administration costs of taking legal charges over assets or securing via debentures. In all these cases, however, the fee is fixed upfront, which may either be added to the loan or paid upfront as a lump sum.
[143] Internally the lender may also be considering capital costs and funding costs, service, sales and distribution costs as well as its appetite for lending.

not publish prices or eligibility criteria. Many lenders do not even publish indicative tables of interest rates and arrangement fees, as may be found when searching for residential mortgages (with different rates depending on common possible circumstances/variables).[144] We found that where banks do publish rates, this is not done on a consistent basis, making it difficult for SMEs to compare across banks.[145]

8.187 Therefore to find out rates an SME will generally need to have a discussion with a relationship manager or other member of staff either in branches or over the telephone, or go through an online application process. Collecting this information can take some time as the process needs to be repeated with every provider and this process differs between banks.

8.188 For larger SMEs, rates are more bespoke and they are more likely to negotiate either the prices (interest rate and arrangement fees) or term of the loan. The Charterhouse follow-up survey on SMEs applying for finance suggested that more than a third (38%) of SMEs with turnover over £250,000 a year tried to negotiate compared with only 9% of SMEs with turnover under £250,000.[146] Typically negotiation is only possible where the SME has a relationship manager (see Appendix 8.1, Table 1), as relationship managers are often able to flex the price of a lending product beyond the bespoke target price.

8.189 Depending on the size of the loan, the risk band of the SME, and the particular bank, a relationship manager may reduce the interest rate by a certain amount of basis points (or to a minimum level) and/or reduce the arrangement fee. This differs between the banks. Barclays noted that its non-senior relationship managers could reduce the interest rate by between [✂] and [✂] basis points depending on the risk rating of the SME.[147] While RBSG told us that [✂].[148] LBG told us that relationship managers could not price below their matrix of prices, although they could [✂].

8.190 In many cases the relationship manager may not have the authority to reduce the price of the loan and require further approval from more senior staff. For instance, of the five largest banks, [✂],[149] [✂], and [✂].

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[144] We found that some lenders publish prices for unsecured SME loans and overdrafts up to the value of £25,000. We are not aware of banks publishing prices for values above £25,000 for SME lending products.
[145] Some lenders provide typical percentages or ranges, others provide a minimum ('from') rate.
[146] SME follow-up surveys.
[147] This is in relation to its SME customers with turnover of up to £5 million.
[148] [✂]
[149] [✂]

8.191 Negotiation therefore for larger SMEs in particular, naturally adds a further layer of opacity which means it is more difficult to obtain clear pricing information.[150]

8.192 A number of banks have told us that they can make lending decisions very quickly for smaller loans and overdrafts. For instance Lloyds' Business Banking's online system can provide instant unsecured overdraft facilities up to £[✄], and can also make offers in principle in relation to unsecured loans up to £[✄] for businesses with an annual turnover of up to £[✄] million. However to receive a fast (or instantaneous) lending quote we were frequently told that the SME needed to already hold a BCA with the bank.[151] This is clearly helpful for SMEs that need a quote from their own bank at short notice. However difficulties with finding out information from other providers, or for larger loans, still remain.[152]

Terms and conditions

8.193 Lending products may stipulate certain terms and conditions of the lending contract. For instance paying off a loan early may result in early repayment charges and penalty clauses, there may be charges for making late repayments, or terms may stipulate the security required for the loan.

8.194 LBG submitted to us that certain fees such as early repayment charges and unplanned borrowing charges were made available to customers through various channels.[153]

8.195 In the Charterhouse follow-up survey on applying for finance 19% of SMEs found it difficult to find out information on penalty charges and early repayment charges (and a further 17% did not look into this).[154]

8.196 The TSC report on conduct and competition in SME lending noted that the presence of multiple credit searches in an SME's credit history could damage the SME's credit score and that this may deter SMEs from

[150] Although we note that in markets with negotiation we will not typically expect customers to negotiate with more than a few providers.
[151] This seems broadly consistent across the banks that offer fast quotes for smaller loans. However, HSBCG's Business Lending Eligibility Checker tool is able to provide users who do not bank with HSBC with an indication of eligibility (but not price) 'within minutes'.
[152] Banks provided us with a range of responses regarding the indicative offers they currently give to SME customers (which are frequently existing customers), and whether they do so at all. Some provide responses instantly, while some take up to 72 hours or longer.
[153] LBG noted that its website set out which loans had early repayment fees, and during quotation LBG provided customers with an indicative breakage cost if they repaid their loan early at various stages of the repayment schedule.
[154] SME follow-up surveys, p46.

comparing providers in the first place.[155] During our SME roundtable the FSB and BCC also raised this as a potential concern.

8.197 Currently, when credit checks are undertaken by credit reference agencies (CRAs), a record is frequently left on the SME's credit file. Without the ability for banks to conduct a 'soft search', there is a risk that SMEs might find that shopping around negatively affects their credit rating and, when actually applying, they might be offered worse terms or prevented from obtaining a loan. We did not find evidence from SMEs that the impact on an SME's credit file is currently a factor contributing towards the low levels of searching.[156] However a number of parties have raised the potential impact of searching on SMEs' credit files. We consider that the low awareness of the potential impact of searching on an SME's credit files is likely to reflect the fact that not many SMEs are currently shopping around and searching (for the reasons we describe in this section).

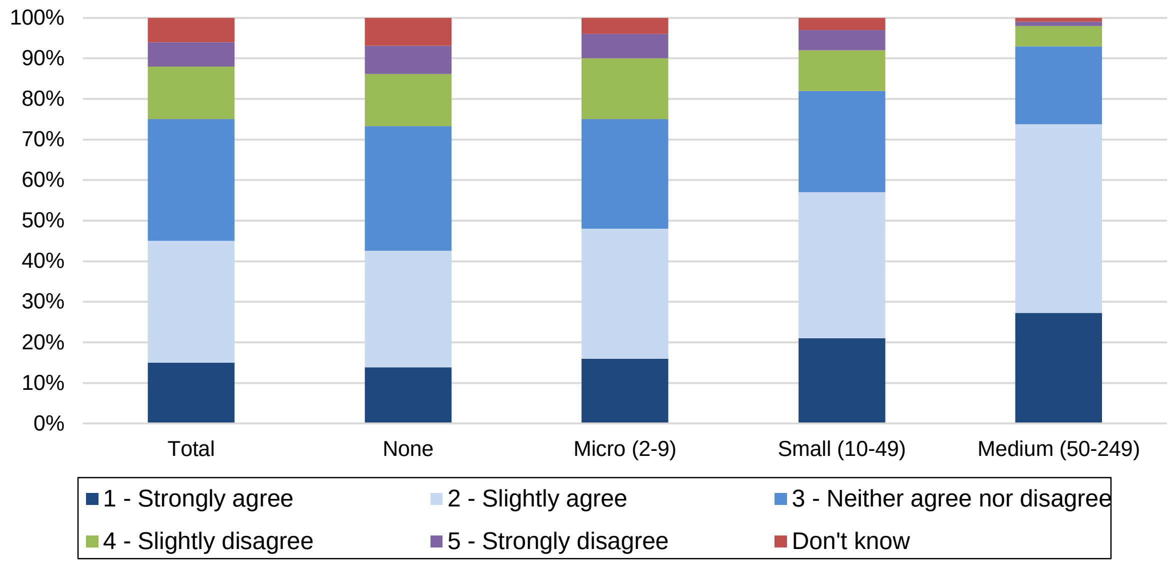
Comparability

8.198 Understanding interest rates can be complex. To compare lending products SMEs need to have a certain level of financial capability and understanding (or pay for the services of someone who does).This becomes more important when comparing across different types of lending products. As noted earlier many SMEs do not have a dedicated person responsible for financial decisions.

8.199 The BBB/BMG's Journey Towards Raising Finance survey suggests that larger SMEs are more likely to think the information they are provided with allows them to judge whether a product is suitable for their needs (Figure 8.10).

[155] House of Commons Treasury Committee (2015), *Conduct and competition in SME lending*, p84.
[156] For instance this was not mentioned as an issue by SMEs when asked why they did not consider other providers in either the Charterhouse follow-up survey of SMEs applying for finance or as part of the Research Works SME qualitative research.

Figure 8.10: Finance providers give sufficient information about their products for the SME to judge whether they are suitable for their needs



Source: BBB/BMG, 2014 'SME Journey Towards Raising Finance' Survey, A4e.
Base: Total (1,000), none (377), micro (334), small (195), medium (94).

8.200 The Charterhouse follow-up survey on applying for finance found that only 2% of SMEs that were applying for finance had used a PCW. Recently, the comparison sector has expanded for lending products, both in the number of sites available[157] and the products covered. However there are still only a relatively small number of PCWs that compare SME lending and some of these focus on SMEs' likelihood of obtaining finance, rather than its price. As such, PCWs currently offer limited help in making comparisons across providers.

Summary on barriers to searching

8.201 We found that prices are opaque and there are significant search costs. While it may be simple for an SME to get a quote from its own BCA bank, it is a lot harder to quickly find and compare quotes from other lenders. Furthermore the factors underlying lending decisions will often be unclear to SMEs before they make an application.

Barriers to switching

8.202 We may not expect to see SMEs switching providers during the term of a particular loan. Changing loan provider would involve paying off the existing

[157] In March's Budget 2016, it was announced that three of these (Bizfitech (which operates Business Finance Compared), Funding Options and Funding Xchange) would be designated under the Small and Medium Sized Enterprises (Finance Platforms) Regulations 2015.

loan and taking out a new loan. As such this is not always possible, and where it is possible then the SME may be subjected to significant costs. For instance certain loans have early repayment charges or other clauses which result in a payment to their existing provider for paying off the loan early.[158] Typically new loans also have arrangement fees which can be significant and thus represent a considerable switching cost.[159]

8.203 We do not consider barriers to switching to be a concern for lending products due to the short-term nature of the majority of loans, and therefore the ability of SMEs to consider the cost of the loan over its full duration.[160] For longer-term loans such as commercial mortgages we have not received any submissions that barriers to switching are a competition concern.

How banks compete on SME lending

8.204 We now look at some key characteristics of the supply of lending by banks, and competitive developments including competition from alternative finance providers.

8.205 Lending markets are characterised by information asymmetry, both between the customer and the potential lender as well as between the main bank and other lenders. This arises because lenders cannot easily distinguish between high-risk and low-risk customers when assessing SME lending applications. It is particularly true for smaller and younger SMEs where there is a lack of available information on the past performance of these businesses.

8.206 Information asymmetries between SMEs and lenders may be reduced when the SME takes out a loan with its main bank. This is because the main bank will typically have information on the transaction history of the SME sourced from its BCA and, in some cases, the PCA of the business owner.[161] This enables the main bank to make a more accurate and quicker assessment about the creditworthiness of an SME as well as being able to better price loans. This is likely to impact on competition in the market.

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[158] LBG told us that it did not have exit fees on any of its lending products (including early repayment charges). However, there are break costs/gains for certain fixed rate products.

[159] Arrangement fees are typically between 1% and 2% of the value of the loan. SME Finance Monitor reports that the average (mean) arrangement fees paid were £969 on a loan and £363 for an overdraft (year to Q2 2015).

[160] Santander was the only party to mention that exit fees on loans created difficulties for SMEs to switch products. Furthermore this was not raised by any SMEs during the Research Works SME qualitative research.

[161] In addition, having access to a pool of data about SMEs will help a bank make better assessments on the reliability of estimates in a business plan. This issue is discussed further in Section 10.

8.207 Santander, for example, told us that, 'as a challenger trying to attract new business loan customers, a key challenge is to be able to gather the transaction data required in order to make a lending decision within the timeframe for providing the funding. Many SMEs apply for funding at short notice; this leaves very limited time for a bank new to the customer to respond'. It added that, 'as a result, incumbent banks had an advantage as they are likely to have had an existing relationship with the SME, and will therefore have more data and a richer understanding of that business'. It further told us that: 'Challenger banks starting from scratch to collect basic information are up against the clock in order to meet the deadline. This difficulty is amplified by the effort made by banks to retain customers.'

8.208 Similarly, Secure Trust noted that banks holding a BCA had significant advantages when making credit decisions. Section 9 considers in more detail whether information asymmetries between an SME's main bank and other lenders is a barrier to entry and/or expansion.

8.209 Debt finance may be required for a number of different reasons and quite often at short notice. For example, where debt finance is needed to help with cash flow, timing may be particularly important (for example, to cover short-term shortfall in funding because a customer has paid late). This could potentially lead to a competitive advantage for the bank where the SME holds its BCA.

8.210 In the remainder of this section we discuss competitive developments, responses to competitor behaviour and the response to alternative finance such as crowdfunding and peer-to-peer lending.

Competitive developments and response to competitor behaviour

8.211 There have been some developments in the process for applying for loan offers for SMEs. In July 2014, Barclays launched a facility to provide SMEs with pre-assessed lending decisions online for unsecured borrowing up to £25,000. Barclays told us that while this new service was principally driven through customer feedback, it was also the result of competitive pressure both from new alternative lending platforms and from competitor banks.

8.212 Similarly, LBG told us that it had streamlined its lending applications and affordability assessment for new lending applications up to £[✂] to provide a quicker assessment. LBG's 'straight through processing' allowed existing customers with estimated turnover less than £1 million, borrowing less than £50,000, and 'straightforward banking needs' to obtain finance through an automated process up to £10,000 via a digital channel (and which increased to £[✂] for overdrafts during H1 2016).

8.213 Similarly, in March 2016 HSBCG launched an online tool which gives SME customers who do not currently bank with HSBC an indication of their eligibility for SME lending products, and [✂].[162] This tool requires a small number of input fields to be filled in by an SME customer, and incorporates CRA data from Equifax.

8.214 Other developments, namely the offer of discounts and incentives, appear to have principally stemmed from government initiatives. The FLS[163] prompted different responses from banks. For example, Barclays provided 2% cashback on loans to boost the amount of resource made available (although it no longer provides this cashback facility). While LBG initially reduced the interest rates on all eligible new term lending to SMEs written from March 2012 by 1% for a pre-agreed period of time. There is also some limited evidence of banks responding to the price offers of competitors at a local level. For example, [✂]

8.215 Meanwhile, despite not participating in FLS, [✂]

8.216 On asset finance and invoice discounting we have found limited evidence of banks responding to competitors' behaviour. As noted in Appendix 8.2, a number of smaller banks indicated that the larger established banks had withdrawn from such finance, which had provided opportunities for new banks such as Aldermore and Shawbrook to enter.

Competition from alternative finance providers

8.217 In recent years there has been a growth in alternative finance for SMEs, including peer-to-peer lending and crowdfunding. While all of the large banks told us that these new providers were significant competitors, they only provided limited examples of changes they had implemented in response to these competitors. The most significant examples were on peer-to-peer lending, where banks mentioned that they had made significant investments improving their digital capabilities and offering more timely lending decisions in response to alternative finance providers such as Funding Circle, Zopa and PayPal.

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[162] HSBCG told us that in March 2016 it had launched a Business Lending Eligibility Checker tool for new-to-bank customers seeking to borrow up to £30,000 via unsecured loans, overdrafts and commercial credit cards. The tool enabled HSBCG to provide an indication of the likelihood that an SME would be able to borrow their requested amount ('likely', 'maybe' or 'unlikely') based on a minimum amount of information it requested from SMEs. It did not provide an indicative price quote.
[163] For further details see Section 3.

Summary of how banks compete on SME lending

8.218 We found evidence of banks seeking to increase their lending volumes by improving the availability of finance and the speed with which an SME can obtain a decision on lending applications. These are however mainly focused on existing BCA customers. We also find some limited evidence of banks responding to the price offers of competitors at a local level. However, this is mostly targeted at larger SMEs and on retaining their existing customers. Evidence of pricing initiatives and discounts aimed at attracting new customers are much more limited and mainly prompted by government initiatives.

Overall conclusions on competition and customer behaviour in SME retail banking

8.219 SMEs are a diverse population, both in size, in the types of sectors they operate in, the length of time they have been in business and their aspirations. However, the vast majority of them are small with a turnover below £2 million.

8.220 Evidence on outcomes in the SME market set out in Section 7 suggests that competition in SME banking markets is not fully effective in both GB and NI:

(a) The markets for both BCAs and SME lending are concentrated and market shares have been stable since 2005 notwithstanding wide variations in price and quality between banks.

(b) There has been limited new entry, in particular for BCAs, and their growth has been limited. Most new entry has been among specialist lenders, such as asset and invoice finance lenders.

(c) There is a weak customer response to variations in prices and quality. We found some banks gaining market share despite appearing to offer a combination of below-average quality and above-average prices. Conversely, there are providers appearing to offer below-average prices and above-average quality that are either losing market share or gaining market share at a very slow pace.

(d) We also found that the extent of innovation has lagged behind the levels observed in the PCA market.

8.221 We examined competition at different stages in the life cycle of an SME:

(a) the start-up phase, when first opening a BCA;

(b) once an SME has chosen a BCA, in particular at the end of the initial free banking period (after 12 to 24 months); and

(c) as the SME grows and becomes more established, the need for other services from the bank (in particular lending).

8.222 When initially choosing a BCA, half of start-up SMEs in GB go to their owner's PCA provider, and many do so without comparing different providers. For those that do some searching, evidence suggests a free banking period was a significant driver for SMEs, although most banks offer initial free banking periods so it is not a clear differentiating factor beyond the different lengths of free banking offered. Few SMEs fully compare the fees that they will pay after the end of the free banking period across banks. This means that the ability of SMEs to search and switch after they have chosen an initial BCA provider is particularly important for competition.

8.223 Once SMEs have chosen and set up a BCA, there is little evidence that they then search or consider switching. Over two-thirds of more established SMEs have never compared the cost of their BCAs with other providers. Even at the end of the free banking period (a natural trigger point for switching) two-thirds of SMEs did not consider switching at all. Of those that did consider switching, very few actually do switch banks. Switching rates are low (less than 4% in GB and 2.6% in NI). Older SMEs tend to remain with their banks for many years.

8.224 The primary reason given for not considering switching was satisfaction with their bank, although a significant number of SMEs also considered that it would be time-consuming or difficult. Moreover even those SMEs dissatisfied with their bank did not consider switching. The low levels of searching and the differences in price and quality between banks (and the relationship to market shares), also suggests that SMEs may not be making an informed decision to remain with their BCA provider.

8.225 We looked at why there are low levels of engagement and found that there are a number of factors that may reduce SMEs' propensity to shop around for BCAs. There is a lack of triggers to look at other BCAs and BCAs are low cost compared with other costs of business. SMEs perceive that remaining loyal to a bank will be beneficial, in particular in relation to future lending decisions. There is also a perception that potential gains from switching are not high and there is limited differentiation between banks.

8.226 We also found there are barriers to searching. While price information is available, tariff structures are complex with a multiplicity of charges and depending on usage. There is also a lack of comparable information on the quality of bank services in the public domain. It is therefore difficult for SMEs to assemble and compare fees and services across banks. There is also a lack of effective comparison tools, including ones that are able to use SME usage data to calculate which BCA offers the best prices and quality. These barriers particularly affect smaller SMEs without specialist financial capability.

8.227 We also identified a number of barriers to switching. The account opening process can be lengthy onerous and time-consuming, particularly because of many banks' processes for undertaking AML checks. Awareness, use and understanding of CASS was particularly low among SMEs, despite most SMEs being eligible. There are also a number of other issues of concern for BCA customers about switching including concerns over lost payments and receipts. For some SMEs, access to lending deters them from switching BCA as they fear that access would be less likely in the future.

8.228 We looked then at how banks compete and their incentives. For start-up SMEs we found that competition between banks is mainly focused on providing free banking periods for BCAs. There is variation between banks in the length of free banking periods offered, although in more recent years there is little evidence of dynamic competition between banks on free banking periods or on service/quality. There is no strong evidence of banks targeting start-up SMEs through marketing or advertising.

8.229 For established SMEs, while many banks offer free banking periods as inducements to switch BCAs, some banks have moved away from this. Newer entrants are focusing on quality and convenience to attract new SMEs. Free banking offers by banks in NI have remained more constant. Banks' acquisition and retention strategies tend to focus on larger SMEs. In particular, larger SMEs have access to more personalised relationship managers, partly to provide these customers with a better quality of service.

8.230 There has been some innovation on BCA tariffs, particularly with the introduction of electronic banking tariffs, but little evidence of price competition on other price aspects. We generally observe less innovation for SMEs compared with personal banking. Most innovations have had their roots in personal banking and there has been a lower uptake of digital channels in SME banking, most notably in mobile banking.

8.231 There are fewer incentives on banks to compete for established SMEs beyond their free banking period, given the difficulties in searching and switching we identified. In particular, banks have limited incentives to invest in activities to increase switching (such as marketing and advertising, innovations in pricing structures etc). This further exacerbates the lack of dynamism in the market and the perception by SMEs that there is little to be gained from switching.

8.232 Competition between banks on free banking periods for start-up SMEs is unlikely to benefit the whole BCA market because we've found there is price discrimination between start-ups and established SMEs and SMEs at start-up are more focused on the initial free banking period rather than future fees when established.

8.233 We separately looked at competition in SME business lending. We found there is little shopping around, with the vast majority of SMEs going to their main bank for finance. It is difficult for SMEs to compare prices and other terms, as prices are opaque and lending products are complex. There is also a lack of tools to help SMEs make comparisons, particularly affecting smaller SMEs without specialist financial capability.

8.234 In addition, an SME may not even consider lending providers other than its main bank because of a combination of factors:

(a) nature of demand ie desire for finance at short notice means that the BCA provider is often best placed to provide finance to SMEs;

(b) time and effort in searching, given opacity of charges and terms and lack of comparison tools;

(c) time and effort involved in applying for finance from other providers given the nature of the application process;

(d) the perceived importance of the relationship with its main bank in getting access to lending; and

(e) the information asymmetry between the SME's main bank and other providers, affecting the ability of other providers to accurately price credit and make a lending decision, and meaning the BCA provider can generally make quicker and more accurate assessments for providing credit.

8.235 These factors give a competitive advantage for the bank where the SME holds its BCA. We found some evidence of banks seeking to improve the availability of finance and the speed with which an SME can obtain a lending decision. However these are mainly focused at existing BCA customers. We also find some limited evidence of banks responding to the price offers of competitors at a local level. However, this is mostly targeted at larger SMEs and focused largely on retaining their existing customers.

8.236 Overall we therefore found that competition for both BCAs and SME lending is not working well. A combination of factors mean there is weak customer engagement and as a result banks have limited incentives to compete in BCAs and SME lending. We consider further the impact of this weak customer engagement on barriers to entry and expansion in Section 9 and the market power of banks in Section 10.

8.237 In Section 11, we set out how this gives rise to an AEC in the provision of BCAs and in the provision of SME lending, in each of GB and NI respectively.

9. Barriers to entry and expansion

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Introduction

9.1 As stated in our Guidelines,[1] entry or expansion by firms, or the prospect of entry or expansion by firms within a short time, will often stimulate competition and can sometimes countervail against features which might otherwise give rise to an AEC. A significant source of competitive discipline may therefore be eliminated or reduced if there is any barrier to market entry and/or expansion, whether an absolute barrier or some other form of restriction.

9.2 We found in Sections 6 and 8 that there are a number of barriers to customers searching and switching providers combined with low levels of customer engagement, and in respect of BCAs and SME lending, linkages between products. As a result, PCA customers and SMEs are not

[1] Guidelines, paragraphs 205–236.

responsive to differences in price or service quality reducing the incentives on incumbent banks to compete effectively.

9.3 This lack of customer responsiveness and product linkages is a barrier to entry and expansion as it makes it difficult for new entrants and smaller banks to acquire new customers. New entrants and smaller banks wishing to expand have to invest large amounts of time and resources over and above the inherent costs of entry and expansion to acquire new customers.[2] Even with such investments, it will take considerable time to acquire a sufficient volume of customers to recover their costs of entry and/or expansion. Incumbent banks on the other hand will have a first-mover advantage as they already have an established customer base over which they can spread their costs. The larger that customer base and the broader that customer base across products, the greater the incumbency advantage.

9.4 In this section, we consider additional potential barriers to entry and expansion other than the high cost of customer acquisition arising from the lack of customer response. We first outline the framework within which we consider barriers to entry and expansion. We then summarise recent entry and expansion, describing some of the trends and market developments that have facilitated and continue to facilitate entry and expansion. In the remainder of this section, we set out the evidence and our analysis on each group of potential barriers to entry and expansion that we have identified summarising at the end of each group our overall assessment of the evidence. At the end of the section, we set out our overall findings on barriers to entry and expansion. The following appendices contain further details of our analysis: Appendix 9.1 Case studies on barriers to entry and expansion; Appendix 9.2 Parties' views on barriers to entry and expansion; Appendix 9.3 Regulatory barriers to entry and expansion; and Appendix 9.4 Natural or intrinsic barriers to entry and expansion.

9.5 As set out previously, our analysis reflects the current framework for the regulation of banks. We recognise that this may change in the future following the EU referendum but at this point it is unclear how or when the regulatory framework will be affected. Unless otherwise indicated our analysis of barriers to entry and expansion applies both in GB and NI.

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[2] In its response to our provisional findings (paragraph 1.3), Barclays argued that the emergence and growth of credible recent entrants such as Metro and Handelsbanken, as well as alternative providers such as PayPal, is evidence that customer acquisition costs are not a material barrier to entry and expansion. Evidence from the case studies and the evidence set out in Sections 6 and 8 on the lack of customer responsiveness confirm that customer acquisition costs are barriers to expansion and/expansion notwithstanding entry. Such new entry has been niche or small scale and one of the main factors identified for this limited scale are customer acquisition costs.

Our framework

9.6 Our Guidelines group barriers to entry and expansion into four broad categories: regulatory barriers, natural or intrinsic barriers, strategic advantages, and 'first-mover' advantages. We have examined potential barriers broadly within this framework.

(a) **Regulatory barriers to entry** – to enter and operate in retail banking markets, providers must meet a number of regulatory requirements or conditions set by UK authorities.[3] Section 3 sets out in greater detail the regulatory regime for banks. In this section we focus on two particular aspects of the regulatory regime: the authorisation process required to be a bank and capital requirements. We also consider the competition impact of the corporation tax surcharge (CTS) introduced in January 2016, and the changes to the bank levy announced at the same time as the CTS.

(b) **Natural or intrinsic barriers** – any firm entering a market will invariably incur costs. In assessing the effects of such costs on entry and expansion we consider the nature of such costs and the extent to which such costs are sunk – ie cannot be recovered upon exit. Economies of scale in combination with sunk investment costs increase the risk of entering a market and may create a barrier to entry where the costs relate to the cost of entry and/or expansion. If economies of scale are significant, entry on a small scale may not be profitable unless aimed at a 'niche' in the market. The risks and costs of entry will also increase if there are economies of scope – if it is less costly for a firm to provide two or more products than for two firms to produce each product and the difference is significant this may be a barrier to entry and expansion. Whilst we have not been able to undertake an analysis of banks' costs for the reasons set out in Section 2, it is generally recognised that there are economies of scale and scope in retail banking markets.[4] There are particular economies of scale and scope in relation to distribution channels and IT which we consider below. We have considered the costs of the following key inputs for a retail bank: access to funding; cost of funding for lending; access to card payment systems; cost of IT systems; and access and cost of distribution channels.

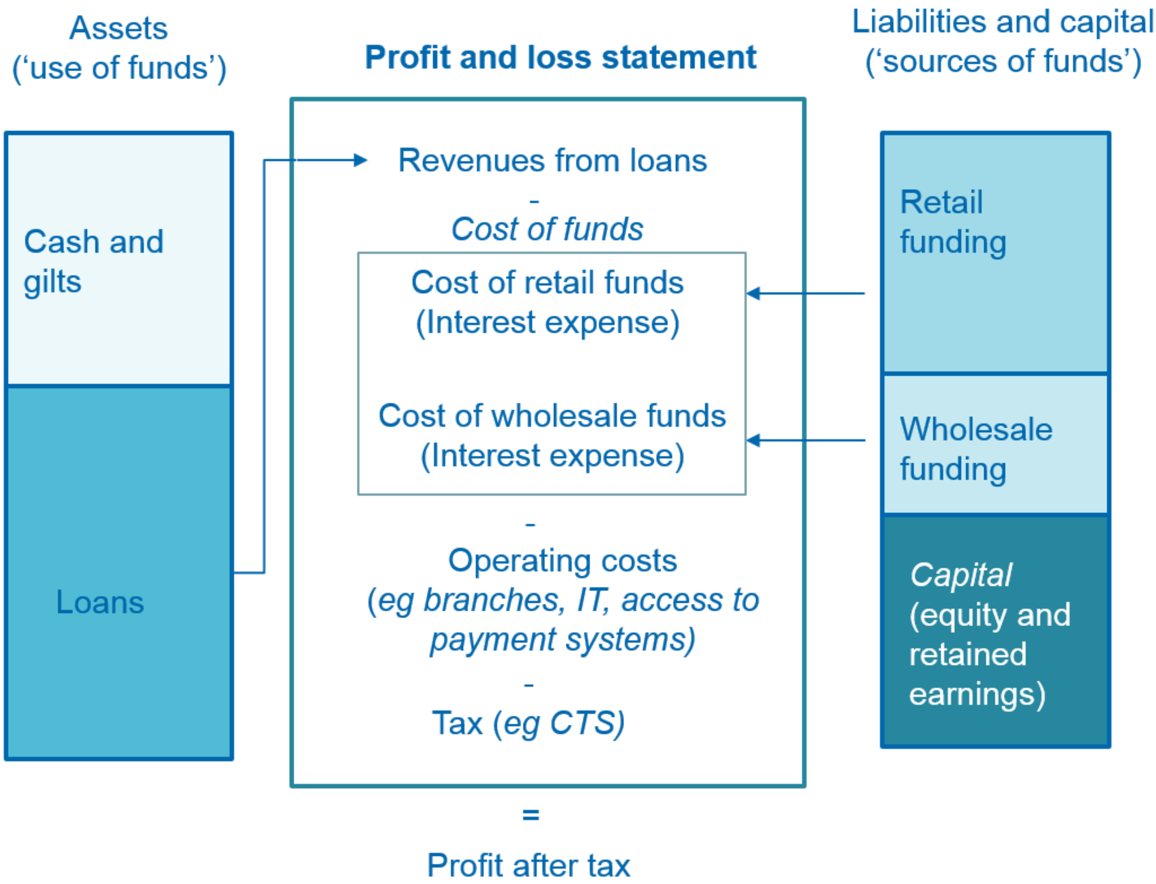
[3] UK authorities responsible for setting and monitoring adherence to bank regulation include HMT, the BoE, the PRA and the FCA. See Section 3 of this report.
[4] For example, ICB report, Cruickshank review and OFT Barriers to entry report.

(c) **Strategic and 'first-mover' advantages**[5] – barriers to entry and/or expansion may be exacerbated by the actions of incumbent banks (supply-side factors), or they may result simply from the established position of existing banks (supply-side and demand-side factors). Regardless of origin, these barriers can raise entry costs and create an un-level playing field for entrants relative to established market participants. As described in paragraph 9.3 above, we have found that the cost of customer acquisition is a barrier to entry and/or expansion. We have therefore focused on further potential strategic advantages arising from access to customer data and access to intermediaries to distribute their products.

9.7 Whilst we have considered potential barriers under this framework, we recognise that these potential barriers are closely connected. This is illustrated in Figure 9.1 below. As described in Section 2, the majority of a bank's assets (one side of the balance sheet) consists of loans made to customers which are funded by liabilities (the other side of the balance sheet) in the form of retail funding (customer deposits) and wholesale funding. In essence banks convert short-term small deposits from their customers into larger longer-term lending ('maturity transformation'). Banks profit from this activity primarily by charging higher interest rates (and fees) on their loans than the interest rates/other benefits/fees they pay out to depositors and for other sources of funding. A bank's mix of retail funding from retail deposits, wholesale funding and capital and its costs of such funding together with operating costs and tax will drive a bank's profitability and therefore its ability to expand and to attract further investment.

[5] 'First-mover' advantage is the gain obtained by firms from entering a market first.

Figure 9.1: Interplay of potential barriers to entry and expansion (barriers reviewed in this section shown in *italics*)



Source: CMA.

9.8 As a result, for example, if there are material differences between banks in the amount of capital they are required to hold this has the potential to be a barrier to expansion in a number of ways:

(a) It will increase a bank's cost of providing the lending relative to other banks. This may in turn affect a bank's pricing, reducing its ability to compete on particular types of lending, for example low loan-to-value (LTV) mortgages.

(b) If a bank is unable to compete in particular lending markets this may in turn increase its wholesale or equity funding costs relative to other banks. Higher costs will directly affect the returns of the bank.

(c) This reduction in returns will in turn potentially reduce its ability or incentives to attract additional funding, including from deposits.

9.9 Similarly, if – for example because of weak customer response – a bank is unable to attract customer deposits (or can do so only at a high cost), which are the largest and generally cheapest sources of funding for lending, it may not be able to compete on price and/or otherwise expand its lending activities. In addition, incumbent banks may have first-mover advantages in attracting new deposits and drawing on different sources of funding for lending arising from their existing back book[6] of inert customer deposits. This may in turn affect the ability of newer entrants to compete effectively in attracting deposits and in providing lending.

9.10 Finally, other factors intrinsic to a bank's operation (such as access to payment systems, IT or distribution channels) can impact banks' costs. To the extent these other factors increase banks' costs, they could seek to offset this by increasing charges to customers and/or offering lower rates of interest. This will lower their funding costs but reduce their ability to attract retail deposits.

9.11 In undertaking our analysis of potential barriers to entry and expansion we have therefore sought to recognise these interrelationships notwithstanding the framework for considering potential barriers to entry and expansion.

Market developments and recent trends

9.12 Entry into the PCA market has occurred in recent years. Four of the seven providers that have entered the PCA market since 2004 were providers of ancillary financial services products that expanded their product offering to include PCAs.[7] Entry into PCAs has also occurred organically (Metro, 2010), and through divestment (TSB, which was divested from LBG in 2013). Further, Atom launched its operations in April 2016 (although currently limited to savings products) and Tandem Bank obtained authorisation from the PRA in November 2015.

9.13 Although we recognise that the acquisition of existing businesses is not entry as such, Santander's entry in the UK through the acquisitions of Abbey National plc, Bradford & Bingley Building Society and Alliance & Leicester Building Society has created a stronger competitive force in the market with the launch of its 1-2-3 reward account.[8]

9.14 In addition to entry into the provision of PCAs, there has been more limited entry into the provision of banking services to SMEs. Of the three[9] that have entered since 2002 that offer a BCA, TSB acquired most of its BCA customers through divestment and has yet to focus as much on expanding

[6] In this section 'back book' refers to the retail deposits of the banks' existing customers.
[7] Virgin Money, the Post Office, Tesco Bank and M&S Bank. The Post Office offers retail banking services under BoI's banking licence. M&S Bank is a wholly owned subsidiary of HSBCG but it has its own banking licence and a profit-sharing agreement with Marks and Spencer plc.
[8] See further Section 5 and Appendix 6.6 on the impact of Santander's 1-2-3 account on the market.
[9] Metro, TSB and Handelsbanken.

its BCA business as it has to date on its PCA business. Further, Handelsbanken (which entered the UK in 1982, initially serving Nordic customers only) expanded to offer domestic banking services, including current accounts, to personal customers and businesses in the UK in 2002.

9.15 In the SME lending market,[10] most of the entry that has occurred has been among specialist lenders and deposit-takers. For example, Aldermore, which entered the market in 2009, offers a range of business finance including invoice finance, asset finance and bridging finance. Shawbrook and Paragon Bank entered in 2011 and 2014 respectively and offer a range of savings and specialist SME lending products (including mortgages). Most recently, OakNorth entered the market for SME lending in March 2015,[11] Atom Bank is starting to provide secured lending to SMEs through a number of specialist business intermediaries[12] and Masthaven Bank has also been authorised for SME lending. None of these new entrants offer general-purpose business loans to SMEs or BCAs but focus on alternative finance products.

9.16 There are further positive developments on the supply side: six retail providers are currently in the application stage of the authorisation process, and a further ten retail firms are active in the pre-application stage of the authorisation process. At least one of these potential entrants is considering supplying current accounts for personal or SME customers (or both).[13] RBSG is in the process of divesting Williams & Glyn, which will have a focus on SME banking. The deadline to complete the disposal is currently December 2017.[14]

9.17 However, while entry has occurred in the PCA and BCA markets and SME lending market, the growth of market share by recent entrants has been limited. For example, Metro, Tesco Bank and Virgin Money each had less than [0–5]% share of the PCA market in 2015. This may reflect the more targeted approach being pursued by these recent entrants.[15] The growth

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[10] In this context, SME lending refers to alternative lending facilities such as asset finance, invoice discounting and commercial mortgages, but excludes general purpose business loans.
[11] OakNorth became authorised with restriction in March 2015 and had its restriction removed in August 2015.
[12] See Atom Bank website.
[13] Information provided by the PRA.
[14] While RBSG continues to work to achieve separation and divestment by the EC-mandated deadline of full disposal by 31 December 2017, on 28 April 2016 RBSG announced that there was a significant risk that divestment would not be achieved by 31 December 2017. On 5 August 2016, RBSG announced that due to the complexities of the Williams & Glyn's separation, and while good progress has been made on the programme to create a cloned banking platform, it had concluded that the risks and costs inherent in a separation programme are such that it would not be prudent to continue with it. RBSG would instead prioritise exploring alternative means to achieve divestment. Work has continued to explore these alternative means and RBS has had positive discussions with a number of interested parties concerning an alternative transaction related to substantially all of the business previously described as Williams & Glyn, although these discussions are at a preliminary stage.
[15] See Appendix 9.1 Case studies.

expectations of recent and prospective entrants have also been very modest, averaging [0–5]% over the five years to 2020.[16]

9.18 Recent entrants (and pipeline firms – those either in the application or pre-application stages of authorisation) are tending to focus their approach according to:

(a) product (eg entering niche product areas such as invoice discounting – this is particularly evident for SMEs);

(b) customer type (eg Tesco Bank and M&S Bank (part of HSBC) have targeted mainly their existing customer bases through a range of in-store advertising while Atom is focusing on those who are routine users of mobile apps, in particular 18- to 34-year-olds[17]); and/or

(c) service and use of technology (eg digital-only propositions such as Atom). New technology has enabled firms to offer such services at relatively low cost and increased efficiency.

9.19 This has meant that entrant banks are not necessarily trying to compete with incumbent banks across all product and service lines, but are seeking to target particular (niche) products or customers and/or to offer a differentiated service model (eg delivering through online channels). Some features of the demand side, in particular customers' willingness to engage through online channels, have facilitated this new type of entry and service innovation.

9.20 Recent developments on the demand side must be taken into account when assessing the extent to which barriers to entry and expansion exist in retail banking. For example, banking is increasingly becoming a self-serve activity and consumers, according to a report by Deloitte, expect greater convenience and 'seamless integration of remote and in-person channels'.[18] 85% of personal banking customers and 64% of SME customers now use online banking.[19] Customer interactions with their bank have also become much more frequent with the majority of online and mobile banking users logging on at least once a week.[20]

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[16] Based on data from Atom, Virgin Money, Tesco Bank, Starling, Metro, TSB and Fidor (estimates from Fidor of its growth is based on Fidor's German rates of expansion). Data harmonised to 2020 equivalent using linear interpolation/extrapolation from stated targets and years.
[17] Reuters (August 2015), 'Atom Bank taps video game technology to win mobile customers'.
[18] Deloitte report, *UK bricks and clicks*.
[19] 85% of personal banking customers: from GfK's PCA consumer survey. 64% of SME customers used online banking as their main channel in 2014: from Charterhouse BBS.
[20] 66% and 74% of PCA customers who use online and mobile banking respectively, log on to online (mobile) banking at least once a week: from GfK's PCA consumer survey.

9.21 This change in customer behaviour has enabled new business models to be brought to the market. For example, digital-only propositions supported by arrangements such as inter-bank branch sharing have become a feasible alternative. It has also led to other service innovations in the PCA and SME banking markets including Paym, cheque imaging, video banking and online account opening.

Regulatory barriers to entry

9.22 As described in Section 3, banks have to meet a number of regulatory requirements to enter retail banking markets and, once there, must meet a number of ongoing requirements to demonstrate that they are financially sound and have high standards of conduct. While regulation has an essential role to play in ensuring a well-functioning banking market and in protecting customers, if regulatory requirements are set too high or applied disproportionately they may hinder competition. Regulation has the potential to delay and even prevent new banks from entering. It can also hinder their expansion by systematically favouring incumbent banks. Incumbent banks will typically have more resources to bear the fixed costs associated with regulation, and the experience to meet regulation at a lower cost than new banks seeking to enter the market.

9.23 Our case studies[21] suggested that the main potential regulatory barriers to entry and/or expansion are the authorisation process and capital requirements. Whilst several larger incumbent banks submitted that there were no regulatory barriers to entry and/or expansion, new entrants and smaller banks submitted that one of the main barriers to entry and expansion was the capital requirements regime.

9.24 Parties, including those subject to our case studies, did not raise concerns on the need to comply with anti-money laundering (AML) requirements[22] as a barrier to entry or expansion and indeed several new entrants saw this area as one in which they could differentiate themselves. We did not receive in response to our provisional findings any evidence to suggest that AML regulations were a barrier to entry or expansion. AML regulations appear sufficiently flexible that their impact in practice will depend on different banks' approach to risk and how they elect to implement the regulations within their account opening processes. We consider how such account opening processes may contribute to barriers to PCA and BCA searching and switching in Sections 6 and 8 respectively.

[21] See Appendix 9.1.
[22] See Section 3 for further details on AML regulations.

9.25 During the course of this investigation the government made a number of changes to the bank tax regime and we received extensive submissions in particular from smaller banks that these changes adversely impacted smaller banks relative to the larger incumbent banks by limiting the former's ability to invest and expand and by dis-incentivising inward investment into UK retail banking.

9.26 We also received submissions from Santander that the banking reforms legislation requiring larger UK banks to separate fully certain core banking services critical to personal and SME customers from other banking services (so-called 'ring-fencing requirements') will:

(a) [✂]; and

(b) exacerbate, as a result of the ring-fencing threshold, the adverse effect of the qualifying declaration regime; this creates a competitive advantage for UK banks not subject to ring-fencing and non UK-headquartered banks, notwithstanding that these banks may have comparable market shares and SME revenues to Santander.

9.27 We note that the ring-fencing requirements were recommended by the ICB to meet prudential concerns following the financial crisis. They continue to be subject to detailed discussions on their implementation between the relevant banks, HMT and the BoE. It would not therefore be appropriate in the context of this investigation to directly assess their impact on competition and we have not therefore investigated further the ring-fencing requirements as a barrier to entry or expansion.

9.28 Appendix 9.2 contains further details on parties' views in relation to regulatory barriers. In light of the above, this section therefore considers the authorisation process, capital requirements and the introduction of the CTS and recent changes to the bank levy. In our summary conclusions on regulatory barriers in paragraphs 9.110 to 9.116 below, we also consider arguments from several parties that the impact of all bank regulation should be considered together and that it is the combination of regulatory barriers that is a barrier to entry and expansion.

Bank authorisation

9.29 As described in Section 3, to operate in the retail banking market, PCA and SME banking providers must apply for permission from the PRA.[23,24] Deposit-taking entities are dual-regulated by the PRA and the FCA and a single authorisation application must be made to the PRA. An entity seeking to carry on regulated consumer credit activities (which includes asset finance and overdrafts) must also apply for authorisation/the relevant permissions from the FCA. Following a joint review by the FSA and the BoE, changes have been made to the authorisation process which took effect from 1 April 2013, details of which are contained in Appendix 9.3.[25]

9.30 The PRA and FCA, in a review one year after implementation of the reforms,[26] found a number of positive developments, including:

(a) a substantial increase in the number of firms discussing with the regulators the possibility of becoming a bank; and

(b) an increase in the level of pre-application support offered to firms by both the PRA and the FCA.

9.31 In January 2016, in a joint initiative the PRA and FCA launched a New Bank Start-up Unit.[27] The objective of this unit is to further enhance the information and support available to prospective and new entrants. It is intended to offer a convenient single source from which potential entrants can obtain advice and guidance to start a new bank, and to provide a focused supervisory resource to support new banks during the early years of authorisation.

9.32 The PRA authorised seven new retail banks between April 2013 and October 2015; all but one of these banks applied for authorisation via the new Option B process (see Appendix 9.3) including Paragon Bank, Atom and OakNorth. Since October 2015, the PRA has authorised a further four new banks; two of which (Tandem Bank and Masthaven Bank) are retail banks. All but one of these banks applied for authorisation via the Option B process (see Appendix 9.3) and are still in the mobilisation phase of

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[23] Some types of provider do not need to be authorised. These are appointed representatives, professional firms that run regulated activities alongside their main business, and local authorities and some housing groups. See FCA firm authorisation.
[24] See FCA regulated activities for a list of regulated UK financial activities.
[25] BoE/FSA (March 2013), *A review of the requirements for firms entering into or expanding in the banking sector.*
[26] PRA/FCA (April 2014), *A review of requirements for firms entering into or expanding in the banking sector: one year on*.
[27] PRA/FCA press release, 20 January 2016. The unit was first announced by HMT in its November 2015 paper, *A better deal: boosting competition to bring down bills for families and firms*. See also the *New Bank Start-up Unit* website.

authorisation. In addition, six retail providers are currently in the application stage of the authorisation process and a further ten retail firms are active in the pre-application stage.[28]

9.33 There has been broad support for the changes to the authorisation process both from recent and prospective entrants. Our case studies on Metro, Virgin Money and prospective entrants provide more detail on some of these firms' experiences.[29]

9.34 Metro's founder and former chairman Anthony Thomson, now chairman of Atom, told us that the authorisation process for Atom had significantly improved since his experience with Metro in 2010, although lead times involved remained significant. In particular, Mr Thomson stated that the clearer structure of the process provided more clarity to firms. Starling and CivilisedBank have had similarly positive experiences and commented that the reforms had improved the authorisation process for entrants. Atom also told us that the capital requirements on entrants were much more realistic and proportionate today than they had been in the past. Atom, Paragon Bank and OakNorth also suggested, nevertheless, that the authorisation process remained a substantial exercise for firms seeking to enter retail banking.

9.35 In response to our provisional findings, no parties submitted further evidence to suggest that the authorisation process is a barrier to entry. Our finding on whether the bank authorisation regime is a barrier to entry is set out in paragraph 9.110 below.

Capital regulatory regime

9.36 The regulatory capital requirements regime exists to protect customer deposits, banks' trading counterparties and the economy from the effects of banks becoming insolvent. It does this by requiring banks[30] to hold sufficient levels of capital to absorb losses in the event of failure or near failure. It comprises a complex multi-tiered system with the requirements placed on banks reflecting their systemic importance, the nature of the portfolio of products and spread of assets of the bank and their ability and willingness to undertake their own risk weighting.

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[28] Based on June 2016 information from the PRA.
[29] See Appendix 9.1.
[30] As previously, in this report we refer to banks as including banks and building societies.

9.37 The framework of the system and the core determinants of the capital that a UK bank is required to hold are set internationally by the BCBS and implemented in the UK through maximum-harmonising EU legislation.[31] The PRA is responsible for ensuring compliance with these regulations in the UK.

9.38 A key element of the regime requires banks to hold a minimum amount of capital against their assets to protect against credit, market and operational risks and is structured as follows:

(a) **Pillar I: Minimum Capital Requirements** – This is the minimum amount of capital banks must hold to protect against credit, market and operational risk and is specified under the Basel Accords. Under existing minimum capital requirements banks have to maintain a minimum ratio of 8% capital to their risk-weighted assets.[32]

(b) **Pillar II: Supervisory Review** – This requires banks to hold an additional amount of capital to cover risks that are either not covered or inadequately covered under Pillar I. Unlike Pillar I, where the capital ratios are agreed internationally by the BCBS and placed into EU legislation through the CRD IV, Pillar II is firm-specific and set by national regulators, in the UK the PRA.

(c) **Pillar III: Disclosure** – This aims to complement Pillars I and II by seeking to foster greater market discipline through improved disclosure by all banks of their capital holdings and risk management practices.

(d) **Additional buffers** – In addition, all banks are required to hold a number of additional capital buffers, such as the capital conservation buffer and the countercyclical buffer.[33] For globally systemically important banks (G-SIBs),[34] an additional buffer is applied to reflect the added risks they pose to the financial system and the wider economy. Some of these buffers, such as the capital conservation buffer, are set by Basel and

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[31] The Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR).

[32] The ratio of a banks' capital to their risk-weighted assets is known as the Capital Adequacy Ratio (CAR). Risk-weighted assets are the total assets held by banks, each weighted for their risk. Risk weights can take a value of 0% to more than 100%.

[33] The capital conservation buffer is designed to ensure that banks accumulate sufficient capital in periods of credit growth which can then be drawn down when losses are incurred without requiring banks to draw from their minimum capital requirements. The capital conservation buffer is currently set by Basel at 2.5% of a bank's risk-weighted assets. The countercyclical buffer aims to ensure that levels of capital take account of the stage of the economic cycle. The countercyclical buffer can range from 0% to 2.5% and is set by the Financial Policy Committee (FPC) of the BoE. This is currently set at 0%.

[34] Banks classified as globally systemic are HSBCG, Barclays, RBSG, and Standard Chartered Bank. The globally systemic buffer will be phased in over three years starting in 2016. National systemic buffers for other major systemic banks in the UK will be set by the FPC and will be implemented in 2019. See the Financial Policy Committee's framework for the systemic risk buffer, May 2016.

transposed into EU legislation by the CRR and CRD IV[35] whereas others such as the countercyclical buffer, the globally systemic buffer and national systemic buffers involve a degree of discretion for the national regulator.

9.39 As a complement to the risk-based capital framework described above, the leverage ratio requires all banks to hold a minimum amount of capital to their total assets (regardless of the riskiness of those assets). The leverage ratio is intended to guard against banks becoming over-leveraged (ie holding too little capital relative to the liabilities they hold) and to protect against under-estimation of risk by banks and regulators. It effectively acts as a floor on the level of capital that banks have to hold and primarily affects banks with a high concentration of assets with low risk weights such as residential mortgages. It is currently set at a minimum of 3%.[36] [✂] are constrained by the leverage ratio, limiting IRB banks' ability to take advantage of the differential by holding large concentrations of low risk assets to benefit from lower capital requirements.

9.40 Under Pillar 1, assets are weighted according to their risk to ensure that banks with riskier lending portfolios hold more capital against their assets compared with banks that hold less risky assets.[37] Banks are able to use one of two approaches when calculating risk weights for credit risk:

(a) **The standardised approach (SA)** – risk weights set internationally by the BCBS, are based on data supplied from credit reference agencies (CRAs), and are transposed into UK law through the CRD IV.[38] The SA applies one risk weight to each asset class based on the broad type and credit quality of the counterparty (eg sovereign, commercial bank, corporate, retail).

(b) **The internal ratings based (IRB) approach[39]** – banks calculate their own risk weights based on their own internal risk models and data. The IRB approach is much more granular and is intended to better reflect the

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[35] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.
[36] Cf. PRA Policy Statement PS27/15.
[37] It is also designed to incentivise banks to hold low-risk assets. If banks were required to hold capital against all of their assets regardless of their risk, there would be incentives on banks just to hold more risky assets in order to maximise their returns. This is the rationale for using a combination of the risk-weighted framework and the leverage ratio.
[38] Risk weights for the SA are agreed internationally by the BCBS and set into legislation in the EU via the CRR. The EBA issues further technical guidance to national regulators on standardised risk weights.
[39] The IRB approach is also sometimes referred to as the model-based approach.

actual risks held by the bank. It requires a bank to have sophisticated risk models and good quality data on its own past lending. Banks approved to use the IRB approach, for example for mortgages, are required to use the IRB approach across all mortgage classes to avoid 'cherry picking' by banks.

9.41 This dual system means that depending on the approach that a bank adopts for calculating risk weights it will be required to hold different levels of capital for the same lending risk. In the UK, banks wishing to use their own risk models need to seek approval from the PRA, which will assess whether the bank meets the requirements to be IRB approved.[40] Because of the requirements and costs to be IRB approved, it is mostly larger banks that are IRB approved. Smaller banks and new entrants are generally on the SA, (see Table 3 of Appendix 9.3) although in relation to residential mortgages several smaller banks are IRB approved.

9.42 The advantage of becoming IRB approved is that, in better reflecting the actual risks of the assets held by the bank, banks with less risky portfolios have lower risk weights than would be the case under the SA. Analysis conducted by the PRA shows that, for certain asset types, there are significant differences in the risk weights under the SA and IRB approach – in particular for safer assets such as mortgage lending. For example, the SA risk weights for prime mortgages with an LTV of less than 80% are 35% (regardless of the precise LTV) whereas the weighted average risk weights under the IRB approach are between 3.3% and 12.7% depending on the precise LTV. For an SME loan, risk weights are between 66.1% and 89.5% for IRB banks and 100% for an SA bank. However, for some other assets, such as credit cards, the reverse is true. Table 4 of Appendix 9.3 provides a comparison of the risk weights for banks under the SA and IRB approach based on analysis conducted by the PRA.

9.43 Figure 4 in Appendix 9.3 illustrates the impact of different risk weights on banks' capital holdings. For example a bank on the SA seeking to provide a retail customer with a £100,000 residential mortgage with an LTV of 60% to 70% would have to hold approximately £2,800 worth of capital compared with £712 for a bank on the IRB approach based on the weighted average IRB risk weights.

[40] The standards that need to be met by banks to use the IRB approach are agreed internationally by the BCBS and set into legislation in the EU via the CRR. The EBA issues further technical guidance to national regulators to further specify the conditions that need to be met by banks to be authorised to use the IRB approach.

9.44 The costs of becoming IRB approved and maintaining IRB approval are significant.[41] Banks wishing to adopt the IRB approach have to make significant upfront investments in developing advanced risk models and infrastructure to support data collection and analyses. Specialist staff to run and maintain the risk models and management time in ensuring compliance with relevant regulations also materially increase the costs for an IRB approved bank relative to an SA bank. LBG submitted that its annual running costs of being IRB approved were approximately £[25–50] million.[42]

9.45 Importantly, a significant impediment to banks adopting the IRB approach is data availability. Banks need to hold significant historical data on their lending in the relevant asset classes – data such as information on the probability of default and the loss given default – in order to be able to model credit risk under the IRB approach. Specifically, banks are required to hold a minimum of three to five years' worth of detailed lending data in the relevant asset class. In practice data is required for longer periods and banks must demonstrate that they have been using such data for internal risk management for at least three years. While it is possible to use pooled data sources, such data must be representative of the relevant bank's own asset portfolio and risk.[43] This can be difficult to achieve.

9.46 The regime applies in the EU across all banks, irrespective of their business model and the scale of their activities. In the USA, by contrast, there is a graduated system: the largest internationally active banks are subject to the full Basel regime like EU banks, whereas other banks are subject to a regime under which the level of supervision and the capital requirements vary depending on whether the bank is a national, regional or community bank.

9.47 There are currently a number of developments being considered by the BCBS that may change the future approach to calculating risk weights which are summarised in Appendix 9.3. In particular in March and December 2015, the BCBS published consultations on proposed revisions to calculating risk weights for credit risk.[44,45] The revisions are intended to address existing 'weaknesses' in the SA to credit risk, and seek to move from the current flat risk weights for mortgages to a more granular approach. The BCBS is also consulting on the design of a standardised floor to be applied to all IRB

[41] See further Appendix 9.3.
[42] LBG response to addendum to provisional findings, paragraph 24.
[43] See *Prudential sourcebook for Banks, Building Societies and Investment Firms: Chapter 4, The IRB approach*.
[44] BCBS (March 2015), *Revisions to the Standardised Approach for credit risk*, consultative document.
[45] BCBS (December 2015), *Revisions to the Standardised Approach for credit risk*, second consultative document.

banks. These consultations form part of broader work to reduce variations in capital ratios across banks.[46]

9.48 In addition, the European Commission has been consulting on the proportionality of the CRR and CRD IV.[47] In its consultation, it states that 'the requirements of the CRR and CRD IV, particularly those relating to credit and other prudential risks, are of general application to all financial institutions, without any distinction being made on the basis of size, business model or business line and are designed to ensure a level playing field.' However, it notes that smaller banks may be less able to spread the fixed overheads of these regulations over their activities. Further it notes that the standards set by the BCBS, on which the CRR was to a large extent based, were originally designed to apply to internationally active institutions only but a conscious decision was made for the requirements of the CRR and CRD IV to apply more widely. It is now consulting on whether the CRR should allow for more differentiation on how the requirements are applied to banks of different sizes as in the USA. The BoE and the PRA are supportive of this development and agree that a more proportionate approach could be adopted on many aspects of the regime.[48]

9.49 In July 2016 the PRA published its first annual competition report[49] setting out how it is delivering against its secondary competition objective to act to facilitate effective competition. In relation to capital requirements, the PRA confirms that it will continue to work to narrow the gap between capital requirements based on the SA and those based on the IRB approach where they are unduly large by making the SA more risk sensitive and by constraining internal models from producing excessively low capital. The PRA has also undertaken a review to consider whether its approach to the IRB application process could be made more proportionate for smaller banks and building societies without undermining the credit risk management standards that the IRB approach requires. It recently held meetings with a number of banks aspiring to be IRB approved and is in the process of providing greater clarity on the requirements for IRB approval, making additional resources available to support banks seeking IRB authorisation. It

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[46] For further information, please see BCBS (November 2014), *Reducing excessive variability in banks regulatory capital ratios: A report to the G20.*
[47] DG FISMA consultation paper on the possible impact of the CRR and CRD IV on bank financing of the economy. For responses see http://ec.europa.eu/finance/consultations/2015/long-term-finance/docs/summary-of-responses_en.pdf.
[48] For further information on the BoE's response to the consultation, please refer to EUSurvey, Published Results: long-term-finance-2015.
[49] PRA Annual Report 2015/16.

is also reviewing its requirements regarding data including the use of external data to supplement banks' own data.

Parties' views

9.50 Several of the larger banks[50] were generally of the view that regulatory reforms had or were in the process of levelling the playing field between SA banks and IRB banks. They submitted that any advantages from being IRB approved were largely, if not completely, offset by additional capital requirements placed on systemically important banks and the costs in obtaining and maintaining IRB approval. These include additional capital requirements, those under the BoE stress testing framework and the various capital floors being introduced. Moreover, in their view, the PRA was already taking appropriate action to reduce the differential between IRB and SA banks and was best placed to take any residual issues forward. LBG submitted that future changes to regulatory capital requirements, possibly including risk weighting floors, may have a material impact on differences between the IRB approach and SA and needed to be considered as part of any analysis of pricing. LBG also argued that it was necessary to look at other regulatory costs such as the provision of fee free basic bank accounts and the funding of CASS in assessing whether the regulation of banks was a barrier to entry or expansion rather than looking at capital requirements in isolation.[51]

9.51 Smaller banks,[52,53] however, including incumbents as well as recent entrants, told us that capital requirements were a significant barrier to entry and expansion. Such banks stated the following:

(a) The uniform application under EU legislation of the regime to all banks was not proportionate and put smaller banks at a competitive disadvantage to larger banks as it was harder for smaller banks to bear the regulatory burden of a one size fits all regulatory regime. Several banks submitted that the USA did not apply a uniform system to all banks and that it had one of the most competitive banking markets.

(b) The wide differentials in risk weights between the SA and IRB approach favoured IRB banks which were invariably large incumbent banks and

[50] HSBCG, RBSG and Barclays. See further Appendix 9.2.
[51] LBG response to addendum to provisional findings, paragraphs 26 and 34.
[52] See Appendix 9.2.
[53] The Building Societies Association told us that there were potential competition concerns in relation to the proposals for bail-in requirements as part of bank resolution (see Appendix 9.2). We have not considered these any further as the BoE is considering these issues as part of its ongoing consultation and implementation of its bank resolution proposals.

was not justified on prudential grounds. Secure Trust submitted for example that SA banks on a risk weight of 35% had between 218% and 700% capital disadvantage relative to IRB banks.

(c) High costs and extensive data requirements meant that it was very difficult for smaller banks and new entrants to be IRB approved.

(d) The very high capital requirements on residential mortgages and, to a lesser extent SME lending, under the SA relative to the IRB approach made it very difficult for smaller banks to generate sufficient returns on capital except in riskier assets. To make sufficient returns, smaller banks had to compete in areas where IRB banks did not compete and/or where they may have a competitive advantage under the regime (eg lending on riskier assets). This in turn also made it more difficult to become IRB approved as such banks would not acquire the relevant data from lending in the relevant asset classes to become IRB approved.

(e) Mortgage lending was the most profitable activity for retail banks and lower LTV mortgages accounted for over 70% of the residential mortgage market. The differential in capital requirements in residential mortgages required SA banks to hold 10 times more capital than IRB banks putting SA banks at a significant price disadvantage in mortgage lending. It also resulted in IRB banks being able to lend at least twice as much for the same capital as an SA bank. This resulted in IRB banks, in particular the larger incumbent banks, having a stranglehold on the mortgage market. This, they submitted, was why, despite new entrants in the retail banking market, there had been no new entrants that were focused on residential mortgage lending.

(f) Higher risk weights in residential mortgages for SA banks also made it more difficult for SA banks to raise capital, as expected returns would be significantly lower than for large banks using an IRB approach. It also reduced the incentives on banks to seek low cost sources of funding by entering into or expanding the provision of PCAs and BCAs.

9.52 In addition, a number of smaller banks submitted that IRB banks were able to use low LTV mortgage assets as collateral giving them significant funding advantages in the wholesale markets and in accessing government funding. We discuss in more detail in paragraphs 9.60 to 9.65 below the potential impact on banks’ cost of funds for lending of higher capital requirements in residential mortgages.

9.53 Sir John Vickers also raised competition concerns[54] in relation to the FPC's proposals on which the BoE has been consulting for the implementation of the systemic risk buffer for large ring-fenced banks. The BoE subsequently considered Sir John's competition concerns in its proposals for the systemic risk buffer published in May 2016.[55] It recognised that there was a potential for competitive distortions inherent in any step-system of the type proposed for the systemic risk buffer depending on where the relevant thresholds were set. It also noted that other approaches such as a flat rate system would similarly give rise to potential distortions (indeed greater ones) and that whilst an income tax style approach may have advantages the current regulations precluded such an approach. Given the stage at which these issues were raised in the investigation and in light of the BoE's lead role in implementing the systemic risk buffer and consideration of the points raised by Sir John, we took the view that there would not be any added value in the investigation undertaking analysis in this area.[56]

Framework for our analysis

9.54 In light of the above we have focused our analysis on the differential in capital requirements between IRB and SA banks. Barriers to entry and expansion give at least some incumbent firms an advantage over efficient potential firms or rival incumbent firms, either by reducing the expected profits, or increasing the expected costs, of entry or expansion.[57] As described above the current dual system of calculating risk weights means that banks will have different capital requirements for the same lending depending on the approach they are under for calculating their capital requirements and the evidence that the difference in risk weights at least is significant. This level differential in capital could lead to a regulatory barrier to entry and/or expansion in retail banking services, through affecting the returns banks receive on retail deposits.

9.55 The capital requirements regime may also lead to SA banks having a reduced ability to compete because of the differential risk weights between SA and IRB banks: higher risk weights mean more capital is allocated to the lending, which leads to a higher cost of funds for banks. These higher costs of funds for SA banks may in turn influence SA banks' pricing for lending products, reducing their ability to compete with IRB banks for lending. In Table 5 of Appendix 9.3 we set out an illustrative example in which we

[54] See Appendix 9.2.
[55] The Financial Policy Committee's framework for the systemic risk buffer, May 2016.
[56] See Sir John Vickers response to addendum on provisional findings and our response.
[57] Guidelines, paragraph 207.

calculate the cost of funds for a £100,000 mortgage using risk weights under the SA and the weighted average IRB risk weights for different LTV bands. In this illustration, we assume that the required return on equity is 12%[58] and the average interest the bank pays on its debt is 2%. In this illustration, in order to demonstrate the impact of risk weights on the cost of funds, we allow only risk weights to vary.[59]

9.56 As Table 5 of Appendix 9.3 shows, the applicable risk weight determines the share of the £100,000 loan that is financed through debt and the share that is financed through equity. Since debt is cheaper than equity – in this example we have assumed the difference to be 10% – using more debt to finance the loan results in a lower cost of funds. The larger the difference between the cost of equity and the cost of debt, the greater the impact of having a higher risk weight. While the calculation is only illustrative, it shows that a firm that switches from the SA to the IRB approach could reduce its cost of funds by around 10 to 20 basis points.

9.57 Where SA banks have a higher cost of funds at lower LTVs compared with IRB banks, this may lead to SA banks having higher mortgage prices. However, the link between risk weights and pricing is not straight forward. Any cost of capital advantage gained by IRB banks will only be observed in mortgage pricing to the extent that they pass their lower capital costs through to customers in the form of lower prices. Instead, banks on the IRB approach might benefit from lower capital requirements through higher margins. This will depend on the intensity of competition in the provision of the relevant lending. In addition, becoming IRB approved requires a considerable upfront and ongoing investment such that IRB banks may seek higher returns than non-IRB approved banks to recoup this investment.

9.58 If it is the case that SA banks charge higher prices because of having higher risk weights than IRB banks, this competitive disadvantage (in the form of lower market shares and/or lower margins in lending markets) would determine the extent to which SA banks have lower returns on equity and

[58] Given the performance of banking shares in the last five to ten years – cf. for example MSCI Europe Financials Index – it is unclear what the best estimate of the required return on equity for banks is. However, based on the data provided by MSCI, we consider that 12% is a reasonable estimate of the average total return on equity for banks in recent years. However, Atom submitted that whilst a 12% return may be appropriate for an established bank, with a diversified set of assets, for new banks to attract equity, returns of approximately 25% are required in particular for a new bank with a higher risk asset profile (see Atom response to addendum to provisional findings, p2). LBG similarly raised concerns over the assumptions made on the rate of return and debt interest which in its view drove the results (see LBG response to addendum to provisional findings). Our calculation is only illustrative and we recognise that for new banks higher rates of return may be required than the average assumed for all banks and that the potential benefits of holding less capital will be at least partly offset by the resulting increase in the cost of equity.
[59] However, other factors which affect mortgage prices also vary between IRB and SA banks. For example, IRB banks tend to be larger and more diversified than banks using the SA, which could lead to lower costs of debt and equity.

deposits compared with IRB banks, along with SA banks' ability to offset any disadvantage through alternative investment options. This disadvantage could lead SA banks to have a reduced ability to compete in retail banking more generally, with product offerings that are less competitive and less investment in innovation. This could reduce the attractiveness of investments in SA banks compared with the next best alternative investment. Ultimately this could deter entry into retail banking.

9.59 We have therefore sought first to compare the differential in the capital requirements (not just risk weights) under the IRB approach and the SA for residential mortgages and for SME lending. In light of that comparison, in order to assess how the differential in capital requirements we found in residential mortgages might impact on competition between retail banks, we then examine three indicators of a potential competitive disadvantage for SA banks in the provision of mortgages: mortgage prices using the preliminary results of the econometric analysis undertaken by the PRA; banks' mortgage balances to assess the importance of mortgages to banks' retail banking businesses; and banks' mortgage portfolios as we would anticipate that SA banks would have a higher proportion of their mortgage portfolio in higher LTV mortgages, where the difference in risk weights between SA and IRB banks is smallest.

Comparison of capital for banks under the IRB approach and the SA

9.60 As described in paragraph 9.42 above, we have found that the risk weights under the SA are significantly higher than under the IRB approach for residential mortgages[60] and for SME lending. In considering the impact of capital requirements on competition, it is important however to examine the differential costs created by the capital regulatory framework as a whole rather than only the risk weight differentials under Pillar I.

9.61 A number of banks[61] submitted that it was not necessary to look at other capital costs imposed under the regime, such as capital buffers for systemic banks, as these were imposed for different reasons. In considering whether or not SA banks are at a competitive disadvantage, it is necessary to look as far as possible at the whole costs of the capital regime rather than isolating only one element of the regime, for example, risk weights under Pillar I. It is also necessary to consider how the capital regime interacts with other

[60] While there is evidence of a similarly large differential in the risk weights for buy-to-let mortgages, in order to focus the analysis, we have only considered residential mortgage loans. In the remainder of this section, when we refer to mortgages we mean residential mortgages.
[61] See Appendix 9.2.

potential barriers to entry, specifically the fact that additional capital buffers seek to address for example prudential concerns around 'too-big-to-fail' following the financial crisis.[62]

9.62 Conversely LBG submitted that we had not taken into account all the costs of the capital regime or other regulatory costs incurred only by larger banks. We recognise that we have not been able in our analysis to include all the costs of the capital regime or other costs of the wider prudential regulation of banks which also impose varying costs on different banks.[63] Although we recognise the limitations of our analysis, we consider that by taking into account the main elements of the capital requirements regime, this provides an indication of the extent of any differential between SA and IRB banks for the purposes of our analysis.

9.63 We therefore analysed the differential in capital requirements between SA and IRB banks using PRA data on Pillar I requirements, Pillar II requirements for individual banks, the values of capital buffers for all banks and buffers for globally systemic banks when issuing a £100,000 residential mortgage and £100,000 SME loan. Full details of this analysis are contained in Appendix 9.3. In relation to SME lending, once the main components of the capital framework and the particular circumstances of individual SA banks are taken into account, the differential in risk weight under Pillar I between the IRB approach and SA for an SME loan of £100,000 is broadly eliminated.[64]

9.64 However, as illustrated by Table 7 of Appendix 9.3, even taking account of Pillar II and the additional buffers, SA banks face significantly higher capital requirements compared with banks on the IRB approach for a £100,000 residential mortgage.[65] The difference varies from approximately £4,500 for low-LTV mortgages to about £2,000 for mortgages with a higher LTV. The PRA confirmed to us that, whilst it is necessary to maintain some gap between banks on the SA and the IRB approach to incentivise better risk management, the differential between the SA and the IRB approach on residential mortgages is larger than could be considered adequate or justified on prudential grounds.

9.65 We therefore focused our analysis on the impact of the residential mortgage differential on competition between banks as any impact on competition is

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[62] See further below on costs of funding.
[63] LBG in particular argued that our analysis should take into account the costs of becoming and maintaining IRB status as well as wider regulatory costs of larger banks which are not borne by smaller banks such as the provision of fee free basic bank accounts and the funding of CASS.
[64] See Table 6, Appendix 9.3.
[65] Unless the leverage ratio is the binding capital constraint.

likely to be far greater given the significant differential in residential mortgages than in SME lending.

Mortgage prices

9.66 Figure 5 of Appendix 9.3 shows that average interest rates have declined for all banks across all mortgages since 2008, but declined most for IRB banks on lower LTV mortgages (LTV less than or equal to 70%). The effect of this is that the average price gap between IRB and SA banks for lower LTV mortgages is now much larger than for higher LTV mortgages.

9.67 While the change in the capital requirements regime occurred at the start of 2008, it cannot be presumed that this explains the decline in average interest rates. Factors other than risk weights are likely to have had a substantial effect on firms' pricing of mortgages in this period. Some factors are likely to have been materially affected by the onset of the financial crisis in 2008, which in turn will have affected banks very differently.[66] For example, the financial crisis had a substantial impact on funding costs: funding costs will have been impacted by cuts to the BoE base rate and increased spreads on wholesale funding. Funding costs also vary across banks, and IRB banks tend to be larger and, therefore, as in many sectors, tend to have cheaper access to wholesale funding, reflecting relative differences in terms of perceived riskiness and reliance on this source of funding.

9.68 The financial crisis also witnessed an industry-wide trend for increases in the relative price of higher LTV mortgages compared with lower LTV mortgages. Before the crisis, average interest rates on lower and higher LTV mortgages were similar, suggesting that risk did not strongly affect pricing. Increases in higher LTV prices will therefore to some extent reflect the more accurate pricing of risk after the financial crisis.

9.69 To precisely estimate the impact of risk weights on mortgage prices and to better control for other factors that could affect these prices, it is necessary to use econometric techniques.[67] The PRA has started a programme of econometric analysis, details of which are presented in Appendix 9.3 .The PRA has explored three different econometric approaches:

(a) The **regime change model** uses the change in the regulatory regime in 2008 as a natural experiment to test how the change in risk weights affected banks' mortgage pricing. It considers the difference in prices

[66] These factors are likely to include: required capital ratios; 'normal' return on unit capital; taxation; operational costs; business model/pricing strategy: LTV preferences; market power; interest rate risk; and credit risk.
[67] For other factors that could affect prices, all of the models discussed below include controls for borrower type, interest rate type and loan-to-income ratio.

between IRB and SA banks, comparing pre- and post-2008, and between high and low LTVs (a 'triple difference' approach).

(b) The **IRB switch model** uses a more sophisticated statistical approach to control for other factors that may affect prices (a 'fixed effects' approach). It also reflects the specific date on which relevant individual banks adopted the IRB approach (as this does not necessarily coincide with the regime change at the start of 2008).

(c) The **historical risk weights model** also applies a fixed effects approach but rather than simply considering whether each bank used the SA or the IRB approach, instead exploits more granular data on their specific risk weights as the main explanatory variable of interest.

9.70 The PRA's analysis is provisional and the PRA intends to undertake further work to refine and test the robustness of its models. Nevertheless, the sensitivity and robustness checks that have been undertaken on the models by the PRA, provide a clear indication of the overall direction of the results, if not the precise magnitude of the impact on mortgage prices of the differential in mortgage risks weights. Overall, we observe a fairly consistent picture that higher risk weights result in higher mortgage prices for lower LTV mortgages. While some specifications suggest the magnitude of the effect may be substantial, there is some uncertainty surrounding this, as estimates of the magnitude vary between the models[68] and some important factors affecting mortgage pricing are not controlled for in the current models: for example, credit risk of the borrower is not fully controlled for because of a lack of data, which may result in an overestimation of the impact and securitisation, which conversely may result in underestimation of the impact; the fees element of pricing is not included; and only initial mortgage rates at the time the loan was originated are included in the analyses.[69] Overall, the fact that we find a relationship between risk weights and prices, though there is some uncertainty over the magnitude of this effect, suggests that competition in the provision of mortgages between IRB firms is leading IRB banks to pass at least some of the risk-weight benefits to customers.

[68] Atom submitted that its own estimate of the magnitude of the disadvantage between SA and IRB banks in the pricing of lower LTV residential mortgages was similar to the PRAs results. In its view a disadvantage of 40 to 50 basis points would cost a customer with a £150k mortgage an extra £700 approximately per annum. This differential would be too great for the product to be competitive (see Atom response to addendum to provisional findings, p3). We do not disagree that such a disadvantage would be significant but recognise that the PRA's analysis is provisional and that some models suggest that the magnitude of the disadvantage may be significantly less than 40 to 50 basis points. See Appendix 9.3.

[69] LBG submitted that the PRA's analysis did not sufficiently account for the costs of becoming and staying IRB approved. It is unclear how to the extent such costs are sunk they should impact on mortgage prices and we assume that annual fixed costs are fully reflected in banks' mortgage pricing.

Mortgage balances

9.71 As set out in Section 2, we reviewed selected industry publications, reports by equity analysts and consulting firms to understand key profitability drivers of retail banks in the UK, as well as emerging trends from their recent financial performance. We found that the provision of mortgages is the most profitable line of business for many of the UK's banks and that the largest of the UK banks have higher than average mortgage profitability. However, the reports we reviewed mainly covered IRB banks, meaning that our ability to compare profitability between IRB and SA banks is limited. Nevertheless, two of the three SA banks in the review (Clydesdale and Yorkshire Building Society) were shown to have the lowest returns on their mortgage businesses in the year analysed (FY 2013), with a reported return on equity of 11.3% and 12.6% respectively, compared with an average of return on equity of 24%. The other SA bank included in the report, BoI, had a reported return on equity of 17.8%.

9.72 We asked banks for data on their mortgage portfolios and total retail banking assets for each year between 2011 and 2014. The submissions included nine IRB banks and six SA banks, with a further four SA banks[70] reporting no mortgage balances being held. While the approach used to allocate assets to retail banking will differ between banks and is a snapshot of a limited number of banks, we nevertheless consider that this assessment allows for a broad indication of the importance of mortgages to a bank's retail banking business.

9.73 As is shown in Table 8 of Appendix 9.3, in 2014 total mortgage balances for the nine IRB banks exceeded £800 billion, compared with £[✄] billion for the six SA banks, almost £[✄] billion of which relates to one SA bank. Among the six SA mortgage banks, two banks had approximately [40–60]% of their UK retail banking assets held as mortgage assets; the other four SA banks had between [10 and 40]%. The evidence shows that the majority of SA banks hold a considerably lower proportion of their total retail assets in mortgages as compared with IRB banks, although we note that the data is limited and data definitions used by banks may not have been wholly consistent. Several SA banks report no mortgage balances including a number of new entrant banks. Conversely, IRB banks hold a high percentage (approximately [60 and 100]%) of their retail assets in mortgages. This evidence is therefore consistent with the hypothesis that SA banks have a reduced ability to compete in the provision of mortgages.

[70] Atom Bank, Paragon, Secure Trust and Shawbrook.

9.74 If SA banks have a reduced ability to compete in the provision of mortgages, this will impact upon the returns on equity and deposits received by SA banks if alternative investment options do not mitigate the disadvantage. We have not sought to try to quantify the size of the SA banks' disadvantage, but the high proportion of mortgage assets held by IRB banks in an area that is the most profitable for many of them is suggestive that mortgages are an important investment option, and that alternative investments are unlikely to provide commensurate returns to SA banks.

9.75 Some banks have entered retail banking with business models that do not include mortgages, some SA banks have a strong retail banking presence in their respective geographical areas and one SA bank is expanding in retail banking with a relatively small mortgage balance. This may suggest that alternative business models are available to banks to compete in retail banking and/or that factors other than risk weights may explain why SA banks generally hold a materially lower proportion of their retail assets in residential mortgages compared to IRB banks. A fuller picture would require an assessment of the proportion of residential mortgage assets held by a greater number of banks through time and a comparison of this to their ability to compete in retail banking markets. It would also need to consider other factors that influence a bank's choices of investment, including its individual business model and risk appetite.

Mortgage portfolios

9.76 We found above that SA banks have higher mortgage prices as compared with IRB banks because of the higher risk weights under SA. Since the difference in risk weighting between SA and IRB banks is most pronounced for lower LTV mortgages, SA banks are likely to be at a particular pricing disadvantage compared with IRB banks in the provision of lower LTV mortgages. The proportion of mortgage assets SA banks hold in lower LTV mortgages as compared with IRB banks may provide some indication of the materiality of this disadvantage in winning business.

9.77 The data received from banks suggests that the mix of mortgage assets between LTV bands varied substantially between IRB banks, between SA banks and across the two types. For example, in 2014, for the 80% and above LTV bands, IRB banks have shares of mortgage assets between [0 and 30]%, compared with SA banks with a range of [0–60]%.

9.78 We have also considered whether there has been a change in banks' mortgage portfolios stock since the introduction of the new capital requirements regime in 2008. The data we have suggests that, between

2011 and 2014, IRB banks[71] increased the percentage of their mortgage assets within the 0–50% LTV band by between 1% and 20%. Among SA banks that operated in 2011, [✂] showed an increased proportion of assets within 0–50% LTV over the period 2011 to 2014, [✂].

9.79 Analysis undertaken by the PRA on mortgage origination (rather than mortgage stock as above), shows that SA banks have increased the proportion of high LTV loans (loans with LTV above 70%) in their portfolio since 2007 by around 10% (see further Figure 7 of Appendix 9.3).

9.80 We summarise our conclusions on capital requirements in paragraph 9.111 and 9.112 below and our findings on whether the capital requirement regime is a barrier to entry and/or expansion are set out in paragraph 9.285 below.

Corporation tax surcharge and bank levy

9.81 During the course of the investigation, the UK government introduced the CTS on banks (including building societies) and announced changes to the bank levy including a reduction in the headline rate from 0.21% to 0.10% over the next six years. A number of parties expressed significant concerns with these changes, details of which are set out in Appendix 9.2.

9.82 Taxation policy is a matter for government and Parliament. The stated objectives of the changes broadly relate to raising revenue in a more sustainable and fairer way from the banking sector, reflecting the risks the banking system poses to the UK economy. Competition was not an objective of this policy, although HMT submitted to us that the resultant tax regime was consistent with the government’s objectives to see greater competition in banking.

9.83 We have considered whether the tax changes in combination lead to differential impacts across banks and whether the changes could deter entry or expansion in, or indeed lead to exit from, retail banking. We have not sought however to evaluate the policy objectives of the bank tax regime changes themselves, although such objectives provide an important context to our assessment of the potential competition impact of the changes. Similarly, we have not considered any wider effects of the tax regime changes beyond any potential competition impacts or the implications of the changes to the range of non-retail banks affected by the tax changes.

[71] Considering those IRB banks which were operating since 2011.

9.84 The levy takes the form of an annual charge on the value of all of the liabilities of the UK banks on a global basis, with a number of exemptions.[72] In particular, the first £20 billion of any bank's taxable debts are exempted. The levy is not a tax on bank profits, but rather on the size of the balance sheet, and therefore has to be paid even when a bank does not make any profit.[73] The levy rate was set at 0.05% at its introduction in 2011 and rose to 0.21% by the budget in March 2015. The bank levy raised £2.2 billion in 2013/14.[74] Approximately 25 banks in the UK are subject to the bank levy, including non-retail banks. Barclays, HSBCG, LBG, Nationwide, RBSG and Santander are currently subject to the levy. Other providers of PCA and SME banking services are currently exempt because their balance sheet liabilities are less than £20 billion.

9.85 When considering the bank levy liability as a proportion of UK profit, there is substantial variation between banks in the ratio of the bank levy to profits. We estimate that the bank levy costs the six largest banks on average [15–20]% of their taxable profits. This variation is driven by the exemptions to the levy, reflecting differences in the composition of banks' balance sheets.

9.86 In the summer budget in July 2015, it was announced that there would be a stepped reduction in the bank levy rate from 0.21% to 0.10% over the next six years, and that from 2021 the levy would only be charged on UK balance sheet liabilities. As the bank levy is charged at the balance sheet date, the new rates affect periods ending after 31 December 2015.

9.87 The Chancellor also announced a new supplementary tax on banking sector profit of 8% to be levied on the profits of all banks and building societies arising after 1 January 2016 (the CTS). The new tax surcharge will be collected alongside corporation tax, similar to the collection of the bank levy.

9.88 The CTS applies to 'total taxable profits' computed for corporation tax purposes, excluding group relief from non-banking companies. Losses arising prior to 2016 are also excluded, which effectively excludes any legacy losses incurred during the financial crisis and start-up losses of recent new entrant banks.[75] There is no carry-forward of unused allowances but

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[72] See further Appendix 9.3.
[73] Unless otherwise specified, profit refers to profit defined for corporation tax purposes.
[74] HMT, Whole of Government Accounts, p83.
[75] Whilst the government introduced restrictions in the 2014 Autumn Statement on the proportion of banks' profits that can be offset under standard corporation tax by historical losses (ie losses incurred prior to April 2015) a specific carry-forward allowance was included for building societies. In addition, losses incurred during a bank's start-up period (defined as five years from the point it began trading) were however exempt from the restrictions on carrying forward losses under standard corporation tax.

there is a £25 million annual allowance, so banks with profits below that level will not pay the surcharge. HMT estimated that between 60 and 100 banks are potentially within scope of the CTS and above the annual allowance.

9.89 HMT submitted to the CMA that the six larger retail banks would remain subject to the bank levy, from which smaller retail banks were exempt due to the £20 billion threshold, and would have an effective additional bank tax rate of 10% or more as a percentage of profits (taking the bank levy and the CTS together). This compares to a bank tax rate of less than 8% for smaller banks with an effective additional rate for the smallest banks of 0% because of the £25 million CTS annual allowance. Around 90% of building societies are not within the scope of the CTS and for banks whose profits are above the £25 million the effective tax rate increases gradually. HMT also noted that it was important to look at the overall bank tax regime and other features of the corporation tax regime which benefit smaller banks including an exemption to the 50% limit on historical losses for losses incurred during a bank's start-up period (ie prior to April 2015) that banks may carry forward to offset their general corporation tax liability.[76]

9.90 As described above the CTS is a tax on accounting profit.[77] As such, this is less likely to distort banks' incentives on price and quality than other forms of taxation. Nevertheless, a tax on profits has the potential to distort banks' investment incentives and the introduction of the CTS will, all else equal, increase the tax liability of both existing banks and potential new entrants. This will lead to a reduction in the rate of returns earned, which would be expected to reduce the attractiveness of investments in banking compared to the next best alternative investment.

9.91 With respect to the bank levy, the reduction in the rate of the levy will, all else equal, result in a decrease in the total tax liability for banks which exceed the £20 billion tax free threshold. We would expect banks to pass through some proportion of this reduction into lower prices or improved service quality. The composition of a bank's balance sheet will also determine how large this reduction will be due to the exemptions built into the levy design.[78]

9.92 In considering the combined effect of the tax changes, we therefore need to consider: the financial impact of the tax changes (and how this varies

[76] See above on position of losses under corporation tax and also HMT submission on the taxation of banks.
[77] Note that the CTS applies to an accounting rather than economic definition of profit. As such it is theoretically possible that a bank is liable to pay the CTS even though it is not covering its cost of capital (and is therefore not making economic profit).
[78] ie banks with a higher proportion of short-term debt versus retail deposits, government-backed debt and long-term debt will benefit the most from the reduction in the rate of the levy.

between banks); and whether and to what extent the tax changes may affect the ability and/or incentives of banks to enter, expand or exit. The proportionate increase in the total tax liability for larger banks (ie those that are subject to the bank levy and the CTS) may be less than that experienced by some smaller banks. We also note that for some banks (depending on the size and composition of their balance sheet) the combined impact on their tax liability may be negative.[79]

Quantification of the financial impact of the changes

9.93 We examined the impact of the changes on the projected tax liabilities of different banks before and after the changes to the bank levy rates and the introduction of the CTS using data provided to us by HMT from banking groups' 2014 annual reports. Whilst this approach is likely to overstate the impact of the changes,[80] our interpretation of this data is that it broadly shows that the six largest banks (ie those that incur the bank levy) experience an increase in their effective tax rate of between 4 and 6 percentage points. Of the other banks analysed, those with profit below the £25 million tax-free threshold do not experience any increase and those with profit above the threshold experience an increase of up to 7 percentage points.

9.94 We also asked the banks to provide internal documents (including management reports, executive/board papers or strategic plans) which cover the impact of the changes to the tax regime and its potential impact on their business. Where this was not covered by the above material, we also asked each bank to provide its own quantification of the impact of the bank levy and CTS. More detailed information on the evidence provided to us by each bank and the caveats in interpreting the material can be found in Appendix 9.3.

9.95 Table 11 in Appendix 9.3 provides an overview of each bank's estimation of the impact of the changes in the tax regime on their tax liability. While there are a number of caveats which limit the comparability of the estimates between banks, we consider that the estimates provide useful information on the size and overall direction of the tax changes. Because the changes in the

[79] We also note the possibility that the uncertainty associated with changes to the tax regime may have a differential impact on banks, even if the financial implications are similar. This could be the case if there is uncertainty over future levels of taxation and larger banks are better placed to manage this uncertainty. We note, however, that this is a feature in common with all taxes and regulatory interventions. Furthermore, the government has legislated the rates of the bank levy out to 2021 with the specific aim of reducing uncertainty for banks (see HMT, Summer Budget 2015, paragraph 1.204, p46).
[80] Because it does not take into account the change in the base to the bank levy from global to UK balance sheet liabilities in 2021 which will benefit banks with significant international exposure.

bank levy impact banks' tax liabilities in a different direction to the introduction of the CTS, it is useful in considering the estimates to distinguish between banks which incur the levy and banks which are exempt from the levy.

9.96 As detailed above, six retail banks incur the levy. Our estimates suggest that initially in 2016, all six banks experience a net increase in their tax liability because the introduction of the CTS is not fully offset by the reduction in the rate of the levy. However, there is some variation in the level of the increase between banks. In aggregate, we estimate that the six levy paying banks will pay around £850 million more in 2016, with [✂] relating to LBG.

9.97 By 2021, when the levy only applies to UK liabilities and the full reduction in the rate of the levy has occurred, the direction of the net impact varies between the banks depending on the scope of their international activities. In aggregate, the tax liability of the six banks which incur the levy will increase by approximately £200 million (relative to the expected tax liability in 2021 before the introduction of the changes).

9.98 Banks that do not and will not pay the levy will experience no offsetting benefit from the reduction in the levy rate. Overall we estimate that the group of 17 retail banks included in our analysis which are exempt from the levy but liable for the CTS will experience a net increase in tax liability of around £75 million to £95 million in 2016, potentially increasing to £150 million to £170 million in 2021. We note that this group of banks includes both recent entrants as well as established banks with large market shares in the relevant geographic market in which they operate (for example AIB, BoI and Danske).

9.99 In response to our working paper, a multiparty submission[81] from a group of 'challenger' banks[82] cited a piece of research by the Sheffield Political Economy Research Institute which stated that the cost of the surcharge for smaller banks would be greater than that for larger banks as a proportion of total liabilities, raising questions about whether the new surcharge would undermine competition in banking. We note that there are some important limitations (both data and methodological) to the analysis carried out by the Sheffield Political Economy Research Institute such that the results are less robust than our estimate based on banks' own data.

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[81] Multiparty submission from a group of 'challenger' banks in response to the CTS and bank levy working paper.
[82] Aldermore, Charter Savings Bank, Close Brothers, Hampden & Co. Bankers, Metro, Secure Trust, One Savings Bank, Shawbrook, Tesco Bank and Paragon.

9.100 Overall, our estimates of the financial impacts show that most of the banks analysed will experience an increase in tax liabilities as a result of the tax changes but banks with lower levels of profitability will, all else being equal, have a lower average CTS tax rate (see Table 11 of Appendix 9.3.

9.101 For those banks analysed that are not exempt from the CTS, the combined increase in tax liability as a percentage of profit is between [✂] percentage points. The exceptions to this general result are banks with profitability levels below the £25 million annual threshold and those with high levels of international exposure that are subject to the bank levy. Two of the largest six banks ([✂]), due to large global activities, experience a net reduction in tax liability by 2021. However, all the six largest banks continue to pay higher effective rates of tax than the smaller banks we analysed.

9.102 In general, we therefore do not find strong evidence of the changes in banks' tax liabilities differing systematically across large versus smaller banks (or across incumbent banks compared to recent entrants).

Assessment of impact on entry, expansion and exit

9.103 Even if the direct financial impact is not distortive, there may be differential effects on banks' entry, expansion and exit decisions. This may be the case if smaller banks are less able to access external sources of finance or have less resources to draw on (in the form of accumulated past profits) than larger banks and are therefore more reliant on profits to finance growth.

9.104 In its response to our working paper, Santander told us that the CTS disproportionately affected smaller banks and 'scale challengers', who had to offer attractive and innovative products in order to compete for incumbent banks' inert customer bases and typically operated on narrower margins than incumbent banks. 'Challenger banks' were therefore less able to accommodate an increase in their regulatory cost base.[83] This reinforced the incumbency advantages that existed in the market. Santander also noted that smaller banks that derived 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.

9.105 It is possible that the changes to the tax regime could deter new entry as investors look ahead to the time that expected profits rise above the tax-free threshold and see the rate of return to investment in banking being reduced relative to other investment opportunities. Consistent with this hypothesis, a

[83] Santander response to CTS and bank levy working paper.

recent entrant told us that its projected profitability was a key element in justifying the investment case for entering the banking sector. Similarly, another recent entrant ([✂]) told us that the increases in taxation in the banking sector had reduced the attractiveness of investments in banking relative to FinTech companies. Furthermore, it told us that it had already noticed a change to this effect in the attitude of potential investors.[84]

9.106 In its response to our working paper,[85] Santander also told us that the CTS disincentivised inward investment into UK banking which was an important factor in boosting externally sourced competition. While we recognise that the attractiveness of the UK banking sector as a whole may be reduced compared to the next best alternative, it is not clear that this will systematically impact smaller banks more than incumbent banks. We also note that Atom was still able to raise finance from an international investor once the introduction and scope of the CTS had been announced.[86]

9.107 Some banks have explicitly estimated the impact of the increase in tax liability on their returns and the impact this will have on their investment decisions. BoI estimated that the changes would result in a [✂]. Aldermore [✂]. [✂] said it might be necessary to increase product prices in order to ensure that hurdle rates were achieved for future investments. Paragon Group told us that while its subsidiary, Paragon Bank, was not currently subject to the CTS, its future ability to expand could be impacted. This was because capital allocations between its group entities were based on relative post-tax returns. As such the banking business within the group could have less capital allocated unless it could pass on the cost of the CTS through higher margins. Secure Trust told us that tax considerations were a factor in its decision to dispose of its Everyday Personal Loans business and Virgin Money told us that the CTS may delay, but not prevent, achieving its IPO targets by about a year.

9.108 We have therefore seen some 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).[87] However, evidence of a specific impact on banks' business plans and expansion strategy is much more limited.

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[84] [✂]
[85] Santander response to CTS and bank levy working paper.
[86] Atom bank received a £45 million investment from Spanish banking group BBVA in November 2015 (source: Spanish lender BBVA 'buys 30pc stake in UK bank Atom' - Daily Telegraph).
[87] Or require them to price less competitively in order to secure this finance.

9.109 Furthermore, we are aware of examples of new or recent entrants continuing to raise external finance since the CTS came into effect. Metro raised £400 million through an IPO in March 2016,[88] Mondo, an app-based PCA start-up, raised £1 million of equity funding within minutes of launching its crowdfunding campaign in March 2016[89] and Starling Bank announced in January 2016 that it had received a $70 million investment.[90]

Summary/conclusions on regulatory barriers

9.110 **Bank authorisation**: This has undergone significant change in recent years enabling a more flexible approach including the option for firms to become authorised with restrictions before committing to large, potentially sunk, upfront investments. While the cost and time implications of authorisation continue to be significant, the recent changes have facilitated the entry by several new providers. New and prospective entrants will also benefit from the New Bank Start-Up Unit which was recently established to provide support to entrants in the process of becoming a new bank and in the early years following authorisation.

9.111 **Capital requirements**: Under the risk weighted assets based capital framework, banks under the IRB approach are required to hold significantly less capital than banks on the SA for similar risk for certain types of assets (unless the leverage ratio is the binding capital constraint). The difference is particularly marked in relation to residential mortgages with the widest differential in lower LTV mortgages. The PRA has confirmed that this differential in lower LTV mortgages is larger than can be justified or considered appropriate on prudential grounds. Whilst several smaller banks are IRB approved (and conversely some larger banks are on the SA) in residential mortgages, it is difficult for new entrants and smaller banks to become IRB approved because of the data requirements and the significant costs of obtaining and maintaining IRB approval.

9.112 We have found that SA banks have higher mortgage prices in lower LTV mortgages compared with IRB banks because of SA banks' higher risk weights. In addition, SA banks from which we were able to obtain data generally have a lower proportion of their assets in mortgages than IRB banks (and several have no mortgage lending at all). Conversely IRB banks hold a high percentage (approximately [60 and 100]%) of their retail assets in mortgages confirming that for such banks at least mortgage lending is an important aspect of their retail banking business. Our review of industry

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[88] Source: Metro Bank achieves £400 million equity capital target - City A.M.
[89] Source: App Bank Mondo Crowdfunds £1 million in 96 Seconds - Forbes.
[90] Source: Starling raises $70 million for UK banking market push – FT.com.

reports suggests that mortgages are the most profitable lending products for banks and an important source of profits for banks. There is however mixed evidence that those SA banks which engage in mortgage lending have a higher proportion of high LTV mortgages in their portfolio than IRB banks although the evidence on loan origination suggests that after 2008 SA banks have a greater overall propensity to originate high LTV mortgages.

9.113 **Bank levy and CTS**: The six largest retail banks will continue to pay higher effective rates of tax than smaller banks following the changes to the bank levy and the introduction of the CTS. We have not found any strong evidence that the bank tax changes will deter entry or expansion or will result in retail banks exiting although we recognise that the full impact of the bank tax changes will take time to emerge. However, there are aspects of the design of the CTS which may lead to differential effects across retail banks which might impact on competition in the future. These include:

(a) the level of the current exemption threshold of £25 million, which if increased could maintain the previous level of tax advantage of smaller banks but we recognise the trade-off between the rate of tax and its coverage in terms of its revenue raising objectives;

(b) as set out in Appendix 9.2, building societies highlighted the particular impact on mutuals, which are less able to access capital funding through new financial instruments;[91]

(c) the treatment of losses under the CTS compared to standard corporation tax, which may particularly impact recent entrants and smaller banks with legacy losses; and

(d) the application of the CTS to banking entities rather than banking activities, which may give firms with particular structures or non-bank providers an advantage in the longer term.[92]

9.114 Several parties submitted that we should not look in isolation at individual regulatory barriers to entry but that it is the cumulative effect of regulatory requirements on smaller banks which is a barrier to entry and expansion. In particular some banks argue that the burden of compliance with regulation is far greater for smaller banks because it is harder for smaller banks to accommodate regulatory costs than larger banks as smaller banks operate on lower margins compared to larger incumbent banks. In addition, several

[91] Such as core Capital Deferred Shares issued by Nationwide.
[92] However, the reduction in returns that occurs because of the CTS may also reduce their incentives to expand into deposit holding aspects of the retail banking value chain.

banks[93] maintained that the level of regulation in particular on smaller banks is not proportionate. For example, Santander submitted that the CMA should analyse whether individually or collectively the rules and requirements for each area of regulation are proportionate to their aims with a view to assessing whether they cause a material impediment to effective competition.[94] We agree that, as in many sectors, the proportion of a bank's costs in compliance with regulations will be greater for smaller firms than larger firms. We also agree that disproportionate regulation can be an impediment to effective competition.

9.115 We have focused in this investigation on those aspects of the regulation of banks which are most likely to give rise to barriers to entry and/or expansion namely bank authorisation, capital requirements and AML. In response to submissions from parties we looked at the recent changes to the bank tax regime and its potential impact on competition. However, we are not able in the context of this investigation to review every aspect of the regulation of banks to determine whether each regulation or the regulatory regime as a whole is proportionate to its objectives. No other specific aspects of the regulation of banks other than ring-fencing requirements discussed above in paragraphs 9.26 and 9.27, have been raised with us during the course of the investigation as a potential barrier to entry and/or expansion.

9.116 The UK government in the recent 2016 Spring Budget stated that it was undertaking a wide government programme aimed at reducing the regulatory burden on banks, in particular smaller banks. In the context of that programme it stated for example that it would continue to pursue more proportionate capital requirements for small banks (including building societies) in the EU.[95] We welcome this programme and the CMA will continue to work with the UK government beyond the life of this investigation in supporting the programme and the UK government and relevant regulators more widely pursuant to the CMA's wider advocacy functions.

Natural or intrinsic barriers

9.117 In this section we consider potential barriers relating to access to essential facilities or inputs such as funding (making a distinction between access to funding and cost of funding for lending), distribution channels, payment

[93] See Appendix 9.2.
[94] Santander response to CTS and bank levy working paper, paragraph 2.1.
[95] Budget 2016 (March 2016), paragraph 1.198. The PRA is similarly undertaking a proactive programme to identify potential areas where a more proportionate approach may be appropriate. This has led it to introducing less onerous reporting requirements under Pillar II, its approach to the Pillar II framework in particular in exempting residential mortgage exposures capitalised under SA from its analysis of geographic concentration risk under Pillar II and its review of the IRB application process. PRA's Annual Competition Report 2016.

systems and IT. Large and/or sunk costs of such access may deter entry; barriers to obtaining such access on competitive terms may also deter both entry and expansion.

9.118 As described in paragraphs 9.6*(a)* to 9.6*(b)* above, whilst we have considered regulatory barriers and natural or intrinsic barriers separately there are a clear interlinkages between them in particular between capital requirements and the cost of funds as discussed below.

Access to funding

9.119 In order to enter any market a firm needs to have access to sufficient initial funding to establish its operations. A potential entrant needs to secure a substantial amount of initial funding in order to obtain authorisation and become operational as a bank. New entrants must also raise enough capital to tide them through an initial period of operations based on their business plan forecasts. For illustration, Atom, which was authorised in June 2015, estimated a total cost of £[✂] million up to launch – as a digital-only bank, its entry costs are likely to be lower than average.

9.120 Whilst the amount of initial funding required is substantial, in our case studies[96] access to initial funding was not generally raised as a particular concern. Anecdotal information from the PRA suggests that new entrants are finding it easier to access initial funding:

(a) Reforms to the authorisation process have reduced the upfront cost required to obtain authorisation and the risk of failing to obtain authorisation.[97] New entrants therefore have more flexibility to stagger their calls for funding over time in a more manageable and cost-effective way.

(b) The business models currently being adopted by potential new entrants (small branch networks or none, the use of bank-in-the-box and software-as-a-service solutions, targeted entry) also tend to be lower cost than existing 'traditional' full service banking models.

9.121 Evidence from Atom's management team, which can draw on first-hand experience of entry at different time periods, supported this view.[98] Actual

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[96] See Appendix 9.1.
[97] See also the discussion of the authorisation process earlier in this section.
[98] Atom told us that it considered that the reforms to the authorisation process had created a more attractive environment for potential banking entrepreneurs and the performance of new banks funded by private equity such as Metro, Aldermore and OneSavings Bank had further stimulated investor interest. While there remained challenges in attracting investment and competing against other opportunities that offered better returns more

levels of potential entry are consistent with the above evidence. As described in paragraphs 9.30 to 9.32, there has been a substantial increase in the number of firms discussing the possibility of becoming a bank with the PRA and an increase in the proportion of licences being granted to new entrants. The recent IPOs of OneSavings Bank, TSB and Virgin Money in 2014, Aldermore and Shawbrook in 2015, and Metro in 2016, also attest to continuing investor interest.

Cost of funding for lending

9.122 As set out in Section 2, one of the main functions of a retail bank is to make loans. A lower cost of funds means that a bank can be more competitive when lending and thus generate higher overall profits. Differentials in funding costs can therefore act as a barrier to entry and expansion if incumbent banks hold an advantage by being able to obtain funds at a significantly lower cost compared to new entrants or smaller banks.

9.123 As detailed above in paragraphs 9.7 to 9.11, banks obtain funding from three sources: capital (equity), retail funding (deposits from retail customers) and wholesale funding[99] (deposits and lending from wholesale investors). In some circumstances they may also be able to draw on government schemes as alternative means of funding. Among these, the joint HMT and BoE Funding for Lending Scheme (FLS) is particularly relevant to this investigation, having since 2013 been targeted towards providing support for SME lending.[100,101] Equity funding is generally more expensive than retail or wholesale funding.

quickly, access to finance was not an insuperable barrier and conditions were improving. Atom's founder, Anthony Thomson, previously launched Metro in 2010.

[99] Wholesale lending can be provided on an unsecured or secured basis. Unsecured funding includes unsecured deposits from other firms, or the issuance of debt of varying maturities such as short-term commercial paper and certificates of deposits or medium term notes and bonds. Secured funding can be obtained via sale and repurchase or 'repo' transactions or the securitisation of illiquid assets. For example, mortgages can be securitised to create residential mortgage-backed securities which are tradable in the highly liquid secondary mortgage market. See *Bank funding costs: what are they, what determines them and why do they matter?*, published in BoE Quarterly Bulletin 2014 Q4 (BoE paper on bank funding costs).

[100] The FLS was launched by the BoE and HMT in July 2012, at a time of significant contraction in lending activity as a result of the financial crisis, and has been extended in modified form with incentives skewed towards lending to SMEs, until January 2018. It is designed to incentivise banks to boost their lending to UK households and private non-financial corporations (PNFCs). It does this by providing funding to banks for an extended period, at below market rates, with both the price and quantity of funding provided linked to their performance in the above forms of lending. See the BoE FLS webpage.

[101] On 4 August 2016, the BoE announced the Term Funding Scheme. While we have not considered this in our report given the timing, it may potentially be relevant to this area/issue. For more information on this scheme, please consult the BoE website.

9.124 Some new entrants and smaller banks have argued that they are disadvantaged on the cost of funding relative to the larger incumbent banks.[102] These parties have argued:

(a) Incumbent banks have access to cheaper, long term and stable retail funding as they have a large back book of deposits from an inert retail customer base, against which they can lend. It was suggested that this advantage would be greatly extended once the BoE base rate starts to rise and that several of the largest banks have already confirmed that their intention is to widen their net interest margin (NIM)[103] in the event of base rate increases.

(b) Larger incumbent banks are able to use their large base of 'cheap' current account deposits to cross-subsidise loss-leading savings accounts and/or by cutting rates to their existing depositors to subsidise the cost of acquiring new deposits. This provides them with additional retail funding advantages over smaller banks and new entrants.

(c) Larger banks are in receipt of a significant subsidy for being too-big-to-fail (TBTF) lowering their cost of wholesale funding.

(d) Larger banks hold higher quality (lower risk) assets that can be used as collateral for cheaper borrowing in wholesale markets (or to access alternative funding schemes such as FLS). In particular, the higher capital requirements for smaller banks in lower LTV residential mortgages means that they are at a competitive disadvantage in competing for such lower risk assets which can then be used as collateral in wholesale markets therefore also increasing the cost of funding.

9.125 In assessing whether new entrants and/or smaller banks are at a significant funding cost disadvantage such as to give rise to a barrier to entry and/or expansion, it is necessary to consider banks' overall funding for lending costs. Banks' total funding costs will vary according to the mix of funding they seek for their commercial activities and the appetite of depositors and investors to provide different types of funding which bear different risks. To get enough funding, banks may have to offer higher returns ie face greater costs. Additionally, macro-economic conditions and regulatory requirements will affect the funding mix and cost.

[102] See Appendix 9.4.
[103] NIM is a measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders relative to the amount of their (interest-earning) assets.

9.126 As regards regulatory requirements, the proportion of capital required is set by prudential regulation and driven by credit risk considerations. These capital requirements and their impact on the cost of funds for banks are discussed in detail in paragraphs 9.41 to 9.49 above and Appendix 9.3. We do not therefore further consider these, or the cost of raising such capital (including the cost of equity), in any detail in this section.

9.127 All else equal, the higher the cost of funding for a bank, the lower the profitability of a bank, reducing the return available to investors, which in turn further reduces demand from investors and increases the cost of funding. Furthermore, equity (capital) is generally more expensive than debt (wholesale) or deposit (retail) funding, so higher levels of capital tend to raise funding costs.[104]

9.128 Our analysis in this section focuses on the direct cost of funding. For retail or wholesale deposits, this is the interest banks have to pay retail customers or wholesale investors for their deposits, whilst for wholesale borrowing this is the interest banks have to pay on their borrowing from wholesale investors. The cost of retail funding, for the purposes of this analysis, is therefore distinct from the cost of providing the services via which retail deposits can be obtained. If banks with cheaper direct costs of retail funding face higher indirect costs of providing it, their overall advantage will reduce; similarly if banks with higher direct costs of retail funding also have higher indirect costs of provision their overall disadvantage will increase.

9.129 The operating costs of providing depository services to retail customers will differ between banks and products, with current accounts, in particular, likely to be more costly to operate than other deposit accounts (such as savings/ISAs) given their more extensive transactional functionality. Current accounts are less commonly provided by smaller banks and newer banks. While such differences cannot readily be quantified and will not be analysed in any detail further in this section, it should be recognised that the full actual cost of retail funding will in practice include some allocation of such operating costs, which may partially offset the effect of differences between banks in the direct costs of retail funding. Similarly, the full ('all-in') cost for different types of wholesale lending will include ancillary costs such as risk management and debt issuance costs.

9.130 The extent to which any funding cost advantages impact overall profitability, or competition within our terms of reference, depends on business decisions such as where and how to deploy the advantage (eg competing more

[104] See further above section on capital requirements and Appendix 9.4.

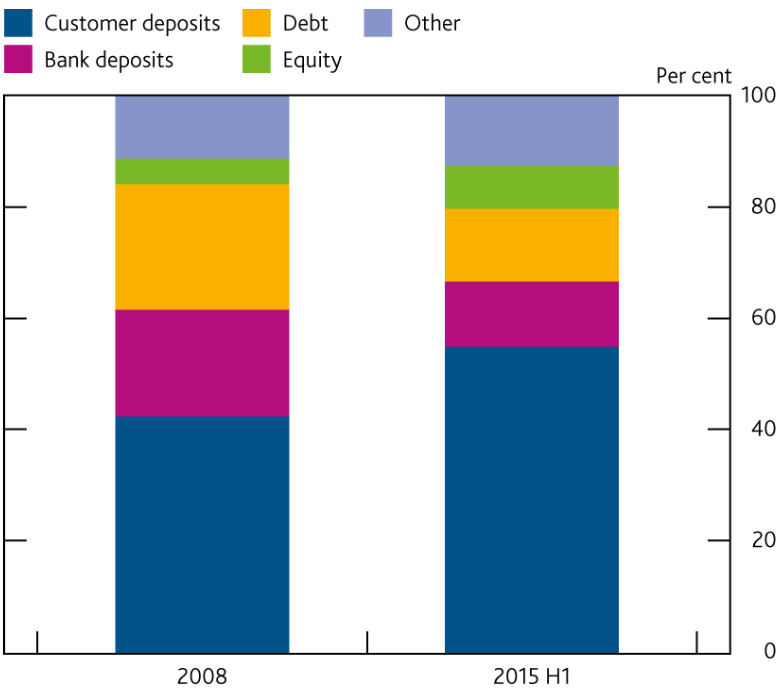
aggressively for lending or for deposits, and in which areas of lending or deposit-taking), the mix of assets held, the business lines being supported and risk management strategies. The ongoing ring-fencing of retail banks will remove some of this discretion.

9.131 Funding cost differentials can therefore act as a barrier to entry and expansion in retail banking, and are relevant to competition for current accounts as sources of funding as well as profit centres in their own right. We will consider in the remainder of this section evidence on differences in retail and wholesale funding costs (including TBTF) as well as concerns raised regarding access to FLS, for larger incumbent banks compared to new entrants and smaller banks. Further detail is contained in Appendix 9.4.

Trends in bank funding

9.132 The mix of funding used by banks was heavily impacted by the 2008 financial crisis. As set out in Appendix 9.4, levels of unsecured wholesale funding fell significantly during the financial crisis as the supply of such funding fell, thus pushing up prices. In this situation, retail deposits such as current accounts and savings accounts (which were seen as a less risky 'safe haven' by investors) became more important to banks. The majority of bank funding still remains retail-focused as shown in Figure 9.2.

Figure 9.2: Major UK banks' liabilities



Source: Bank of England Financial Stability Report, December 2015, p47.
Notes: Major UK banks are Santander, BoI, Barclays, Co-op Bank, HSBCG, LBG, NAB, Nationwide, RBSG and Virgin Money.

9.133 Given that the cost of retail funding tends to be lower than the cost of wholesale funding,[105] the recent shift towards retail funding will have tended to reduce the average cost of funds, all else equal.

Retail funding

9.134 Smaller banks and new entrants are currently particularly reliant on retail funding[106] – KPMG, for example, has estimated deposits represent around 80% of their total funding, with retail customers the largest single source.[107] Differentials in retail funding costs are therefore particularly relevant in assessing whether funding costs can act as a barrier to their expansion.

9.135 The evidence suggests that incumbent banks have retail funding advantages over new entrant banks and the larger the incumbent bank the more significant the value of deposits (and the more inert the customer base),[108] the stronger the advantage:

(a) The weak customer response and product linkages we found in Sections 6 and 8 mean that it is costly and time consuming for new entrants and smaller banks to acquire customer deposits. As a result, incumbent banks with access to a back book of existing lower cost customer deposits have a lower cost of retail funding than new entrants and smaller banks. They also benefit from the relative stability of retail deposits as a source of funding.[109]

(b) The FCA's cash savings market study[110] illustrates the benefits to banks of product linkages between PCAs and savings accounts. Particularly for easy access savings accounts, it found that large PCA providers hold significant savings balances from their PCA customers; interest rates on easy access accounts held with the large PCA providers are lower on average than those with other providers; and customers that hold savings accounts with the large PCA providers tend to be less responsive to reductions in the interest rate compared with customers holding savings accounts with small and medium-sized banks. As a result, all else equal, the FCA found that it is harder for small and medium providers, compared with larger providers, to attract and retain

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105 This is theoretically the case given that retail customers (unlike wholesale customers) are not using deposits solely as an investment vehicle but have wider considerations of security, transactional capability and ease of access in mind.
106 A number of smaller banks reported they did not use, or relied to a minimal extent on, wholesale funding.
107 *A new landscape: Challenger banking annual results.* KPMG, May 2016.
108 See further Section 6 for a discussion on the proposition of inert customers relative to size of bank.
109 Retail deposits are generally considered a stable source of funding in normal circumstances, particularly where subject to deposit protection. See BoE paper, Bank capital and liquidity.
110 Cash Savings Market Study Report. See further Appendix 9.4.

such retail deposits unless they not only offer higher interest rates on easy access savings accounts than the larger providers to attract deposits, but also maintain these higher interest rates on deposits to retain such deposits.

(c) The FCA also found that firms typically reduce interest rates to longstanding easy access and cash ISA customers over time.

(d) We have considered representations made by parties that banks are 'cross-subsidising' across customer segments and/or products. Whilst we have not found evidence of cross-subsidy such that banks are not recovering the incremental cost of providing a product,[111] a large existing back book of stable retail deposits gives incumbent banks flexibility in pricing such that different products and customers can make differential contributions to the recovery of common/shared costs. Moreover, such flexibility in pricing can provide an opportunity for incumbent banks to retain such retail deposits and be able to target their pricing in acquiring new customers. Banks' ability to price discriminate in particular between back book customers and new customers is considered in more detail in Section 10.

9.136 In light of the above, incumbent PCA providers will have funding advantages as they have, and can more easily and cheaply retain, a significant volume of banks' retail deposits. However, the FSCS, by guaranteeing the safety of deposits up to £75,000, offsets some of the advantage that incumbent banks might naturally expect over smaller banks and new entrants in being entrusted with deposits given their greater brand familiarity to customers and longer track record.

9.137 In our assessment we have looked at a variety of estimates of retail funding costs. These take account of both the advantages to incumbent banks and the offsetting contribution of FSCS, as it is inherently difficult to estimate their separate effects. BoE data for April 2016 on effective interest rates across both current and savings accounts, for example, confirms a material advantage.[112] The estimated effective interest rate for the largest six banks in the UK is around [✂] lower than that of a selection of smaller banks, and this gap widens if focusing only on the largest four banks. This data represents the total retail funding gap averaged across deposits from households and private non-financial corporations. However, disaggregated data shows that the differentials observed arise predominantly from

[111] See Section 6.
[112] CMA estimate based on BoE analysis of effective interest rate data. See Appendix 9.4.

household deposits, which is consistent with the evidence identified in paragraph 9.127 as driving incumbent banks' retail funding advantage.[113,114]

9.138 A 2016 KPMG report likewise finds retail funding differentials to be important, and that the type of deposit account provided is also relevant. The report attributes estimated cost of funds differentials between 'Larger Challengers' and 'Smaller Challengers' to the former's 'seasoned, stable deposit back books' and the fact that 'a number of the 'Larger Challengers' also provide current accounts, which are not a significant feature of the 'Smaller Challengers', with the exception of Metro'.[115]

9.139 Looking at savings alone, the same KPMG report found that on average, the 'Challengers' offer the best rates for savers (easy access rates: Smaller Challengers 108 basis points, Larger Challengers 73 basis points, Big Five 36 basis points).

Wholesale funding

9.140 As regards wholesale deposits, we examined BoE data for April 2016 on effective interest rates for non-retail deposits as a proxy for this purpose.[116] The estimated effective interest rate for the largest six banks in the UK is around [✄] lower than that of a selection of smaller banks, which indicates some advantage. We consider that the likely reasons for this are the same as those that give incumbent banks retail funding advantages above, together with wholesale lenders potentially favouring larger incumbent banks below. In addition, natural business dynamics may come into play. For example, large wholesale investors may have more complex needs that a larger, more diversified incumbent bank may be better placed to fulfil.

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[113] While we look at the aggregate data for household and non-financial private corporations combined, as a proxy to estimate retail funding differences, this estimate is likely to include some overlap between retail and wholesale deposits as the category of 'private non-financial corporations' includes larger firms, a proportion of which can be expected to behave more as wholesale investors.

[114] While an analysis of effective interest rates paid by banks to depositors does not take into account one-off acquisition costs such as upfront switching incentives, this is unlikely to change the position as such incentives are less prevalent in cash savings which represent the majority of retail funding deposits, and for current accounts low switching levels limit such costs.

[115] *A new landscape: Challenger banking annual results.* KPMG, May 2016. The Big Five are Barclays, HSBCG, LBG, RBSG and Santander. Larger Challengers are BoI, Clydesdale, first direct, Handelsbanken, Nationwide, Paragon, TSB, Virgin Money and Williams & Glyn. Smaller Challengers are AIB, Aldermore, Charter Savings Bank, Close Brothers, Metro, One Savings Bank, Secure Trust, Shawbrook, and a number of digitally focused banks (Atom, Fidor, Mondo, Starling and Tandem).

[116] CMA estimate based on BoE analysis of effective interest rate data. See Appendix 9.4. For the purposes of this analysis we considered all non-retail deposits, ie deposits from central & local government, public corporations, UK monetary financial institutions (banks and BSOCS), financial corporations and non-profit institutions serving households.

9.141 As regards wholesale lending, the evidence indicates that, all else equal, larger incumbent banks tend to have greater access to wholesale markets at lower cost due to factors including:

(a) expectations of government support (the TBTF subsidy as discussed in more detail below);

(b) higher coverage by intermediaries;

(c) higher liquidity of the debt issued; and

(d) potential advantages in collateral.

9.142 This was supported by representations by banks such as Metro, Aldermore and Secure Trust. Other banks such as Shawbrook felt that it could adequately access the wholesale market. This is discussed in more detail in Appendix 9.4.

9.143 These types of advantages are a function of wholesale market demand and risk preferences, and therefore, TBTF aside, not isolated to retail banking. For example, in assessing the risk of default investors will consider factors such as the commercial strategy and asset mix of different firms, their corporate structure, the more extensive track record and information available for more established banks, expectations of government support (which, for the banking sector, manifests as TBTF) and regulatory requirements (which, for the banking sector, affects capital, liquidity and organisational structure).

9.144 It would be expected that taking such factors in the round, larger more established businesses can often be more attractive to wholesale investors than potentially riskier, less well known entities. It is therefore difficult to disentangle the extent to which differentials between incumbent and other banks' wholesale funding costs naturally arise from rational behaviour that would likely still persist in a well-functioning market, relative to any sector-specific competitive distortions. In particular:

(a) For systemically important banks, to the extent that regulators are requiring higher resilience from these banks, one would expect to see a benefit to their funding costs. For example, TSB told us that larger banks were typically more able to manage the risks in their business, were more profit-resilient and tended to have better credit ratings, allowing them to raise wholesale money cheaper than smaller banks.[117]

[117] TSB hearing summary, paragraph 48.

(b) The interplay between the level of capital required and the total cost of funds is also not straightforward. While equity is generally more expensive than debt, higher levels of equity imply lower credit risk and less risk around future returns on equity, which tends to reduce any cost differentials that would otherwise result from changes in the funding mix.

(c) There are numerous other interactions among the factors investors will take into account. For example, capital requirements affect the asset mix of a bank, which in turn affects the quality of the collateral they can offer for secured wholesale funding. Competitive distortions such as customer inertia impeding expansion in PCAs or SME banking (see Sections 6 and 8), or SA banks being required to hold higher levels of capital than IRB banks for equivalent low LTV mortgage assets, will also affect commercial strategies and investors' views of different banks' prospects. To the extent that any of these factors reduce the quality of collateral that can be used, or constrain the risk/return trade-off perceived by wholesale investors, they will increase the cost of wholesale funding.

9.145 Given the complexity and interactions between the many factors driving investment decision-making, it is difficult to precisely disentangle the incremental impact of any sector-specific systematic distortions. One notable exception is TBTF, which has in recent times been the subject of much regulatory intervention. The next paragraphs consider the background to this issue and assess its potential impact.

- *TBTF subsidy*

9.146 Some members of the 'Challenger Bank panel of the BBA argued[118] that large systemically important banks benefit from a TBTF[119] subsidy where they are seen as less risky because investors understand that governments would be reluctant to risk financial turmoil and contagion by allowing them to fail. From a prudential point of view such a subsidy would be undesirable as it creates a moral hazard by incentivising beneficiary banks to behave in a more risky manner as they will not bear all of the cost of doing so. From a competition point of view, banks that are deemed TBTF have an advantage as this reduces the risk of beneficiary banks for investors and hence lowers (subsidises) their cost of wholesale funding.[120]

[118] Challenger roundtable summary.
[119] Also referred to as 'too-important-to-fail', given that the interconnectedness of the firm in question to the financial system is the main risk factor to the stability of the wider economy.
[120] While TBTF may have a number of effects, these are likely to be focused on wholesale funding, in particular unsecured wholesale funding given that the availability of collateral reduces credit risks for secured wholesale

9.147 This issue gained particular prominence during the financial crisis, when governments had to step in to bail out struggling financial institutions. Since the financial crisis much regulatory activity (both in the UK and at international level) has been focused on this issue. Recent and ongoing measures include:

(a) Measures to improve banks', in particular Global Systemically Important Banks' (G-SIBs), financial resilience through increased capital and liquidity requirements and capital adequacy buffers.[121]

(b) Measures to facilitate bank resolution – the process by which regulators can intervene to manage the failure of a bank in an orderly way.[122] In addition the FSBRA provides for the ring-fencing of systemically important UK retail banks requiring such banks to separate their retail banking activities broadly from their investment and wholesale banking activities.[123]

(c) Increased international coordination between authorities.[124]

9.148 As discussed in Appendix 9.4, there are signs of the market reacting to these initiatives. Ratings agencies have started to reduce their 'government support' uplifts for big banks.[125] For example, in May 2015, Fitch announced a three-notch downgrade for RBSG and LBG on its senior unsecured debt ratings at both holding company and operating company levels on this basis,[126] while Moody's took a similar action for systemically important UK banks in June 2015.[127] Spreads between senior and structurally subordinated debt of UK G-SIBs also suggest that resolution regimes are gaining credibility.[128]

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funding. For retail funding, the existence of deposit protection means that any TBTF effects can be expected to be confined to deposits beyond the protection limit, while equity holders might not benefit from a bailout directly because their claims could be fully wiped out when a bank is bailed out.

[121] See paragraph 9.38(d) above and Section 3.

[122] See Banking Act 2009, Financial Services Act 2010 and the Bank Recovery and Resolution Directive.

[123] See further Section 3. A number of wholesale activities can remain within the ring-fenced retail bank including transactions with central banks and deposits from large corporates and other banks.

[124] For example, the development of firm-specific cooperation agreements to increase cross-border coordination and information-sharing between home and host authorities, the establishment of Crisis Management Groups to agree resolution plans for globally systemically important banks, and the establishment of resolution colleges in accordance with the Bank Recovery and Resolution Directive for cross-border firms that have operations in more than one Member State. See BoE press release: A 21st century approach to dealing with failed banks – speech by Sir Jon Cunliffe at the 1st Single Resolution Board Annual Conference.

[125] See BoE press release: A 21st century approach to dealing with failed banks – speech by Sir Jon Cunliffe at the 1st Single Resolution Board Annual Conference.

[126] Published announcements from ratings firms.

[127] Moody's, June 2015, Rating Action: Moody's concludes review on 14 UK banks' ratings; assigns CR Assessments to 17 UK banks.

[128] See BoE press release: A 21st century approach to dealing with failed banks – speech by Sir Jon Cunliffe at the 1st Single Resolution Board Annual Conference. Sir Jon notes in his speech an apparent jump in awareness

9.149 In its response to our provisional findings, Secure Trust[129] argued that despite ring-fencing and improvements in regulation, in practice, wholesale funders continued to believe that 'TBTF' banks would not be allowed to fail. It considered that RBSG and LBG, notwithstanding the revised regulations and their future ring-fencing, would not be allowed to fail given their respective positions in consumer and SME/corporate banking in the UK. As such, it argued that such banks enjoyed a 'multi-billion pound' cost of funding subsidy which would 'persist indefinitely'.

9.150 We have considered a range of evidence on the magnitude of the TBTF subsidy, with estimates up to 100 basis points across different debt instruments and methodologies[130] as discussed in Appendix 9.4.

9.151 These estimates are significant and the financial crisis focused attention on the magnitude of the issue. TBTF is a serious prudential concern and regulators are deeply engaged with addressing it. We believe it is too early to take a view on the eventual success or otherwise of such measures, given that a very substantial part of these remains ongoing. In the meantime, indications from the market of lower expectations of government support offer encouraging signs of progress in the right direction but the evidence suggests that it continues to impact banks' relative costs of funding.

Funding for lending

9.152 Our analysis has considered the impact of FLS on bank funding costs and how this may vary across banks and in the longer term.

9.153 FLS was introduced in 2012 to incentivise banks to boost their lending to the UK real economy by offering funding on advantageous terms to banks that increase their lending. As discussed in Appendix 9.4, its availability as a cheaper alternative to wholesale or retail funding has been welcome to smaller banks and new entrants, particularly given the higher costs of funding they face compared to larger incumbent banks. A number of small banks participate in the FLS.[131] Although the FLS has been helpful to smaller banks and new entrants, the scheme is not aimed at supporting particular

at the beginning of 2016, with the average spread for senior debt issued by European G-SIBs increasing by over 25% within little more than a week.

129 Secure Trust response to provisional findings, p2.

130 BoE Financial Stability Paper No. 32 – February 2015. *Estimating the extent of the 'too big to fail' problem — a review of existing approaches.*

131 The list of participants in the FLS can be found on the BoE website.

lenders. The FLS is therefore available on the same terms to all eligible lenders.

9.154 Some smaller banks have criticised the FLS, arguing that they are disadvantaged relative to the larger banks as they are not able to provide the collateral required to access FLS to the extent desired,[132] and noting that LBG draws down on the scheme more than any other firm.

9.155 The BoE is aware of these concerns and has taken a number of steps to ensure that smaller banks can participate including broadening the range of collateral accepted. To support new banks joining the FLS, the BoE has recently published an aide memoire that explains the proactive steps it has taken to be in a position to accept collateral from new/small banks.[133] The BoE explained that it now begins engaging with new banks at a very early stage, before they have been authorised by the PRA so they can use the facilities from the start. It has substantially increased the range of eligible loan assets it will accept into its liquidity operations, whilst also relaxing the conditions for such loans. Any adjustments for such collateral are based on qualitative and quantitative assessment of the underlying loans and are not set to be higher for any particular type of counterparty.

9.156 The latest extension of the FLS, to the end of January 2018,[134] has also been designed with differences between incumbent and smaller/newer banks in mind. Allowances will reduce over the extension period, but to a lesser extent for new banks. With this design, the extension should continue to provide some support for SME lending to established and new banks alike, while facilitating a smooth transition to other funding sources and allowing a reasonable lead time to manage this process.

9.157 Published data on usage of the FLS shows that a wide range of banks have made use of the scheme including many small lenders.[135] Under the remaining 18 months of the FLS drawdown period, some of the smaller banks have the largest unused borrowing allowance compared to the biggest UK lenders, none of which have capacity to draw from the scheme beyond 1 August 2016.

9.158 As schemes such as the FLS help to reduce banks' cost of funds, funding costs can be expected to increase once such government support is

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[132] See Appendix 9.2, for example, Secure Trust's response to the updated issues statement. Secure Trust also stated that disparities between the SA and IRB approach to capital requirements for low LTV mortgage asset classes contribute to this as banks using the SA are less able to compete for prime mortgage assets.
[133] The Bank of England's Operations Under The Funding For Lending Scheme – Operating Procedures.
[134] BoE News Release - Bank of England and HMT announce extension to the FLS.
[135] BoE publication *Funding for Lending Scheme – Usage and lending data for the first part of the Scheme*.

removed, potentially further changing competitive differentials. We note the potential for government intervention to affect competition (whether in favour of larger or smaller banks) and the importance of continuing to consider how best to minimise any impact on competition from this or any other interventions. This is illustrated, for example, by the efforts of the BoE to facilitate access to the FLS scheme by smaller/newer banks and larger banks alike and in the design of the FLS extension to gradually phase out the support available while taking into account differences in the ability of banks to draw on the scheme.

9.159 Several banks have recently called on the CMA to consider amendments to the FLS to redress the incumbency advantages in funding.[136] We note that the FLS is a macroeconomic scheme, designed to incentivise banks to boost their lending to the UK real economy. While it acts through the banking sector, it is designed to support the economy, rather than the banks themselves. The FLS is therefore available on the same terms to all eligible institutions, with firms generating borrowing allowances in the same way depending on their net lending, and paying the same fee. However, the BoE has taken a number of steps to ensure that smaller banks are able to participate in the scheme, for example engaging earlier with new banks and allowing them to access the BoE's lending facilities, and enabling smaller banks to continue to grow their allowances within the FLS' latest extension. Usage data shows that a wide range of banks, including smaller banks, have been able to access FLS. We note that changing such a scheme to target specific lenders risks unintended consequences and a more effective and proportionate approach would be for the BoE and FCA to continue to facilitate participation by new and smaller banks in FLS and for the CMA to implement the remedies in this final report that will help them to grow their deposit base.

9.160 We summarise our conclusions on both access to funding and cost of funding for lending in paragraphs 9.225 to 9.230 below and whether either are a barrier to entry or expansion in paragraph 9.290 in our overall findings on barriers to entry and expansion.

Branches

9.161 Traditionally, branches have been the principal distribution channel for banks. Branches serve a number of purposes for banks and their customers. For banks, branches provide a platform for customer acquisition, customer retention, and brand recognition. Customers use branches for a number of

136 Letter dated 30 June 2016 from a group of 'challenger' banks to the HMT.

activities including checking account balances, handling cash payments/withdrawals and obtaining advice.

9.162 Recent developments are altering the role of branches. Many of the functions previously served solely by branches can now be served digitally: over the telephone, online and on mobile devices. Multi-channel banking has become the new norm whereby customers interact with their bank through a combination of 'direct' channels (telephone, online and mobile), and more traditional channels (branches and business centres).

9.163 Our case studies suggest that branches remain important to new entrants/potential entrants. For Nationwide, the impact on its existing branch network of accommodating SME service requirements was a factor in its decision to put on hold entry in the SME market.[137] However, it recognised that this concern may become less important in the future as SMEs increasingly adopt mobile and digital banking solutions. [✂].[138] Metro's business model is branch based and it highlighted that a shortage of suitable high street corner sites with the requisite planning usage could have a material effect on its expansion strategy in PCA and in SME markets.[139]

9.164 The size of TSB's branch network was highlighted by the OFT as a significant factor in ensuring that TSB could be an effective competitor[140] in its advice in September 2013 to the Chancellor of the Exchequer on the impact of competition of the LBG (and RBSG) divestitures. The importance of a branch network and the relationship between share of branches and share of the PCA market was an issue addressed in a number of TSB's policy documents.[141] Virgin Money stated that a branch network appeared to be important for a significant proportion of customers but that their importance was declining largely due to the growing popularity of alternative channels such as the internet. It considered that its network of 75 branches (acquired from Northern Rock) provides it with good coverage of major urban centres in the UK. Coupled with advanced digital banking capabilities, Virgin Money did not consider that the size of its network would be an obstacle to further expansion.[142]

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[137] See Appendix 9.1.
[138] [✂]
[139] See Appendix 9.1. While Metro raised planning issues, since April 2014 it has not required planning consent to take an existing retail shop and convert it into a bank which has significantly reduced the difficulties for Metro in acquiring new sites.
[140] TSB considered that an effective competitor bank required a network of 700 or more branches.
[141] See Appendix 9.1. Appendix 9.4 contains our analysis of the relationship between market shares and branch numbers.
[142] See Appendix 9.1.

9.165 For newer entrants, however, our case studies did not suggest that an own-branch network was required and several (Atom, Starling and CivilisedBank) have agency arrangements with other banks to use their counter services for their customers. However, OakNorth stated that it was too costly to build an own branch network and it was reticent in partnering with a competitor bank. It had therefore decided not to offer BCAs given the need in its view to provide branch cash handling services.

Role of branches

9.166 In recent years the number of bank branches in the UK has been in decline. This has been driven by a combination of demand-side and supply-side factors. For consumers, the ease and convenience of direct banking is driving down demand for branches. For banks, consolidating their branch networks can generate significant cost efficiencies.

9.167 In 2013, there were 10,208 bank branches in the UK (see Table 9.1 below). This fell to 9,661 at the end of 2014. The UK's branch network has remained relatively concentrated by brand and by geography: Barclays, HSBC, Lloyds, NatWest and Santander accounted for 63% of branches in the UK in 2013 and 2014.

Table 9.1: Total number of branches in the UK 2014*

			%
	2013	*2014*	*YoY change†*
England	8,208	7,799	–5.0
Scotland	1,123	1,037	–7.7
Wales	596	562	–5.7
NI	281	263	–6.4
Total	10,208	9,661	–5.4

Source: CMA analysis.
*Based on data from AIB, Barclays, BoI, Clydesdale, Co-op Bank, Danske, HSBCG, LBG, Metro, Nationwide, RBSG, Santander, TSB and Yorkshire Building Society. Data provided as at 1 January 2014 (approximated stock 2013) and at 1 January 2015 (approximated stock 2014). Includes retail branches and co-located business centres. Excludes branches (business centres) that only service SME customers.
†Year-on-year change in the stock of branches between 2013 and 2014.

9.168 Figures from the Campaign for Community Banking Services (CCBS)[143] indicate that, at the end of 2015, there were 8,340 bank branches suggesting an acceleration in the decline of the number of branches in the UK in 2015.[144] In addition, several larger banks in July 2016 announced further branch closures.

[143] CCBS is a co-ordinating body for national organisations representing sectoral interests adversely affected by the closure of local bank branches. CCBS has 18 members including consumer organisations Which? and Age UK. See CCBS website.
[144] CCBS, Branch network reduction: 2015 report.

9.169 Some banks also have stand-alone branches or business centres for SME customers providing services such as a dedicated business banking counter service and relationship/business banking advisers. The total number of business centres in the UK has been more stable than retail branch numbers since 2013 (see Appendix 9.4).

9.170 Figures 3 and 4 of Appendix 9.4 plot the decline in the number of (retail) branches since 2010 for banks with greater than 500 and fewer than 500 branches respectively. With the exception of Halifax (part of LBG), Nationwide and TSB, brands with relatively large branch networks (more than 500 branches) have been closing branches in every year since 2010. Nationwide also had a smaller branch network in 2014 compared to 2010. A similar trend of branch closures can be seen for those banks with relatively smaller branch networks. For the nine banks with more than 500 branches, the average branch network size in 2014 remained significant at 961.

9.171 A report by Deutsche Bank[145] quotes research by CACI,[146] which found that 80% of the UK market today can be covered by a bank through around 800 branches. CACI forecasts that 600 branches will 'deliver effective nationwide customer coverage' in five years' time. The CCBS told us that it agreed with CACI's estimates of optimal branch networks for incumbent banks. However, it told us that it also believed that neutral transaction handling outlets (which might be Post Office counter services, discussed later in this section, or shared-use branches) would still be required in many other centres to supplement the remaining branches and offset smaller, geographically imbalanced branch networks of smaller banks such as TSB and Williams & Glyn once divested from RBSG.

9.172 In addition to an overall branch network consolidation, remaining branches are being replaced with smaller, more digitally-focused outlets. Banks' branch strategies include migration to self-service technology (including 'smart ATMs' with enhanced functionality such as cash and cheque paying-in facilities, and the use of tablets by customers in branch), reduced counter services and teller staff as a result of greater use of online and mobile banking and self-service technology, greater use of a centralised pool of advisers that engage with customers via video-conferencing and alternative branch formats such as temporary pop-up branches and mobile banking vans.

[145] UK Retail Banking 2014: Bank to the Future, Deutsche Bank Equity Research, September 2014.
[146] CACI is a location planning consultancy that has worked with a number of banks to assess their optimal branch network size.

Importance of branches to customers

9.173 Customer preferences may be driving a response by banks (existing banks and new entrants) as well as responding to a reduction in the supply of bank branch services. Banking is increasingly becoming a self-serve activity for consumers. Consumers are, according to a report by Deloitte, demanding greater convenience and expect a seamless integration of remote and in-person channels wherever they may be.[147]

9.174 Between 2012 and 2014 the total number of branch visits by PCA customers in the UK fell by 15%. Over the same period, the number of logins to mobile banking apps rose fourfold, overtaking logins to internet banking for the first time in 2014 (as shown in Figure 9.3 below). While the rate of growth in mobile registrations (by PCA customers) has slowed since 2011 as the stock of adopters has grown,[148] the rate of decline in the importance of branches is expected by some banks to accelerate as it is 'eroded by technological innovation'.

Figure 9.3: Proportion of usage by PCA customers by channel (branch visits/logins/calls)

[✂]

Source: CMA analysis.
Notes:
[✂]

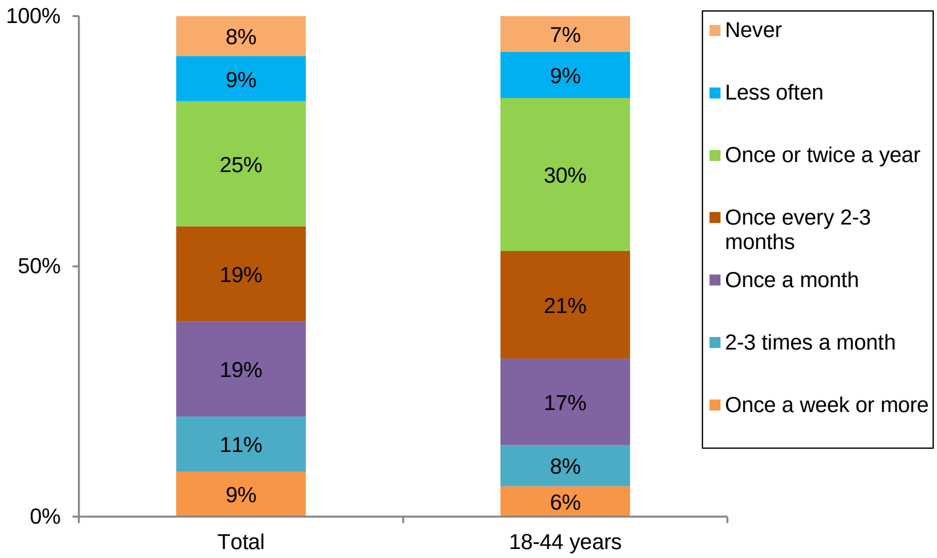
9.175 Despite the recent trends observed in branch footfall, consumer research undertaken by GfK and independently by a number of parties illustrates that some customers continue to place a high value on branch availability and accessibility.

9.176 GfK PCA consumer research shows that branch convenience (location and opening times) is considered the third most important feature of a PCA for customers (joint with internet banking) after quality of staff and customer service, and quality and speed of handling problems. Local branch convenience is considered as essential or very important to more customers (63%) than having a national branch network available (58%).[149]

[147] Deloitte (2014), *Bricks and clicks – Mapping the future of branches*.
[148] Mobile registration rose 148% from 2011 to 2012, 80% from 2012 to 2013 and 37% from 2013 to 2014. Note: data is not available for TSB for mobile banking channel, and for LBG the figures for number of customers registered for mobile/internet banking are calculated by aggregating the individual figures for each LBG brand and therefore will overestimate the total number of customers registered due to double-counting of customers registered with more than one LBG brand.
[149] TSB customer research found that to 69% of customers having a branch close to where they lived was important. TSB (2014), *Why branches matter in a digital age*. Research carried out by ComRes for TSB, poll of 2,010 people (2014).

9.177 Despite the reported importance of bank branches, according to GfK PCA consumer research, less than two-fifths (39%) of PCA customers visit their branch at least once a month (see Figure 9.4). This falls to 31% for PCA customers aged between 18 and 44 years. 42% of respondents use a branch less than twice a year (this includes those who said they 'never' use a branch). Consumers may, therefore, place some intrinsic value on a branch presence even where they are not frequent users. In contrast, 66% and 74% of respondents use internet banking and mobile banking respectively and most are frequent users (logging on to their account at least once a week).

Figure 9.4: Frequency of branch visits*



Source: GfK PCA consumer survey.
*Respondents were asked 'How often, if at all, do you go into a bank branch for anything to do with your main current account?'
Base: All (total = 4,549; low income = 966; only one channel = 1,239; 18 to 44 years = 2,090).

9.178 Although branches at present continue to be the primary source of customer acquisition for banks, the proportion of PCA customers acquired through branches is on a downward trend: on average 78% of PCAs were opened in branch in 2014, down from 81% in 2013.[150] This downward trend is likely to continue (for personal and SME customers) as banks invest in technology which enables straight-through online account opening and customers become increasingly comfortable with using online channels (see Appendix 9.4).

[150] We do not have comparative data on SME customer acquisition by channel, but a survey of start-up SMEs undertaken by Charterhouse shows that, on average, 82% of start-ups open their BCA in branch.

9.179 Branches are currently commonly used by customers for transactional purposes: 85% of PCA customers[151] and 80% of SME customers[152] that visit a branch use paying-in facilities (either counter services or machines). In-branch cash deposit and withdrawal facilities appear to be of greater importance to start-up SMEs, of which 84% cited paying in cash or cheques as the main reason for using a branch.[153]

9.180 It is generally accepted that in the future, branches will be used less for transactional purposes as these customer interactions are directed to smart-ATMs and other direct channels (using technology such as cheque imaging that allows remote cheque depositing).[154] Branches are likely to increasingly focus on service, sales and relationship building.[155] As described above this process has already begun as banks replace existing branches with smaller, more digitally-focused outlets, enabling banks to reduce staff costs and increase efficiency.

Branches as a cost of entry

9.181 As summarised in paragraph 9.165 above, the need for and cost of an own branch network were issues for several entrant banks in our case studies. The building and maintaining of branches (and a branch network) incurs significant fixed and ongoing costs: a report by Deutsche Bank estimates that branches account for 30 to 40% of a bank's retail costs.[156] This affords scale and scope efficiencies to banks with large customer bases and broad product ranges.

9.182 Atom told us that the acquisition of retail branch space and running costs made branches prohibitively expensive. However, Atom told us that as a result of not having a branch network, online providers could devote a larger budget to advertising, bolstering customer acquisition. It also had an agency agreement with another bank for its customers to use that bank's branches.

9.183 LBG told us that while it recognised that there were likely to be transition costs for the change in use of real estate, the 'sunk' element of costs associated with branches was minimal because branches could be quickly

[151] 85% of respondents to GfK's PCA consumer survey (undertaken in 2015) that had used a branch in the last year used it for paying in cash or cheques (base: 3,764 customers).
[152] This is a minimum estimate of branch counter use due to the methodology used in Charterhouse's BBS questionnaire. Although we know what proportion of respondents used branch counter services for their SME, we do not know the exact proportion of other staff at the SME who use branch counter services for the SME when the respondent does not use branch counter services themselves.
[153] 84% of SME start-ups in Charterhouse's follow-up survey reported that paying in cash or cheques was the main reason for requiring access to a branch (base: 252 SME start-ups).
[154] Indeed, this can be seen in the figures from the Charterhouse BBS.
[155] Jones Lang LaSalle report, *Global retail banking: key trends and implications for retail banking real estate*.
[156] Deutsche Bank Equity Research (September 2014), *UK Retail Banking 2014: Bank to the Future*.

refitted and used for alternative purposes. Further, LBG told us that property costs represented only around [✂]% of branch costs. LBG noted that the remainder of branch costs were predominantly staff costs. Due to the automation of some branch services (through, for example, the introduction of automated deposit machines) and the migrations of sales and services online, staff numbers and branch costs had reduced significantly.

9.184 Barclays argued that legacy branch networks represented a cost to incumbent banks, as they needed to be adapted in response to declining demand. Furthermore, in doing so, banks carried the risk that innovation and new entry would result in these assets becoming 'stranded'.[157] In light of LBG's evidence on branch costs set out in paragraph 9.183 we therefore consider that the risk that incumbent banks' existing branch network assets become stranded is relatively minimal. Further, Barclays told us that demand for traditional branch-based transactional services was declining and customer needs could be met through alternative services that were not located in traditional branches, including smart ATMs and assisted service counters.

9.185 In response to concerns over the impact of branch closures on (particularly rural or isolated) customers and communities, the main high street banks, consumer groups and the government signed up to an industry-wide agreement called the Access to Banking Protocol in March 2015. Under this protocol, the BBA agreed guidelines which require banks to work with local communities to establish the impact of a branch closure, find suitable alternative provision to suit individual communities and to put satisfactory alternative banking services in place before a branch is closed. The protocol also commits the industry to making sure there is the right support to help customers use internet and mobile banking.

9.186 While the cost of building and running an own-branded branch network may deter or prevent entrants from doing so, there are a number of alternatives that may act as a substitute channel. These include inter-bank agency agreements (IBAAs)[158] and counter services at the Post Office. Though they do not carry the brand advantages of traditional branches, these arrangements can reduce barriers to entry or expansion where branches are deemed necessary for customer acquisition and/or account maintenance. Atom, Starling and CivilisedBank have such agency arrangements, which while costly, have enabled them to enter the market with a primarily digital

[157] Barclays response to provisional findings, paragraph 2.13.
[158] Some agency agreements will be packaged with other benefits such as (indirect) access to payment systems. This is the case for Atom, which has an agency agreement in place with a high-street retail bank.

offering but with the ability to supplement their offering, especially for SMEs, with counter services.

9.187 The CCBS noted that use of improved IBAAs, and post offices if and when improved, would be a big step towards increasing competition in ‘no choice’ communities. It argued that approximately 1,200 communities had access to only one or two bank branches as a result of branch closures. Given the continued importance of branches to customer acquisition and retention, especially for SMEs, in its view shared service branches would open the door to new entrants and smaller banks as well as improving competition between established players.

9.188 We bring together our findings on branches in paragraph 9.231 below and conclude on whether branches are a barrier to entry or expansion in paragraph 9.291 below.

Payment systems

9.189 Payment systems enable the electronic transfer of funds between people and institutions.[159,160] Over 98% of sterling payments (by value) are made electronically in the UK.[161] Thus, to compete in the retail banking market, financial institutions require access to the payment systems infrastructure which they may acquire either directly or indirectly via an indirect access provider (IAP).[162]

[159] PSR (November 2014), *The PSR and UK payments industry.*
[160] The FSBRA defines a payment system as: ‘a system which is operated by one or more persons in the course of business for the purpose of enabling persons to make transfers of funds, and includes a system which is designed to facilitate the transfer of funds using another payment system’.
[161] BoE Settlement Accounts, p4.
[162] See PSR indirect access market review terms of reference, Glossary, p16. An IAP is a payment service provider (PSP) that provides indirect access to a payment system to other PSPs for the purpose of enabling the transfer of funds within the UK. Our working paper *Barriers to entry and expansion: capital requirements, IT and payment systems* referred to ‘sponsor banks’; sponsor banks are one type of IAP.

9.190 The main interbank payment systems in the UK are Bacs,[163] Cheques and Credit Clearing (C&CC),[164] CHAPS,[165] FPS [166] and LINK.[167] Banks will usually also need access to the core UK card systems, Visa and MasterCard, for card issuance. Since March 2015, each of these payment systems has been regulated by the PSR.[168]

9.191 At provisional findings we identified two broad areas of concern in relation to payment systems:

(a) barriers to attaining direct access; and

(b) market failures in respect of indirect access.

9.192 However, in our provisional findings we decided to deprioritise further assessment of payment systems. The PSR, which became operational only in April 2015, was undertaking a programme of work looking in detail at these issues. In addition, as the economic regulator with concurrent competition powers in relation to participation in payment systems and the ability to monitor relevant developments in the industry over time, the PSR was best placed to take this work forward. Most parties responded that it was appropriate for the PSR to take matters forward rather than both the CMA and the PSR. We received no further evidence on the areas of concern we identified in response to our provisional findings. However, a group of smaller 'challenger' banks submitted[169] that whilst the PSR had primary responsibility in this area, the CMA should make concrete proposals to the PSR as access to payment systems is a key barrier to entry and expansion for new entrants and smaller banks. Secure Trust in particular submitted that the only way to address the problems that indirect participants faced was to

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[163] Bacs offers a service handling electronic payment orders. It processes payments through two principal electronic payment schemes: Direct Debit and Bacs Direct Credit. (FCA (2014), *The PSR and UK payments industry*.)
[164] C&CC processes paper items such as cheques and credit vouchers in England, Scotland and Wales. NICC (Northern Ireland cheque clearing) is the equivalent interbank payment system in NI that processes cheques and other paper instruments. No issues have been raised with us by parties in relation to NICC, and we note that NICC is not within the scope of the PSR's market review into the supply of indirect access to payment systems or its market review into the ownership and competitiveness of infrastructure provision. We do not therefore consider NIIC any further. See *Payment systems in the United Kingdom*.
[165] CHAPS is the UK's real-time, high-value sterling interbank payment system where payments are settled over the BoE's real-time gross settlement system. It provides continuous (real-time) settlement of funds transfers individually on an order-by-order basis.
[166] FPS processes virtually all internet and telephone banking payments (as well as other services such as Paym in the UK. It provides near real-time payments as well as standing orders.
[167] The LINK network enables customers to access their accounts from any participating institution's ATMs.
[168] HMT (March 2015), *Designation of payment systems: response to the consultation*, p9.
[169] Letter from a group of challenger banks in response to provisional findings. See further Appendix 9.1.

have a single clearing system owned by a common use facility where all banks receive the same service on a pay-as-you-go basis.[170]

9.193 We remain of the view that the PSR is best placed to take the concerns of indirect participants forward. The PSR has been established only recently as the lead regulator of these issues and it would not be appropriate for the CMA to seek to duplicate and pre-empt the extensive programme of work that the PSR is already undertaking to address the issues of concern to indirect participants including reviewing the infrastructure of payment systems. Indeed, just prior to publication of this report the PSR published its final conclusions into its market review on the ownership and competitiveness of the infrastructure that supports Bacs, FPS and LINK. It found that there is no effective competition for UK payments infrastructure for these three payment systems and is consulting on a series of remedies to address this.[171] Further details are set out below.

9.194 We therefore summarise below the issues we identified first in relation to direct access and subsequently on indirect access and update on the work being undertaken by the PSR and wider industry since our provisional findings. Further detail on the structure of payment systems and the evidence we received from parties early in the investigation on issues of concern in relation to payment systems is contained in Appendix 9.4.

Direct access

9.195 To attain direct access to payment systems (to become a 'direct participant'), PSPs must fulfil a number of eligibility criteria. For some payment systems it is a condition of membership that settlement bank members have a settlement account at the BoE.[172] Further, a range of technical and operating requirements[173] must be satisfied, and other requirements, such as legal, regulatory and risk management requirements apply.

9.196 These access criteria impose a cost, in capital and resource, on PSPs seeking to become direct participants of the main interbank (and card) payment systems. Fees/tariffs (usually consisting of an annual account

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[170] See Appendix 9.1.
[171] PSR Final report: market review into the ownership and competitiveness of infrastructure provision
[172] This is a requirement for direct access to Bacs, CHAPS, C&CC and FPS. Under the BoE's current policy, banks and building societies are eligible for settlement accounts but e-money institutions and payment institutions are not.
[173] Technical and operating requirements are scheme-specific. For example, to become a direct member of CHAPS, participants must have SWIFT interfaces (known as Computer Based Terminals) located within their systems to connect to the network and process messages to and from participant payment systems. See *CHAPS Technical requirement document*.

management fee plus a per-item usage fee) also apply and are set unilaterally by individual payment schemes.

9.197 Smaller market participants told us that the cost of attaining and maintaining direct member status meant that new banks wishing to provide a transactional service may only have the option to use an agency banking arrangement (ie via a sponsor bank). The PSR estimates that the fixed cost associated with becoming a direct member is in the region of £[✂] million (though this varies between providers and will not be mutually exclusive of IT expenditures). It is evident that direct members of payment systems tend to be larger than indirect members (measured by total business revenue) and they tend to process more inbound and outbound transactions; thus, they are more likely to benefit from economies of scale.[174]

9.198 Improving access to payment systems and making governance of payment system operators more inclusive and transparent are stated key priorities of the PSR. The PSR has issued a number of directions which came into effect in June 2015 requiring scheme operators to ensure fair, open and risk based criteria for access and to publish their access requirements.[175] In December 2015, the PSR published its first annual report on progress towards more open and flexible direct access and more inclusive and transparent governance arrangements.[176] The report confirms that progress has been made:

(a) All operators now publicly disclose their access requirements in a clear and easy to use form.

(b) There is increasing demand for direct access and eight PSPs have entered into formal discussion for direct access.

(c) Whilst it can take up to 18 months to directly access a payment system, FPS can now potentially onboard a new direct access member in nine months once the member's IT systems are in place and it has completed relevant documentation. The PSR expects other payment systems to similarly reduce their onboarding times.

(d) There is greater transparency with board minutes and votes being published and operators have ensured that no board members are also directors of major infrastructure providers. However, the PSR recognises

[174] See Appendix 9.4 for a list of which banks have direct membership of payment systems.
[175] PSR update on access August 2015.
[176] Access and Governance of Payment Systems Report.

that more needs to be done by the operators to represent the views of users in their decision making processes.

9.199 The PSR will publish its annual progress report on direct access (and governance) in early 2017. This will include an assessment of information provided through compliance reports submitted by payment system operators in accordance with the access rules introduced by the PSR in June 2015.

9.200 The PSR also launched in March 2015 an infrastructure market review focused on determining whether there is effective competition in the provision of infrastructure services related to interbank payment systems and, if not, what the main reasons are for this.[177] The conclusions as noted above were published the end of July 2016. The PSR found there is no effective competition for the provision of UK payments infrastructure for the three main interbank payment systems (Bacs, FPS and LINK). The main issues it identified were: the lack of competitive procurement exercises by the payment system operators; UK payment systems use of bespoke messaging standards being a barrier to entry; and the joint control of the four largest shareholder PSPs over both operators and VocaLink reducing competition. As a result, it outlined a package of three remedies to address the issues it identified: competitive procurement exercises; the adoption of a common international messaging standard for Bacs and FPS; and the divestment by the four largest VocaLink shareholder PSPs of their interest in VocaLink. A consultation on these remedies will be published in late 2016 and is expected to set out the draft remedies decision, including remedy design and an assessment of the effectiveness and proportionality of the remedies.

Indirect access

9.201 Indirect access provides an alternative channel through which PSPs can connect to the payment systems infrastructure (eg via a sponsor bank). According to the PSR's definition, a PSP has indirect access to a payment system if it has a contractual arrangement with a sponsor PSP to enable it to provide payment services (ie transfer funds using that payment system) to its own customers.[178] The majority of indirect access in the UK is currently provided by the four largest banks: Barclays, HSBCG, LBG and RBSG.

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[177] See PSR infrastructure market review ToR.
[178] See PSR indirect access market review ToR, p4.Statement regarding the acquisition of VocaLink by MasterCard Incorporated | Payment Systems Regulator (PSR)

9.202 While the option to access payment systems indirectly via an IAP can facilitate entry to retail banking, a number of concerns have been raised in respect of indirect access, further details of which are contained in Appendix 9.4. These concerns fall broadly into four categories:

(a) **Quality of service provision by IAPs** – The quality of service that indirect participants can offer their customers is constrained by the quality of service (in terms of speed, reliability and security of supply) that the IAP provides, weakening their ability to compete on all aspects of service.

(b) **Fee arrangements between IAPs and indirect participants** – Transaction fees are in part dependent upon the volume of transactions processed; entrants and smaller market participants may not benefit from the scale advantages enjoyed by larger participants. A mark-up on the amount payable by the IAP to scheme operators is also by some IAPs which may reflect the costs associated with providing the service.

(c) **Information provision by IAPs to enable comparison by (potential) indirect participants** – Information about fees and service provision is complex and opaque, reducing the ability of prospective indirect participants to compare offerings and to negotiate terms and prices. This may also reduce the ability of indirect participants to switch amongst IAPs, providing limited incentives for IAPs to improve their proposition.

(d) **Reliance by indirect participants on downstream competitors** –The sharing of commercially sensitive information between indirect participants and the IAP may give rise to concerns, particularly as there is currently no legal framework governing the handling of that information. However, we have not received any evidence to suggest that this is an issue and Barclays commented that it had rigorous safeguards and controls to ensure that commercially sensitive information was handled appropriately. We would expect all IAPs to have similar procedures in place.

9.203 Further evidence provided by members of the Challenger Bank Panel of the BBA suggests that the advantages associated with having newer, more efficient IT systems do not extend to payment systems where these are accessed via an IAP.[179] Metro told us that the 'cost of integrating into the legacy systems of large banks [for access to payment systems] is huge' and

[179] Challenger banks roundtable hearing summary.

while '[Metro] has better systems in many areas, it becomes unstuck where it has to interact outside of its own IT ecosystem'.

9.204 The work described above being undertaken by the PSR to make direct access a more viable option in particular for retail bank indirect PSPs will address some of the issues highlighted above. In respect of indirect access the PSR launched a market review into indirect access in March 2015.[180] On 21 July 2016, the PSR published its final report in which it found that competition in the supply of indirect access appears to be producing some good outcomes but that the PSR has specific concerns about the quality of access, limited choice for some PSPs, and barriers to switching. The findings in its report relate to some of the concerns stakeholders raised during our investigation, in particular in relation to:[181]

(a) **Quality** – The final report found that the main concern for many indirect access PSPs (particularly larger PSPs) was around obtaining 24/7 real time access to the FPS. The PSR found that there were technical limitations involved in indirect PSPs having 24/7 real time access. The PSR also found that a number of indirect access PSPs considered that their ability to innovate and/or the quality of their offering to their customers was affected by the quality of the indirect access services they received. However, it also said that it was seeing investment and innovation in new and improved service offerings, which should improve quality and choice outcomes for all indirect PSPs. In addition, it noted that FPS had announced that five companies had now gained accreditation to provide direct technical access to FPS via the new aggregator model, providing more options for PSPs to have direct technical access.

(b) **Fee arrangements** – Whilst difficult to calculate prices in a consistent way, the PSR found that there was significant variation in the prices indirect PSPs paid for access to payment systems but that the overall feedback it had received to date did not indicate a widespread level of concern with price. The PSR noted that prices for indirect access were usually determined as part of a wider commercial negotiation for a broad range of services. It concluded that the evidence was inconclusive as to whether pricing of indirect access was impacting on competition in particular on innovation. In relation to the FPS, the PSR found that some

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[180] PSR indirect access market review ToR.
[181] PSR MR15/1.3 - Final report: market review into the supply of indirect access to payment systems.

large indirect PSPs did not pay significantly more for indirect access compared to the fees they would pay for direct access.

(c) **Information provision** – The PSR introduced a Sponsor Bank Information Direction,[182] which took effect on 30 June 2015, requiring the four main IAPs to publish information relating to their indirect access services to improve the transparency and availability of information for PSPs that want to get access to interbank payment systems. In addition, during its review it noted that a number of indirect PSPs with existing access relationships[183] indicated that there were difficulties in being kept informed of operational issues and that termination notice periods were potentially too short to enable indirect PSPs to effectively migrate to an alternative sponsor bank. On 1 September 2015, Payments UK, working with the PSR and the four main IAPs, published an interim Code of Conduct setting out a range of measures and commitments to improve these concerns relating to indirect access to interbank payment systems (see further below).[184]

(d) **Reliance on downstream competitors** – The PSR noted that it had not received any substantive evidence as part of its market review to support the hypothesis that IAPs are restricting access in order to restrict or influence downstream competition.[185] As noted above it is also not an issue in relation to which banks have raised concerns with us.

9.205 For larger indirect PSPs such as retail banks, the PSR considered that direct access was becoming a more viable option for a greater number of PSPs. This would increase their choice and ultimately promote greater competition in the provision of access services to other indirect PSPs. For example, four new PSPs were scheduled to become direct PSPs in the FPS by the end of the year, one of which had also announced that it would become a provider of indirect access to other indirect PSPs. The BoE has also announced that it will be extending settlement account access to non-bank PSPs, which means more PSPs will have the option of direct access.

9.206 The PSR said it would continue to monitor developments in indirect access and review the effectiveness of its work and changes in the market, and report on progress annually in its access and governance report.

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[182] PSR (2015), Specific direction 1 (Access: sponsor banks).
[183] See PSR (2016), *Market review into the supply of indirect access to payment systems: interim report*.
[184] See Access to payment systems Code of Conduct.
[185] See PSR (2016), *Market review into the supply of indirect access to payment systems: interim report*.

Ongoing work in relation to payment systems

9.207 In addition to the two market reviews on infrastructure and indirect access and its work on direct access described above, the PSR has also created an independent industry forum, the Payments Strategy Forum (Forum). The Forum's aim is to promote strategy setting and innovation in relation to payment systems for the benefit of all service-users in areas where collaboration is needed because of the network effect of some aspects of payment systems.[186] The Forum published its draft strategy for consultation on 13 July 2016 and is expected to publish its final strategy in the autumn.[187]

9.208 In addition to the work of the PSR, there are a number of important ongoing industry initiatives. FPS is currently undertaking a programme of work looking at an alternative model for accessing its service. This would enable PSPs to connect to a 'technical aggregator' that combines demand from multiple PSPs. This will create economies of scale and facilitate access by PSPs at a lower per-transaction cost than would be achieved by connecting directly to the central infrastructure. It should also increase the quality of access to FPS, which has been raised with us as an issue by a number of parties that currently have indirect technical access to FPS.[188]

9.209 Santander told us that six FinTech providers had recently committed to developing services under the alternative access model for FPS. Virgin Money told us that it welcomed the PSR's support for improved access to payment systems by means of direct technical access being considered by FPS. This, Virgin Money believed, could make it much easier for new banks to access payment systems.

9.210 Working with the industry's primary Indirect Access Providers, and the PSR, in September 2015 Payments UK[189] published a Code of Conduct covering 'indirect access' to UK payment systems for Payment Service Providers (PSPs). The principal aim of this voluntary Code is to improve the experience of Indirect Payment Service Providers (Indirect PSPs) by clearly setting out the responsibilities of Indirect Access Providers that have subscribed to the Code. To ensure effectiveness, the Code was put into practice and a formal consultation then launched with the wider industry. In light of the PSR's indirect access market review and the comments received

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[186] See PSR press release (September 2015): Payment Systems Regulator confirms members of the new strategy-setting Payments Strategy Forum.
[187] The Forum's Draft Strategy.
[188] See Appendix 9.4 for more information on technical access.
[189] Formerly the Payments Council, Payments UK is the trade association launched in June 2015 to support the UK's payments industry. See Payments UK website.

from this consultation, Payments UK is now working with Indirect Access Providers to further refine the Code.

9.211 In April 2016, Payments UK launched a new service designed to help the industry better access and implement the standards it relies on. This service, the Standards Collaboration Framework, provides the industry with a single authoritative resource. The service ensures rigorous version control and allows relevant industry stakeholders to obtain all of the up-to-date standards documentation crucial to supporting the UK payments infrastructure. Faster Payments Scheme Limited (FPSL) was the first user to take up this new service.

9.212 Payments UK's World Class Payments stated that its work had taken an evidence-based approach to determine what future innovations were required by customers, business and the growing payments industry. The objectives were to ensure that: (i) customers' needs are met; (ii) change supports competition and new entrants to the payments market; and (iii) the critical resilience, efficiency and reliability of payment systems are maintained.[190] In August 2015, Payments UK published its initial report on its work in which it sets out evidence gathered from a range of stakeholders. The findings were shared with the Forum to help inform their strategy setting. It also identified 13 capabilities or features that are needed to maintain world class payments in the UK. These include the following priority capabilities:

(a) **Open access to the payments infrastructure** – Improved access to the payments infrastructure for all those who offer payments to customers; this includes new and existing providers in the marketplace. Payments UK believes this is a prerequisite for healthy competition and innovation in the industry and as such is the focus of its work.

(b) **New features and services for customers** – New features and services such as Confirmation of Payee (Assurance), Request to Pay and Enhanced Data which provide customers with more control and confidence, supporting growing demand for real-time payments. In particular, Request to Pay and Enhanced Data will allow organisations to provide added value and competitive advantage with their payments services.

9.213 Other initiatives include an industry code of conduct, which has been designed to address some of the issues identified in respect of indirect

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[190] Payments UK, World Class Payments.

access. An interim code was published in September 2015,[191] and was welcomed by the PSR.[192] The interim code is focused on the suppliers of indirect access services and is intended to help to increase confidence in the supply of indirect access services and to improve outcomes for service-users.[193] In particular, the code should help to address concerns regarding the continuity and security of supply, contractual arrangements, reliance on downstream competitors, and the communication of information to indirect participants.[194] The interim code sets out four commitments between the code subscriber (the IAP) and the code beneficiary (the indirect PSP):

(a) Entitlement to a written agreement for the supply of indirect access.

(b) Support services and communication of important information.

(c) Managing the security of supply of the service.

(d) Ensuring the security of the indirect PSP's information.

9.214 Compliance with the code will be assessed via a self-certification approach and monitored on an ongoing basis by the code administrator (currently Payments UK).

IT systems and infrastructure

9.215 Another essential input to the provision of retail banking services is IT. Broadly, the required IT consists of two parts:[195] (i) the core IT platform (the hardware architecture); and (ii) the IT software and applications that connect to the core platform.

9.216 To support PCA and BCA provision, banks' IT systems must be capable of processing large volumes of transactions. These systems have traditionally been very expensive to develop and maintain, accounting for approximately two-thirds of the cost of entry according to HSBCG.[196] They have also accounted for a significant proportion of the economies of scale and scope in retail banking.

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[191] Payments UK (August 2015), *Code of Conduct for Indirect Access Providers, Version 1.0*. The code of conduct has been published in interim form that concluded in February 2016 ahead of code finalisation in late 2016. See Payments UK press release (September 2015): New Code of Conduct launched to benefit Payment Service Providers with Indirect Access to UK Payment Systems.
[192] PSR (September 2015), *Industry code of conduct for indirect access - our response*.
[193] PSR Consultation 15/1, p49; and PSR hearing summary.
[194] See PSR indirect access market review terms of reference, p5.
[195] Referred to in this section collectively as 'systems'.
[196] See Appendix 9.4.

9.217 Two technological innovations have significantly reduced the capital outlay necessary to develop operational IT systems:

(a) **'Off-the-shelf' solutions** – Pre-configured/packaged core IT platform solutions with modular architecture which are available to purchase 'off-the-shelf'; also known as 'bank-in-a-box'.[197]

(b) **Outsourced solutions** – 'Software as a service' enables applications to be centrally hosted by vendors on behalf of a customer. Core IT platforms may also be outsourced in a similar way. Access in both cases is provided via the internet.

Off-the-shelf solutions

9.218 The first UK bank to use an off-the-shelf IT solution was Metro. Metro employed Temenos' pre-configured T24 Model Bank IT platform, which had a high level of fit with its own business model.[198] As well as choosing an off-the-shelf solution, Metro opted to outsource its core banking system to a third party.[199] Metro told us that employing Temenos' pre-configured solution minimised the size of its initial capital outlay and cut implementation time by around one half. Metro has an account-based pricing agreement with Temenos for the core banking platform and pays a fixed monthly rental to Niu Solutions for hosting it, enabling it to 'better control its cash flows'.[200]

9.219 Atom and CivilisedBank have each followed an approach similar to Metro's, acquiring off-the-shelf solutions on an outsourced basis. CivilisedBank told us that it expected its core IT platform to cost in the region of £5 million. This is significantly lower than the cost incurred by some providers to integrate existing 'legacy' systems with new ones for the provision of PCAs or BCAs.[201] Opting for a hosted solution further lowers IT maintenance costs by being centrally managed and updated (discussed below).

9.220 Santander told us that while new entrants were able to enter at relatively low cost by using off-the-shelf IT solutions, it was not the case that 'one size fits all'. In particular, off-the-shelf solutions may be suitable for organic entrants, but for providers that had existing customers, integration into pre-configured

[197] For example, Temenos' T24 banking solution.
[198] See Appendix 9.1.
[199] Niu Solutions Holdings Ltd hosts Metro's core banking systems.
[200] See Appendix 9.1.
[201] For example, Tesco Bank and Santander. Santander told us that it spent approximately £[✂] million on its SME IT system alone.

solutions was not always possible, and at least in the short term may create a barrier to expansion. [✂]

9.221 Similarly, the IT costs associated with entering the BCA market were sufficiently high (relative to other options to invest in its retail infrastructure) to deter Nationwide from entering the BCA market.[202]

9.222 [✂]

Software as a Service

9.223 Software as a Service (SaaS) solutions allow banks to outsource hardware (whether it is pre-configured or bespoke), the maintenance of hardware and software, and user support to an external third party. This creates scale efficiencies (eg system updates can be applied to a number of users at once) and lowers individual firms' costs. In addition to the cost advantages afforded, new IT systems are designed to be more flexible and to facilitate the addition of new functionality.[203] Software applications can be added to these systems on a 'plug-and-play' basis, creating an 'ecosystem' of applications hosted virtually in cloud technology.

9.224 Although it has been raised with us that there may be a critical size at which off-the-shelf and hosted solutions cease to be adequate, we have not received any evidence to support this. HSBCG stated that innovative low-cost IT solutions were fully scalable. HSBCG also noted that to the extent that a bank faced IT costs as it expanded, there was no difference in adapting an off-the-shelf (hosted) solution to the difficulties faced by any other bank wishing to expand, including those with legacy systems. It told us that larger banks in fact faced a clear competitive disadvantage in relation to IT costs because of their inability to use innovative IT solutions in conjunction with their legacy systems.

Summary/conclusions on natural and intrinsic barriers

9.225 **Funding** – Access to initial funding has not been raised as a concern by banks, including new entrants. While firms experience some challenges given the significant amounts involved, access to initial funding is becoming easier due to the reforms to the authorisation process and trends towards lower-cost forms of entry. The continuing flow of entry we have observed does not suggest that access to initial funding is a material issue.

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[202] See Appendix 9.4 and Appendix 9.2 on Nationwide's plans to enter the BCA market.
[203] ACI, *Replacing legacy payment systems*.

9.226 However, as regards the ongoing cost of funding for lending, incumbent banks benefit from access to a stable book of lower cost retail deposits and have a wholesale funding advantage, with the impact of the former particularly acute given smaller and newer banks' current tendency to rely on retail funding.

9.227 These lower retail funding costs for incumbent banks reflect high customer acquisition costs resulting from the weak customer response and product linkages identified in Sections 6 and 8. Analysis of cost differentials for household deposits, which represents the majority of retail deposit balances, confirms this advantage, with BoE data on average effective interest rates showing a [✂][204] advantage for the largest six banks compared to a selection of smaller banks and new entrants. This is supported by our analysis of PCA competition in Section 6 and the FCA's analysis of competition for household cash savings which, together, suggest that:

(a) back book customers tend to earn less over time and therefore are a cheaper source of funds than the cost of attracting new customer deposits; and

(b) the weak customer response in the PCA market we have found links into the cash savings market.

9.228 In relation to wholesale funding, the position is more complex. Wholesale funding is more sensitive to risk/return considerations (including, for secured funding, the quality of collateral offered) and there are many (often interlinked) factors that can drive varying levels of investor demand. Differences in investor appetite for different types of firm, with size and longevity typically relevant criteria, are common across all sectors. Given the complexity and interactions between the many factors driving investment decision-making, it is difficult to precisely disentangle the incremental impact of any sector-specific systematic distortions, excepting TBTF which has been the subject of many studies and continues to be a major focus for prudential regulators in the UK and globally. The significant estimates of TBTF alone are sufficient to conclude that larger incumbent banks enjoy some advantages in wholesale funding beyond what might naturally be expected in a well-functioning market, and, as we have identified, other factors such as access to collateral and barriers to competition for current accounts, may compound such advantages.

[204] Estimated on the basis of deposits from household and private non-financial corporations.

9.229 Quantifying the level of differentiation in the cost of funds on a like-for-like basis between incumbent banks and in particular larger incumbent banks and new entrants/small banks is difficult. Moreover, the extent to which any funding cost advantages impact overall profitability, or competition within our terms of reference, depends on business decisions such as where and how to deploy the advantage (eg competing more aggressively for lending or for deposits, and in which areas of lending or deposit-taking), the mix of assets held, the business lines being supported and risk management strategies. The ongoing ring-fencing of retail banks will remove some of this discretion.

9.230 Finally, we note the potential for government policy aimed at stimulating lending, such as the joint HMT/BoE FLS, to have a significant impact on bank funding costs, and welcome the efforts made in the operation and extension of the FLS to facilitate the participation of smaller banks and new entrants alongside larger banks.

9.231 **Branches** –Traditionally branches have been the principal distribution channel for banks but recent developments are altering the role of and need for branches in particular the traditional large own-branded branch network. Digital distribution channels are increasingly serving the traditional functions of branches and the number of branches in the UK has been in decline. New technology is fast being adopted that enables straight-through online account opening for PCAs and BCAs. There is also evidence that the process for granting SME loans is becoming more automated. Whilst branches remain important to customer acquisition these supply-side developments, in combination with a greater willingness of consumers to engage with their bank through alternative channels, is likely to reduce the need for branches in modern retail banking markets. The building and maintaining of a branch network incurs significant fixed and ongoing costs but we have not found evidence that new entrants face higher costs or other difficulties compared to incumbent banks if a branch network is part of their strategy. Our case studies found that new entrants were adopting a number of non-branch based entry strategies including the use of IBAAS, counter services at the Post Office, existing retail networks as well as digital only propositions.

9.232 **Payment systems** – we decided to deprioritise work on payment systems in light of the PSR having been established in March 2015 and undertaking a programme of work to improve the viability of direct access for retail banks and on indirect access. In addition to work being undertaken by the PSR on the infrastructure of payment systems there are also various industry initiatives looking at alternative models for accessing the FPS, improving access to payments infrastructure, developing new features and services and an industry code of conduct for indirect participants.

9.233 **IT** – IT costs, which are largely 'sunk' (ie cannot be recovered upon exit), are a cost of entry to the retail banking market. However, recent technological innovations, namely the availability of off-the-shelf IT platforms and hosted solutions, have led to a significant reduction in the upfront capital and maintenance costs of IT systems for entrant banks.

Strategic and 'first-mover' advantages

9.234 As described in paragraph 9.3 above we have found that the lack of customer responsiveness to price and quality together with, in relation to SME banking, product linkages is a barrier to entry and expansion as it raises the cost of customer acquisition over and above the inherent costs of entry and expansion. As a result incumbent banks will have 'first-mover advantages' over new entrants and the larger the incumbent bank and more diversified their product portfolio the stronger the incumbent banks' advantages, including over smaller banks wishing to expand. In Section 8, we found that there were information asymmetries between an SME's BCA provider and other potential lenders through access to the SME's BCA transaction data. In this section, we consider more widely whether incumbent banks have additional informational advantages that might be a barrier to entry and/or expansion. We also consider whether access to intermediaries is a barrier to entry and/or expansion.

Access to proprietary information

9.235 Incumbent banks have access to a significant volume of customer transaction data that they source from their existing customer base. Access to such customer data as in many retail markets gives such banks a potential advantage over other market participants and may act as a barrier to entry and expansion.

9.236 There are four main ways that access to customers' transaction data may act as a barrier to entry and expansion:

(a) First, incumbent banks may be able to better develop, target and sell products to their customers. This in turn leads to higher acquisition costs for new entrants which have to dedicate more resources to attract customers away from incumbent banks.

(b) Second, it allows incumbent banks to better assess credit applications, leading to more optimal decision making and better pricing of loans and overdrafts. Where new entrants have less information on the credit quality of borrowers, they are more likely to misprice loans and overdrafts and potentially reject profitable opportunities.

(c) Third, it allows incumbent banks to process credit applications more efficiently and with reduced paperwork. One of the main reasons provided by SMEs for going to their main bank is reduced 'hassle' and the opportunity to obtain funds more quickly.

(d) Fourth, incumbent banks are able to use historical and pooled data on their customers to better assess the risk of lending to customers and to better predict the needs of customers through the use of 'propensity' models.

Better develop, target and sell their products

9.237 Evidence outlined in Section 8 and Appendix 8.1 shows that there is a relationship between an SME's consideration of switching and the number of products it holds. For example, the proportion of SMEs that considered switching from their main bank declined significantly as the number of products they held rose. This was supported by qualitative research conducted by the FCA, which found that 'having multiple products linked to the account was a potential barrier to switching. Amongst businesses this was occasionally referenced by those who had overdrafts and/or lending linked to their account or international banking arrangements'.[205] This would suggest that access to customers' transaction data may create advantages for incumbent banks and raise entry costs if banks are able to use this data to better target and sell products to their customers (at least in relation to SMEs).

9.238 In response to our inquiry a number of new and smaller banks raised the issue of transaction data providing advantages to incumbent banks. For example, OakNorth and Secure Trust[206] both told us that by virtue of being a customer's current account provider, an incumbent bank had a much greater knowledge and insight into the customer's behaviour compared with other banks. This gave 'considerable advantages' to incumbent banks when it came to cross-selling and credit decisions. Secure Trust also told us that incumbent banks ought to be able to innovate in a more informed and targeted manner than smaller rivals because of their unrivalled insights into their customers' behaviour. This could give incumbent banks an advantage in attracting new customers and retaining existing customers through more targeted product offerings and marketing.

[205] See 'Engagement with current accounts and the switching process' Optimisa Research for FCA, p32.
[206] Secure Trust response to updated issues statement.

9.239 This was consistent with the information provided by some incumbent banks[207] which told us that access to customers' transaction data enabled them to better target and market products to their customers. In particular, access to transaction data enabled banks to identify suitable contact opportunities or stages in a customer's life where they may have a specific product need. For example:

(a) [✂] told us that the marketing of other personal products and services to customers who already had a PCA was facilitated because, among other things, the nature of the PCA product created a rich source of high quality transactional and relationship data [✂][208] to better identify suitable contact opportunities. For customers that did not hold a PCA, there were less opportunities for contact, as generally there was less transactional activity, [✂].

(b) [✂] told us that one of the ways it learned about its customers and their needs was from PCA transactional data. The information was then used to provide customers with suitable marketing and products. [✂] also told us that it would contact customers if products that they had previously shown an interest in were on offer or if prompted by customer activity.

9.240 A number of banks, including HSBCG, LBG and TSB discussed the different approaches used to market to their PCA and non-PCA customers and highlighted that marketing to PCA customers can 'be more tailored to the needs of [those] PCA customers, given [their] knowledge of those customers'.

9.241 Similar views were expressed with reference to SMEs. For example, [✂] told us that there were some differences in how it marketed its SME banking products to BCA customers compared to other SME customers. In particular, it noted that it sent its BCA customers relevant information about other banking products where it had identified on the basis of customer behaviour or propensity that such customers may have a need for additional banking products. This information was sent using direct mail or email.

9.242 The growth of online and mobile channels has enhanced opportunities to use transaction data to market products. [✂] noted that the marketing of other business products to customers who already had a BCA was enhanced because of 'the wider range of channels available to interact with the customer (e.g. branch, mobile banking, etc.), more extensive data held on the customer, and the greater frequency of customer contact'. Online and

[207] [✂]
[208] '[✂]

mobile channels also provided greater opportunities to collect information on the customer as there was more frequent interaction between the bank and the customer.

9.243 As with PCAs, using transaction data to spot opportunities to further sell products was a common way of extending their product reach amongst customers. For example, [✄].

9.244 While incumbent banks may have an advantage over new entrants due to their access to current account data, we observed that banks with a pre-existing retail presence may have similar informational advantages. Banks with a retail presence can leverage information from their existing retail customers to help target financial products. M&S Bank told us that it leveraged its retail activities when marketing to customers. M&S Bank products were promoted to M&S retail customers (subject to marketing preferences) via email, up to three or four times a year. Simultaneously, M&S retail offers and incentives were promoted to M&S PCA customers, Premium Club customers and some credit card customers (eg vouchers).

9.245 This is consistent with information supplied by LBG, which told us that while access to customers' transaction data had the potential to enable providers to better target and market products (to around half of customers that do not opt out of direct marketing), it had not yet been able to use data as effectively as it would like to target its products. It told us that the data that it had today was probably less relevant than the behavioural data that non-bank organisations held such as CRAs, social media or supermarket spend patterns.[209]

9.246 Banks make use of transaction data to better target and market their products. However, this is common in many other retail industries; for example, supermarkets and online retailers widely use information on their customers shopping habits gathered from loyalty cards and their own databases to provide personalised offers and products. Indeed, we have seen evidence of high street retailers that have come into the banking market using their data from their retail activities to help inform their marketing for banking. This is a natural feature of many retail markets and likely to continue with the growth of digital banking.

[209] LBG hearing summary, paragraphs 36 & 37.

Better assess and more accurately price lending products

9.247 Lenders need access to borrowers' credit information to make an assessment of the risks associated with lending. Incumbent banks may be able to more accurately price lending products compared to new entrants as they have access to customers' transaction history and can use the information to more accurately assess creditworthiness of applicants.

9.248 As set out in Section 8, when making a credit decision, banks use four main sources of information to assess lending applications:

(a) Information from the application form about the person/SME, the product being applied for and plans for the future.

(b) Behavioural data (where available), from a person, SME or SME owner(s)' existing products with the bank or from historical bank statements (for new customers).

(c) External credit data from CRAs.

(d) Other information, such as the sector and bank's appetite to lend to that sector.

9.249 Each bank applies different weightings to these sources. However, only where there is adverse information, such as outstanding debts or County Court judgements, would this lead to an outright rejection on the basis of external credit data and no other data reviewed. In all other situations, an assessment is made on the basis of all four factors. Some assessments make no use of CRA data. Below is a summary of banks' use of data when assessing SME applications.

Table 9.2: Banks' credit assessments

Bank	*Loan amount*	*Information used for credit assessment*
Barclays	[✄]	[✄]
	[✄]	[✄]
HSBC	[✄]	[✄]
	[✄]	[✄]
LBB	[✄]	[✄]
RBS	[✄]	[✄]
Santander	[✄]	[✄]
Metro	[✄]	[✄]

Source: CMA analysis.

9.250 Where banks cannot use or have limited transaction data because the customer is external to the bank, greater reliance is placed on the data supplied by CRAs and this can often be an imperfect substitute. For example, Barclays said that, where it could not use transaction data in its models, more reliance on other sources (including CRAs) lessened the power of these models to measure the ability of the customer to repay the loan. This in turn is likely to lead banks to either misprice loans because they cannot appropriately assess risk or to miss potential profitable opportunities.

9.251 As set out above, this is likely to be a greater issue in relation to lending to SMEs. The SME lending market is characterised by poor and asymmetric information. According to a review by the BoE,[210] there is a particular problem for younger and smaller SMEs where there is a lack of information on their performance. HSBCG estimated that 2.3 million firms are not registered. This makes it difficult for lenders to verify whether credit checks are being run on the correct SME or simply one with the same name. One respondent to the BoE discussion paper said that SMEs with no credit rating tended to be treated as having a high risk rating.[211]

9.252 There are several reasons why there may be poor CRA data on SMEs, including low availability of public data on these businesses. For example, financial accounts data from Companies House is limited because SMEs that meet two or more of the following criteria are only required to provide very limited financial information:

(a) Turnover below £6.5 million.

(b) A balance sheet of less than £3.26 million.

(c) An average of 50 or fewer employees.[212]

9.253 HSBCG also commented that 'there are significant limitations in the data available from CRAs, particularly for unincorporated businesses'.

9.254 Furthermore, where CRA data is not publicly available elsewhere, access is governed by the principle of reciprocity. This means that all current lenders and new entrants can access data as long as they provide (or will provide) equivalent data. Within this, however, there are 'closed user groups' for particular data sets. These restrict data to certain types of lenders or to providers of certain products. Data on BCAs is held within a closed user group so only those banks that submit data on BCAs can access data on

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[210] BoE (May 2014), *Should the availability of UK credit data be improved?: A discussion paper.*
[211] BoE (November 2014), *Summary of feedback received on the Bank of England's May 2014 Discussion Paper on UK credit data*, p8.
[212] Companies House (July 2015), *Life of a company - part 1: annual requirements*.

BCAs. This effectively prevents non-BCA providers from obtaining valuable information about SMEs.

9.255 Secure Trust told us[213] that 'data generally available to non-current account providers is much less powerful, is historic and relies on the accuracy of information supplied by lenders under the reciprocal code with the CRAs. [This is not] … as insightful as being able to review the behaviour of a customer's current accounts in real time.' Paragon Bank told us that although 'having an existing long-term relationship [with a customer] gives the lender more information on which to base a responsible lending decision'. It considered 'there is potential for recent government initiatives (such as improving SME credit data sharing and referrals to alternative lenders) to open up competition'. However, it recognised that it was too early to predict the impact of such policies.

9.256 The government has recently introduced initiatives aimed at improving lenders' and banks' access to information on SMEs to enable them to make better credit decisions. The SBEE Act[214] requires banks (meeting certain market share thresholds) to share data on their SME customers with other lenders through CRAs and requires those CRAs to provide equal access to that data to all lenders. The SBEE Act also makes VAT registration data available to assist lenders with the verification of SMEs. This will particularly help CRA checks for some smaller SMEs, which are not incorporated but are eligible for VAT (ie have a turnover of over £82,000). This will not, however, help verify the identity of the smallest SMEs as they are not required to be VAT registered. The SBEE Act came into effect on 30 June 2016.

Be more efficient in assessing credit applications

9.257 Incumbent banks may be more efficient in assessing credit applications compared to new entrants because they have all the information on the customer readily available.

9.258 The process of applying for credit can be very time consuming and burdensome for customers if they choose to apply for credit in a bank other than the bank where they already have an account ('main bank'), as they have to provide more paperwork.

9.259 Although this is also an issue with respect to personal loans, there is more information on these compared to that on SMEs (especially younger and/or smaller SMEs), as described above. Additionally, because SMEs are more

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[213] Secure Trust response to updated issues statement.
[214] See Section 3.

complex in nature than individuals, more extensive paperwork needs to be provided for SME loan applications (eg business plans, strategies, identities of all directors). In addition when seeking a loan, banks will typically ask for 18 months' worth of statements to assess the creditworthiness of an SME if the SME is not a BCA customer of that bank.

9.260 This may lead many customers to seek credit products from their 'main bank' in an attempt to reduce the time and cost of applying for finance. This is especially the case as speed in lending decisions is a key requirement for SMEs looking for finance, and these typically seek finance at short notice.

9.261 This issue was also noted in the BoE's credit data discussion paper,[215] which stated that incumbent banks offering BCAs could assess loans much more quickly and cost-effectively as they could source their data from their own systems rather than require the SME to provide information. This suggests that incumbent banks' are able to more accurately assess credit applications through access to their customers' BCA.

9.262 With respect to PCAs, some parties[216] have commented that incumbent banks are able to more efficiently assess credit applications through access to their customers' transaction data. In particular:

(a) [✂] noted that, for personal loans, it generated and maintained provisional loan limits for existing PCA customers, allowing them to instantly draw down those funds if they wished to, subject to completing a short application. This reflected the high speed at which credit could be provided for those that already held a PCA with [✂].

(b) [✂] stated that marketing to PCA customers could be more specific, as it had information on a customer's credit score and associated lending limits. This suggested the high speed at which credit could be provided for those that already held a PCA with TSB.

9.263 Barclays stated that it sent [✂].

Use historical and pooled data where individual-level data is not available

9.264 Having access to data on a large number of customers allows incumbent banks to use pooled data where data for a particular customer is not available. This means they might be able to, for example, more accurately price risk by estimating the probability of default for different types of

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[215] BoE (May 2014), *Should the availability of UK credit data be improved?: A discussion paper.*
[216] [✂]

customers based on their historical, pooled data, and the expected loss from those customers defaulting. Also, they might use such data to identify similar types of consumers with a propensity to need/buy certain products.

9.265 With respect to PCAs, some parties have made comments that reflect incumbent banks’ ability to use historical and pooled data on groups of customers to substitute for individual-level data. In particular:

(a) HSBCG noted that choosing which customers to target with marketing ‘is built around propensity models (ie statistical analysis of the customer database to help predict which customers are likely to respond to the product offer; it is primarily used for mortgage offers, personal loan offers and credit card offers).’ These helped HSBCG identify which of its customers were most likely to have a need for other products. These models could be used to assess and potentially offer pre-approved credit card and personal loan applications.

(b) M&S Bank also used propensity models to promote credit cards to PCA customers and to identify those that were most likely to respond.

9.266 For SMEs, [✂] also mentioned that it sent its BCA customers relevant information about other banking products where it had identified on the basis of customer behaviour or propensity that such customers may have a need for additional banking products.

Intermediaries

9.267 Different channels are used by banks to distribute their products and services. These channels include branches (discussed earlier in this section), telephone, online and intermediaries and other third parties. The use of distribution channels varies considerably by product and by bank.

9.268 Access to intermediaries and other third parties for the distribution of products may be restricted in a market if (exclusive) relationships exist between incumbents and distributors. This can create barriers to entry or expansion for new and existing banks.

9.269 We define intermediaries here in the broadest sense, to mean any business or individual that introduces a customer to a bank, including brokers, accountants, lawyers, business formation companies[217] and PCWs.

[217] For example, introductions with a bank may be made when businesses register with Companies House through a business formation company.

Intermediaries in the PCA market

9.270 The evidence we have collected suggests that intermediaries play a very limited role in the distribution of PCAs. As discussed in Section 6, PCWs are used by some PCA providers to promote their accounts. However, only two banks (HSBCG and LBG) told us that their use was significant in driving new account openings.

9.271 Intermediaries appear to play much more of a role in the sale of other financial products, including mortgages, which may be cross-sold to PCA customers. TSB told us that approximately 60% of all UK mortgages were sold via intermediaries. Danske told us [✂].

Intermediaries in the SME market

9.272 Intermediaries are used by some banks and specialist lenders in the distribution of products to SMEs. Intermediaries are primarily used by providers of SME banking for the distribution of business lending and niche products such as asset finance and invoice discounting. Some providers also use intermediaries in the distribution of BCAs.

9.273 LBG told us that external professionals such as brokers, professional advisers and business groups contributed to the number of SME banking customers that were referred to it. LBG told us that [✂]% of SME customers that switched to it from another provider in 2013 came from paid brokers, other professionals or referrals from existing SME customers. LBG used around [✂] brokers (typically small accountancy and legal firms) in the sale of invoice finance, hire purchase and leasing. In addition to these formal (and paid) introducer relationships, LBG used informal (unpaid) relationships with lawyers and accountants to encourage future customer introductions. These would often introduce start-up SMEs, SMEs that were dissatisfied with their existing provider and SMEs that had been declined for lending/other services by other providers.[218] The majority of LBG's focus for future investment was in alternative channels, in particular branches, online and mobile.

9.274 Barclays told us that it sold some SME loans (up to the value of £[✂]) through brokers. [✂] business loans to SMEs with annual turnover of [✂] were sold via intermediaries in 2014 (at a total value of £[✂] drawn debt). Barclays also used intermediaries to sell its BCAs to SMEs. Barclays told us that it had established partnerships with [✂] business formation companies

[218] In some cases, LBG told us that these introductions resulted in LBG being invited to tender for the SME's requirements alongside a number of other providers.

and [✂] indirect affiliates (small scale formation companies). It estimated that customer introduction through business formation companies resulted in the opening of around [✂] new BCA accounts annually. Barclays also used a range of intermediaries including accountants, business advisers, brokers, and 'key business introducers' to acquire SMEs.

9.275 Metro also told us that external intermediaries were one of the main sources of new customers to SME finance.

9.276 However, a number of banks told us that intermediaries did not feature in the distribution of their products to SMEs. [✂].[219] Charterhouse's follow-up survey supports this: 81% of SMEs applying for finance did so without obtaining advice from any source.

9.277 Handelsbanken told us that its branches were its main distribution channel, and it did not sell SME products via intermediaries. Handelsbanken's relationship managers did, however, play an important role in forging relationships with the business community in their locality, and this was likely to be a source of informal introductions. Similarly, [✂] did not use or pay referral fees to intermediaries to sell business banking products. [✂].

Summary/conclusions on strategic/first-mover advantages

9.278 **Access to transaction data**: Incumbent banks have an advantage over new entrants due to their access to customer data and are able to make use of such data to better target and market their products. However, this is common in many retail industries for example, supermarkets and online retailers widely use information on their customers' shopping habits to provide personalised products and offers. With increased digitilisation the use of such data is likely to increase. Our case studies did not suggest that access to customer data was an issue for new entrants and we have not received strong evidence otherwise to suggest that it is a barrier to entry or expansion. However, in relation to SME lending, access to customers' transaction data can provide greater insights into customers' probabilities of defaults and therefore allow banks to better price products. The absence of information in the market on SMEs (particularly younger and smaller SMEs) means that the alternative sources for assessing credit quality are much more limited. Whilst there are ongoing reforms that are likely to reduce these advantages, it is too early to tell the full impact of these.

[219] [✂]

9.279 **Intermediaries**: While some banks use intermediaries to distribute their products, there are wide variations between banks and product groups. Where intermediaries are used as a channel of distribution, they are complementary to other channels rather than substitutes. There is very limited use of intermediaries in the sale of PCAs across banks, with the exception of PCWs, which are important to customer acquisition for at least two banks.

9.280 A number of banks – smaller banks as well as incumbent banks – have a combination of formal and informal arrangements with intermediaries for the sale of SME finance and niche lending products. However, others do not use any formal arrangements with intermediaries for the distribution of their products. Branches, online, mobile and telephone services remain the main sales channels for these banks, and their ability to compete does not appear to be impeded by a lack of a large intermediary network.

Overall findings on barriers to entry and expansion

9.281 We have looked in detail at a number of potential barriers to entry and expansion. Based on the evidence and analyses set out above and in the relevant appendices, we have found the following.

9.282 **Customer acquisition**: We have found that one of the main challenges for new and smaller banks seeking to enter and expand in retail banking markets is customer acquisition. As set out in Sections 6 and 8 the supply of PCAs, BCAs and SME lending is characterised by weak customer response to price and quality including, in respect of BCAs and SME lending, product linkages. This means that new entrants and smaller banks seeking to enter and/or expand have to invest large amounts of resource in order to attract customers away from the larger established incumbent banks over and above the inherent costs of entry and expansion. Even then, it will take some time before they are able to acquire a sufficient volume of customers to recover their costs of entry and expansion and/or to have a sufficient presence in the market commensurate with their initial investment. The evidence from our case studies confirms the difficulties faced by new entrants in this respect and which is supported by the evidence on niche entry and the slow growth of new entrants and smaller banks.[220] We therefore find that the high cost of customer acquisition arising from weak customer response, including product linkages in SME banking, is a barrier to entry and expansion in PCAs, BCAs and SME lending.

[220] See in particular Sections 5 and 7 respectively on market shares.

9.283 **The authorisation process**: Whilst the cost and time implications of authorisation continue to be significant, recent changes have facilitated entry by several new providers and a number of prospective providers are in the early stages of seeking authorisation. We therefore find that the authorisation process is not a barrier to entry.

9.284 **AML**: We have not found that the AML regulations themselves are a barrier to entry or expansion but as set out in Sections 6 and 8 banks' approaches to risk and how they therefore implement the regulations within their account opening processes contribute to barriers to searching and switching in particular for SMEs.

9.285 **Capital regulation**: The capital requirements regime places SA banks at a competitive disadvantage in lower LTV mortgages because they have higher risk weights than IRB banks. Two members of the inquiry group[221] are of the view that the evidence is sufficient to support a finding that the capital requirements regime for mortgages has sufficiently large effects on the costs and returns of SA banks to be a barrier to entry and/or expansion in retail banking more generally including the supply of PCAs and of SME banking services. The majority of the inquiry group, however, consider that further evidence would be needed in order to be confident about the scale of the impact that is attributable to the capital regime. In their view, further evidence on the materiality of the competitive disadvantage and the impact on competition and outcomes would be needed in order to support a finding that the differential in mortgage risk weights is a barrier to entry and/or expansion in PCAs, and/or SME banking (or indeed in other retail banking markets).

9.286 We decided that it would not be appropriate to undertake further analysis to determine whether SA banks' disadvantage in lower LTV mortgages gives rise to a barrier to entry and/or expansion. We do not have powers to change the capital requirements regime and the regime as a whole is the subject of a number of significant developments for reform at international level. Moreover, the PRA, BoE and HMT have confirmed that they are actively considering the issues we have identified as a matter of priority including the proportionality of banking regulation, the extent of the capital differentials between IRB and SA banks and the regulatory burden on smaller banks. Given this and the primary purpose of the capital regime to ensure the safety and soundness of the UK banking system, we consider that the BoE and the

[221] Professor Alasdair Smith and Professor Tom Hoehn.

PRA, as the UK's prudential regulators, are best placed to identify what action should be taken to address the concerns we have identified.

9.287 A number of smaller banks that responded[222] to our addendum to provisional findings on capital requirements disagreed that we should not undertake further work. Whilst they agreed that the CMA could not change the internationally set capital requirements regime unilaterally, they were of the view that the CMA should undertake further work and make clear recommendations setting out a roadmap for reform to achieve a level playing field between SA and IRB banks. We recognise the significance of capital requirements to competition in retail banking and that the competitive disadvantage that we have found in mortgage markets has the potential to impact on competition across retail banking markets. However, we are of the view that it would not have been an appropriate use of resources in the final months of the investigation to undertake such further work for the reasons set out above.[223] For the same reasons[224] we do not consider that it is appropriate or indeed necessary for this investigation to identify how the issues we have identified should be addressed. We set out below in paragraph 9.298 our views as to the importance of competition in the ongoing work of the relevant authorities.

9.288 **Bank levy and CTS**: We have not found strong evidence that the introduction of the CTS and the changes to the bank levy are currently deterring entry and expansion or causing exit from retail banking. The bank tax regime continues to favour smaller banks including new entrants, and this is welcome, given the other barriers to entry and expansion which we have identified. However, the recent changes to the bank tax regime have reduced the previous tax advantage that new entrants and smaller banks had over those banks subject to the bank levy. In addition, as outlined in paragraph 9.113 above there are aspects of the design of the CTS which may lead to differential effects across retail banks and which might impact on competition between banks in the future. We therefore welcome HMT's

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[222] See Appendix 9.2. In a further submission to the TSC dated 30 June 2016 copied to us, a group of 'challenger' banks requested that the CMA make a direction to HMT and the PRA to develop a framework for the sharing of anonymised origination and performance lending data from the bigger banks to enable smaller banks to use such data to build internal models to become IRB approved. The PRA's view on the use of pooled data is set out in Appendix 9.2.
[223] Whilst we could not make formal recommendations, having not formally found the capital requirements regime to be a barrier to entry or expansion, nevertheless an informal recommendation could be appropriate.
[224] The complexity of reforms in this area and the paramount need to ensure the safety and security of the UK banking system in this context. The PRA has confirmed that reforms need to address the differentials from both sides – improving the modelling under IRB and also making the SA more reflective of UK risk (see Appendix 9.2). As also set out in Appendices 9.2 and 9.3 we note the views of the PRA and of other parties. For example, Santander submitted that the use of pooled data was not straightforward and would result in having higher risk weights than if it used only its own data.

commitment to keeping the impact of the bank tax regime on smaller banks and new entrants under review.

9.289 **Access to funding**: We have not found that access to initial funding is a barrier to entry.

9.290 **Cost of funding for lending:** The high cost of customer acquisition we have found in Sections 6 and 8 including product linkages, means that it is expensive and takes time for new entrants and smaller banks to attract retail deposits. Incumbent banks on the other hand benefit from access to an existing stable book of lower cost retail deposits and from product linkages in particular between current and savings accounts. The larger the customer base and the more diversified the product portfolio due to such product linkages, generally the greater the cost of funding advantage for an incumbent bank. We also find that incumbent banks enjoy some advantages in wholesale funding, most readily quantifiable in terms of TBTF although other factors may compound such advantages over and above the firm-level differentials to be expected in a well-functioning market.

9.291 **Branches**: Branch usage has significantly declined in recent years and multi-channel banking (branch, telephone and digital) is now the most common way in which customers use their bank. Branches remain important to customer acquisition for PCAs and in particular BCAs, and establishing an own-branded branch network involves significant costs. We have not found, however, that new entrants or smaller banks have a cost disadvantage or other difficulties relative to incumbent banks if a branch network is part of their strategy. In addition, as shown by our case studies, new entrants are able to adopt alternative business models including the use of digital channels as well as the Post Office, IBAAs and/or existing retail networks. We do not therefore find that access to a branch network is a barrier to entry and/or expansion.

9.292 **Payment systems**: We have identified a number of issues with respect to payment systems that suggest that indirect participants (most new and smaller banks) are at a competitive disadvantage compared to direct members in accessing payment systems. The PSR, which has only been fully operational since April 2015, is currently looking in detail at these issues and we consider that the PSR is best placed to take forward and address these issues.

9.293 **IT**: Technological innovation has reduced the cost and risk of upfront capital investment in IT architecture, which has previously represented a significant sunk cost to firms seeking to enter the retail banking market. New entrants are now able to purchase preconfigured (‘off-the-shelf’) IT solutions and outsource the hosting of IT platforms and applications to third parties. We have not found evidence that such systems are not able to expand as a bank grows organically and indeed they appear to be less costly than many banks' existing legacy systems in enabling expansion and the development of new products and services. We therefore do not consider IT to be a barrier to entry or expansion.

9.294 **Access to customers' transaction data**: Incumbent banks have an advantage over new entrants due to the access to their customer data and are able to make use of such data to better target and develop their products and cross-sell. This is common in many retail industries; for example, supermarkets and online retailers widely use information on their customers' shopping habits to provide personalised products and offers. With increased digitalisation, the use of such data is likely to increase. Our case studies did not suggest however that access to customer data was a barrier to entry and/or expansion and we have not otherwise received strong evidence to suggest that it is a barrier to entry and/or expansion.

9.295 In relation to SME lending, however, we have found that an SME's BCA provider will benefit from better trading and credit histories on their existing SME customers as well as access to pooled data than alternative providers. This gives an SME's BCA provider an advantage in pricing and assessing risk which is particularly relevant for smaller SMEs as there is a lack of publicly available information on the trading and financial performance of such SMEs. Access to information can also reduce the time involved and inconvenience to SMEs of the loan application process, which is considered in more detail in Section 8. Given this, we consider that in addition to information asymmetry between BCA providers and alternative providers, access by incumbent banks to their individual customers' data and to shared data through CRAs is a barrier to entry and expansion in SME lending.

9.296 **Access to intermediaries**: While some banks use intermediaries to distribute their products to SMEs, and to a lesser extent, personal customers, there are wide variations between banks and product groups. Where intermediaries are used as a channel of distribution, they are complementary to other distribution channels. We found no evidence that new entrants or smaller banks have difficulty accessing intermediaries if the use of intermediaries is part of their customer acquisition strategy.

9.297 In conclusion, we therefore find that the high cost of customer acquisition including product linkages and, in relation to SME lending, in addition information asymmetries, makes it difficult for new entrants and smaller banks to expand and are a barrier to entry and expansion. Combined with the economies of scale and scope in retail banking this means that incumbent banks have first-mover advantages and are able to spread their costs over an established customer base. They also have lower costs of funding for lending as they have access to stable and lower cost retail deposits from their established customer base as well as wholesale funding advantages. These incumbency advantages are particularly strong for established banks with larger customer bases.

9.298 Our remedies detailed in Sections 13 to 16 will address the main causes of the poor customer outcomes we have found.[225] The other issues that we have identified in particular in the context of barriers to entry are complex and longstanding. As detailed above, the UK government and various regulators and authorities, both UK and international, have a lead and ongoing role to play in making the UK retail banking market more competitive. In all these areas, we urge the relevant authorities to give due weight to competition objectives. In this context, we welcome what is happening on various fronts to address some of the issues we have identified:

(a) The PRA's work programme to make the IRB application process more proportionate for and to facilitate transition to the IRB approach by smaller banks. The PRA has confirmed in particular that it is making additional resources available to support banks to transition to the IRB approach and is reviewing data requirements including the use of external data.

(b) The BoE and PRA's commitments to supporting wider reform with a view to achieving a more proportionate approach to the prudential regulation of retail banks in the UK.

(c) HMT, BoE and the PRA's proactive identification of areas of regulation where a more proportionate approach could be adopted whilst still achieving relevant regulatory objectives and HMT's programme aimed at reducing the regulatory burden on banks and in particular smaller banks.

(d) The BoE and PRA's commitment to narrowing the differentials between capital requirements where they have discretion and, together with HMT

[225] In a letter dated 30 June 2016, a group of 'challenger' banks proposed that the CMA makes a number of recommendations to HMT, and/or the BoE to address their concerns on capital requirements, the cost of funding and taxation. We set out in above our views on the proposals on capital requirements. In relation to funding, we consider that the remedies we are putting in place address the main cause of the cost of funding for lending advantage of incumbent banks and note that the BoE has taken steps to broaden the range of collateral it accepts in its facilities, including the FLS, and to provide additional support to new lenders wishing to access the scheme. The BoE has confirmed that the FLS is designed to support lending and not particular banks and therefore all participants have access on the same terms. We have not found that the recent changes to bank taxation are a barrier to entry and/or expansion but we welcome HMT's commitment to keeping under review the impact on competition of the bank tax regime.

and the European Commission, in the negotiation of the current proposed reforms of the SA and of capital risk floors being consulted upon by the BCBS as well as future reforms.

(e) The UK government's and BoE's ongoing work to strengthen bank resolution to address TBTF.

(f) The PSR's extensive work programme to improve access to payment systems.

(g) HMT's commitment to keeping under review the impact on smaller banks and on new entry of the bank tax regime in light of the specific issues we have highlighted. We also urge HMT to continue to monitor the impact of its fiscal policies on competition in retail banking more generally.

9.299 The CMA has confirmed to the inquiry group that it will continue to liaise with the relevant authorities as part of its advocacy and/or concurrency objectives with a view to ensuring that competition in retail banking remains a priority and is given due weight in the development and implementation of government policy and in the ongoing work of the various relevant authorities in this area.

10. Market structure and market power

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Concentration in retail banking markets

10.1. The structure of a market at any point in time will reflect the results of current and previous competition in the market including entry, growth, decline and exit of firms. Market structure is affected by both organic growth or decline and discrete structural changes, such as mergers and divestments. It also reflects underlying supply and demand factors including: on the supply side, the extent of economies of scale and scope; and, on the demand side, the extent to which customers demand a variety of differentiated products and levels of customer engagement.

10.2. The Herfindahl-Hirschman Index (HHI) is a common measure of market concentration, where the higher the number the more concentrated the market. Table 10.1 below shows that HHI in the markets we considered are all in excess of 1,500, and in line with our guidelines, we consider these markets to be concentrated.[1]

Table 10.1: Market structure in GB and NI, 2015*

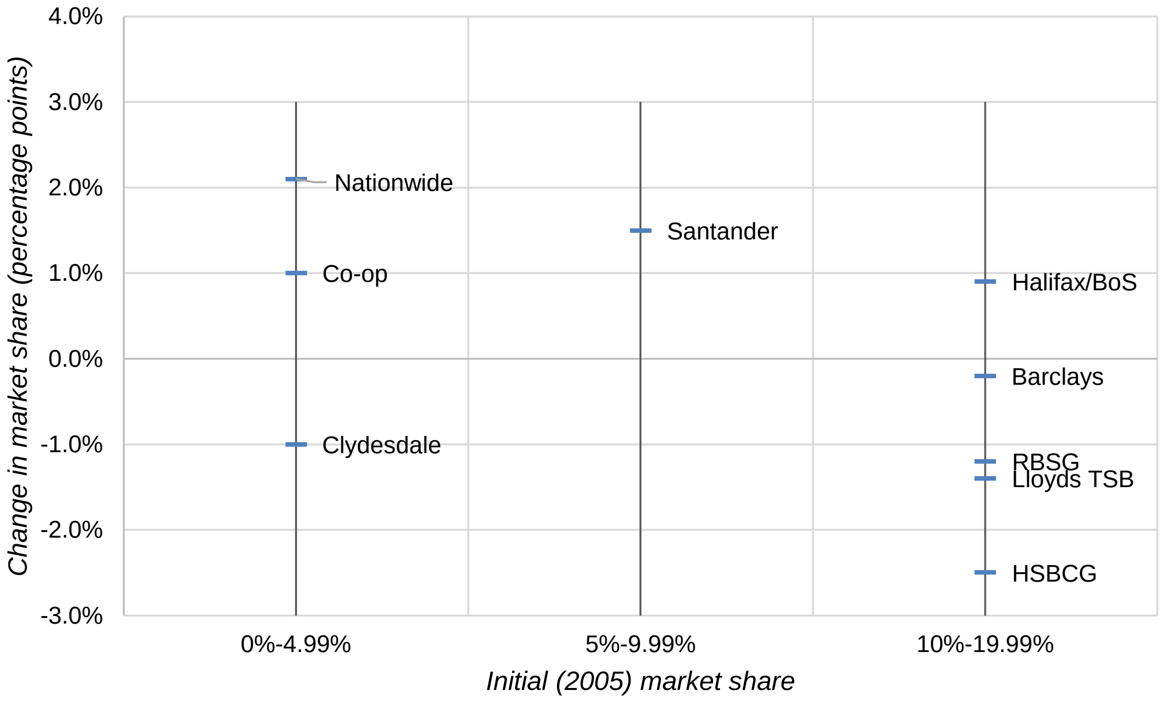
	active BCAs	*main PCAs*	*value of outstanding GPBLs*
GB			
Share of largest four banks %	82	73	81
HHI	1,810	1,623	1,942
NI			
Share of largest four banks %	86	71*	91
HHI	2,015	1,539	2,662

Source: CMA analysis of data submitted by banks (see Sections 5 and 7).
* We have used banks' data to calculate HHI.
† The group of the largest banks for the NI market varies with the metric used. The largest four providers of main PCAs do not coincide with the largest four BCA and GPBL providers. For the GB market the four largest providers of PCAs, BCAs and GPBLs are Barclays, HSBCG, LBG and RBSG.
Notes:
1. General-purpose business loans include commercial mortgages but exclude other types of loan such as peer-to-peer lending, business credit cards, invoice finance and asset finance. Precise figures are not available for SME deposits.
2. Post-rounding numbers are used in the table.

[1] Markets with HHI exceeding 1,000 are described as concentrated, see Guidelines.

10.3. Organic change in market shares through customer acquisition in retail banking markets occurs slowly (see Figures 10.1 and 10.2 below showing market share change since 2005 in absolute and proportionate terms respectively). There is some tendency for PCA market shares of small banks to have increased since 2005, and for larger banks' market shares to have reduced slightly in percentage points terms, but more so in proportionate terms.[2,3]

Figure 10.1: Absolute change in GB PCA market share, 2005 to 2014, versus 2005 market share



Source: CMA estimates based on GfK FRS data up to 2014.
Note: Initial market shares are based on banking groups at the start of the period, except for Abbey National and Alliance & Leicester for which figures are not available as these brands were acquired by Santander. Lloyds TSB acquired Halifax/BoS in January 2009: therefore growth reflects about three years under separate ownership and six years under common ownership. TSB was divested from LBG in 2014: Lloyds TSB figures include both Lloyds and TSB.

Figure 10.2: Proportionate change in GB PCA market share, 2005 to 2014, versus 2005 market share

[✂]

Source: CMA estimates based on GfK FRS data.
[✂]

[2] Banks with less than 1% market share are omitted.
[3] The main exception to this is Clydesdale, a long-established smaller bank which has experienced declining market share. [✂]. HSBCG is perhaps another exception as it has lost nearly 20% of its market share in the 2005 to 2015 period.

10.4. Our information on longer term trends in BCA market shares is less complete than on PCAs (see Section 7). General trends appear more variable than for PCAs among the larger banks, but the pattern is broadly similar: in aggregate, the four largest banks experienced a small decline in market share while smaller banks have had a small increase.

10.5. There have been several mergers and divestments in recent years which have affected levels of concentration: Santander's acquisition of Alliance & Leicester in 2008; LBG's acquisition of HBOS in early 2009; and its subsequent divestment of TSB in 2014. The net effect of mergers and divestments – in particular the merger of LBG and HBOS – increased concentration more than the subsequent divestment of TSB reduced it.

10.6. Some banks argued that concentration levels were modest and lower than in other markets which have been found to be competitive (for example, HSBCG referred to retail mobile phones).[4] One bank referred to a statement in our merger guidance that previous phase 1 merger decisions involving retailers suggest that the CMA has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above).[5]

10.7. Banks also commented on the fact that over the last three years the market shares of the largest banks have tended to decline, TSB has been divested from LBG, and a further decline in concentration will occur when Williams & Glyn is divested from RBSG[6]. Each market has individual characteristics and statements about other markets are not necessarily relevant to the PCA and SME banking markets. Therefore, we do not consider we should dismiss issues relating to the level of PCA and SME banking concentration simply because the level of concentration is not as high as in some other markets which have been found at some point in time by a competition authority to be competitive. Also, a merger assessment decides a different question to a

[4] HSBCG response to updated issues statement, paragraph 5.18.
[5] *Merger Assessment Guidelines*, paragraph 5.3.5.
[6] Following the RBSG bailout by the UK government in October 2008, RBSG was subject to a European Commission (EC) state aid review and as a consequence is in the process of divesting Williams & Glyn, required by 31 December 2017. While RBSG continues to work to achieve separation and divestment by the EC-mandated deadline of full disposal by 31 December 2017, on 28 April 2016 RBSG announced that there was a significant risk that divestment would not be achieved by 31 December 2017. On 5 August 2016, RBSG announced that due to the complexities of the Williams & Glyn's separation, and while good progress has been made on the programme to create a cloned banking platform, it had concluded that the risks and costs inherent in a separation programme are such that it would not be prudent to continue with it. RBSG would instead prioritise exploring alternative means to achieve divestment. Work has continued to explore these alternative means and RBS has had positive discussions with a number of interested parties concerning an alternative transaction related to substantially all of the business previously described as Williams & Glyn, although these discussions are at a preliminary stage.

market investigation (whether a specific transaction results in a substantial lessening of competition).

10.8. We consider that the evidence shows that retail banking markets are concentrated and have become more so following recent mergers. In the next section we consider the evidence on the relationship between market structure and outcomes in the retail banking markets.

Market structure and outcomes

10.9. The relationship between market structure and outcomes in banking has been considered by past investigations, the ICB in 2011, and numerous academics. There is a range of empirical academic research looking at the relationship between concentration and competition in banking internationally. The studies we have reviewed point to concentration being associated with weaker competition although few of the studies are focused on the UK, and they mostly relate to wider banking markets rather than more specific markets such as PCAs, BCAs or SME lending, which are the focus of this investigation.

10.10. As previously stated, there have been recent changes in concentration following several mergers and divestments in the UK retail banking markets. It is difficult to draw inferences from these market developments on the impact of concentration on competition, especially as both mergers were proposed at the time of the 2008 financial crisis and the divestment of TSB is relatively recent (see Appendix 10.1 for further details).

10.11. As part of our investigation, we have undertaken an assessment of market shares and outcomes in PCA and SME markets (for further details see Section 5 on PCA outcomes and Section 7 on SME outcomes). We were not able to make price comparisons for business loans as loan charges and rates are not published and are difficult to compare as they depend on the characteristics of the loan and the borrowing SME.

10.12. Our comparisons of BCA prices are subject to limitations,[7] but overall we did not see any evidence of a clear relationship between BCA market share and outcomes.

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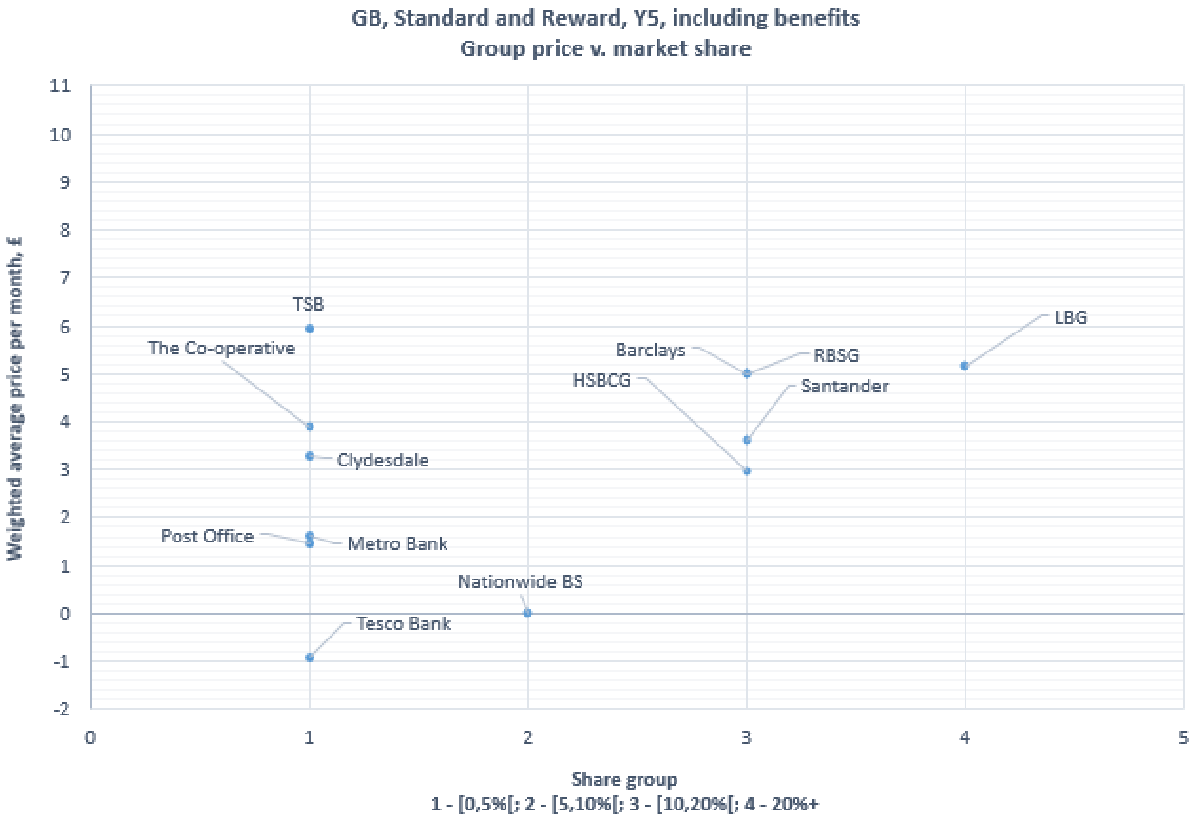
[7] Our BCA price comparison relates only to transactions list prices and does not take account of incentives offered to start-up SMEs and switchers nor of overdraft pricing. It is limited to SMEs with turnover of less than £2 million and does not take into account interest paid on credit balances by some banks. Transactional charges and fees make up just under 50% of the charges on BCAs for SMEs with a turnover of less than £2 million. Data on BCA quality is also somewhat more limited. Furthermore, comparisons of BCA pricing and quality are more difficult to interpret due to differences between SMEs and because there is more negotiation of BCA prices.

10.13. For PCAs, Figure 10.3 shows group-estimated average price by group market share for GB. The average price for each bank is constructed using the portfolio of products offered by each bank, weighted by the proportion of the bank's current customers using each product.[8] Producing estimates of PCA prices is not straightforward methodologically, and to reflect the fact that the prices are estimates and so subject to some degree of imprecision, we interpret the figure on the basis of the relationships we observe, rather than the exact numbers (see Section 5 for details of the analysis).

10.14. We see that there is a tendency for larger providers to have higher average prices, with a correlation coefficient of 0.56 between average group price and actual market shares. TSB is an exception to this general relationship, as it has a comparatively high price and comparatively low market share. This may be explained by TSB being recently divested from LBG in 2014, such that it has not been subject to the same underlying demand and supply factors as other firms in acquiring its market share and it inherited products, prices and customers from LBG. For NI, no relationship emerges.[9]

[8] As of 2014 using data from our transactions database.
[9] The underlying customer transactions data for NI customers was incomplete in some respects and so we have had to make adjustments for this, leading to price estimates which are less robust.

Figure 10.3: Group-average prices and market shares (Standard and Reward, Year 5 prices including benefits), GB



Source: CMA analysis of Runpath price outputs.
Notes:
1. Market shares based on Appendix 5.1 PCA market structure of provisional findings report.
2. RBSG was not able to provide GB and NI shares for RBS and NatWest separately.
3. For Metro, we have assumed all accounts are in GB.
4. The Co-operative (Co-op Bank) market share was calculated based on NI/UK ratio to total.
5. Tesco Bank's market share and Post Office's market share in GB were obtained from 'Main PCAs (FRS data)' in 2014 and are [✂]% and [✂]%, respectively.

10.15. In summary, from our assessment of price and market share across retail banking markets we see that there is some tendency for group average prices to increase with market share in the PCA market in GB. We do not find a corresponding relationship in the PCA market in NI, or BCA markets in GB or NI, however the NI and BCA analyses are less complete than the PCA pricing analysis.

Assessment of market structure and market power

10.16. Market power can arise through firms having unilateral market power or as a result of firms coordinating their behaviour. We have not found evidence to suggest that coordinated behaviour is a feature of any of the markets we are investigating.[10]

10.17. In this section, we consider possible sources of market power.[11] Figure 10.3 shows the correlation between PCA prices in GB and market shares: the larger firms tend to charge higher prices. This correlation may suggest that larger firms have more market power, and there might therefore be a concern that the combination of concentration and barriers to entry and expansion (namely incumbency advantages) we have found are having adverse effects on competition in this market. However, correlation does not imply causation and we need to consider carefully possible explanations.

10.18. In a differentiated product market where firms compete on price, the extent of a firm's unilateral market power is related to the elasticity of demand for its product: the more insensitive demand is to an increase in price (ie the more inelastic), the greater the market power of the firm. Therefore, the weak customer response we have found in retail banking markets gives banks a source of unilateral market power over their existing insensitive customers.

10.19. The extent to which PCA customers are sensitive to price varies. We have found that there is weak customer engagement and the majority of PCA customers are insensitive to price. However, there are also some customers who are more price sensitive and actively look for better deals and switch in response to price and quality differences.

10.20. If banks are able to target lower price products at customers who are likely to switch it would allow them, for example, to offer one price to existing customers (and maintain margins) and a lower price to new customers (or to elastic existing customers).

10.21. We have therefore assessed the extent to which banks are able to segment their customers, in order to assess the extent to which the observed relationship between average price and market share is due to different product and customer mixes between banks.

[10] In relation to coordinated behaviour we stated in our updated issues statement that, in line with our issues statement, we did not consider that coordinated behaviour was a feature in the provision of PCAs or SME retail banking services. This was because the market conditions necessary for coordination to be sustained, as set out in our Guidelines (paragraph 251) were not met. None of the respondents to the updated issues statement provided evidence that the conditions for coordination were met or that coordinated behaviour was a feature of the markets and this was confirmed in our provisional findings.
[11] In our provisional findings we identified two mechanisms, product differentiation and the proportion of (in)active customers, which we analysed separately. Having reviewed parties' responses to our provisional findings, we consider that a better approach, as set out below, is to consider product differentiation and the effects of having a large customer base of inert customers together.

10.22. In the exposition above, we have used price as the competitive variable, but firms will face similar decisions with respect to service quality, and so we also consider this in the following section.

Extent of price and service quality differentiation

10.23. Banks may segment customers for PCAs through different products targeted at different types of customers. For BCAs, banks may do this through: *(a)* different products for different types of customer; *(b)* different terms for those customers who reveal a willingness to switch; and/or *(c)* direct negotiation with more engaged customers.

Parties' views

10.24. Barclays, HSBCG, LBG and RBSG submitted that banks were able to discriminate between active and inactive customers.[12] Banks pointed to offers made both to new-to-market customers and switchers, which reduced their price compared with the price paid by existing customers.

10.25. LBG said that banks were able to target introductory offers at new customers as an incentive to switch provider; and that all providers were able to target customers in this way, irrespective of their size; hence the mechanism linking market share to customer outcomes could not hold:

(a) In relation to BCAs, all providers could target free banking offers to new and switching customers. Negotiation of prices was also prevalent for larger SMEs, which meant that providers were able to offer further incentives to acquire or retain these customers.

(b) In relation to PCAs, all providers could identify which customers were new or switching. All providers could and many did offer switching incentives or introductory offers to new customers. Such introductory offers and switching incentives were common in other retail financial services markets such as savings and credit cards, and other markets, such as magazine subscriptions and pay TV. LBG offered the same underlying products and prices to all of its PCA and BCA customers once any introductory offer had expired, and made it as easy as possible for customers to switch between products.

10.26. HSBCG also referred to banks' ability to differentiate between existing customers either: *(a)* in response to an approach from a customer indicating

[12] Responses to our updated issues statement.

they were considering switching; *(b)* through analysis of customer activity data; or *(c)* through ongoing active contact with customers.[13]

10.27. Santander noted that because banks seeking to expand had to induce customers to switch from other banks, their customer base was likely to be made up of a pool of more engaged customers compared with larger incumbent banks which were able to profit from a large degree of 'back book customer inertia'.

PCAs

10.28. Banks offer different types of PCAs targeted at different customer segments (see Appendix 6.7 for further details):

(a) First, banks were specifically targeting more affluent customers, although the definition of affluent varied among banks. For example, [✂]. HSBCG told us that HSBC targeted 'emerging affluent' customers, who it defined as those earning more than the UK average (£27,000 or more a year) and turning over at least £1,750 per month in their PCA, and 'affluent customers', who earned a minimum of £100,000 a year.

(b) Second, banks were targeting students and younger customers (ie those opening their first bank account). For example, RBSG told us that it targeted students in a number of ways including by its simplified overdraft proposition, offering student accounts (rather than basic accounts) to international students, offering a free National Express coach card and simplifying its sales process to make it easier to open accounts, particularly online.

10.29. The conditions attached to new PCAs launched by the banks, which often require customers to have minimum inflows into the account and a minimum number of direct debits, are consistent with the banks' aims to attract primary banking relationships with more affluent customers. Examples of these are below.

(a) The Barclays Blue proposition requires at least two direct debits and customers to pay in a minimum of £800 per month. The monthly charge for this account is £3, in return for £7 in reward.[14]

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[13] HSBCG response to updated issues statement, paragraph 5.12(a).
[14] Barclays Blue account, consulted 8 September 2015.

(b) Clydesdale and Yorkshire Bank Current Account Direct require customers to pay in a minimum of £1,000 per month. This account does not have a monthly charge.[15,16]

(c) The Halifax Reward account requires at least two direct debits and customers to pay in a minimum of £750 per month. Customers receive £5 per month with this account, if they meet this criteria, and it does not have a monthly charge.[17]

(d) The HSBC Advance account requires customers to pay in a minimum of £1,750 every month. This account does not have a monthly charge.[18]

(e) The Club Lloyds account pays interest if the customer has at least two direct debits per month and charges a monthly fee of £5 if the customer pays in less than £1,500 per month.[19,20]

(f) To benefit from cashback and interest, the Santander 123 account requires customers to have at least two direct debits, pay in a minimum of £500 per month. The account pays interest on balances between £1,000 and £20,000, and cashback is paid on certain types of expenditure including utilities payments. The monthly charge for this account was £2, and rose to £5 in January 2016.

10.30. In addition to the evidence on whom the banks were targeting, we considered banks' submissions on the types of PCA customers they were gaining and losing through CASS switching. There were varying responses, but the responses suggested that, of the customers who were switching, Santander was attracting the relatively affluent, while the relatively less affluent customers were switching to Halifax. For example, HSBCG told us that the HSBC customers it was losing were typically: [✂].

- *Retention of existing PCA customers*

10.31. We examined to what extent banks were seeking to retain their existing customers to reduce switching to competitors. Some improvements to existing accounts, such as lower arranged overdraft charges or improving quality of service and innovation, will benefit existing customers. However, if banks introduce new accounts and only offer these to new customers, or to

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[15] To receive a £150 cash incentive a customer is required to have at least two direct debits. A customer can open a Current Account Direct product without two direct debits but will not qualify for the £150 incentive.
[16] Clydesdale Current Account Direct and Yorkshire Bank Current Account Direct, consulted 8 September 2015.
[17] Halifax bank accounts, consulted 8 September 2015.
[18] HSBC Advance account, consulted 8 September 2015.
[19] LBG stated that over [90–100]% of customers did not pay this fee.
[20] Club Lloyds account, consulted 8 September 2015.

those existing customers who are more likely to switch, then this could give them the ability to segment new and old customers, potentially leading to existing customers receiving a worse deal than new customers or internal switchers. There is less competitive pressure if new and active customers get better deals than existing customers.

10.32. There was varied evidence from banks on their approaches when launching new accounts. Some of the banks did advertise new accounts to existing customers, but it was unclear how extensive this was:

(a) HSBCG told us that when it launched the HSBC Advance account the advertising was aimed at acquiring new customers because existing PCA customers who qualified would be automatically upgraded to HSBC Advance.

(b) LBG told us that it marketed its Club Lloyds account to existing customers and 800,000 actively switched to the new account between March 2014 and September 2015. Customers were not automatically upgraded because Club Lloyds had a monthly fee if customers did not meet eligibility criteria. However, internal documents also recognised that existing Vantage customers would lose out when Lloyds reduced the interest rates, although these customers would still receive credit interest of 1.5% on balances up to £5,000. An LBG paper stated: [✂].

10.33. Nationwide said the large incumbent banks habitually made offers and/or new products available to attract switchers but did not promote equivalent benefits to their existing customers. Nationwide also commented that it potentially also gave large incumbent banks an advantage over 'challengers' since incumbent banks had a larger 'back-book' of inactive customers than 'challengers' and that this limited the ability of 'challengers' to achieve growth and scale.[21] A similar point was made by TSB.[22]

- *Evidence on PCA product prices*

10.34. If a bank is able to set different prices for similar products, then it could have the ability and incentive to charge lower prices to active customers and higher prices to inactive customers. We analysed product level prices to see if there is evidence that, for any given bank, some products are significantly cheaper or more expensive for most or all potential customers.

[21] Nationwide response to updated issues statement, paragraph 5.3, and Nationwide response to provisional findings, paragraphs 2.27–2.29
[22] TSB response to updated issues statement, paragraph 22.

10.35. We see that most banking groups offer a number of different products, and that there are substantial differences between product prices charged at most banking groups. Higher market share banking groups offer some lower priced and higher priced products, such that these banking groups are offering products which are better value for money for all customers compared with other products they offer.[23]

10.36. In order to assess the extent to which the more active customers have lower priced products and less active customers have higher priced products, we would like to test whether customers tend to have held lower priced products for fewer years than higher priced products. The number of years that customers have held a product, on average, is a measure of customer inertia.

10.37. The data we hold on the number of years that customers hold individual products has limitations.[24] However, we are able to identify the products that have been launched by the largest banks since January 2014.

10.38. Table 10.2 shows that product prices for each bank vary around the group average price. Newer products available from LBG (e.g. Lloyds Club), HSBCG (e.g. M&S Bank Current Account) and Santander (e.g. Santander 1|2|3 Current Account) are cheaper than their older products. The newer products launched by RBSG (e.g. NatWest Reward Account) and Barclays (e.g. Barclays Bank Account with Blue Rewards) include cashback offers which we were unable to take into account in our calculation of price due to data on average annual cashback values being as yet unavailable.

[23] We consider customer segmentation based on account eligibility criteria (using the number of direct debits and the amount the customer has paid into the account each month), as this segmentation allows us to assess whether product prices vary by the customer segment targeted by banks. The majority of customers (around 70% and above of customers at the majority of banks) fall within three segments (which are not dependent on direct debits): less than £500; £1,000 to less than £1,500; and £1,750 or more. We therefore focus our assessment on these.
[24] Some banks have a large number of accounts which have the same start date. This is likely to be because customers have been transferred from one IT system to another, possibly as a result of a merger or acquisition, and all given the same account opening date regardless of when accounts were actually opened.

Table 10.2: Product and group average prices (Standard and Reward, Year 5 prices including benefits), GB

Banking group	***Brand***	***Product***	***Product price***	***Group price***
LBG	Lloyds Bank	Lloyds Bank Classic Account	[✂]	£5
	Lloyds Bank	Lloyds Bank Club Lloyds Current Account	[✂]	
	Halifax	Halifax Current Account	[✂]	
	Halifax	Halifax Current Account - with Control	[✂]	
	Halifax	Halifax Reward Current Account	[✂]	
	Bank of Scotland	Bank of Scotland Classic Account	[✂]	
	Bank of Scotland	Bank of Scotland Classic Account with Control	[✂]	
	Bank of Scotland	Bank of Scotland Classic Account with Vantage	[✂]	
RBSG	NatWest	NatWest Reward Account	[✂]	£5
	NatWest	NatWest Select Account	[✂]	
	RBS	Royal Bank of Scotland Reward Account	[✂]	
	RBS	Royal Bank of Scotland Select Current Account	[✂]	
Barclays	Barclays	Barclays Bank Account	[✂]	£5
		Barclays Bank Account - with Control	[✂]	
		Barclays Bank Account with Blue Rewards	[✂]	
		Barclays Premier Current Account	[✂]	
		Barclays Premier Current Account - with Control	[✂]	
HSBCG	HSBC	HSBC Advance Bank Account (New)	[✂]	£3
		HSBC Bank Account	[✂]	
		HSBC Bank Account Pay Monthly	[✂]	
		HSBC Premier Bank Account	[✂]	
	first direct	first direct 1st Account	[✂]	
	M&S Bank	M&S Bank Current Account	[✂]	
	M&S Bank	M&S Bank Premium Current Account	[✂]	
Santander	Santander	Santander 1|2|3 Current Account	[✂]	£4
		Santander Choice Current Account	[✂]	
		Santander Everyday Current Account	[✂]	
Nationwide BS	Nationwide Building Society	Nationwide BS FlexAccount	[✂]	£0
		Nationwide BS FlexDirect Account	[✂]	
TSB	TSB	TSB Classic Current Account	[✂]	£6
		TSB Classic Current Account - with Control	[✂]	
		TSB Classic Plus Account	[✂]	
		TSB Classic Plus Account - with Control	[✂]	
Clydesdale	B	B B Current	[✂]	£3
	Clydesdale Bank	Clydesdale Bank Current Account Control	[✂]	
		Clydesdale Bank Current Account Plus	[✂]	
	Yorkshire Bank	Yorkshire Bank Current Account Control	[✂]	
	Yorkshire Bank	Yorkshire Bank Current Account Plus - 16 and over	[✂]	
	smile	smile Current Account	[✂]	
The Co-operative Bank	The Co-operative Bank	The Co-operative Bank Current Account	[✂]	£4
Metro Bank	Metro Bank	Metro Bank Current Account	[✂]	£2
Post Office	Post Office	Post Office Standard Account	[✂]	£1
Tesco Bank	Tesco Bank	Tesco Bank Current Account	[✂]	-£1

Source: CMA analysis on Runpath price outputs.

- *PCA price and length of time account held*

10.39. Although we are not able to observe the number of years that customers hold individual products, we have information that allows us to calculate this at the brand level. Figure 10.4 shows the average length of time customers have been with each bank brand is positively associated with the weighted average price for GB, with a correlation coefficient of 0.75. It suggests that banks which have had customers for longer tend to charge higher prices on average than banks whose customers are newer and more active. For NI we find a similar relationship.

10.40. This is consistent with the finding of our econometric switching model that customers whose bank of origin is one of the four largest banking groups are less likely to both search and switch (see Appendix 6.2). The explanation for this is likely to be that smaller banks that are seeking to expand have to induce customers to switch from other banks, so their customer base is made up of a larger proportion of engaged customers compared with larger banks.

10.41. This suggests that customer inertia is relevant to understanding the observed relationship between group average price and market share.

Figure 10.4: Brand average prices and average time products are held for that brand (Standard and Reward, Year 5 prices including benefits), GB

[✂]

Source: CMA analysis of Runpath price outputs.
[✂]

- *Gains from switching PCA within the same bank*

10.42. Our analysis of financial gains from switching (see Appendix 5.4), which should be interpreted carefully, is also relevant to our assessment of the extent to which banks are able to segment customers and target lower priced products at the more active customers.[25] These estimates are based on a static assessment in the sense that we assume no changes in customer behaviour or provider prices, and so should not be interpreted as the gains that all customers could achieve if all customers switched to the best alternative product.

10.43. Table 10.3 shows that customers could make an average saving of £3 per month if they were to switch to the lowest priced product for them offered by either their current bank or banking group. It shows the potential gains from switching from standard/reward accounts to standard/reward accounts and from packaged accounts to packaged accounts or to standard/reward accounts (see Section 5).

[25] These results include all banks, including those with only one type of bank account. This will reduce the average benefits. Since many of these single account banks like Metro and Danske have a small market share the effect is expected to be limited.

10.44. This is consistent with our analysis of product prices and suggests that some customers are not actively seeking better value products from their current bank.

Table 10.3: Annual savings from switching to lowest priced product from existing bank and banking group (£ per month)

	1 month (excluding switching incentives)
Matched records – using current Runpath price data for customer's PCA	
Internal switching (within brand)	
– Standard/reward PCAs	£16
– Packaged PCAs	£71
Internal switching (within group)	
– Standard/reward PCAs	£33
– Packaged PCAs	£112

Source: CMA calculation using Runpath data.

- *Evidence on service quality*

10.45. Differences in prices across products may be explained by differences in quality. Banks may also vary the service quality by product so as to achieve higher margins on customers less likely to switch by offering lower quality service.

10.46. For PCAs, we found that several banks offer the same level of service across products.[26] Some banks did offer different levels of service with respect to access channels and prioritised telephony services for some products.[27]

10.47. The banks provided us with examples of improving the quality of service, and examples of digital innovations. Many banks have made substantial investment in digital banking services. Many of these improvements have been made to the benefit of all customers.

SME banking

10.48. Our analysis of competition between banks for SMEs is presented in Section 8. The evidence we review in Section 8 shows that banks are able to price differentiate between SMEs in the following ways:

(a) Banks typically offer different terms to new-to-banking SMEs (start-ups) and existing SMEs, through the offer of free banking periods to start-ups.

[26] TSB, Co-op Bank, Clydesdale and Danske.
[27] [✂]

(b) Banks are also able to target switchers: some banks offer a limited free banking period to switchers, which is not offered to existing customers.

(c) Banks will typically segment SMEs based on the turnover or the value of the business. This segmentation influences the products available and the degree of negotiation on tariffs and terms as well as the level of support and quality of relationship management SMEs receive.

10.49. The majority of SMEs are within ‘business banking’ (95%), which is generally for smaller businesses with turnover up to around £2 million. Negotiation of prices and terms is limited. ‘Commercial banking’ serves the remaining SMEs (around 5%), which are more likely to be able to negotiate on price and other terms (see Section 8 for more details). These SMEs will generally also be provided with an individual relationship manager by their bank, which is a differentiator based on service quality.

Conclusion on extent of price and service differentiation

10.50. The evidence suggests that banks offer different priced products and to some extent are able to segment existing and new customers through offers to new-to-market customers and to switchers. It shows that the newest products tend to be lower priced than older products available from the same banking group. It shows that there is a positive relationship between average price and customer inertia (as measured by the average number of years customers have been with the brand). The evidence also shows that some customers would be able to gain financially if they were to switch to a lower priced product available from their current bank.

10.51. There are limits to banks’ ability to segment customers in this way, and this is particularly the case for aspects of service quality. Banks are unlikely to have sufficient information to identify customers who regularly search the market for the best deal. This may therefore limit the ability of banks to fully price differentiate between the more and less active customers in the PCA market, as well as for BCAs. However, banks could differentiate to a greater degree between SMEs with full relationship management (these are mostly larger SMEs), or between SMEs for loans, where there is scope for negotiation on prices and terms.

10.52. We also noted that some competitive parameters do not lend themselves well to differentiation by customer type such that incentives to compete along these dimensions may be diminished for banks with large inert customer bases. For instance, decisions on investments in service innovation, which would apply across the customer base. We have, however, found that there have been a number of innovations in the PCA market in recent years, particularly with respect to digital investments which usually apply across the customer base.

Conclusions on market structure

10.53. We found that retail banking markets are concentrated and have become more so following recent mergers. Although the longer-established banks have been losing market share, this has occurred slowly and the four large longer-established banks in GB still have the largest shares of both PCA and BCA markets.[28]

10.54. The combination of persistent concentration in a market and barriers to entry can be indicative of competition problems and be associated with worse outcomes for customers. Indeed, we found some tendency in the PCA market in GB for banks with larger market shares to have higher average prices than newer banks with lower market shares. We have sought to analyse the reason for this tendency.

10.55. There is some evidence that might suggest that customer mix, and the proportion of active and inactive customers, is an important factor explaining why we find that banks with larger market shares tend to charge higher prices on average. This is because banks have some ability and an incentive to set higher prices to less active customers, and banks with large market shares tend to have less active customers.

10.56. We noted that there are limits to the banks' ability to segment customers, which means that there may be scope for market share to affect price. This is because a larger bank with a greater proportion of inactive customers may have less incentive to reduce prices if some of its inactive customers switch to the lower priced product.

10.57. We also note that the incentives of banks with large market shares may be dampened to some degree. Customers of banks with high market shares may be more inelastic than those of smaller banks if they have strong preferences for their own bank and if they see the products of other banks as imperfect substitutes. Evidence from the GfK survey suggests that this effect may be limited, as the perception of customers is that there is no

[28] They also have the largest shares of general purpose business loans (we do not have accurate figures for all business loans). The four longer-established banks in NI hold four of the top six positions in PCAs and the top four positions in SMEs.

differentiation between banks,[29] but counter to this the survey also found that more than four-fifths (85%) said they either trusted strongly or tended to trust their own bank, a much higher proportion than those who said the same about other banks (49%).[30]

10.58. In conclusion, we consider that the differences in the proportions of inactive versus active customers between large and small banks and the ability of banks to offer different products to these types of customer are important factors in the tendency of larger banks to have higher prices in the PCA market in GB. The larger banks offer lower priced accounts to new customers and switchers, but because they have relatively larger proportions of customers on more expensive accounts than the newer and smaller banks, the prices of banks with high market shares are, on average, higher. The difference in the proportion of active and inactive customers at large banks as compared to smaller banks may have been the result of them having weaker incentives to compete for active customers, including concerns about engaging their own customers to switch. We note in particular, the role that entrants and banks seeking to expand have had in the introduction of lower priced accounts.

10.59. We did not find evidence of a similar tendency for banks with high market shares to have higher average prices in the BCA markets or in NI, but these analyses were less complete than the GB pricing analysis.

10.60. Overall, we find there is insufficient evidence to support a finding that the current concentrated market structure is itself having adverse effects on competition and detrimental effects on customer outcomes in the PCA, BCA or SME lending markets.

10.61. Taken together, this evidence signals the role that entrants and banks seeking to expand have in the markets with respect to competition for new customers. These banks have a greater incentive to instigate lower prices for new customers than banks with larger customer bases offer their existing customers in order to encourage customers to switch bank. An example of this is the introduction of the Santander 123 product as a result of which, some banks with large customer bases reacted by also competing more vigorously for new customers and switchers, as can be seen from the evidence on the increase in the offering of new accounts targeted at switchers and which tend to offer better value to customers (see Appendix

[29] In the GfK PCA consumer survey 49% of respondents agreed with the statement that 'There are real differences between banks in the current accounts that they offer', with the other half of respondents either disagreeing or being indifferent (see Section 6).
[30] See paragraph 65 of GfK PCA report.

6.6). Therefore, entrants and smaller banks seeking to expand play an important role stimulating competition in this market, though this is not as effective as it would be with increased customer engagement.

10.62. We have reached this finding on the basis of the current evidence and current levels of concentration, including the recent divestment of TSB from LBG. We would stress that changes to the current level of concentration, either through merger and/or divestment, should be considered on their merits as to their impact on competition. The high levels of concentration in the market and the incumbency advantages stemming from the weak customer engagement that we have found are sufficient to justify a cautious approach to any future merger activity. The loss of rivalry from any bank merger could raise competition concerns. While any merger would need to be looked at on its merits against the backdrop of the market as it stands at the time of the merger, we would expect that any significant merger involving the four largest GB banks may lead to adverse effects.

10.63. Different considerations apply to concentration changes only involving smaller banks. We have found that because of the weak customer response it is difficult for new entrants and smaller banks to expand organically. Expansion by smaller incumbent banks through acquisition enabling such smaller banks to spread their fixed costs across a greater number of customers, may somewhat improve the competitive threat from such banks, although without increased customer engagement the main barrier to expansion would remain. Similarly, an effective demerger of Williams & Glyn from RBSG has the potential to provide a stimulus to competition, in particular if it is of sufficient scale. Consequently, mergers only involving smaller banks would be unlikely to have the same impact on the market and may have the potential to improve competition in the relevant markets.

11. Adverse effects on competition findings

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11.1 On 6 November 2014, the CMA board in exercise of its power under sections 131 and 133 of EA02 made a reference to the chair of the CMA for an investigation into the supply of retail banking services to PCA customers and SMEs in the UK.

11.2 We have found, pursuant to section 134(1) of EA02, that there are features of the relevant markets, which alone or in combination, prevent, restrict or distort competition in the supply of PCAs in the UK and in the supply of certain retail banking services to SMEs in the UK such that there are AECs within the meaning of section 134(2) of EA02.

PCAs

11.3 We have found that a combination of the following features in the provision of PCAs in each of GB and NI respectively give rise to AECs:

(a) **Barriers to accessing and assessing information on PCA charges and service quality**: PCA charging structures are complex and there is limited comparable information on service quality. In order to identify the best account for them customers need to be able to combine this complex information on charges with a detailed knowledge of their own account usage and access information on service quality. It is therefore difficult for customers to compare different banks' products and services and there are few effective tools available to help them choose the best account.

(b) **Barriers to switching PCAs**: customers perceive that switching accounts is burdensome and there is still a fear that something will go wrong. Awareness of and confidence in the CASS switching service is still low.

(c) **Low levels of customer engagement**: few customers search for better offers and the number of customers switching PCAs, in part or in full, remains very low. A lack of triggers for customers to engage in the

market, the low cost of PCAs for many customers, reported satisfaction despite low levels of searching and a belief by many customers that there is little to be gained from searching and/or switching, together with features (a) and (b) contribute to continued low levels of customer engagement. Low engagement is also due to customers' limited awareness of their account usage and the interest they earn on their balances.

(d) **Incumbency advantages**: customer acquisition costs are high because of features (a) to (c), and, combined with economies of scale and scope in retail banking markets, this results in incumbent banks having first mover advantages over new entrants and smaller banks wishing to expand.

11.4 The impact of the first three of these features is greater for overdraft users and even more so for unarranged overdraft users for the following reasons:

(a) **Barriers to accessing and assessing comparable information are greater for overdraft users** because of the difficulty of comparing complex overdraft charges between different providers. It is important to be able to compare these charges as they can have a significant effect on the cost of a PCA. In particular, customers exceeding their pre-arranged credit limit can incur substantial charges but there is no easy way for a customer to find and compare the charges or credit limits an alternative PCA might offer them. The lack of tools to do this is also a barrier to searching for customers seeking higher arranged credit limits.

(b) **There are additional barriers to switching for overdraft users** because of uncertainty surrounding the acceptance and timing of an overdraft approval. Moreover, heavier unarranged overdraft users may have fewer options either for switching PCAs or switching to other forms of credit.

(c) **There is a lack of customer engagement in relation to overdrafts.**

(i) Heavier users of overdrafts, in particular unarranged overdrafts, have a lower tendency to switch than lighter overdraft users. Overdraft users are also those who would potentially gain most from switching, and gains increase with heavier usage, especially heavier unarranged usage. This lack of engagement is in part due to the greater actual and perceived barriers overdraft users face when searching and switching.

(ii) There are also weaker constraints on overdraft charges because of the lack of customer engagement with their overdraft usage as demonstrated by the low customer awareness of this usage. This is also the case for unarranged overdraft usage, which is a particular issue given that such usage: is outside a credit limit that a customer has pre-agreed in advance; is often inadvertent as many customers are not being informed on a timely basis of when they may exceed this limit; and involves a significant increase in charges that can build up over time, especially for heavier unarranged overdraft users.

11.5 The combination of features (a) to (c) in paragraph 11.3 and (a) to (c) in paragraph 11.4 above means that there is a weak customer response to differences in prices and service quality. This leads to banks having unilateral market power over their existing customer base. As a result, the incentives on banks to compete on prices, service quality and/or innovation are reduced.

11.6 Further, as a result of the weak customer response, there are high customer acquisition costs, which make it difficult for new entrants and small banks to expand, and is a barrier to entry and expansion. This barrier to entry and expansion, combined with the economies of scale and scope in retail banking markets, gives incumbent banks first mover advantages as they have an established base of customers over which to spread their costs. Such banks also have a costs of funds for lending incumbency advantage in particular due to access to an established book of lower cost retail deposits. These incumbency advantages are particularly strong for longer-established banks with large existing customer bases.

11.7 An overall consequence of features (a) to (d) in paragraphs 11.3 and 11.4 above is that larger longer-established banks are able to maintain high and stable market shares.

11.8 While competition between banks to attract new customers has increased, in particular for the primary banking relationship, and increasing digitalisation in banking is reducing the barriers to customer engagement, we have found that many customers are not benefiting from this increase. In particular, the competitive pressures on overdraft charges are low and even lower for unarranged overdraft charges.

BCAs

11.9 We have also found that a combination of features in the provision of BCAs in each of GB and NI respectively give rise to AECs. These features are as follows:

(a) **Linkages between PCAs and BCAs**: many SMEs open their BCA with their existing PCA provider, often without searching for alternative providers.

(b) **Barriers to accessing and assessing information on BCA charges and service quality**: BCA charges are complex and there is a multiplicity of BCA charges and fees making comparability difficult. There is also limited comparable information on service quality. In order to identify the best account for them, SMEs need to combine this information on charges with a detailed knowledge of their own expected account usage, and access information on quality. Information on own account usage can be difficult to access and/or, for some SMEs, uncertainty as to future usage makes it difficult for SMEs to compare different BCA products. There is also a lack of effective comparison tools and advice from intermediaries to help SMEs, particularly smaller SMEs, choose the best account.

(c) **Barriers to switching BCAs**: the account opening process for SMEs can be lengthy, onerous and time-consuming because of banks' processes in particular relating to AML requirements. Use, awareness of and confidence in CASS remains generally low. In addition, the switching process is perceived to be by many SMEs, time-consuming, difficult and risky. Payments and/or receipts being delayed and/or not received can have a significant impact on an SME as well as potential loss of historical and payment data. In addition, for some SMEs, access to finance may deter them from switching BCA for fear that doing so would reduce their ability to continue to access finance and/or access finance in the future.

(d) **Low levels of customer engagement**: as with PCAs, there are limited triggers for SMEs to engage once they have a BCA; BCAs are low cost relative to other business costs and many SMEs are satisfied with their BCA. In addition, many SMEs consider that there is little to be gained and potential disadvantages from searching and/or switching, in full or in part. Together with features (a) to (c) this leads to low levels of customer engagement more generally, as shown by the significant number of SMEs that do not search and by the low number of SMEs switching BCAs, in full or in part.

(e) **Incumbency advantages**: customer acquisition costs are high because of features (a) to (d), and, combined with economies of scale and scope in retail banking markets, this results in incumbent banks having first mover advantages over new entrants and smaller banks wishing to expand.

11.10 The combination of features (a) to (d) in paragraph 11.9 means that there is a weak customer response to differences in prices or service quality. This leads to banks having unilateral market power over their existing customer base. As a result, the incentives on banks to compete on prices, service quality and/or innovation are reduced.

11.11 Further, as a result of the weak customer response, there are high customer acquisition costs, which make it difficult for new entrants and small banks to expand and is a barrier to entry and expansion. This barrier to entry and expansion, combined with the economies of scale and scope in retail banking markets, gives incumbent banks first mover advantages as they have an established base of customers over which to spread their costs. Such banks also have a costs of funds for lending incumbency advantage in particular due to access to an established book of lower cost retail deposits. These incumbency advantages are particularly strong for longer-established banks with large existing customer bases including those with an existing base of PCA customers given the product linkages between BCAs and PCAs.

11.12 An overall consequence of features (a) to (d) in paragraph 11.9 above is that larger longer-established banks are able to maintain high and stable market shares.

11.13 Many banks offer initial free banking periods for start-ups, as well as free banking periods as inducements to BCA switchers, but beyond that banks' acquisition and retention strategies tend to focus on larger SMEs. Some banks have sought to simplify charging structures and/or have developed some new services in particular to reduce the need for branch access. However, there has been limited new entry in the provision of BCAs, limited new product development and less innovation compared with the PCA market. Smaller SMEs that no longer benefit from their free banking period are most likely to be adversely affected by the reduced competitive constraints on banks.

SME lending

11.14 We have also found that a combination of features in the provision of SME lending in each of GB and NI respectively give rise to AECs. These features are as follows:

(a) **Strong linkages between BCAs and SME lending products**: the large majority of SMEs go to their BCA provider for finance having done little or no searching. SMEs also place significant weight on their relationship with their BCA provider when considering finance because they perceive that they are more likely to get access to funding, on better terms and/or more quickly and easily from their BCA provider as a result of their existing banking relationship.

(b) **Barriers to comparing lending products**: charges are opaque and lending terms including early repayment and penalty clauses can also be complex. There is a lack of effective comparison tools which may particularly affect smaller SMEs that do not have specialist financial capability.

(c) **Nature of demand for SME lending products**: in addition to the importance of a banking relationship to SMEs, SMEs quite often require finance on short lead times, for example to assist with cash flow. Applying for finance can take time both in preparing and gathering the necessary financial information to make an application, in waiting for the lender's decision as well as in negotiating relevant terms where applicable. The amount of time and effort required to apply to other banks, often leads SMEs to choose their existing bank.

(d) **Information asymmetries between an SME's BCA provider and other providers of lending products**: BCA providers will benefit from having better trading and credit history on an existing SME customer than other providers and are therefore at an advantage over other providers in pricing and assessing credit risk, as well as in reducing the time involved in and the inconvenience to SMEs of the application process. Such advantages are particularly relevant for smaller SMEs as there is a lack of publicly available information on the trading and financial performance of such SMEs.

(e) **Incumbency advantages**: customer acquisition costs are high because of features (a) to (d), and, combined with economies of scale and scope in retail banking markets, this results in incumbent banks having first mover advantages over new entrants and smaller banks wishing to expand.

11.15 The combination of features (a) to (d) in paragraph 11.14 means that there is weak customer response to differences in prices or service quality. This leads to banks having unilateral power over their existing customer base. As a result, the incentives on banks to compete on prices, service quality and/or innovation are reduced.

11.16 Further, as a result of the weak customer response, there are high customer acquisition costs, which makes it difficult for new entrants and small banks to expand, and is a barrier to entry and expansion. This barrier to entry and expansion, combined with the economies of scale and scope in retail banking markets, gives incumbent banks first mover advantages as they have an established base of customers over which to spread their costs. Such banks also have a cost of funds for lending incumbency advantage in particular due to access to an established book of lower cost retail deposits. These incumbency advantages are particularly strong for longer-established banks with large existing customer bases including those with an existing base of BCA customers given the strong product linkages between BCAs and SME lending, and the information asymmetries between an SME's BCA provider and other providers of lending products.

11.17 An overall consequence of features (a) to (d) in paragraph 11.14 above is that larger longer-established banks are able to maintain high and stable market shares.

11.18 While banks have sought to improve the terms, availability and speed of decision-making, such developments have primarily been aimed at retaining their existing BCA customers, competing for larger SME customers or prompted by regulatory or governmental initiatives rather than competition. Smaller SMEs that are less able to negotiate terms are most likely to be adversely affected by the reduced competitive constraints on banks in SME lending.

Linkage between the AECs

11.19 While we have identified three separate AECs in PCAs, BCAs and SME lending respectively for each of GB and NI, these AECs are linked. An incumbent bank with a large established base of PCA customers will benefit from that established base not only in the provision of PCAs but also in the provision of BCAs, given the linkages between the two products. This in turn will give such an incumbent bank advantages when competing in the provision of SME lending given the even stronger linkages between BCAs and SME lending, the information asymmetries between an SME's BCA provider and other lending providers and the costs of funds incumbency advantage from having access to lower cost retail deposits for lending. Detriment arising from each AEC that we have identified will therefore arise not only within each of the individual product markets in which we have identified the relevant AEC as arising but also in the individual product markets of the other AECs.

11.20 The GB and NI markets are also linked. We have identified the same features in the GB and the NI markets that lead to each of the AECs. Further, a number of banks operate in both markets with consistent offering in terms of price and service levels across the UK.

Customer detriment

11.21 We have considered the nature and potential scale of the detriment to PCA customers and to SMEs arising from the AECs we have found.[1]

11.22 There are more than 70 million active PCAs, with approximately 97% of adults having a PCA. PCAs generated revenues of around £8.7 billion in 2014. There are over 5 million SMEs in the UK accounting for over 99% of all UK businesses. Some 5.5 million BCAs generated revenues of approximately £2.7 billion in revenues in 2014. A further £2.8 billion in revenues was generated from general purpose business loans in 2014.

11.23 The costs to customers (and indeed to the UK economy as a whole) of ineffective competition in PCAs and SME banking is therefore likely to be high. In trying to assess the scale of the detriment to customers we have focused on the extent to which outcomes for customers are worse than those we would expect in a well-functioning competitive market as a result of the AECs we have identified. Dynamic benefits from increased competition are by their nature difficult to quantify. If there were more customer engagement, we would expect banks to have stronger incentives to compete on prices, quality and/or innovation. These wider dynamic benefits would create more pressure on banks to develop products that benefit customers, including more incentives on providers to develop PCAs, BCAs and SME loans with charges and services which are clearer to, and valued by, customers.

11.24 Recognising the difficulties in quantifying the dynamic benefits of increased competition and the difficulties in undertaking a profitability assessment of PCA or SME banking, we have sought to focus on the detriment from customers paying higher prices than they would do in a well-functioning market. We have found significant variation in prices between banks and that the larger banks which benefit from the stronger incumbency advantages generally have higher prices (and lower quality) than smaller banks. Even a small increase in charges of only 1 to 2% resulting from ineffective competition would lead to customer detriment of between £100 million and £300 million per year across PCAs and SME retail banking in the UK. This excludes customer detriment from lower quality and innovation which is less readily quantifiable.

11.25 In relation to PCAs, we also undertook analysis to estimate the direct harm to consumers arising from the lack of switching.[2] Our analysis found that, in

[1] For the purposes of section 134(4) of EA02.
[2] See Section 5.

GB, for standard/reward product customers, around 90% of account customers could gain by switching to a cheaper product, and the average gain from switching for customers is around £92 a year. In NI, we found that around 90% of standard/reward account customers could gain by switching to a cheaper product, and the average gain from switching for customers is around £66 a year.[3]

11.26 On aggregate, we found that, if all customers who would benefit from doing so switched to a cheaper product, there could be around £4.6 billion gains per year for standard/reward customers in GB, and £87 million per year in NI. This is a static analysis of consumer harm from lack of switching, which does not take into account changes in the incentives for banks to compete if there were more switching, nor does it take into account other aspects of banks' offering (such as service levels). Nevertheless, taking these caveats into account, and the fact that we would not expect all gains from switching to be realised in a competitive market, the magnitude of potential gains from switching shows that the overall PCA detriment due to lack of customer engagement is substantial.

11.27 In addition, we have identified that the consumer detriment for overdraft users is likely to be particularly high as a result of the low competitive pressures on overdraft charges, in particular unarranged overdraft charges. In 2014, 45% of PCA customers used overdrafts to varying degrees. Total fees and charges on overdrafts paid by PCA customers were in the order of £2.9 billion in 2014 in the UK, with £1.7 billion accounted for by arranged overdraft charges and the remaining £1.2 billion for unarranged overdraft charges and fees. We found that the detriment from lack of switching for overdraft users was larger than for those who do not use overdrafts, as indicated by the fact that gains from switching are larger on average for overdraft users. We estimated the average gain from switching for overdraft users to be £130 per year in GB (against £65 per year for those who do not use an overdraft) and £124 per year in NI (against £43 per year for those who do not use an overdraft). In addition, we found that a significant number of overdraft users believed that they did not use an overdraft when they did or underestimated their usage. There is therefore additional customer detriment from customers incurring overdraft charges that could be avoided altogether if there was increased customer engagement with their overdraft usage and greater transparency in banks' overdraft charging.

[3] Results for NI are less robust, because the underlying customer transactions data for NI customers was incomplete in some respects and so we have had to make adjustments for this in order to produce price estimates.

11.28 The detriment is higher for heavier users of overdrafts, in particular of unarranged overdrafts. This is because the pricing of overdrafts, especially more expensive unarranged overdrafts, affects these customers more as a result of their heavier usage. Such customers also have more to gain from switching.

11.29 We did not carry out a similar analysis for BCAs or for SME loans as for PCAs to quantify the direct benefits from switching. For BCAs, our BCA pricing analysis found that there was significant variation in monthly charges between banks, indicating substantial gains from switching BCAs for SMEs. We undertook indicative analysis and estimated, based on our BCA pricing analysis, that, in GB, SMEs would save approximately £77 per year on average on their BCA if they were to switch. In NI, we estimated that SMEs would save approximately £112 per year on average on their BCA if they switched.[4] This suggests substantial market wide gains from switching for SMEs, of the order of £380 million per year.[5] This is a static analysis of consumer harm from lack of switching, which does not take into account changes in the incentives for banks to compete if there were more switching, nor does it take into account other aspects of banks' offering (such as service levels). Nevertheless, taking these caveats into account, and the fact that we would not expect all gains from switching to be realised in a competitive market, the magnitude of potential gains from switching shows that the overall BCA detriment due to lack of customer engagement is substantial.

11.30 Moreover, these estimates do not take into account the direct detriment to SMEs arising from the AEC in the SME lending markets. We were not able to conduct similar analysis for SME loans, largely due to the nature of SME loan pricing which makes it difficult to compare prices on a like-for-like basis. However, given in particular the strong linkages we have found between BCAs and SME loans, with 90% of SMEs currently obtaining a loan from their existing BCA provider, and given the lack of comparison tools currently available, we consider that the static detriment to SMEs resulting from the AEC in the SME lending markets is likely to be substantial.

[4] Due to the assumptions in the BCA pricing analysis, this is likely to be a conservative assumption, as it does not take into account any period of free banking that an SME would get if it switched to another bank.
[5] Given that there were around 5 million active BCAs in 2015.

Part 2: Remedies

12. Remedies: Introduction and framework for consideration

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12.1 Having found that there are a number of features in the provision of PCAs, BCAs and SME lending which give rise to AECs (see Section 11) we are required to decide whether action should be taken by us or whether to recommend that others take action, in order to remedy, mitigate or prevent the AECs/and or customer detriment.

12.2 Part 2 of our final report sets out our assessment on remedies and our final decision on the appropriate package of remedies to take forward. In reaching this decision we have consulted with a range of different parties and have taken into consideration their views and the evidence submitted to us (our process is described further in Section 1). Part 2 is structured as follows:

- Section 13: Foundation remedies to make PCA and SME banking markets work better for customers – covering the introduction of an open API banking standard to share data, publication of service quality data and the introduction of prompts for customers to consider their banking arrangements.

- Section 14: Current account switching package – sets out our proposed measures to improve the awareness of, confidence in and the process of switching current account.

- Section 15: Additional remedies targeted at PCA overdraft customers – covers our further measures to increase awareness of and engagement with the overdraft usage and charges, and to reduce the detriment arising from overdraft usage.

- Section 16: Additional SME remedies – outlines measures to increase the transparency of prices of and eligibility for SME lending, enhance the ability of SMEs to compare banking products and improve BCA opening procedures.

- Section 17: Other remedy options – explains our reasoning for not taking forward other remedies such as measures to control outcomes (ie imposing price controls), measures regarding FIIC accounts and structural remedies.

- Section 18: Relevant customer benefits – assesses if there are any relevant customer benefits that would be lost as a result of our remedies

- Section 19: Effectiveness and proportionality of the package of remedies – evaluates how the remedies address the AECs and other aspects (eg timescales, implementation, monitoring and enforcement) and whether the package is proportionate.

- Section 20: Our decision on remedies.

12.3 In our assessment of each of the remedies which are being progressed (Sections 13 to 16), we set out:

- a summary of the measures being taken forward;

- how the remedy addresses the AEC and/or resulting customer detriment;

- the key considerations relating to the design of the remedy; and

- how the remedy should be implemented (including method and timings).

Framework for the consideration of remedies

12.4 Having identified a number of features that give rise to AECs, the CMA is required under EA02[1] to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or detrimental effect on customers so far as it has resulted from, or may be expected to result from the AEC.

12.5 A detrimental effect on customers is one that results, or may be expected to result, from any AECs and takes the form of either:[2]

(a) higher prices, lower quality, or less choice of goods or services in any market in the UK (whether or not the market(s) to which the feature or features concerned relate); or

[1] EA02, section 134(4).
[2] EA02, section 134(5).

(b) less innovation in relation to such goods and services.

12.6 If the CMA decides that action should be taken, it must then decide what action should be taken and what is to be remedied, mitigated or prevented.[3] In deciding these questions, EA02 requires the CMA in particular to 'have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effects on customers so far as resulting from the adverse effect on competition'.[4] To satisfy this requirement, the CMA considers how comprehensively potential remedies (or packages of remedies) address the AEC and/or resulting detrimental effects on customers, as well as whether the potential remedies are effective and proportionate.[5]

12.7 The CMA generally prefers to address the causes of the AEC directly, however, where this is not possible or as an interim solution, the CMA may introduce measures to mitigate the harm to customers created by the AEC.[6] In practice, the CMA may decide to take several discrete actions itself and/or make several discrete recommendations. This combination of measures is referred to as a package of remedies.

12.8 In deciding what remedy or remedies to take forward, the CMA will first look for a remedy that would be effective in achieving its aims. The CMA has made several general observations in its guidance about factors relevant to its consideration of effectiveness.[7] First, a remedy should be capable of effective implementation, monitoring and enforcement. Second, in assessing effectiveness the CMA will take into account the time period over which a remedy is likely to have effect, including how quickly the remedy will take effect and the expected duration of the AEC that the remedy is designed to address. A third consideration is the way in which remedies will interact with each other and with any other existing or expected regulation of the relevant market.

12.9 In considering the reasonableness of different remedy options, the CMA will have regard to their proportionality. A proportionate remedy is one that:[8]

(a) is effective in achieving its legitimate aim;

(b) is no more onerous than needed to achieve its aim;

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[3] EA02, section 134(4).
[4] EA02, section 134(6).
[5] The Guidelines, Part 4, paragraph 329.
[6] The Guidelines, Part 4 paragraph 333.
[7] The Guidelines, Part 4, paragraphs 334–341.
[8] The Guidelines, Part 4, paragraph 344.

(c) is the least onerous if there is a choice between several effective measures; and

(d) does not produce disadvantages which are disproportionate to the aim.

12.10 In reaching a judgement about remedies, the CMA will consider its potential effects on those persons most likely to be affected by it, generally customers and the businesses subject to the remedies. The CMA will seek to quantify the costs and benefits associated with a remedy where it is reasonably practical to do so, taking into account any relevant customer benefits (RCBs) arising from the adverse feature or features of the market concerned.

12.11 We have considered RCBs and the effectiveness and proportionality of our remedies package, including the costs and benefits and RCBs, in Sections 18 and 19.[9]

12.12 Our package of remedies will introduce a number of new requirements on providers that they will be obliged to comply with, once the provisions of our Order come into effect. These new requirements however do not negate the ongoing responsibility of providers to comply with other legal or regulatory obligations they have.

General comments on the scope of remedies

Private banking

12.13 HSBCG operates a private banking business in the UK, which is in a separate corporate entity to its retail consumer banking business. In response to our provisional decision on remedies, it submitted that given the distinct nature of this business and that the CMA had not carried out any material analysis of competition or consumer outcomes in the provision of private banking services, it would be inappropriate for the PCA remedies package to apply to this business.[10] Barclays also submitted that private banking customers/high net worth individuals should be excluded from the CMA's proposed PCA remedies. It highlighted that these customers had a number of important and distinct characteristics, which distinguished them from other PCA customers and the number of such accounts was small.[11] RBSG submitted that the market investigation had focused on mainstream retail and SME banking, which was highly differentiated from private wealth/private banking customers and it would therefore be inappropriate to

[9] Section 134(8)(a) of EA02.
[10] HSBCG response to provisional decision on remedies – scope of CMA PCA remedies package.
[11] Barclays response to provisional decision on remedies, paragraph 1.4.

extend the remedies package to private wealth/private banking businesses.[12]

12.14 We have considered these submissions and concluded that it would be disproportionate for our remedies to apply to private banks where they operate independently from other parts of the business (eg with separate IT systems) and the incremental costs of complying with our remedies would thus be high.[13]

12.15 Some banks offer ‘premium banking’ services such as HSBC Premier or Barclays Premier, which offer a more personalised banking service than the standard service, and we do not consider it appropriate to exclude these from our remedies as premium banking, like other retail banking, focuses on managing an individual’s income whereas private banking focuses on the investment or wealth management.

12.16 Private banks have high eligibility thresholds, generally based on a consumer’s investable assets and/or income. However, there is no single, clear industry-wide definition. We are therefore currently minded to exclude private banks where customers are required to have over £1 million of investable assets. However, we intend to consult on the exact definition and relevant threshold for private banking for the Order during the implementation period.

12.17 Some private banks (where they are not part of a larger banking group) may in any event fall within our de minimis threshold discussed below.

De minimis threshold

12.18 In our provisional decision on remedies we consulted on the potential to introduce de minimis thresholds for some of our remedies. This was to ensure that we would not be introducing requirements on the smallest of providers, which could be disproportionate, while ensuring that the measures would cover the vast majority of the market to ensure that they would be effective. Our general proposed de minimis threshold for the relevant remedies was 150,000 to 200,000 active PCAs per provider and 20,000 to 25,000 active BCAs per provider.

12.19 Having considered responses to our provisional decision on remedies and given further thought to this issue for each of the individual remedies, we

[12] RBSG response to provisional decision on remedies.
[13] Private banking can be termed loosely as banking, investment and other financial services by banks to high net worth individuals.

have decided to have a de minimis threshold for a number of our remedies.[14] Our general approach has been to set the de minimis threshold such that the remedies will apply to those providers (ie banking group rather than individual brand or division) that have 150,000 active PCAs and that have 20,000 active BCAs.[15,16] This approach helps ensure that our remedies package will be effective with the remedies covering the vast majority of the market, and proportionate by not placing undue burdens on the smallest suppliers where these are not necessary.

[14] We explain where we are applying the de minimis thresholds in Sections 13 to 16.
[15] An exception to this is the de minimis thresholds we have decided on for the core service quality remedy. In GB this remedy will apply to those brands that have 150,000 active PCAs and those brands that have 20,000 active BCAs. In NI, this remedy will apply to those brands that have 20,000 active PCAs and those brands that have 15,000 active BCAs. See Section 13.
[16] Our overdraft alert remedy will apply to those providers that have 150,000 active PCAs, excluding accounts that do not charge either for overdraft balances or for attempting to exceed a pre-agreed credit limit (such as basic bank accounts). See Section 15.

13. Foundation remedies to make PCA and SME banking markets work better for customers

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Overview

13.1 Three cross-cutting measures comprise the foundations of our remedy package. Each measure addresses important underlying causes of the AECs we have found in both PCA and SME banking markets.

13.2 The main objectives of these remedies are to:

(a) ensure that customers can make reliable comparisons between providers by accessing details of their products' prices and features and sharing securely with other providers and third parties, such as price comparison websites (PCWs) and designated finance platforms,[1] their transaction

[1] As defined in the SBEE Act, section 7(2).

history via open standard application program interfaces (APIs) (see paragraphs 13.5 to 13.87);

(b) ensure that customers can compare the service quality of current and prospective providers by requiring banks to make available information about customers' willingness to recommend their services to others and operational performance metrics in respect of PCA and SME banking services, including to finance platforms and comparison websites (see paragraphs 13.88 to 13.162); and

(c) promote customer engagement by prompting current account holders to consider their existing banking arrangements and to take appropriate action, such as searching, comparing or switching providers or products. Such prompts may be issued periodically, at key milestones in a customer's banking relationship and on the occurrence of specific events. To maximise the impact of these prompts, we are recommending further testing by the FCA, prior to implementation (see paragraphs 13.163 to 13.229).

13.3 These three foundation measures provide a platform to enhance the effectiveness of our other remedies and of market-based solutions to the problems we have identified. While complementary to each other and to the other remedies, they also have some common characteristics that underpin their importance to the overall remedy package:

(a) First, all three remedies make use of technological developments which we expect to improve the reliability, and substantially reduce the costs to customers, of searching for and comparing providers and make it easier and cheaper for providers to issue targeted, timely communications to customers.

(b) Second, all three remedies aim to facilitate the development of an effective intermediary sector, including PCWs, finance platforms and other financial technology (FinTech) providers, to help customers find the best provider for them. Intermediaries whose business models are built around helping customers find and move to better value alternatives will have strong incentives to develop innovative new products and services that make use of the opportunities provided by these measures.

(c) Third, all three remedies allow scope for 'fine tuning' of the presentation of relevant information, either by intermediaries, or through 'road testing' prompts or other material that banks are required to provide to customers (eg through randomised controlled trials (RCTs)).

(d) Fourth, the focus of all three remedies is on empowering SMEs and PCA customers to make good use of the information made available to them by these remedies and to take greater control of their banking arrangements. The actions that customers take as a consequence may involve switching provider, or alternatively achieving a better deal from their existing bank (eg through internal switching or by avoiding unnecessary charges).

13.4 The three measures described in this section directly address many aspects of the AECs and the resulting customer detriment set out in Section 11. They are also likely to enhance the impact of other remedies in our remedy package. In the following paragraphs we discuss the contribution made by each remedy.

Open Banking – open API standards and data sharing

Summary of the remedy

13.5 Figure 13.1 below sets out our first foundation remedy, which is of central importance to our remedies package. The focus of this remedy is to deliver open API banking standards and to require the largest banks in GB and NI to make data available using these standards so as to enable consumers and SMEs to more easily identify products which suit their needs and to facilitate the creation of new digital services to help them manage their money.

Figure 13.1: Summary of measures to develop and require the use of open API standards and data sharing through them

We have decided to make an Order:

- requiring that RBSG, LBG, Barclays, HSBCG, Nationwide, Santander, Danske, BoI and AIBG (the largest banks in GB and NI) adopt and maintain common API standards through which they will share data with other providers and with third party service providers including PCWs, account information service providers (AISPs) and payment initiation service providers (PISPs). We will require these banks to:

  (a) set up an entity (the Implementation Entity) that will be tasked with agreeing, implementing and maintaining open and common banking standards to a project plan and timetable approved by the CMA once the CMA has approved the composition, governance arrangements, budget and funding proposed by the banks (listed above) for the Implementation Entity;

(b) appoint following approval of the CMA a suitably qualified, independent person (the Implementation Trustee), whose services will be paid for by the largest banks in GB and NI (listed above) and who will have a mandate, approved by the CMA, to act as chair of the Implementation Entity with responsibility for the delivery of the project's objectives;

(c) use their best endeavours to achieve the objectives of the project within the timetable agreed with the CMA; and

(d) agree to be bound by the decisions of the Implementation Trustee;

- requiring the largest banks in GB and NI (listed above) to release and make available through an open API by 31 March 2017, and thereafter maintain as open data, the following reference and product information:

  (a) The prices, charges, terms and conditions together with customer eligibility criteria, in the case of loans, for all PCA and BCA products (including overdrafts) and all SME lending products within our ToR (including unsecured loans); and

  (b) The Reference Data (for example branch and ATM location, branch opening hours) specified by the CMA;

- requiring the banks listed above to make available as open data and through an open API, service quality indicators (for example, customer recommendation scores) specified by the CMA in its remedy on service quality (see paragraph 13.104) and at the time required by that remedy;

- requiring the largest banks in GB and NI (listed above) to agree with the IT open standards for APIs with full read and write functionality and make available through them PCA and BCA transaction data sets, to be released no later than the transposition deadline of the second Payment Services Directive (PSD2) ie by 13 January 2018.

How this remedy addresses the AECs and/or the resulting customer detriment

An open API standard, open data and data sharing

13.6 This remedy has the potential to increase rivalry significantly in PCA and SME banking markets in both GB and NI, by reducing or removing several of the main barriers to accessing and assessing product and provider information that we have identified. The remedy will:

(a) require providers to make information on PCA and SME banking products, including prices, terms and customer eligibility criteria, available as open data to customers and to third parties such as finance platforms and PCWs. This will address barriers to accessing this information for PCA and BCA customers;

(b) enable SME and PCA customers to compare the likely cost of rivals' products – and in the case of SME loans their eligibility for these products – by authorising their existing account provider to share their transaction histories with third parties in a secure environment, subject to the customer's informed consent and using open standard APIs. This will address barriers to assessing the costs and suitability of different providers' PCAs and BCAs and, in the case of SME loans, the information asymmetries and incumbency advantages of BCA providers that we found; and

(c) facilitate the growth of a dynamic intermediary sector (including PISPs and AISPs)[2] with the ability and incentive to help customers obtain better terms from their current providers or switch to new products or providers which offer better value.

13.7 This remedy has the potential not just to reduce or remove the frictions that customers encounter on their existing 'journey' of searching for, selecting and potentially switching providers, but to change nature of the customer journey itself by facilitating the emergence on a large scale of new service providers with different business models offering innovative solutions to consumers and SMEs.

13.8 The types of market development that this remedy could bring about are far-reaching and include:

(a) the unbundling of products that are typically sold together by providers at present, such as overdrafts and current accounts;

(b) eroding or removing the incumbency advantages enjoyed by BCA providers because of their access to their customers' transaction histories when considering loan applications from SMEs; or

(c) overcoming customer inertia by, for example, and with the customer's consent, automatically transferring cash from current accounts paying

[2] PISPs and AISPs are defined in PSD2 in Articles 4(15) and 4(16) respectively. For a discussion of what these services do see The Second Payments Services Directive, PUK, July 2016.

low or no interest to higher interest earning ones or transferring money into accounts that are about to go into overdraft.

13.9 Some third party services already exist which demonstrate the potential new options that open APIs would make available to banking customers. These include, for example, services which monitor transactions and balances in current accounts, forecast the account holder's cash flows and provide a line of credit (or a link to alternative lenders) whereby money is automatically paid into the account if it is necessary to do so to avoid overdraft charges and withdrawn subsequently when the account is back in credit.[3]

13.10 However, to use these and similar services it is generally necessary at present for customers to disclose to the service provider their internet banking log-in credentials which may affect, or be perceived to affect, the guarantees against fraud that banks provide.[4] This inhibits take-up and we believe that such services will gain greater market acceptance when our remedy, which removes the need for customers to disclose these highly sensitive details to a third party, is adopted.

Background to the development of the remedy

13.11 In our provisional decision on remedies we explained the benefits that open and common API and data standards could have for competition and customers in the retail banking sector. We described a government/industry initiative intended to pave the way for open standards in retail banking: the Open Banking Working Group (OBWG). We said that we intended to adopt remedies which built upon this initiative which is described in more detail in Appendix 13.1.

Remedy design considerations

13.12 We set out in our provisional decision on remedies three key questions that we needed to answer to design our remedy:

(a) What data should providers be required to share and how?

(b) How could open standards for APIs and data be best developed?

(c) How quickly could the various components of the remedy be delivered?

[3] See SafetyNet Credit's website. See also the Pariti and Money Dashboard websites. Accounting software providers such as Sage and Xero can also provide cloud-based services for SMEs with links to their bank accounts.
[4] See, for example, this explanation by NatWest to a customer of the bank's terms and conditions in respect of services such as OnTrees.

13.13 We invited views on the overall effectiveness of this remedy and on the specific questions set out above. We next describe the views of parties on the remedy (in general and on these specific questions) and then set out our conclusions.

The adoption of Open Banking Standards

- *Parties' views*

13.14 The views of the largest providers were very positive. LBG said that Open Banking would enable new business models and technologies to develop and compete with existing providers.[5] HSBCG told us that APIs/Open Banking had the potential to transform competition in the sector.[6] Barclays, similarly, said that open API standards would have a transformative impact on the market.[7] Nationwide told us that it had a transformative potential.[8]

13.15 Smaller banks too were generally in favour. Santander said that it supported our adoption of open APIs as a foundation remedy, subject to the necessary safeguards being put in place.[9] Danske, which had participated in the OBWG, also said that it welcomed the introduction of API standards though said that the costs of meeting our proposed release date for the Midata datasets would be prohibitively high and entirely disproportionate for the smaller banks who had not participated in the original project.[10]

13.16 AIBG, however, said that despite the market share of its First Trust bank in NI, AIB itself had a very small banking operation market in GB. It therefore said that it would be disproportionately costly for the remedy to apply to its GB operations.[11]

13.17 FinTechs also expressed their support for this remedy. FData said it strongly endorsed the open API remedy and the provisional decision to require the largest banks in the GB and NI markets to make PCA transaction data (among other data) available through an open API. However, it also said that in implementing the remedy there should be equal representation for

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[5] LBG response to provisional decision on remedies, paragraph 2.1.
[6] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 1.
[7] Barclays response to provisional decision on remedies, paragraph 2.1.
[8] Nationwide response to provisional decision on remedies, paragraph 3.2.
[9] Santander response to provisional decision on remedies, Annex 1 paragraph 1.1.
[10] Danske response to provisional decision on remedies, paragraph 2.1.
[11] AIBG response to provisional decision on remedies.

different types of banks, different financial sectors and FinTechs.[12] We discuss this issue further below in paragraph 13.40.

13.18 Comparison platforms too supported the remedy. Funding Options said that we had delivered a practical set of remedies to improve choice and availability in UK retail and SME banking, proposing immediate actions able to deliver positive short-term impact whilst laying the groundwork for longer-term structural shifts such as the emergence of bank APIs.[13] BGL, operator of comparethemarket.com said that the API remedy could remove a key barrier to customer switching.[14]

- *Our conclusions*

13.19 We reviewed First Trust's and AIB's shares of the NI and GB markets respectively and noted that AIB's share of the GB market was very small. Further, AIBG told us that [✄].

13.20 To ensure consistency, we also looked at the other NI banks' shares of the GB market. We found that BoI and Danske had similarly small shares.

13.21 We have therefore decided that it would be unreasonable to compel BoI, Danske or AIBG to comply with the requirements of this remedy in GB, though they may choose to do so for commercial reasons and to comply with the provisions of PSD2 when these come into force.[15]

13.22 We also considered the NI shares of the largest GB banks but did not find these to be of such a small scale so as to exclude the application of the remedy to them in NI.

What data should providers be required to share and how?

- *Parties' views*

13.23 Parties generally supported our proposals, which closely followed those of the OBWG and which comprised reference data (such as ATM and branch locations and opening hours), product data (relating to current account and SME loan prices terms and conditions) and PCA and BCA[16] transaction

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[12] FData response to provisional decision on remedies, Section 4.
[13] Funding Options response to provisional decision on remedies, p2.
[14] BGL response to provisional decision on remedies, paragraph 3.10.
[15] We consider that open API standards will provide a mechanism for payment service providers to comply with their requirements under PSD2.
[16] We also invited views on whether certain SMEs should be out of scope, based on their turnover.

data. Some parties, however, thought that a wider range of products should fall within the scope of our remedy.

13.24 FinTechs and some providers argued that open data should be made available on a wider range of products and that the scope of the Implementation Entity's remit should be expanded accordingly. FData said that a much wider range of financial products should be placed in the API, including savings accounts, credit cards, loans,[17] mortgages, investments and pensions.[18] 118 118 Money argued that, in order to create a level playing field, all consumer loan products should be included in the scope of the remedy, not just overdrafts.[19]

- *Our conclusions*

13.25 We recognise that extending the scope of our remedy to require the sharing of data on a wider range of products could have benefits. However, there would be risks attached to doing so. The timetable we are proposing is already challenging and adding more products at this stage could jeopardise it. We would not, in any case, be able to require providers to share data about products which are outside of ToR. We have therefore not extended the scope of this remedy to include products that fall outside of our ToR. Nevertheless, we envisage that those charged with implementing this remedy will be mindful of the benefits that might be obtained by, for example, including, in their discussions on standards, products which are defined as payment accounts in PSD2 but are not BCAs or PCAs.

13.26 We also received responses related to the type of SMEs that should fall within the scope of this remedy and be able to share their transaction data with API-based services, or whether the remedy should be subject to an upper turnover limit. It is not clear to us how banks will be able to apply a threshold in practice since they might not be aware of a SME's turnover, or even if they are, how they would be able to provide differential access to APIs on this basis. We concluded that the precise definition of eligible SMEs should be considered by the Implementation Entity and Implementation Trustee, taking into account these practical considerations. If an annual turnover threshold were set below that of our ToR, it should be at or above £6.5 million as this would bring at least 99% of SMEs within the scope of the remedy.

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[17] As our remedies do apply to SME loans we interpreted this as referring to consumer loans, which are outside our ToR.
[18] FData response to provisional decision on remedies, paragraph 5.3.7.
[19] 118 118 Money response to provisional decision on remedies, pp4 & 5.

How could open standards for APIs and data be best developed?

- *Parties' views*

13.27 In our provisional decision on remedies we proposed that since no suitable organisation existed currently, a new vehicle or entity would need to be created for the specific purpose of taking the remedy forward. This, the Implementation Entity would provide a forum for the discussion and agreement of technical standards and governance arrangements and should be chaired by a person, the Implementation Trustee, with the power to impose a solution in the event that no consensus emerged. There was general agreement with this approach.

13.28 HSBCG told us that, in the light of the expedited time frame which the CMA had indicated it wished to pursue, it was engaging with other banks, via Payments UK, over how the Implementation Entity should be set up and constituted, prior to the publication of the CMA's final report. It agreed with the CMA that the Implementation Entity should provide a forum for discussion of the implementation options, and also have the means to impose a solution where consensus did not emerge, to ensure timely delivery. It said that Payments UK was best placed to coordinate initial discussions between the banks on how the entity should be constituted since it had considerable experience in a range of similar initiatives, including CASS and the Agency Bank code of conduct.[20]

13.29 HSBCG told us that it considered that the Implementation Trustee should be a lawyer with a specialisation in privacy and data protection. The Implementation Trustee, it said, would require a significant amount of support from technical architects who were independent of the banks and that they would need to have (or be supported by) good project management capability, as well as experience of aligning different stakeholders with potentially divergent interests and views. It said that the Government Digital Services office (GDS) may be well placed to assist in this regard, as it had a strong track record in coordinating multiple government departments behind single sets of data standards.[21]

13.30 Barclays also noted the potential role of Payments UK in helping set up the Implementation Entity but indicated that there might be a longer-term and wider role for such a body. It said that in the short term there was a need to galvanise the industry into delivery and this would require leveraging the

[20] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 22.
[21] ibid, paragraph 25.

capability of an entity capable of delivering industry-wide infrastructure projects which should also have the independence and leadership of the OBWG. It suggested that Payments UK (drawing on its CASS and collaborative payments track record) set up a group with sufficient independent governance to become the Implementation Entity at least in the short term. This, it said, could be independently chaired by the co-chairs of the OBWG. Their joint leadership, alongside observers from the FCA and HMT, should ensure that implementation targets were realistic but challenging. Barclays considered that the PSR should also be an observer, given that it is proposing open APIs in payments. Barclays also said that the Implementation Entity should remain mindful of similar initiatives, such as Nesta, to ensure an efficient industry approach. For example, Nesta's plans for a data sandbox were very similar to the sandbox described by the OBWG. It would be helpful if a single sandbox could be used for both purposes as this could realise efficiencies, thus helping with timelines.[22]

13.31 RBSG agreed with the proposal to create an Implementation Entity and appoint an Implementation Trustee and told us that it would also support representation of at least some of the challenger banks on the Implementation Entity.[23]

13.32 The FinTechs submitted that representation on the Implementation Entity should extend beyond the providers. FData said that the Implementation Entity must be populated in a balanced way, with equal representation for different types of banks, different financial sectors and FinTechs.[24]

13.33 The Open Banking Standard group urged us to require explicitly that the Standard be developed in an open, inclusive and transparent manner.[25]

- *Our conclusions*

13.34 In our provisional decision on remedies we said that we intended to use our order-making powers to require the largest banks in GB and NI to come forward with proposals for the composition, governance arrangements, funding and budget of the Implementation Entity, to enable it to undertake the work necessary for the adoption of common and open data, API and security standards. We similarly said that we would require them to propose

[22] Barclays response to provisional decision on remedies, paragraphs 2.9–2.11.
[23] RBSG response to provisional decision on remedies, Section 1.1.
[24] FData response to provisional decision on remedies, paragraph 6.4.
[25] Open Banking Standard group response to provisional decision on remedies, p1.

a suitable candidate for the role of Implementation Trustee, to drive the process to completion.

13.35 Subsequently, we engaged with Payments UK, which had begun to assist the banks to develop plans for the Implementation Entity and retain an executive search firm to identify suitable candidates for the Implementation Trustee role. These plans are not yet fully developed and we do not have a list of potential candidates for the Implementation Trustee role. However, on the basis of the proposals and plans we have seen so far we are reasonably confident that the providers will be in a position to present a satisfactory plan for the creation of the Implementation Entity and will be able to identify suitable candidates for the Implementation Trustee role.

13.36 We thought, nonetheless, that it would be useful to set out here our expectations of the Implementation Entity and the Implementation Trustee.

- *Our expectations of the Implementation Entity*

13.37 The Implementation Entity should be agile, focused, inclusive, adequately resourced and transparent. We recognise that there is some tension between these objectives and that a balance will therefore need to be struck.

13.38 To deliver the outcomes we have specified, within what is an ambitious but achievable timescale, the Implementation Entity should be agile, its structure, organisation and processes streamlined and conducive to rapid and efficient decision-making. This would tend to imply a tight management/ steering group and a flat organisation structure.

13.39 Equally, the Implementation Entity should have a very clear and narrow focus. A paper produced for the Payments Strategy Forum by its Horizon Scanning Working Group,[26] for example, set out the case for tying together the CMA's proposals with the requirements of PSD2 more generally, envisaging an expanded and continued role for the Implementation Entity or its equivalent within this. While this has some appeal we would not wish to see the Implementation Entity's remit extended if this would jeopardise the successful and timely implementation of our remedies. That said, the Implementation Trustee may wish to be mindful of any benefits that might occur through including additional products in the standards-making process, for example a wider range of lending products or those payment accounts covered by PSD2 which fall outside our ToR.

[26] API Governance, Payments Strategy Forum.

13.40 The ability to make decisions quickly needs to be balanced with the need to reflect not just the views and interests of the large banks but also those of other major stakeholders, for example the smaller banks and FinTechs. While the Implementation Trustee may to some extent be able to represent the views of these major stakeholders we consider it preferable for them to represent themselves within the Implementation Entity, including on its steering group. Although the wider stakeholder group may be too large or diverse for every perspective to be represented on the steering group its members' views and the valuable technical expertise they have could potentially also be communicated through an advisory group or groups. Finally, given the FCA's role in the oversight of PSD2 and HMT's sustained interest in the open banking project, we think it would be appropriate for both to have at least observer status on the Implementation Entity's steering group.

13.41 The Implementation Entity needs to be adequately resourced with dedicated staff employed directly and/or seconded, as relevant, from the banks. We will require this and that the largest banks in GB and NI who fund the Implementation Entity must grant the Implementation Trustee's reasonable requests to provide or procure specific resources needed to perform their function.

13.42 Stakeholders not actively participating in the work of the Implementation Entity but whose interests may be affected by it need to be informed of the decisions that it is contemplating and have the ability to intervene if they consider it necessary. Such transparency could, for example, be achieved by establishing an Implementation Entity website on which documents and news could be shared and comments posted and involvement could be facilitated through an advisory group or groups.

- *Our expectations of the Implementation Trustee role*

13.43 The role of the Implementation Trustee is pivotal to the success of this remedy since they will be ultimately responsible for the delivery of the remedy outcomes we have stipulated.

13.44 To balance these responsibilities the Implementation Trustee role must have the power to:

(a) require information from providers;

(b) require the resources they consider necessary (including the ability to retain independent advisers) for the fulfilment of the mandate; and

(c) impose a decision on participants in the event that there is no consensus.

13.45 The role is thus not simply to monitor the activities of the Implementation Entity or to act as a non-executive director. The role is closer to that of an executive chair. We do not consider that a particular professional background is essential for the performance of this role but the Implementation Trustee must, of course, be independent. The appointment of the Implementation Trustee will be subject to the approval of the CMA.

13.46 We have noted at several points the possibility that the remit of the Implementation Trustee and the Implementation Entity could be expanded to encompass other products besides those specified in our ToR. Although we have made it clear that we feel the Implementation Entity and Implementation Trustee should focus closely on these products, the Implementation Trustee may also wish to be mindful of the relevance of the Open Banking remedies to a wider range of products (see paragraph 13.39).

13.47 The role necessarily entails a major commitment of time between now and at least January 2018, particularly in the first few months of the project.

How quickly should the various components of the remedy be delivered?

13.48 In our provisional decision on remedies we set out our proposed timetable for the release of open APIs and specified data sets. We said that we would require the largest banks in GB and NI to make open data (ie product and reference datasets) available through open APIs by the end of Q1 2017. We said that current account transaction data sets should be released through open APIs in two tranches: 'Midata' (redacted, read-only PCA transaction data) no later than Q1 2017 and unredacted PCA and BCA data according to a timescale agreed with the CMA to be no later than the deadline for its transposition into UK law of PSD2 (ie by 13 January 2018).

- *Parties' views*

13.49 The majority of banks told us that the timetable we set out in the provisional decision on remedies was unrealistic and/or gave rise to significant risks.

13.50 HSBCG told us that the initial OBWG delivery timetable had been premised on the prompt formation of an appropriate governance body to drive forward the further development and implementation of common standards and definitions in respect of both the technical aspects of APIs (needed for all data), and the security aspects (needed for any customer data). This had not happened yet, which inevitably lengthened the time frame for implementation.[27]

13.51 HSBCG drew a distinction between data which posed security or confidentiality risks and those which did not. It said that the development of an API for open data did not generate issues around security. It said that it should be feasible to implement APIs in respect of open data within nine months of the finalisation of common technical standards (or, in the case of service quality data, as soon as it is available). It said that this indicated that a Q1 2017 deadline was not realistic and pointed to a deadline of Q4 2017. It proposed that the deadline be set by the Implementation Trustee once common technical standards had been agreed: the implementation timescales would depend on the specific requirements set by the Implementation Trustee.[28]

13.52 For closed data APIs to be implemented,[29] HSBCG said a common and single solution to a range of interlocking security-related issues needed to be delivered, which would take more time and might be dependent on the PSD2 Regulatory Technical Standards (RTS) process which could extend into 2019.[30] The main security-related issues were (i) authorisation and authentication standards; (ii) standardised permissions frameworks (ie the need to ensure and manage explicit customer consents); (iii) whitelists (ie lists of third parties with the necessary security clearances); and (iv) customer redress mechanisms. It said that the OBWG had provided a significant amount of guidance in relation to each of these aspects.[31]

13.53 As regards Midata data sets, HSBCG said that the Q1 2017 deadline was proposed by the OBWG at the start of 2016 on the premise that a governance framework would be put in place shortly whereas this had not happened. It said that it might be possible to implement APIs for the Midata data sets within 12 months of the finalisation of common technical standards, provided that prompt agreement could also be reached in respect of key aspects of the security protocols. It said that it considered that the Midata data set APIs would require a whitelist process[32] and would also require a clear redress framework, to address the risk of data security

[27] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 21.
[28] ibid, paragraph 36.
[29] That is data which is not currently made public or shared, such as PCA and BCA transaction data.
[30] For a description of this process see the EBA's consultation on the PSD2 technical standards.
[31] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 13.
[32] A process of, in this context, ensuring that FinTechs wishing to receive transaction data via APIs met industry-agreed digital security standards.

breaches (for example, identity theft) in respect of read-only customer data.[33]

13.54 RBSG said that it was concerned that the current proposed timetable was very aggressive and did not reflect adequately the technical challenge of all banks being able to provide information in a consistent format that could then be provided to third parties. It said that considerable industry alignment was needed on a large number of parameters, and a large number of interested parties would need to buy in to the technical solution to ensure that it worked effectively.[34]

13.55 RBSG suggested that a possible solution to timetabling concerns was for the Implementation Entity to be empowered to set its own timetable for approval by the CMA, or at least to be empowered to vary the timetable (subject to CMA approval) if necessary.[35]

13.56 Barclays said that the CMA had adopted the time frames suggested by the OBWG in December 2015, without taking into account that these were set out on the basis that HMT gave the go-ahead for implementation in January 2016. As this did not happen, the industry had effectively lost considerable implementation time envisaged by the OBWG. Accordingly, in Barclays' opinion, to reflect the delay in giving the go-ahead, the deadlines for releasing APIs should be pushed back by four to seven months (the time between the original OBWG start point to the release of the CMA provisional remedies or to the CMA final report).[36]

13.57 Barclays noted in particular the risks of sharing closed data with third party providers. It said that the release of the Midata data sets as APIs to myriad third parties (without governance in place) was very different to the situation today where customers uploaded their Midata file to a single well-established comparison site. The release of transactional data, it said, required complex issues to be carefully considered and resolved. For example, in the absence of a governance structure to 'white list' third parties, banks could provide access to customer accounts to a third party that did not meet security standards, or a fraudulent third party pretending to be legitimate. If the third party suffered a data breach, they would have no

[33] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 15.
[34] RBSG response to provisional decision on remedies, paragraph 1.4.
[35] ibid, paragraph 1.4.
[36] Barclays response to provisional decision on remedies, paragraph 2.6.

obligation to report it to the bank or the customer, and the customer would have limited recourse.[37]

13.58 It said that the OBWG recommended that Midata should be released as an API after the launch of the independent authority which would address these issues. Barclays strongly recommended that the CMA allow the industry additional time as recommended by the OBWG to put in place customer protections before personal data was made available to third parties.[38]

13.59 Nationwide questioned the feasibility of our proposed timescale in the context of the time it would take to identify and appoint a suitable Implementation Trustee and to specify and assemble the components of the Implementation Entity. It said that in the ordinary course it could be expected to take up to nine months alone to appoint the Implementation Trustee. Asking the six relevant providers to propose the composition, governance arrangements, funding and budget of the Implementation Entity and a suitable candidate for the Implementation Trustee without any further guidance would delay the implementation of this remedy. Even once operational, it might prove difficult to ensure that the Implementation Entity's discussions remained productive and decision-making timely as the CMA envisaged that a large number of stakeholders would be represented in the Implementation Entity, each of which was likely to promote a slightly different interest.[39]

13.60 Other banks also considered our proposed timescale to be tight.

13.61 Santander said that while it supported the CMA driving the development and adoption of open APIs, it considered the timeline to be ambitious. It said that although the CMA explained that it was adopting the OBWG timeline, in fact between January and May 2016 the relevant developmental activity was on hold, pending further HMT guidance and agreement on OBWG next steps, and awaiting the publication of the provisional decision on remedies.[40]

13.62 Danske said that it was entirely unrealistic and disproportionate to require the smallest of the nine banks to release the Midata PCA data sets at the same time as the much larger ones which had participated in Midata and were therefore likely to comply with this remedy without much, if any, additional effort. It said that the CMA had acknowledged that there were disproportionately high costs involved for smaller banks in adopting and

[37] ibid, paragraph 2.4.
[38] ibid, paragraph 2.5.
[39] Nationwide response to provisional decision on remedies, paragraph 3.7.
[40] Santander response to provisional decision on remedies, Annex 1, paragraph 1.3.

integrating the necessary technology into legacy systems in order to produce what was an intermediate remedy until the open API became available. It said the unnecessarily short implementation time frames proposed by the CMA were a serious concern as they were likely to lead to mistakes and security breaches occurring.[41]

13.63 AIBG, similarly, did not feel that the CMA's timetable was feasible, including because of the timing of the adoption of the RTS and the scale of the project. It suggested that the Implementation Entity determined an appropriate timescale when it was formed.[42]

13.64 FinTechs, by contrast to banks, thought that our proposed timescale was achievable and could even be advanced in some respects. FData considered the CMA's proposed timescale to be satisfactory, with the exception of BCA data which the CMA should group with PCA data in the Q1 2017 deadline.[43] However, FData said that the release of Midata data sets would not be helpful to its members since they were redacted and were thus of little or no use. Consequently, it said its members would continue to use screen-scraping technology until unredacted PCA and BCA transaction data was available through an API.[44]

13.65 Funding Options drew a distinction between read-only and read-write[45] APIs in terms of risk. It said that read-only BCA APIs did not carry the fraud and AML risks of full read-write APIs and that most major banks already offered read-only BCA APIs for services such as integration with SME accounting software.[46] It said that the timelines for the delivery of read-only BCA APIs, which were vital to help SMEs shop around for financial services such as loans, should be months not years.[47]

- *Our conclusions*

13.66 We considered the submissions that we received in response to our proposed timetable. We did so in the context of:

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[41] Danske response to provisional decision on remedies, paragraphs 2.8 & 2.10.
[42] AIBG response to provisional decision on remedies, page 2.
[43] FData response to provisional decision on remedies, paragraphs 5.2.3 & 5.2.4.
[44] ibid, paragraphs 5.3.6 & 5.3.7.
[45] We interpret the former as being synonymous with AISP services and the latter PISP services.
[46] Accounting software suppliers such as Xero and Sage supply accounting software which SMEs can link to their BCAs, for example to help reconcile payments.
[47] Funding Options response to provisional decision on remedies, p3.

(a) the central importance that we attach to this remedy, its potential impact on competition and the priority that should therefore be attached to it by the industry;

(b) the fact that discussions over the advantages of open API standards have been going on since at least 2014 and that following the intensive work that was undertaken by the OBWG in the last quarter of 2015 a road map for their introduction was published in February 2016;

(c) the nature of the work that needs to be done to allow an Open Banking Standard to be introduced, which is dependent not on the passage of time but on the focus of attention and resource and cooperation between providers; and

(d) the need for the timetable that we finally set to be stretching but credible in order to incentivise parties to finally bring this project to fruition.

13.67 In reaching our final decision about timing, we first considered the nature of the tasks facing the Implementation Entity and the Implementation Trustee.

13.68 The Implementation Entity and Implementation Trustee will need to address and make decisions in four broad areas:

(a) API standards;

(b) data standards;

(c) security standards and redress; and

(d) governance arrangements.

13.69 Although finding solutions to problems in the first three areas certainly presents many practical challenges, the evidence that we have reviewed suggests that these are not particularly difficult to overcome technically. In all three cases industry standards already exist and the issue is often therefore not how to develop a new standard but which of these existing standards or technologies it is appropriate to choose.[48] The OBWG undertook a considerable amount of work in these areas and we are confident that, provided it is adequately and appropriately resourced, the Implementation Entity will bring this to a satisfactory conclusion.

[48] In the very important case of authentication, for example, the OAuth 2.0 protocol is widely seen as appropriate though there is some debate in the Open Banking Standard of the need for an additional layer of security, OpenID Connect, to be provided where read-write API technology is in use. Similarly, the OBWG report discusses the relative merits of the SOAP and REST architecture styles and XML and JSON resource formats.

13.70 The issue of governance and participation is less technically challenging but is nonetheless contentious and critical to the successful implementation of this remedy. In particular we consider that the criteria used in the process of 'whitelisting' third party providers needs to be agreed early on between providers, FinTechs and other participants in, or observers of, the Implementation Entity.

13.71 Whitelisting is the process whereby third party service providers are deemed to be suitable to share banking data with. Clearly, a risk-based approach is appropriate here with higher security standards and protocols being required where sensitive data is involved and in particular where the third party provider can initiate customer payments (ie it is a PISP). However, the process of whitelisting presents a risk to the effectiveness of this remedy since banks might, in order to restrict the number or type of third party provider they wish to share data with, impose obligations on them that go beyond what is necessary to ensure customer security. This is because banks' incentives to restrict the scope of data sharing may reflect a desire to restrict or slow down competitive developments, as well as the objective of ensuring that data is handled securely, which is shared by all parties.

13.72 In order to obtain access to a payment service user's payment account level data, an AISP or PISP will need to be registered with or authorised by the FCA and meet the requirements of PSD2 when these come into force in the UK on 13 January 2018. Firms will need to apply prior to this date to ensure that they are authorised by 13 January 2018. However, HSBCG told us that[49] these provisions of PSD2 may post-date our remedy and PCWs may not qualify as AISPs under PSD2, in which case separate whitelisting arrangements will need to be put in place for them.

13.73 Funding Options proposed the adoption of security standards used in government procurement. HSBCG referred to the potential use of GDS expertise in this context. We are also aware that BBB gained some expertise in this area during the due diligence it conducted as part of the designation process for financial platforms under the SBEE Act.

13.74 We attach great importance to this aspect of our remedy and will accordingly ensure that the Implementation Trustee's mandate requires that it is addressed early on in order to ensure that whitelisting arrangements are agreed and put in place well before the release of the data sets we have specified. We also encourage the Implementation Trustee to work with the

[49] HSBCG response to provisional decision on remedies – comments on open API remedy follow-up submission, paragraph 72.

Information Commissioner's Office to ensure the manner in which providers share transaction data complies with data protection laws.

13.75 Finally, on redress and as we noted in our provisional decision on remedies, we regard the provisions of PSD2 to be sufficient to address the risk that consumer confidence in services using API technology will be undermined. These provide that in the case of unauthorised transactions the payer is entitled to address a refund claim to the account provider even where a third party PISP or AISP is involved and without prejudice to the allocation of liability between the PSPs.[50] We would expect the UK transposition of PSD2 to cover PCWs as well and deal with any concerns over redress.

13.76 We next considered the release of the Midata data sets, which we had proposed for Q1 2017.

13.77 We recognised the costs and difficulties this timing could create for smaller banks, particularly those which had not participated in the original Midata initiative. We noted too that even for the larger banks, completing what we saw as an interim step would absorb IT resources since an API standard would have to be developed. Further, releasing Midata data sets before industry-wide rules had been agreed for the whitelisting of PCWs and other platforms could give rise to bilateral arrangements between banks and TPPs which we think would be less than ideal. In addition, we took account of the FData submission that FinTechs would not find redacted transactional data sets useful, even if distributed via an open API, and would as a consequence continue screen-scraping to access unredacted data.

13.78 We thought that these submissions indicated that the costs and risks associated with the inclusion of a separate Midata data set release in our proposed implementation plan were relatively high compared with the likely benefits to customers and that there could be practical advantages in eliminating what was, in effect, an intermediate stage in the remedy implementation process. We have therefore decided to remove this data release from our proposed schedule.

13.79 Removing this element from the project plan will free up resources. Some of these can be allocated to other stages in the release schedule, the first of which will be the release of reference and product data. This release presents relatively few technical obstacles as regards API or data standards, raises no confidentiality or security issues and does not require a whitelisting regime to be in place. We see no reason to extend the timetable for this

[50] See Articles 72 to 74 of PSD2.

release beyond Q1 2017 although we acknowledge that elements of it may be constrained by the actual availability of data, for example in the case of service quality indicators. We therefore envisage that the Implementation Trustee, subject to the approval of the CMA, would have some limited discretion over exactly what data sets the banks were required to release by this deadline.

13.80 Eliminating the Midata phase will release resources that can also be allocated to the development, adoption and application of technical standards for subsequent stages of the project: unredacted PCA and BCA data and read-write API technology. It will also allow more time for the creation of the whitelisting arrangements and other components of the governance regime.

13.81 We have decided to retain the January 2018 deadline for the release of unredacted current account transaction data and open API standards with full read and write functionality. We acknowledge, however, that there is some uncertainty as to when the RTS being developed by the EBA will be finally approved and the extent to which they will be aligned with the standards agreed by the Implementation Entity. The Implementation Trustee’s mandate will therefore specify that although January 2018 remains the deadline for the agreement of the standards underpinning this element of the remedy, he or she may approach the CMA for agreement to a delay in the adoption and implementation of these standards if to do otherwise would give rise to significant risks or inefficiencies arising from their lack of alignment with the PSD2 RTS.

Cost of remedies

13.82 We considered the cost of this remedy and in particular whether its scope or implementation timetable placed unreasonable burdens on the industry.

13.83 Although the absolute cost of this remedy will be material, very similar obligations will be imposed on the industry by PSD2 in two years. We therefore focused on the additional costs of our remedy and, in particular, whether our proposed timetable for the adoption of the remedy was significantly more onerous than that for PSD2.

13.84 We have already noted that the timetable for the first release of open reference, product and performance data should not present providers with a major problem as it gives rise to no security or privacy concerns and most of the data is already in the public domain.

13.85 The read and write API functionality poses greater challenges. However, the OBWG participants concluded that it was feasible to address concerns, including those relating to privacy, in relation to unredacted PCA and BCA transaction data within that timeframe. Read and write functionality also raises challenges involving issues of security and fraud prevention but our timeframe does not require providers to adopt the relevant measures any sooner than the redress provisions in relation to PSD2 coming into force.

13.86 Finally, we considered the costs to the industry of supporting the Implementation Entity and the Implementation Trustee. We envisage that most of the support for the Implementation Entity will arise from the provision of time and expertise of employees both from providers and FinTechs. This could also potentially include the cost for external support, if for example, a professional services firm is procured to assist with the project management function. The cost of the Implementation Trustee and the procurement of data services involved in operating a 'sandbox', for example, would involve providers incurring external expenditure. However, we do not expect that the total costs of support in cash or kind, would exceed £20 million. As these costs will be being spread over two years and are likely to be shared between providers we do not consider them to be unreasonable.

13.87 We therefore concluded that the cost of the remedies would exceed that of complying with PSD2. However, the difference was likely to be small, particularly relative to the benefits of prompt implementation of this key measure.

Measures to enable PCA customers and SMEs to make comparisons between providers on the basis of their service quality

Summary of the remedy

13.88 Figure 13.2 below sets out our second foundation remedy. The focus of this remedy is to enable customers and SMEs to be able to access and compare information on providers' service quality.

13.89 Many providers continuously monitor and benchmark their performance against competitors including by using survey research to measure customer satisfaction and customer willingness to recommend the provider to others. Further, information about some features of providers' offers which could affect their quality of service, such as the number and location of their branches and their opening hours, is available to customers.[51] However,

[51] Though these may not always be in a standardised format, or easy to compare across providers.

other information, such as the time it typically takes to open a current account, the reliability of transaction services or how quickly or well they handle complaints, is not.

13.90 The most comprehensive source of service quality information for SMEs of which we are aware of is Business Banking Insight (BBI), a website[52] which collects and provides information on banks' quality of service to SMEs through a quarterly survey. Consumer-facing organisations such as Which? also periodically report on the service quality of PCA providers. Further, the Nesta challenge prize, which we discuss in detail in Section 16, is expected to facilitate the entry of new, and the expansion of existing, providers of service quality information to SMEs. In addition, our remedies to deliver open APIs, which we discuss earlier, are likely to facilitate the availability of service quality information for PCA holders and SMEs as open data, distributed through APIs.

Figure 13.2: Summary of remedy enabling PCA customers and SMEs to make comparisons between providers on the basis of their service quality

- We have decided to make an Order requiring PCA and BCA providers in GB and NI (separately for each brand above a minimum level of active accounts)[53] to publish results from an independent survey[54] covering the following four/five Core Service Quality Indicators for PCAs/SMEs respectively:

  (a) Customers' willingness to recommend their current account provider's quality of staff and customer service to friends, family or other SMEs.

  (b) Customers' willingness to recommend the provider's branch services.

  (c) Customers' willingness to recommend the provider's online and mobile banking services.

  (d) Customers' willingness to recommend the provider's credit services (the provision of overdrafts and loans).[55]

[52] Jointly driven by the FSB and BCC, BBI was originally initiated by HMT and is supported by an advisory group that includes the BBA, RBSG and BEIS.
[53] Set at 150,000 active PCAs in GB, 20,000 active PCAs in NI, 20,000 active BCAs in GB and 15,000 active BCAs in NI. See paragraph 13.145.
[54] Survey data should be collected on a rolling annual basis. Survey questionnaire and methodology to be approved by the CMA. Respondents should be asked questions about services they have used recently where relevant.
[55] In the case of PCAs, this measure would capture provision of overdraft services only, while in the case of SMEs, the measure would capture provision of overdrafts and general purpose business loans (secured and unsecured).

- *(e)* (For SMEs only) Customers' willingness to recommend the provider's relationship/account management services.

- The service quality metrics will be published prominently by each provider on their websites, in branches and in promotional leaflets (in a manner specified by the CMA), separately for GB and NI and by brand, and updated every six months. Published data will contain a comparative element, where each brand's score will be compared with other brands in GB/NI.[56]

- The above data should also be made available every 6 months as open data to third parties, such as PCWs and finance platforms.

- Additionally, we have decided to recommend to the FCA (within the FCA's existing remit) to implement a second part of the remedy to require PCA and BCA providers[57] to publish, and make available to others including as open data, additional (objective) measures of service performance encompassing their PCA, BCA and SME lending products and principal sales/delivery channels.[58]

How this remedy addresses the AECs and/or the resulting customer detriment

13.91 This remedy is intended to provide relevant, reliable and comparable information on providers' service quality to help PCA customers and SMEs choose between providers.

13.92 In developing this remedy option, we have distinguished between core information on service quality, which should be published prominently in places where it can be accessed and easily assessed by a vast number of customers, and more detailed information which should be published primarily for the benefit of intermediaries and more sophisticated and/or

[56] We will undertake customer research to inform the precise format and content of the core data summary prior to implementation, in order to make it most useful and relevant to the customers at whom it is aimed. See paragraph 13.140.
[57] The FCA may wish to consider extending the requirement to SME lending providers within their existing remit.
[58] The additional data could include measures in the following areas:
(a) For both personal customers and SMEs:
  (i) interruptions to, and unavailability of, services including digital;
  (ii) performance of telephone service/call centre;
  (iii) availability of (services in) branches (by branch where relevant); and
  (iv) complaints handling.
(b) For personal customers only:
  (i) provision of overdraft management services;
(c) For SMEs only:
  (i) nature and provision of relationship/account management; and
  (ii) simplicity and speed of business account and credit facility opening procedures.

engaged customers, and which can be transformed by intermediaries into data that can be easily accessed and assessed by customers.

13.93 In relation to the mandatory disclosure of core information, we know from previous research that simply providing all customers with significantly more information would not guarantee better outcomes.[59] Overloading customers with information is a particular risk in a market characterised by low levels of engagement; a point made by several of the parties who responded to our provisional decision on remedies, Remedies Notice and information requests.

13.94 Our qualitative research among SMEs and personal customers indicates that, for smaller businesses and personal customers, there is a requirement for 'at a glance' information to help them compare providers, or develop a shortlist.[60]

13.95 On this basis, we think that providing, in easily digestible form, comparable measures of providers' performance across a small number of key quality facets would be the most effective way of addressing the difficulties faced by customers in accessing information on which to base an assessment of rival providers' service quality that we have found. We think that indicators based on customers' willingness to recommend various aspects of service quality would be the most suitable metrics in this regard. We have considered alternative measures (such as satisfaction) either instead of, or in addition to, willingness to recommend and have found that the evidence supports willingness to recommend metrics, and more generally, publication of a small number of metrics.

13.96 While this approach may address the information needs of relatively un-engaged PCA customers and time-poor SMEs, more sophisticated comparisons, undertaken most likely by larger SMEs, professional advisers or intermediaries such as PCWs and FinTech companies, would be facilitated by requiring providers to publish more detailed performance information as open data, distributed via APIs.[61]

13.97 In addition, because SMEs quite often require finance on short lead times, and the majority go to their BCA provider for finance, having done little or no searching, providing some metrics on SME lending (for example, the

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[59] See for example, Ofcom (March 2013), *A Review of Consumer Information Remedies*.
[60] Optimisa Research report.
[61] Santander told us that it considered the most effective way of allowing SMEs to make comparisons between BCA providers on the basis of their service quality would be to include on all PCWs a single satisfaction score representing SMEs' experiences. We agree that comparisons between providers are easier and quicker if data on all providers is available from one source, and believe that PCWs, advisory services and similar providers could have an important role both in the case of PCAs and SME products.

average time taken for new credit facilities to be available) would give more information to SMEs when considering lending, and would work together with our other SME remedies outlined in Section 16 to prompt SMEs to consider other lenders.

Remedy design considerations

13.98 The principal remedy design questions that we sought to answer were:

- *(a)* Which facets of service quality are important to consumers and SMEs?
- *(b)* Who should collate service quality data and how?
- *(c)* How should information relating to service quality of providers and/or products be published?
- *(d)* How should service quality data be presented?
- *(e)* Which providers should be required to publish service quality data?

13.99 We reached our decision by considering all of these aspects of remedy design together, including how they interact with other remedies, but for clarity discuss each in turn.

Facets of service quality

13.100 In the context of PCAs and BCAs, service quality can be considered to cover aspects of customer service (eg politeness of staff, speed of response to queries or complaints, etc) as well as product characteristics and features (eg can the account be managed via a particular channel, withdrawal limits, etc).

13.101 This remedy is intended, when adopted in combination with the other remedies in this package, to enable PCA customers and SMEs to more easily compare providers of banking services on the basis of the service quality they provide.

13.102 Appendix 13.2 presents (i) our analysis of evidence from customer surveys (both our own and from off-the-shelf material submitted by parties), (ii) which service quality data is currently available to and used by customers, (iii) what parties told us about the information customers require, (iv) which aspects of service quality providers monitor themselves, and (v) quality data published in other sectors. Based on this evidence, our view is that requiring all banks to provide relatively unengaged consumers and time-poor SMEs with large volumes of performance data would not necessarily enable them to identify the products which best suited their needs. Rather, a small number of comparable summary performance indicators is more likely to help customers develop a shortlist of potential providers to research further.

13.103 Therefore, we have decided that there should be a distinction in the data that providers should be required to collect and make available (including via APIs), as follows:

(a) A small number of measures, published prominently, separately for PCAs and SME products, based on customer perceptions of performance across key areas (Core Service Quality Indicators); and

(b) Additional indicators of performance across a wider range of service areas encompassing providers' PCA, BCA and SME lending products and delivery channels which should be published, and made available through APIs (Additional Service Quality Indicators).

- *Core Service Quality Indicators*

13.104 The Core Service Quality Indicators should contain no more than five measures for each of PCA and SME customers, in order to be quick and easy to access and assess. In their responses to our provisional decision on remedies, Barclays,[62] RBSG[63] and the FSCP[64] agreed with publishing a small number of Core Service Quality Indicators.

13.105 A set of customer service indicators based on the same type of measure (eg willingness to recommend, or satisfaction) is more likely to be readily understood. Conversely a combination of types of measures would risk confusing customers and/or increasing the difficulty understanding the data. We have decided that the Core Service Quality Indicators should be based on willingness to recommend, because in order to achieve a high rating a higher level of standard is usually required, and because it is part of the data already sourced and monitored by most providers who typically told us that it would be a useful measure to share with customers. We present further evidence in Appendix 13.2.

13.106 Our list of Core Service Quality Indicators for PCAs contains:

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[62] Barclays response to our provisional decision on remedies, paragraph 3.4.
[63] RBSG response to our provisional decision on remedies, paragraph 2.
[64] FSCP response to our provisional decision on remedies, p3.

(a) willingness to recommend provider[65] to friends and family;[66]

(b) willingness to recommend provider's online and mobile banking services to friends and family [users of services];

(c) willingness to recommend provider's branch services to friends and family [users of services]; and

(d) willingness to recommend provider's overdraft services to friends and family [users of services].

13.107 Our list of Core Service Quality Indicators for SMEs contains:

(a) willingness to recommend provider[67] to other SMEs;

(b) willingness to recommend provider's relationship/account management[68] to other SMEs [users of services];

(c) willingness to recommend provider's online and mobile banking services to other SMEs [users of services];

(d) willingness to recommend provider's branch and business centre services to other SMEs [users of services]; and

(e) willingness to recommend provider's credit (overdraft and loan) services to other SMEs [users of services].[69]

13.108 In its response to our provisional decision on remedies, RBSG told us that the list of Core Service Quality Indicators was appropriate and likely to be

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[65] Where the term provider covers each brand which offers PCAs to customers, and which is above the de minimis threshold (see paragraph 13.145).
[66] We would envisage that the preamble to the question asking customers about their willingness to recommend the provider would ask the customers to think about the quality of staff and customer service, as our survey found this to be of great importance to PCA customers (see paragraph 5.106). It also means that respondents are less likely to include in their response other factors (eg price, media coverage, etc), which was raised by LBG as a flaw of simple customer satisfaction measures.
[67] Where the term provider covers the brands which offer BCAs to customers, and which are above the de minimis threshold (see paragraph 13.145).
[68] We would expect the survey question to ask about the care and attention the SMEs receive from their provider (and which falls within relationship/account management) such that the question is applicable to all SMEs, and is comparable across providers. This mitigates the issue of differences in relationship management services between brands and businesses of different sizes raised by LBG in its response to our provisional decision on remedies.
[69] Barclays told us that the inclusion of customer recommendations of credit services is understandable, but that this is the most challenging of the five core indicators for SMEs as typically only around one-third of SME customers will be using finance from their BCA provider at any point in time making the sampling challenges very acute, particularly for smaller providers (Barclays response to our provisional decision on remedies, paragraph 3.6). We think that our de minimis thresholds in each market is sufficiently high to allow for collection of robust data on provision of credit services to SMEs (see paragraph 13.145 for more details on the de minimis thresholds).

effective in capturing the most important aspects of service quality,[70] and TSB agreed with the inclusion of a metric measuring the customers' willingness to recommend the bank.[71]

13.109 On the other hand, TSB told us that it was unconvinced of the efficacy of publishing the other core indicators (ie willingness to recommend specific channels), as rather than signifying advocacy for a channel these are likely to reveal customer experience without providing further detail.[72] We think that the metrics capture elements of both the customer experience (as the data will reflect the views of only those customers which have used the channels recently and their experience) and advocacy, both of which are relevant to retail banking customers.

13.110 LBG told us that it considered that the Core Service Quality Indicators were flawed because they were based on averages and not personalised to the customer (eg channel usage, account usage and turnover, business sector, business size).[73]

13.111 In order to present indicators that are personalised to customers depending on their characteristics, the survey would need to achieve larger sample sizes for each bank and each year, in order to have large enough sample sizes (and thus robust results) for the different customer groups of interest. This may be possible for the larger banks with large customer bases, but creates practical difficulties for smaller banks. We weighed the benefits of data which can be presented by a number of customer characteristics against the practical difficulties of achieving sufficient sample sizes for the different customer groups for each provider, every year (or the alternative of excluding further providers from the survey). On balance, we think that *(a)* it is important that the survey covers as many providers as possible for which robust survey data can be obtained; and *(b)* PCA customers and smaller SMEs (which are the majority of SMEs) told us that they wanted 'at a glance' information that was easy to compare as a proxy for the overall performance of the bank (see paragraph 13.94). However, we would encourage the FCA to consider requiring providers to publish and/or make available as open data Additional Service Quality Indicators in such a way that results can be filtered by a number of customer characteristics (see paragraph 13.117).

13.112 LBG also told us that there were problems with definitions of different service elements (eg differences in relationship management services between

[70] RBSG response to our provisional decision on remedies, paragraph 2.1(b).
[71] TSB response to our provisional decision on remedies, paragraph 29(a).
[72] ibid, paragraph 35.
[73] LBG response to our provisional decision on remedies, paragraph 3.2(a).

brands and for businesses of different size).[74] Our view is that the survey questions relevant to relationship/account management in particular will need to be phrased such that they capture the differentiated offerings by different providers, and to different types of businesses. The resulting metric will then be a combination of quality of the service, customers' experiences as well as customers' perceptions of how the service compares to their needs and/or wants, and which we think is a useful summary measure of quality of this service.

13.113 A number of parties suggested alternative and/or additional metrics for inclusion in the Core Service Quality Indicators. For the reasons outlined above we consider that the metrics which we have included in Core Service Quality Indicators (outlined above in paragraphs 3.25 and 3.26) are expected to be most effective at remedying the AECs we have found. However, we are making a recommendation to the FCA to consider whether metrics suggested by parties in their responses to our provisional decision on remedies should be included in Additional Service Quality Indicators (see paragraph 13.116).

13.114 In relation to PCA metrics, RBS told us that basic bank accounts should be reported on separately from 'core current accounts' because basic bank accounts *(a)* were not full service PCAs, *(b)* were servicing a very specific financial and social segment, and *(c)* these might only be offered through certain channels and only some banks had been mandated to provide basic bank accounts.[75] Our view is that for the purposes of Core Service Quality Indicators, basic bank accounts should be included with other current accounts because: *(a)* where a service is part of the basic bank account offering (such as access to branch services or access to digital services) the service does not generally vary by type of current account; *(b)* customers holding basic bank accounts will not be asked for their willingness to recommend a service they do not have access to and therefore do not use (ie overdrafts); and *(c)* in relation to overall willingness to recommend, respondents will be asked to think about the quality of staff and customer service which is as relevant to customers with basic bank accounts as to customers with other current accounts.

- *Additional Service Quality Indicators*

13.115 We are making a recommendation to the FCA to implement this part of the remedy (insofar as it is within the FCA's existing remit). The FCA will

[74] ibid, paragraph 3.2(b).
[75] RBSG response to our provisional decision on remedies, paragraph 2.1(e).

consider the appropriate additional measures, as well as the scope, methodology and publication of these measures. Our list of the broad areas to be covered by Additional Service Quality Indicators contains:

(a) For both personal customers and SMEs:

(i) Interruptions to, and unavailability of, services, for example, the number of unplanned interruptions to internet banking service lasting longer than (timeline to be determined), number of instances when customers could not log in to mobile app, number of planned interruptions during working hours.

(ii) Performance of telephone service/call centre, for example, the average call abandonment rate, the average length of time before telephone calls are answered, average tenure of call centre workers, ratio of incoming calls to operatives.

(iii) Availability of (services in) branches[76] (by branch where relevant), for example, availability of extended opening hours, number of staff employed who can complete particular transactions, ratio of staff to customer footfall, proportion of customers using automated account managers.

(iv) Complaints handling, for example, proportion of complaints resolved within a specified period, average length of time taken to resolve complaints.[77]

(b) For personal customers only: differences in overdraft services such as alerts, grace periods and overdraft control tools, and how helpful these are for avoiding overdraft charges.[78]

(c) For SMEs only:

(i) Nature and provision of account/relationship management, for example, criteria which SMEs need to meet in order to have a dedicated account/relationship manager, number of business per account manager.

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[76] And business centres in the case of SMEs.
[77] We note that the FCA collates some data on complaints and this should not be duplicated.
[78] See Section 15.

(ii) Simplicity and speed of business account and credit facility opening procedures,[79] for example, average time needed for an account to be opened, approval rate for new credit facilities, average time taken for new credit facilities to be available, whether provider subscribes to regimes in place to allow businesses to access specialist financial services with confidence, such as for example the Lending Code.[80]

13.116 In their responses to our provisional decision on remedies, parties also suggested the following metrics,[81] which the FCA could consider as part of its work on Additional Service Quality Indicators:

(a) Data relating to the number of employees of PCA and BCA providers that hold membership of a relevant professional body/hold a suitable qualification/have achieved a professional standard.[82]

(b) Metrics relating to dissatisfaction, for instance regarding complaint and query handling.[83]

(c) Statistics on breaches of cyber security and fraud breaches.[84]

(d) Further metrics derived from customer surveys, in particular making a payment, complaint handling and dealing with fraud.[85]

13.117 We recommend that the FCA consider to what extent (at least some) Additional Service Quality Indicators could be collated separately by a number of key customer characteristics (such as, for example, overdraft users vs non-users in the case of PCAs, and by size or sector in the case of SMEs).

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[79] RBSG told us that it had some concerns around length of time to open a BCA or credit facility as this could be substantially affected by customers who did not respond to requests for information that were necessary in order to make an application and, therefore, was not an appropriate metric to compare across banks since it was substantially out of their control (RBSG response to provisional decision on remedies, paragraph 2.1(c)). Our view is that there are a number of ways in which this data can be presented such that the customers who do not respond to requests for necessary information are excluded, or given less weight. Barclays suggested average time for customer to complete application form, average number of stages involved in process, and SMEs' willingness to recommend account opening process as useful metrics. It will be for the FCA to specify which metrics should be part of the Additional Service Quality Indicators, and how they should be presented.
[80] The ABFA told us that at present the Lending Code was limited in its coverage of business lending to loans, credit cards and overdrafts to micro-enterprises only, and did not, for instance, cover the funding provided to SMEs by the ABFA's members, which was covered by the independent Standards Framework (ABFA response to provisional findings, p2).
[81] Some of these metrics were suggested for inclusion in Core Service Quality Indicators, however as mentioned in paragraph 13.113 above, we consider that they should be considered for inclusion in Additional Service Quality Indicators.
[82] Chartered Banker Institute response to provisional decision on remedies, p4.
[83] Money.co.uk response to provisional decision on remedies, p1.
[84] Professor Milne response to provisional decision on remedies, p6.
[85] Barclays response to provisional decision on remedies, paragraph 3.7.

13.118 Many personal customers or smaller SMEs may not access the Additional Service Quality Indicators directly, but we think it likely that larger SMEs, professional advisers, and intermediaries such as PCWs and FinTech companies, would do so. This will be facilitated by prompt implementation of other remedies we are proposing to adopt, in particular measures to introduce open API standards and increase the availability of open banking data.

13.119 Both Additional and Core Service Quality Indicators may also be accessed by existing, or new, third parties undertaking industry-wide assessments, or expert reviews of products and/or providers, and we believe that publication of Core and Additional Service Quality Indicators would increase the breadth of data upon which such assessments are made.[86] We do not consider it necessary to require the publication of industry-wide assessments, or expert reviews, as, given the number of market solutions that already exist, we would expect these to be built upon or additional ones to develop.

Collecting data on service quality

13.120 This remedy will require each relevant provider to publish biannually[87] Core Service Quality Indicators which are survey-based data.

13.121 We have decided that survey data for Core Service Quality Indicators should be collated by one independent survey agency for each of the PCA and SME surveys.[88] Given their importance to customers, as well as the likely prominence that would be given to the Core Service Quality Indicators by providers and the media, it is very important that the survey data on which they are based is collected on a standard, common basis with robust sampling techniques and data collection methods. Further reasons for our decision, as well as the alternative approach we considered, are outlined in Appendix 13.3. In their responses to our provisional decision on remedies,

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[86] Barclays told us that consideration could be given to whether an effective measure of the facets of service quality may be an independent panel or credible third party, which could assess the facets of service quality and provide a rating for them, such as currently done by the Fairbanking Foundation. LBG also told us that industry-wide expert reviews should be considered to provide a comparable score against a common set of metrics for each provider.
[87] In order to achieve sufficient sample sizes for all relevant providers on a continuous basis, we think that survey data will need to be collected on a rolling annual basis – ie a number of interviews are undertaken each month, such that the full sample is available after 12 months. However, providers should update their published data every 6 months, covering the previous 12 months. For example, any data published in January/February 2018 would have been collected over the period January–December 2017, while data published in July/August 2018 would have been collected over the period July 2017–June 2018.
[88] Or one independent survey agency undertaking both surveys.

Fairer Finance,[89] Nationwide,[90] LBG[91] and RBS[92] told us that they agreed that survey data should be collated by an independent survey agency.

13.122 Survey-based data published by each provider would therefore derive from an independent survey covering PCAs and an independent survey covering SME banking, where the methodologies and questionnaires have been approved by the CMA. In each case this may either be an (modified) existing survey (such as the BBI survey on the SME side) or a new survey.

13.123 The most practical way of bringing this about is likely to be for one independent industry body[93] to be responsible for preparing survey methodology and obtaining the CMA's approval, inviting agencies wishing to tender for the work to submit their proposals, appointing survey agencies, calculating and collecting the funding from each relevant provider, providing relevant survey data to each provider once available, etc. The final arrangements would be subject to the approval of the CMA. We note that this type of arrangement is already in place on the SME side in the form of the BBI, which is responsible for the procurement and collation of survey data, and which has indicated that it would be willing (subject to the appropriate checks) to make the necessary modifications to its survey methodology to meet the requirements of this remedy on the SME side. We encourage providers to submit proposals outlining how they will meet the requirements of this remedy to the CMA.

- *Survey methodology considerations*

13.124 As the aim of Core Service Quality Indicators is to provide relevant and easily comparable information on providers' service quality to help PCA customers and SMEs choose between providers, it is crucial that the data is robust. This has implications for survey methodology (questionnaire, sampling and in-field).

13.125 In particular, in order to ensure that data is robust (including sufficient sample sizes) for smaller providers (see paragraphs 13.5 to 13.13) for details of which providers are included in this remedy), the survey data will need to be collected over 12 months. This has implications for when the first set of results can be published (see paragraphs 13.152 and 13.153), but it will still be possible to publish updated results every six months, such that

[89] Fairer Finance response to provisional decision on remedies, p1.
[90] Nationwide response to provisional decision on remedies, paragraph 3.13.
[91] LBG response to provisional decision on remedies, paragraph 3.5(b).
[92] RBSG response to provisional decision on remedies, paragraph 2.1(d).
[93] Or two bodies, each responsible for one of the PCA and SME surveys.

each time updated data is published it covers the most recent 12 months for which data is available.

13.126 In terms of sampling, using random sampling it is easy to recruit adequate numbers of customers of all the major banks but not of smaller banks which have far fewer customers. The most cost-effective way of sampling low penetration brands in general is to use customer lists as the sampling frame and recruit from these, again using a random sampling approach. It is possible to apply mixed methodology to a survey, free-finding respondents from larger banks[94] and recruiting from customer lists for smaller banks. However, it is preferable to have the same recruitment method for both, which would need to be using customer lists in this case. This ensures that any differences in research findings are not simply a function of the differing recruitment method.

13.127 We can see benefits from specifying the survey methodology in such a way that it is not tied to one survey agency, but it is up to the providers to ensure that the data collected for Core Service Quality Indicators meets the requirements of this remedy and is subject to approval by the CMA.

- *Funding of surveys*

13.128 The surveys would be funded by the relevant providers in proportion to their active[95] PCA and BCA account numbers respectively in each of GB and NI, because:

(a) the more accounts (and thus customers[96]) a provider has, the more of their customers will have access to the survey results; and

(b) it avoids imposing a disproportionate financial burden on smaller providers.

13.129 In their responses to our provisional decision on remedies, Barclays[97] and LBG[98] agreed that the funding of both surveys should be in proportion to relevant providers' market shares.

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[94] Standard random sample eg using Random Digit Dialling if telephone research.
[95] Only customers with active accounts will be part of the survey, and these make up the majority of accounts (in 2015 86% of PCAs and 89% of BCAs were active accounts).
[96] As the majority of accounts are individual (ie not joint) accounts.
[97] Barclays response to provisional decision on remedies, paragraph 3.10.
[98] LBG response to provisional decision on remedies, paragraph 3.5(b).

13.130 It will be for the FCA to determine how Additional Service Quality Indicators are to be collected, though we note that these are likely to be predominantly, if not exclusively, objective data.[99]

How information on service quality should be published

13.131 Service quality information is likely to be of relevance to both *(a)* a provider's existing customers, who would be able to compare their provider with competitors and who might at some point contemplate opening an account elsewhere; and *(b)* potential customers, who are looking for a first account, or considering switching from other providers.

13.132 We also know that different customer groups access banking via different channels, and at different times, and we need to ensure that Core Service Quality Indicators are published where they can be accessed and assessed by as many of the customers to whom they are aimed as possible, which means publishing this data via several different channels.

13.133 We have decided that providers should display their Core Service Quality Indicators:

(a) prominently in branches;[100]

(b) no more than one click away from mobile and online banking home pages;[101,102] and

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[99] We would expect providers' own data to be collated by the providers adhering to common definitions and formats as specified by the FCA.

[100] In its response to our provisional decision on remedies, Barclays told us that branch-based literature requirements should be reconsidered as branches continued to decline in relevance and it would be highly costly to revise the literature every six months to reflect the latest results. Consequently, Barclays suggested that these requirements were reduced in line with usage (Barclays response to provisional decision on remedies, paragraph 3.9). RBSG told us that information in branches might be lost as customers were generally focused on completing their business rather than shopping around, which most now preferred to do online. RBS also told us that banks needed flexibility on the information that must be displayed and that there was a finite amount of information that could be displayed in branches and banks already had a number of display requirements under existing regulation and had their own marketing priorities (RBSG response to provisional decision on remedies, paragraph 2.1(e)). We think that branches and branch-based literature are an important source of information for customers when considering a new current account, and therefore it is crucial that any literature which contains information about current accounts also contains Core Service Quality Indicators. This remedy will be subject to the CMA's usual remedy review procedures.

[101] Such as on their pages for personal and business customers, which are one click away from the homepage.

[102] Fairer Finance told us that banks should not be required to publish service quality scorecards on their websites and that such ratings would undermine competition in the ratings market within which Fairer Finance operated (Fairer Finance response to provisional decision on remedies, p2). We consider that *(a)* the Core Service Quality Indicators are not a substitute for the ratings which, for example Fairer Finance publishes, but are rather a complement, and *(b)* it is important that customers are able to find information on service quality in the places where they are most likely to look for it or where they are most likely to see it.

(c) in information leaflets likely to be seen by prospective customers, such as those setting out the features and benefits of the current accounts the provider is offering.

13.134 LBG told us that in order to ensure the costs of this remedy were proportionate, the CMA should consider providing flexibility to providers on where this information was displayed, subject to meeting the CMA's criteria that it must be displayed prominently; as such the CMA should offer guidelines on where information should be displayed, rather than prescriptive instructions.[103] RBS told us that it accepted the need for some measure of standardisation but that it would also be important to retain some measure of flexibility so that banks could incorporate the service quality data into their customer communication material in a holistic way.[104] We are aware of the tension between, on the one hand, ensuring the information is presented in a format and in locations where customers would find it most useful and, on the other hand, allowing banks flexibility over where the information is displayed. However, our primary objective is to ensure that the remedy is effective and we will thus specify in the Order the lowest level of standardisation necessary that will ensure our objective is met.

13.135 Further, Core Service Quality Indicators should be made available as open data to third parties such as PCWs and Finance Platforms.[105]

13.136 We recommend that the FCA consider whether, and if so, how Service Quality Indicators can be included on the annual statement of fees that will be required under the Payment Accounts Directive (PAD).[106]

13.137 It will be for the FCA to decide how and where Additional Service Quality Indicators should be published, which may include publication on providers' websites (in a reasonably accessible location) and Additional Service Quality Indicators made available as open data to third parties such as PCWs and Finance Platforms.[107]

Presentation of service quality data

13.138 We considered how information on service quality should be presented in order to make it easy for customers to assess it.

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[103] LBG response to our provisional decision on remedies, paragraph 3.5(c).
[104] RBSG response to our provisional decision on remedies, paragraph 2.1(e).
[105] As defined in the Small and Medium Sized Business (Finance Platforms) Regulations 2015.
[106] Article 5.
[107] We have decided to make a recommendation to the FCA to implement the Additional Service Quality Indicators (see paragraph 13.155).

13.139 Since the purpose of this remedy is to facilitate comparisons between providers, there is a strong case for requiring providers to present the Core Service Quality Indicators *(a)* in a standard format, *(b)* on a comparative basis, ie how their scores compared with other banks', and *(c)* covering the same time period.

13.140 We will do further customer research to inform the precise format and content of the core data summary prior to implementation, in order to make it most useful and relevant to the customers at whom it is aimed.[108] In particular, the customer research will explore: *(a)* the presentation of the recommendation scores (for example whether the results should be presented as percentages, as 'x out of 10',[109] or visual representations); *(b)* the comparison across providers (for example ranking of providers, the score achieved by the top 3 providers, and whether this should be absolute or relative); and the visual presentation of service quality data (for example whether data should be presented in a table, in a diagram, using stars, and whether it should include colour-coding). We are planning to mandate the precise presentation of Core Service Quality Indicators in the Order. Before we publish the Order, providers are invited to submit options[110] for presenting Core Service Quality Indicators in particular where there is evidence that (i) it is likely to catch customers' attention, and (ii) is easy to understand.

Which providers should be required to publish service quality data

13.141 The effectiveness of this remedy is likely to be greater the more of the market is covered by the remedy.

13.142 We considered whether any exceptions should be made in practice. Larger providers that already monitor their performance are likely to face relatively low additional costs in collecting the information. We recognise, however, that the burden on smaller providers and potential entrants (of collecting/funding the collection of survey data for their customers), given the difficulty, and thus cost, of collecting a sufficiently robust sample of them, would be greater. We also note that there may be practical issues with survey design which would make it infeasible to collect sufficient samples for very small providers on an annual basis.

[108] Barclays was of the view that the presentation of service quality data should be subject to rigorous testing, for example, by testing the usefulness of a static ranking vs an interactive tool.
[109] Or xx out of 100.
[110] Taking into account the requirements for (i) standardisation across providers and as far as possible channels, and (ii) comparison with other providers.

13.143 On the other hand, we note that smaller banks and new entrants could have a strong incentive to invest in customer research as a way of acquiring new customers and retaining existing ones. We note that even relatively small providers, such as Handelsbanken, use surveys to compare their performance with their larger rivals.

13.144 Few parties provided comments in response to our provisional decision on remedies regarding whether exceptions should be made for smaller providers and/or start-ups. Barclays[111] and RBS[112] were supportive of a de minimis threshold, below which providers would not be required to publish Core Service Quality Indicators. RBS also stated that the de minimis threshold should apply to brands, rather than banking groups, as different brands within the same group might offer very different service propositions.[113] On the other hand, LBG considered that it was in the customers' interests that the remedy applied to all providers.[114]

13.145 Our decision is that all PCA and BCA providers[115] above the following thresholds (based on 2015 data) in GB/NI will be required to collect and publish the relevant[116] Core Service Quality Indicators in the market in which they exceed the threshold:

(a) 150,000 active[117] PCAs in GB;

(b) 20,000 active PCAs in NI;

(c) 20,000 active BCAs in GB; and

(d) 15,000 active BCAs in NI.

13.146 The threshold needs to be lower for BCAs in both GB and NI, and for PCAs in NI because the markets are smaller, and/or in order to ensure that Core Service Quality Indicators are available for at least some challenger banks, thus allowing customers to make more comprehensive comparisons, while

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[111] Barclays response to provisional decision on remedies, paragraph 3.10.
[112] RBS response to provisional decision on remedies, paragraph 2.1(f).
[113] ibid, paragraph 5.
[114] LBG response to provisional decision on remedies, paragraph 1.17.
[115] For this remedy, de minimis applies separately for each brand, where relevant, as survey results will be collected and published by brand. Providers offering SME lending but not BCAs are excluded from the Order, as (i) only one core measure relates to SME lending, (ii) overdrafts are only offered together with BCAs, and (iii) the BCA providers represent the vast majority of the SME lending market by value of loans outstanding at end of 2015, and by number of loans outstanding at end of 2015.
[116] Not all smaller banks will offer branch services, for example.
[117] An active account is an account which is not dormant under the following definition: Account which has had no customer-generated payments or transfers (including standing orders and direct debits, but excluding charges and interest on the account) coming into, or leaving, the account in the previous 12 months.

ensuring that robust results can be obtained for providers which are just above the threshold.

13.147 This covers the vast majority of active accounts and includes larger providers in both GB and NI, while also excluding a large number of very small providers.

13.148 Providers which are currently below the threshold, but which grow (organically, or through mergers or acquisitions for example) their account numbers to above the threshold would be required to collect and publish the relevant Core Service Quality Indicators (and contribute to the cost of the survey in proportion to account numbers) once they are above the threshold for two consecutive years. Conversely, providers which are currently above the threshold, but whose account numbers fall to below the threshold would be required to continue collecting and publishing the relevant Core Service Quality Indicators (and contribute to the cost of the survey in proportion to account numbers) until they are below the threshold for two consecutive years, or unless their account numbers reduce to below 75% of the relevant threshold (whichever occurs first). This is to avoid capturing providers which may hover around the threshold for some time, and where *(a)* it could potentially cause confusion for customers to see data for these providers in some periods and not others, and *(b)* survey sampling would be more difficult where changes need to be made more often.

13.149 It will be for the FCA to decide which providers will need to collate and publish Additional Service Quality Indicators.

Implementation issues

13.150 We will implement, and monitor, the obligation to collect and publish Core Service Quality Indicators ourselves through an Order on relevant providers. We consider that it is feasible for us to do so, and would ensure a more rapid outcome.

13.151 We consider that certain tasks related to the Core Service Quality Indicators could be undertaken by parties following our final report but prior to the publication of the Order, which would reduce the time necessary to start publishing service quality data outlined in this remedy once the Order is published. These include the setting up of the governance to ensure data is collected and disseminated to relevant providers, and preparation work for a tender to appoint survey companies. However, we also recognise that it can take time to undertake good quality surveys of the scale that will be required (including fieldwork, data checks and collation).

13.152 In our provisional decision on remedies, we consulted on an implementation timescale of six months following publication of the Order.[118] Barclays told us that it considered this was an unrealistically short period, particularly for SMEs as many providers needed to cooperate, and survey sampling might require the use of customer lists for smaller providers to achieve robust sample size, which brought privacy issues and could take time.[119] RBS told us that logistically, implementing a number of different remedies within a six-month period would be extremely challenging, given the finite capacity of skilled resources, systems capabilities and other regulatory changes which were required within the same period (eg changes required by the FCA and by changes to the Lending Code) and suggested that the CMA considered adopting a more staggered approach.[120] Santander told us that the Implementation timeline was unrealistic, and that unless existing survey providers were used, the supplier selection process, funding mechanism methodology and fieldwork would take some months to complete.[121] TSB told us that the envisioned time frame would be challenging, particularly so for challenger banks.[122] In order to take account of the change in survey frequency from biannual to annual, and taking into account parties' views, our view is that this remedy would be implemented within 15 to 18 months of the Order being published.

13.153 Though the survey data should be collected on a rolling annual basis, updated data should be published every six months. We do not see any benefits in specifying particular points in the year when (updated) data on service quality should be collated and published (eg 1 January and 1 July), over publishing as soon as the data is available and every six months from then on. However, in order to have the greatest impact, all relevant providers should publish their (updated) data on the same day so that customers can make like-for-like comparisons across providers. Providers will need to agree with the CMA the date for publication of data, which should be within 18 months of the publication of the Order.

13.154 As it may take up to 18 months after publication of our Order for core service quality data specified under this remedy to start being published by providers, in the interim period we require continued provision of the existing BBI survey,[123] as:

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[118] This was for a biannual survey. We have decided to require the publication of results from an annual survey – see paragraph 13.125.
[119] Barclays response to provisional decision on remedies, paragraph 3.11.
[120] RBSG response to provisional decision on remedies, paragraph 2.
[121] Santander response to our provisional decision on remedies, paragraph 2.2.
[122] TSB response to provisional decision on remedies, paragraph 47.
[123] For details of the specific transitional measure regarding the underlying survey of the BBI website that we are proposing please see Section 16.

(a) there are benefits to customers from the publication of this comparative data;

(b) there is an option for providers to use existing data (to the extent the questions and survey methodology are approved by the CMA) in order to meet the requirements under this remedy; and

(c) it is an important interim measure considered for the implementation of our remedy on developing a comparison site(s) for SMEs as discussed in Section 16.

13.155 The implementation of the obligation to collect and publish Additional Service Quality Indicators, including finalising the precise measures included, evaluation and refinement of measures over time, would be better facilitated by the FCA. We will make a recommendation to the FCA (within its existing remit) to implement this part of the remedy. The FCA will consider the appropriate additional measures, as well as the scope, methodology and publication of these measures. We envisage that this part of the remedy would be implemented within two years after the publication of this report.

13.156 The Core Service Quality Indicators are expected to deliver continuing benefits to consumers and SMEs, and we do not envisage changes in the markets that would reduce significantly, or remove, the need for this remedy. Therefore, our view is that we should not require a sunset clause, but that this remedy should be subject to the CMA's usual remedy review procedures.[124] We and the FCA may consider in future whether the Core and Additional Service Quality Indicators could be grouped together under the FCA's overall responsibility.

Cost of remedies

13.157 In order to form a view of the cost of this remedy, we looked at information on how much existing surveys cost, how much providers currently spend on research and how much it may cost providers to start collecting and publishing various metrics on their performance.

[124] LBG told us that the CMA should recommend to the FCA that it undertook work to assess the ongoing effectiveness of this remedy in helping customers to make correct decisions about the quality of a provider, and to enhance its effectiveness, and that this review should consider moving to metrics developed by comparison tools based on objective service metrics as these emerge as an alternative to satisfaction (LBG response to provisional decision on remedies, paragraph 3.3). We are implementing this remedy ourselves, and will therefore monitor the remedy in line with our usual remedy review procedures, which include changes to metrics as a result of any change in circumstances.

13.158 BBI told us that the BBI project as a whole, including the existing survey, website rebuild and maintenance, and PR, had cost around £[✂] a year and was currently funded by four larger providers. In our provisional decision on remedies, we considered that each of the surveys of PCA and SME customers that we propose above may cost somewhat more as they would need to achieve sufficient sample sizes for the smaller providers but that , based on the CMA's experience from its inquiries, we would not expect these together to cost more than £5–£6 million a year. This was a conservative number based on the remedy applying to all providers and the most costly methodology (random sampling) under which costs for smaller providers increase exponentially. Given our remedy now only imposes a requirement on those providers above the de minimis thresholds (see paragraph 13.145), the costs will be much lower. While costs will vary depending on the methodology chosen, we would expect these to be in the order of £1 million.

13.159 In addition, we are aware that many providers already do their own customer research, some of which may be replaced by the proposed surveys, and which would therefore reduce the cost of this remedy to the providers.

13.160 In its response to our provisional decision on remedies, Santander told us that the burden on providers resulting from the requirement to publish Additional Service Quality Indicators may be material, and would include the costs arising from a further round of review led by the FCA, the costs of providing an assortment of information which may have limited utility for most customers, and the commitment required from both the banks and the FCA pursuant to the contemplated scrutiny by the FCA of the measures provided, and thus the FCA should consider the utility of each Additional Service Quality Indicator and that the introduction of any such measures should be trialled.[125] LBG told us that the cost of the Additional Service Quality Indicators could be reduced over time by removing the requirement for redundant metrics (ie metrics which may not be required by comparison tools in future).[126] It will be for the FCA to consider these points when designing this part of the remedy, however we believe that the costs of collecting the providers' own data for the purpose of Additional Service Quality Indicators should be fairly low as much of the data may already be collated (though perhaps using different definitions than may be required under this remedy).

[125] Santander response to provisional decision on remedies, paragraphs 2.6 & 2.7.
[126] LBG response to provisional decision on remedies, paragraph 3.5(c).

13.161 Further, providers periodically update their websites, information displayed in branches and informational leaflets, including as a consequence of changes to terms and conditions and introduction of new products, which should make publishing the data required under this remedy easy and relatively inexpensive.[127]

13.162 Costs of monitoring compliance with this remedy are also likely to be low since monitoring will be based on providers providing periodic compliance reports to the CMA in relation to Core Service Quality Indicators. It will be for the FCA to work with providers to develop and test the efficacy of specific Additional Service Quality Indicators and implement this part of the remedy, and we would expect the costs of supervision of this part of the remedy to also be low.

Measures to increase customer awareness of the potential benefits of switching and prompt customers to consider their banking arrangements

Summary of the remedy

13.163 We have decided to introduce measures aimed at prompting customers to review their PCA or BCA arrangements at times when they may have a higher propensity to consider a change. The purpose of these measures will be to increase customer awareness of the potential benefits of switching PCA or BCA and to prompt further investigation of other providers. Figure 13.3 below summarises our remedy.

Figure 13.3: Measures to increase customer awareness of the potential benefits of switching and prompt customers to consider their banking arrangements

- We have decided to make an Order requiring all PCA and BCA providers in the UK (subject to a de minimis threshold based on number of current accounts) to cooperate with the FCA in a research programme, including RCTs, to identify those prompts that are most likely to be effective in changing customer behaviour.

Providers will only be required to participate in the research programme if selected by the FCA.

[127] Barclays told us that it would be highly costly to revise branch-based literature every six months to reflect the latest results (Barclays response to provisional decision on remedies, paragraph 3.9). We think that there are ways in which the costs of revising branch-based literature can be kept to a minimum, such as by printing only the required amounts for each six-month period, rather than planning for say a year, and by timing changes to terms and conditions, or introduction of new products to coincide with the publication of updated data.

- We have decided to recommend to the FCA to:

  (a) undertake a research programme, including RCTs, in conjunction with a selection of PCA and BCA providers in the UK to identify those prompts that are most likely to increase customer awareness of the potential benefits of switching and prompt customers to consider their banking arrangements;

  (b) subject to the results of the research programme, use its rule-making powers in keeping with the FCA's Banking Conduct of Business Sourcebook (BCOBS),[128] to implement a series of prompts to be communicated to customers in line with the optimal timing, content and medium parameters identified by the research programme. The FCA will monitor and supervise compliance with its rules;

  (c) consider the extent to which the content and presentation of the prompts should be standardised, in order to ensure that a consistent message is delivered to customers by all providers; and

  (d) monitor the effectiveness of these prompts, and, as and when necessary, redesign the prompts to reflect market and regulatory developments, including the impact of our wider remedies package on customer engagement.

- In addition, we have decided to require BCA providers to also send prompts to SMEs not covered by the FCA's BCOBS, but included within our ToR. We expect the Order to apply to the BCA providers subject to the FCA's rules.

How this remedy addresses the AECs and/or the resulting customer detriment

13.164 We have found that customer engagement in both the PCA and BCA markets in both GB and NI is low.

13.165 For PCA customers, we have found that few customers search for better offers and the number of customers switching PCAs, in part or in full, remains very low. This is due to a lack of triggers for customers to engage in the market, the low cost of PCAs for many customers, reported satisfaction despite low levels of searching, and a belief by many customers that there is

[128] Alongside consumers and some charities, the FCA's BCOBS applies to microenterprises (ie a business with an annual turnover of balance sheet total of less than £2 million and fewer than ten employees), which comprise around 97% of autonomous SMEs (see the FCA discussion paper on its approach to SMEs as users of financial services, p5 (November 2015)).

little to be gained from searching and/or switching.[129] Our findings for BCA customers are very similar.[130]

13.166 PCAs and BCAs are 'evergreen' products (ie they have no contract end date), and consequently, PCA customers and SMEs are not required to consider if their PCA or BCA is the best available, or most appropriate, product for them.

13.167 The purpose of this remedy is to prompt customers, both periodically and at key milestones throughout their relationship with their current account provider, to review their existing banking arrangements and to perform one or more of the following actions:

(a) Consider whether their existing banking arrangements meet their needs by reference to their account usage and the related costs.

(b) Consider changing their banking behaviour to make more effective use of their existing BCA or PCA, or to reduce the costs of their account usage.

(c) Consider switching to a more suitable product and/or provider. This could be achieved by switching to another product offered by the customer's existing provider (internal switching) or by switching to a product offered by an alternative provider (external switching).

13.168 We have identified two different sets of prompts:

(a) Event-based or situation-based trigger points: prompts triggered by the occurrence of specific events or situations, such as the closure of a branch or the end of an SME's free banking period.

(b) Periodic prompts: recurring prompts, such as the issue of an annual summary.

13.169 The use of event-based or situation-based trigger points and periodic prompts is intended to achieve different, but complementary, objectives:

(a) The delivery of prompts upon the occurrence of selected trigger points engages with a segment of customers at times when they are more likely to be receptive to the potential benefits of switching and the

[129] See Section 11.
[130] See Section 11.

consideration of other providers. However, these prompts are only likely to reach any individual customer on an irregular basis.

(b) Periodic prompts engage with a wider audience on a more regular basis. Further, our qualitative research indicated that periodic reminders could help to normalise consideration of switching providers.[131] For example, TSB has proposed to us that all PCA customers should be provided with a standardised Monthly Bill, in order to encourage regular engagement with their banking arrangements.[132] The use of periodic prompts also addresses, to some degree, the 'evergreen' nature of PCAs and BCAs (see paragraph 13.166) by replicating to some extent the annual contractual renewal process inherent in other markets, such as the insurance industry.

13.170 We considered how else the evergreen nature of current accounts could be addressed. For example, customers could be required to renew their current account periodically.

13.171 We considered that the mandatory renewal of current accounts could potentially be implemented via an opt-in or opt-out mechanism:

(a) Opt-in: customers would be required to give consent to their current account provider to continue their existing banking arrangements.

(b) Opt-out: customers would continue their existing banking arrangements unless they notified their current account provider to close their account.

13.172 Given the fundamental importance of current accounts to customers in managing their finances, there is a high risk of unintended consequences by requiring customers to opt in to ensure the continuation of banking services. For example, the closure of a PCA or BCA could result in the loss of income and/or the failure to meet financial obligations.

13.173 However, the alternative mechanism (ie requiring customers to notify their provider to close their account), although eliminating the risk of the with-drawal of banking services, is not materially different to existing conditions and does not encourage or incentivise customers to act.

13.174 We concluded that the use of periodic prompts was preferable to the introduction of a mandatory renewal process.

[131] Optimisa Research report, p38.
[132] TSB response to Remedies Notice, paragraphs 22 & 23 and TSB response to provisional decision on remedies, p1.

Remedy design considerations

13.175 We summarise below our consideration of the key issues relating to the design of the remedy, covering:

(a) further testing of remedy design prior to implementation;

(b) the timing of messages to customers;

(c) the content and presentation of those messages; and

(d) the source of prompts and the medium of their delivery.

13.176 We set out our detailed analysis of these design considerations in Appendix 13.4.

Further testing

13.177 We have decided to recommend to the FCA to undertake research, including RCTs, to identify the most suitable design features of the remedy, such as the content and presentation of the prompts, as well as the most effective channels of communication.

13.178 We expect that the FCA will prepare for testing following the publication of our final report, and begin testing following the making of the Order (see paragraph 13.208 for further information on the timing of remedy design and implementation).

13.179 Appendix 13.4 contains more information on further testing of the remedy design.

Timing of messages to customers

- *Event- or situation-based prompts recommended for further testing*

13.180 We have decided to recommend to the FCA that it tests the following event-based or situation-based prompts, in order to assess whether they are likely to increase customer engagement:

(a) A material change in the key product features of a BCA or PCA. Subject to testing by the FCA, we consider that the following material changes to the key product features of a BCA or PCA could represent effective trigger points:

(i) An adverse change to the pricing of the BCA or PCA (eg the removal of an introductory offer, such as an initial credit interest rate, or the increase of a BCA tariff).

(ii) The withdrawal of a product (eg the removal of a legacy BCA or PCA).

(iii) The withdrawal of a service (or services) from a product's offering (eg the reduction or removal of an overdraft facility).

(b) The closure of a customer's branch.

(c) The imposition of cumulative overdraft charges.

(d) The expiry of an SME's free banking period.

13.181 The above list of prompts selected for further testing is not exhaustive and testing may identify other viable prompts.

- *Periodic prompts recommended for further testing*

13.182 We have decided to recommend to the FCA that it tests the effectiveness of periodic prompts along with the issue of periodic summaries to PCA and BCA customers, including:

(a) undertaking testing to understand whether changes to the content, presentation and timing of annual summaries can encourage customers to take action upon receiving them;

(b) considering requiring providers to provide annual summaries to their BCA customers; and

(c) considering whether prompts with other periodic summaries, in addition to prompts along with the submission of an annual summary, can increase customer engagement.

13.183 In response to our provisional decision on remedies, Nationwide proposed that providers with a market share of 10% or more should be required to send periodic prompts to customers on back-book products or those customers who had not switched their PCA for more than ten years.[133]

13.184 The benefit of periodic prompts is that they can reach all customers on a more regular basis than prompts triggered by certain events or situations.

[133] Nationwide response to provisional decision on remedies, p4.

Excluding providers based on market share or customers based on length of tenure dilutes the impact of such prompts.

13.185 Instead, the content and presentation of the prompts could be tailored for different types of customers. It will be for the FCA to determine the most effective content and presentation, and whether the tailoring of prompts to different customer groups is likely to increase the effectiveness of such prompts. It is also important to note that low customer engagement, which this remedy is designed to address, is not isolated to banks with market shares above a particular level.

13.186 Appendix 13.4 contains further information on the timing of messages to customers.

Content and presentation of messages

13.187 There are a number of common messages that could be included in the prompts:

(a) Advising customers to review their existing banking arrangements.

(b) Communication of the rewards or benefits of switching. We consider that presenting customers with the financial gain or loss they could achieve or incur by switching or not taking action is more likely to be more effective than the recommendation of an alternative product and/or provider. The financial gain or loss from switching or not taking action could be presented to customers in a number of ways:

(i) An average gain or loss based on the market as a whole.

(ii) An indicative gain or loss based on different customer profiles (eg a heavy overdraft user or a customer holding a high credit balance in their current account).

(iii) A personalised gain or loss based on a customer’s transaction data, to the extent that this is compatible with PSD.

We recommend that the FCA tests the most effective way of presenting this information to customers, and works with providers to understand the feasibility of them providing such information to customers.

(c) Referral to sources of comparative information. We expect the availability of sources of comparative information available to both PCA customers and SMEs to increase over time. Therefore, the prompt could, for example, refer customers to an independent portal or website

that details all of the different comparison services available to customers.

(d) Communication of the benefits of using CASS to switch current accounts.

(e) Referral to sources of further guidance. For PCA customers, the Money Advice Service (MAS)[134] is currently responsible for enhancing consumer understanding and knowledge of financial matters and the ability of consumers to manage their financial affairs. On 16 March 2016, the government announced its intention to replace MAS with a new organisation from April 2018. It will be for the FCA to determine the appropriate body to which PCA customers should be referred for further guidance on financial matters in place of MAS.

13.188 For BCA customers, there does not appear to be single source of guidance. The prompt could encourage SMEs to discuss their banking requirements with their individual trusted adviser, such as their accountant. We have also decided to recommend to BEIS that it works with the BBB and professional associations, such as the Institute of Chartered Accountants in England and Wales (ICAEW) to explore ways in which their members can channel advice on identifying and choosing providers and sources of finance to SMEs.[135] The above list is not exhaustive and each of these messages may not be suitable for all of the prompts that we have recommended to the FCA for testing.

13.189 The common messages described above could be supplemented with or modified by messages tailored to reflect the particular circumstances for each prompt, although further testing will be required by the FCA to assess the likely effectiveness of any such content. See paragraphs 111 and 112 in Appendix 13.4 for examples of how messages could be tailored for each prompt.

13.190 We recommend that the FCA tests:

(a) the precise messaging that is likely to be effective in changing customer behaviour for each of the selected prompts; and

(b) a number of presentational styles and formats, in order to understand how best to present the messaging to encourage greater customer engagement.

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[134] MAS was set up by the government in April 2010 to offer free and impartial money advice to consumers.
[135] See Section 16.

13.191 As we have decided that a customer's existing current account provider is best placed to deliver the prompts (see paragraph 13.194), allowing providers to prompt customers in line with their existing communications may bolster the authenticity and credibility of the messages. However, at the same time, some form of standardisation of content and presentation may ensure that a consistent message is delivered to customers by all providers.

13.192 We recommend that the FCA:

(a) considers the extent to which the content and presentation of messages should be standardised, in order to ensure that a consistent message is delivered to customers by all providers; and

(b) monitors the effectiveness of these prompts, and as and when necessary, redesigns the prompts to reflect market and regulatory developments, including the impact of our wider remedies package on customer engagement.

13.193 Appendix 13.4 contains further information on the content and presentation of messages to customers.

Source and medium of delivery of prompts

13.194 We have decided that the customers' existing current account provider is best placed to deliver the prompts.

13.195 We think that any circumvention risk can be addressed by the FCA considering the extent to which the content and presentation of messages should be standardised, in order to ensure that a consistent message is delivered to customers by all providers (see paragraph 13.192).

13.196 Our qualitative research found that channel usage would likely be dependent on a customer's existing communication preferences, and where possible, the use of multi-channel communication could help maximise the effectiveness of the prompts.[136] For example:

(a) A letter and/or email could be appropriate channels to initiate contact with the customer as these mediums were well-suited to communicate detailed messages.[137]

[136] Optimisa Research report, pp46 & 47.
[137] Optimisa Research report, p57.

(b) The initial communication could then be followed up by a notification or reminder via the customer's mobile banking application or a secure message via the customer's online banking portal.[138,139]

13.197 We recommend that the FCA undertakes testing in order to determine the optimum multi-channel communication method.[140]

13.198 Appendix 13.4 contains further information on the source and medium of delivery of prompts to customers.

Implementation issues

13.199 We have considered the following issues in relation to the implementation of the remedy:

(a) Method of implementation.

(b) Timing of implementation.

(c) The remedy's interaction with existing and future laws and regulations.

(d) Monitoring of compliance with and enforcement of the remedy.

Method of implementation

13.200 We have decided to issue an Order requiring all PCA and BCA providers in the UK (subject to a de minimis threshold) to cooperate with the FCA in a research programme, including RCTs, to identify those prompts that are most likely to be effective in changing customer behaviour. Providers will only be required to participate in the research programme if selected by the FCA.

13.201 We have decided that this remedy will be subject to a de minimis threshold of 150,000 active PCAs and 20,000 active BCAs.[141] In response to our provisional decision on remedies, LBG told us that there should be no de minimis threshold for the remedy, as it was in the interest of customers that the remedy should apply to all providers.[142] However, we think that the de

[138] Our qualitative research suggested that secure messaging was often ignored, and the prompts would need to appear at the log-in stage to attract attention (Optimisa Research report, p50).
[139] Although the research suggested that customers were less familiar with receiving notifications via their mobile banking application, we consider that mobile banking adoption – which is largely driven by smartphone adoption, which is greater among the younger population – is likely to increase over time.
[140] The consideration of optimal channels should allow for the development of new mediums in line with ongoing technological change.
[141] Using a common definition across providers.
[142] LBG response to provisional decision on remedies, p3.

minimis threshold is set relatively low, thus covering most active accounts, and including a range of providers in terms of size, in both GB and NI, while also excluding the large number of very small providers.

13.202 Moreover, the de minimis threshold will not prevent providers that fall below the threshold from approaching and working with the FCA to participate in its research programme. However, it does mean that those providers cannot be required to participate in the research programme, if selected by the FCA.

13.203 For those providers who are selected by the FCA to participate in RCTs (within a timeline agreed with the FCA), this will include as a minimum:

(a) selecting a sample of customers (according to the criteria specified by the FCA) and randomly assigning each customer to either a treatment or control group;

(b) delivering the prompts identified as suitable for testing by the FCA (see paragraphs 13.180 to 13.186) via different channels to each of the groups; and

(c) gathering the data necessary and sharing it with the FCA to measure the effectiveness of the various prompts.

13.204 We are encouraged by the overall positive response to our provisional decision on remedies proposal to recommend to the FCA to undertake a research programme, including RCTs. Nevertheless, our view is that an Order appears to be the most effective way of ensuring the participation of providers. Doing so will reduce the administrative burden associated with accepting undertakings from multiple providers.

13.205 We have decided to recommend to the FCA to:

(a) undertake a research programme, including RCTs, in conjunction with a selection of PCA and BCA providers to identify those prompts that are most likely to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers;

(b) subject to the results of the research programme, use its rule-making powers in keeping with the FCA’s BCOBS to implement a series of prompts to be communicated to customers in line with the optimal timing, content and medium parameters identified by the research programme. We would expect the FCA to monitor and supervise compliance with their rules;

(c) consider the extent to which the content and presentation of messages should be standardised, in order to ensure that a consistent message is delivered to customers by all providers; and

(d) monitor the effectiveness of these prompts, and as and when necessary, redesign the prompts to reflect market and regulatory developments, including the impact of our wider remedies package on customer engagement.

13.206 In addition, we have decided to require BCA providers to also send prompts to SMEs not covered by the FCA's BCOBS, but included within our ToR. We expect the Order or undertakings to apply to the BCA providers subject to the FCA's rules. We envisage the incremental costs to BCA providers of sending prompts to these SMEs to be minimal, as they represent a small proportion of SMEs.

13.207 It will be for the FCA to determine how the remedy is implemented in its rules. We think that requiring providers to send prompts to all new and existing customers is likely to be the most effective way of increasing customer engagement.

Timing of implementation

13.208 The precise timings for the research programme and subsequent implementation of the prompts will be for the FCA to decide on. However, we expect the FCA to prepare for testing following the publication of our final report, and to begin testing following the making of the Order. We expect that testing and the analysis of results will be completed by the end of 2017. The FCA would then consult on any proposed changes to its rules or guidance in the summer of 2018.

Laws and regulations

13.209 The design and implementation of the remedy would need to have regard to the following laws and regulations:

(a) Data protection legislation;

(b) PAD; and

(c) PSD, PSD2 and CCD.

- *Data protection legislation*

13.210 In response to our Remedies Notice, the ICO told us that the prompts to be delivered to customers under this remedy might constitute direct marketing. Therefore, the remedy would need to comply with the regulation of direct marketing provided for in the Data Protection Act 1998 (DPA) and Privacy and Electronic Communications (EC Directive) Regulations 2003 (PECR).[143]

13.211 In particular, Regulation 22(2) of PECR prohibits the sending of direct marketing by electronic mail, which includes text messages, unless the recipient has provided consent (ie the recipient has opted in to receiving direct marketing) or the requirements of Regulation 22(3) are met.[144]

13.212 As only some customers have currently opted in to receive marketing messages, the efficacy of this remedy would be significantly diminished if the prompts were considered to represent direct marketing.

13.213 We have consulted with the ICO and are satisfied that sending prompts intended to change customers' behaviour will not, in principle, constitute direct marketing, although this depends on the precise wording of the prompts. The prompts are not intended to be the communication of advertising or marketing material.

13.214 We do not consider that this issue will act as a significant obstacle to the effective implementation of this remedy. It will be for the FCA to ensure that this remedy complies with the relevant data protection and electronic marketing legislation.

- *PAD*

13.215 PAD sets common regulatory standards that EU member states must meet, in order to improve the transparency and comparability of fees related to current accounts. PAD came into force on 17 September 2014 and has been implemented in the UK by the Payment Accounts Regulations 2015.

13.216 PAD requires member states to mandate to PCA providers the provision of two new standardised documents to PCA customers: a pre-contractual fee

[143] Section 11 of the DPA defines direct marketing as 'the communication (by whatever means) of any advertising or marketing material which is directed to particular individuals'. The ICO has also published guidance on direct marketing, which explains that the definition of direct marketing extends beyond commercial marketing and includes 'the promotion of an organisation's aims and ideals'.
[144] Regulation 22(3) allows for direct marketing to be sent by electronic mail without the recipient's consent if the recipient is provided with an opportunity to opt out of receiving such messages at the time they provide their details, and at each subsequent communication, if contact details are obtained in the course of the sale or negotiations for the sale of a product or service and the direct marketing is in respect of the provider's similar products and services.

information document and an annual statement of fees. The statement of fees must include at least the following information:

(a) the unit fee charged for each service and the number of times the service was used;

(b) the total amount of fees incurred for each service, each package of services provided and services exceeding the quantity covered by the packaged fee;

(c) the overdraft interest rate applied and the total amount of interest charged relating to the overdraft (where applicable);

(d) the credit interest rate and the total amount of interest earned; and

(e) the total amount of fees charged for all services.

13.217 PAD is a minimum harmonisation measure, thus allowing member states to adopt more favourable provisions to the consumer (within the bounds of PSD and other relevant legislation), including sending more frequent summaries. The content and presentation of these documents will be prescribed in forthcoming EU technical standards, which are yet to be developed by the European Banking Authority.

- *PSD, PSD2 and CCD*

13.218 PSD sets out various requirements as to the information which must be provided to customers by banks and it has been transposed into UK law. PSD is a maximum harmonisation directive, which means that member states may not impose varied or additional requirements on banks concerning matters falling within its scope. However, PSD does not seek to harmonise all informational requirements on banks, and there remains flexibility for member states to impose requirements relating to matters falling outside the scope of PSD.

13.219 Articles 47 and 48 of PSD set out the information that providers are required to provide customers in relation to individual payment transactions. They include a reference to identify the payments, the amount of payment, any charge for the transaction, exchange rates, date of credit or debit.

13.220 PSD2 will replace PSD.[145] It aims to update the current framework on payment services, extending its scope to payment services providers that

[145] PSD2 came into force in January 2016. Member states must transpose it into national law by January 2018 and following the recent referendum on EU membership the UK Government still plans to do this.

were previously unregulated, and to improve the transparency and security of payment services.

13.221 CCD harmonises certain aspects of the provision of consumer credit across the EU. It is considered in greater detail in our discussion on overdraft alerts (see Section 15).

13.222 We do not think that the information that will be provided to customers under this remedy conflicts with PSD, PSD2 or CCD. Among other considerations, the FCA will, however, need to take into account the scope of these directives when designing, testing and implementing the remedy via its rule-making powers.

13.223 These directives will not prevent the FCA from being able to mandate providers to send prompts to customers. However, care will need to be exercised in relation to mandating the content of prompts which duplicates information required under or otherwise within the scope of either PSD, PSD2 or CCD. We expect that the FCA will consider and where necessary take advice on such matters, informing the CMA and involving it as appropriate.

Monitoring and enforcement

13.224 We will ensure that providers comply with the provisions contained in the Order. Once the remedy is implemented, the FCA will be best placed to monitor and supervise compliance with its rules.

Cost of remedies

13.225 There are likely to be three principal costs associated with this remedy:

(a) Finalisation of remedy design.

(b) Remedy implementation.

(c) Monitoring and enforcement.

13.226 The cost of finalising remedy design largely comprises the undertaking of testing by the FCA, and will depend on the extent of testing required to finalise the key remedy design parameters. There could also be additional costs should it be deemed necessary by the FCA to undertake testing (lab testing) in preparation for RCTs, and to engage an academic expert to assist in the design of the prompts.

13.227 The primary costs of delivering the prompts to customers are likely to involve the design of content and changes to providers' IT systems and wider communications infrastructure.

13.228 The cost of monitoring compliance with and enforcement of the remedy will depend on the rules made by the FCA, and the extent to which the FCA will be required to modify the arrangements for monitoring and supervising compliance with its rules.

13.229 The FCA will assess the costs of the remedy design, implementation and monitoring and enforcement against the benefits that the introduction of the prompts, as part of our overall package of remedies, will be expected to deliver.

14. Current account switching package

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Overview

Measures we have decided to adopt

14.1 The switching of current account provider by PCA customers or SMEs can be characterised, not as a single event, but as a process or 'journey' comprising a sequence of steps. The last step in this journey is customers initiating the switching process, either closing their former account (which we refer to as a 'full switch') or keeping both the old and the new account open (referred to as 'partial switch' or 'multi-banking').

14.2 In this section we set out remedies aimed at improving customers' experience of this final step. These remedies will provide additional assurance to customers about the ease and benefits of switching accounts. They will also create a more effective governance framework for the Current Account Switch Service (CASS)[1] operated by Bacs,[2] so that the service continues to be developed and operated, through effective participation of a wide range of relevant stakeholders, in the interest of customers.

Reforms to CASS governance

14.3 A well-designed and more customer-focused CASS governance structure would provide those managing the service with stronger incentives to operate and develop the service in the interests of customers. In particular, it would lead to greater transparency, customer focus and diversity of views in the management of CASS.

14.4 The specific changes to CASS governance that we have decided to adopt are: requiring greater transparency around the decisions made by the Management Committee (MC), its subcommittees/groups and CASS's performance; expanding the membership of the CASS decision-making bodies to ensure greater independence, and diversity of views in the MC and its subcommittees/ groups; and introducing regulatory oversight of CASS by an appropriate body.

14.5 These changes would have the benefit of motivating the MC and Bacs' management team to continue to seek out new ways to improve the switching process for the benefit of customers over the long term. These, in turn, would help in addressing the AECs by increasing the confidence in and awareness of CASS thereby reducing barriers to switching.

Improvements to the switching process

14.6 The measures that we have decided to adopt to improve specific aspects of the switching process, ie extending the length of the CASS redirection period, and making transaction history more easily available to customers,

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[1] CASS is managed and owned by Bacs. CASS is a free-to-use service designed to make it quicker and easier for customers to switch current accounts. It is available to consumers, small businesses, small charities and small trusts. Customers can switch their personal or business current accounts to another provider with all their incoming and outgoing payments (ie direct debits and standing orders) switched automatically. The switching process takes seven days and customers can choose the exact date of the switch. The service includes a CASS Guarantee which fully protects customers against financial loss if something goes wrong during the switch. Over 40 UK banks and building societies participate in CASS.

[2] Bacs is a membership company limited by guarantee, with responsibility for the schemes behind the clearing and settlement of UK automated payment methods, direct debit and Bacs direct credit, as well as the provision of managed services for third parties, such as the Cash ISA Transfer Service, and the development, management and subsequent ownership of CASS. See Bacs website.

will increase customers' confidence in CASS and decrease the risks of switching.

14.7 Our remedy to extend the redirection period under CASS will provide further assurance to customers that their payments will not go missing after switching accounts through the implementation of a form of 'perpetual' redirection for users who may need it. This measure achieves many of the perceived benefits of ANP at a much lower cost.

14.8 Providing a facility for customers to receive their transaction history at the time of and after account closure will help reduce the perceived or real risks of switching, and encourage customers to switch accounts.[3]

Measures to increase awareness of and confidence in CASS and the switching process

14.9 This remedy will support Bacs in its efforts to increase customer awareness of and confidence in CASS, so that customers' concerns in relation to the convenience and security of switching no longer pose a barrier to switching current accounts.

14.10 It complements our proposal to reform CASS governance enhancing the incentives of Bacs and the MC to operate and develop CASS in the interests of customers. It also complements our measures to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers, where the message can be communicated to individual customers at times when they are more likely to be receptive of such messages.

Measures we have decided not to adopt

14.11 We also considered the following remedies but have decided not to pursue further as part of this inquiry:

(a) introducing account number portability (ANP);

(b) introducing a partial switch service guarantee and requiring all providers to offer the partial switch service; and

[3] For example, past bank statements could be required to be submitted for a mortgage or loan application.

(c) requiring the transfer of continuous payment authorities (CPAs) on debit cards when switching through CASS.[4]

14.12 While we felt that each of these measures had merit, we have decided not to pursue these further for the following reasons:

(a) Both ANP and our proposal for an extension to the redirection period are ways of addressing the same underlying concerns relating to payments going astray in the switching process. While ANP is generally easier for customers to grasp and tends to perform better in customer surveys, in practical terms, our proposal of extended redirection is effective at reducing the risks of missed payments. ANP also raises some concerns about security, specifically a greater perceived danger of account fraud. Further, our proposal, which allows for permanent redirection for customers who may need it, costs substantially less to implement than ANP and is capable of much more rapid implementation, which is an important dimension of effectiveness. After taking all factors into account, extended redirection is effective in addressing our concerns, and is much less expensive and onerous to implement compared with ANP.

(b) Bacs told us that it was considering ways of meeting the requirements of customer segments which were not currently fully met by the current CASS or the partial switch services, notably customers with overdrafts and SMEs. In particular, Bacs stated that it was conducting a research-based approach to ensure that any changes to the lead-up to switching fulfilled the specific needs of overdraft users and in particular, how these needs might be addressed through the promotion of harmonised account opening processes. Further, Bacs planned to undertake research to break down the SME market into various segments to obtain data from participants on behavioural trends and perceived obstacles to switching. Following this research, Bacs will evaluate changes required to the central CASS propositions, such as an enhanced partial proposition specifically aimed at complex/additional needs. While not mandating a stand-alone partial switch remedy, we note that it facilitates multi-banking, and encourage Bacs to explore ways of developing an enhanced partial switch service based on the outputs of its proposed research, and work with its partial switch service participants to increase the customer awareness of this service.

[4] For further details on our decisions not to pursue these remedies, refer to paragraphs 14.74–**Error! Reference source not found.** (for ANP) and Appendix 14.5 (for partial switching and CPAs).

(c) Our assessment of requiring transfer of CPAs on debit cards when switching through CASS suggests that:

(i) few customers are likely to be adversely affected by the non-transfer of CPAs;

(ii) debit card scheme providers already offer a solution for many customers who could be affected; and

(iii) the likely cost and complexity of building a facility to automatically transfer CPAs as part of the switching process would be considerable and disproportionate.

14.13 In the remainder of this section, we set out further details of our decisions on the design and implementation of the remedies included in the current account switching package.

Reforms to CASS governance

Summary of the remedy

14.14 We found that barriers to switching accounts still remain despite the introduction of CASS and that awareness of and confidence in CASS was low.

14.15 In our Remedies Notice, we noted that a well-designed governance structure would have the benefit of motivating Bacs' management team and the MC in operating and developing CASS in the interests of the customers in the long run. We also stated that the current balance of influence between providers in the MC who are likely to be net winners and those that are likely to be net losers from the switching process may not fully align with Bacs' objectives of promoting awareness of and confidence in CASS.

14.16 From an operational and strategic perspective, CASS is run by participating banks through the MC[5] and is supported by Bacs' resources and staff. CASS's budget and spending plans are decided by the MC, and Bacs' board approves these only from a financial planning perspective. Although CASS is subject to corporate oversight by the Bacs board,[6] this is limited to activities

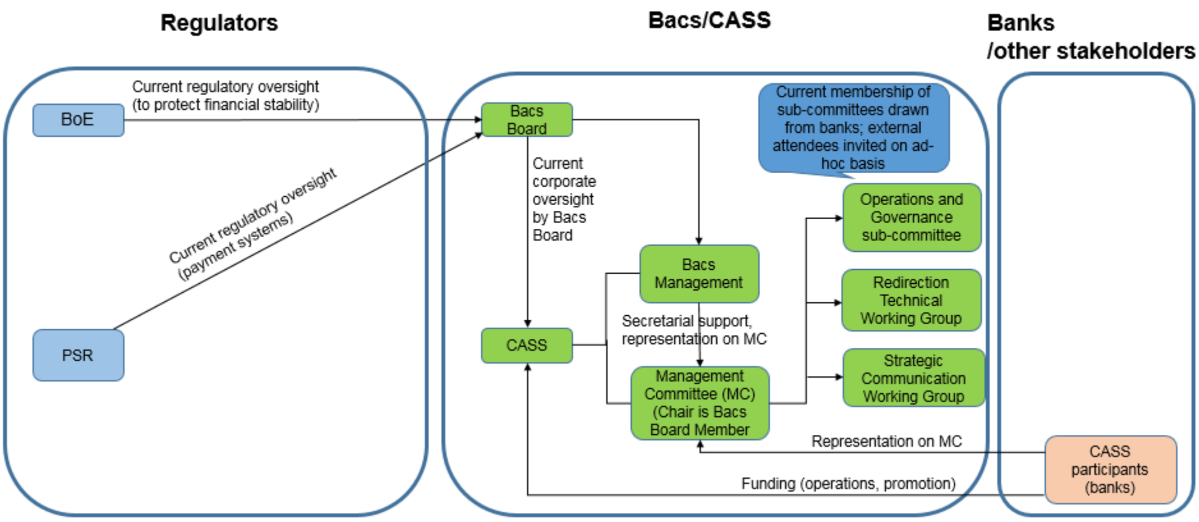
[5] The MC's Terms of Reference state that in addition to CASS participants (banks), other external experts may also be invited to attend the MC meetings where necessary. These may include representatives from the BBA, other Scheme companies, regulators and suppliers (eg VocaLink).
[6] See Bacs board.

that might result in reputational or financial impacts to Bacs, or have any potential implications on the stability of the payment systems.

14.17 The Bank of England (BoE) and the PSR have some oversight of Bacs, but this does not extend to directly overseeing CASS governance.

14.18 Figure 14.1 illustrates current governance of CASS.

Figure 14.1: CASS current governance



Source: CMA.

14.19 We have decided to introduce a remedy to strengthen CASS governance, with the overall objectives of increasing awareness of and confidence in the service, to address existing barriers to switching and customer engagement. This remedy is summarised in Figure 14.2.

Figure 14.2: Reforms to CASS governance and requiring regulatory oversight

Changes to CASS corporate governance

We have decided to seek undertakings from Bacs:

- to ensure greater transparency around decisions of the MC[7], and CASS performance. This could be done, for example, through Bacs publishing on its website on a regular basis *(a)* minutes of the meetings of the MC along with a summary of the decisions taken by other subcommittees/ groups reporting to it; *(b)* CASS's performance against Key Performance Indicators (KPIs); and *(c)* an annual report on CASS's performance by the MC Chair, which should also be

[7] Effectively CASS's board.

provided to the CASS regulator (see our measure to introduce regulatory oversight of CASS below).

- that it appoints an independent[8] Chair of the MC, and includes independent members, representatives of relevant customer groups and intermediaries, for example PCWs in the MC and its subcommittees/groups.[9]

We expect the implementation of changes to CASS' corporate governance within six months of the CMA's acceptance of undertakings from Bacs.

Regulatory oversight of CASS

We have decided to make a recommendation to HMT to introduce regulatory oversight of CASS by an appropriate body.

We envisage that this regulatory oversight of CASS would be relatively light touch, and be limited to potentially include the following:

- Ongoing: review of, and report on CASS's performance against KPIs.
- Annually/periodically:
  - Agree CASS's governance arrangements including KPIs, membership and Terms of Reference of the MC; and
  - Agree CASS's annual and longer-term (eg three-year) strategic plans.

It will be for HMT to decide on the precise scope of regulatory oversight as well as the timetable to introduce regulatory oversight of CASS.

How this remedy addresses the AECs and/or the resulting customer detriment

14.20 We found that aspects of the current account switching process act as a barrier to switching for both BCA and PCA customers in GB and NI. In particular, we found that some customers had a concern that something would go wrong when switching accounts, and that awareness of and confidence in CASS was low.

14.21 The objective of this remedy is to have a well-designed CASS governance structure based around principles of transparency, independence and

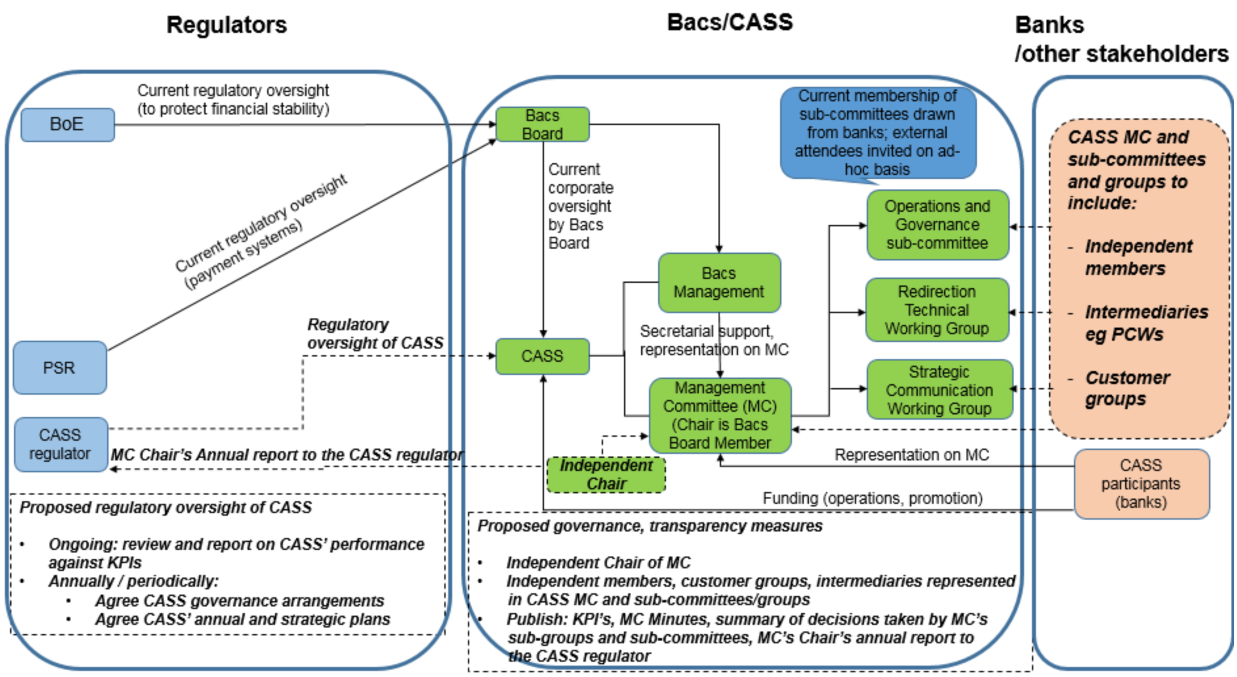
[8] Independent from banks and Bacs.
[9] These new members should have full rights in respect of participating in the proceedings and decision-making of the MC and its subcommittees/groups.

diversity of views, which would provide those managing the service with stronger incentives to operate and develop the service in the interest of customers. This would also have the benefit of motivating Bacs' management to continue to innovate to improve the switching process, and to consider customers' interests when making decisions about the service over the long term. Overall, our measures will help in addressing the AECs identified, by increasing confidence in CASS and reducing barriers to switching.

14.22 Another benefit of reforming CASS governance would be that it would reduce the need to mandate particular conduct by CASS participants on an ongoing basis. The changes to the governance of CASS we have decided to introduce will both enhance our other remedies that target specific aspects of CASS, and also ensure that the service is run and developed effectively in the interests of customers in the future.

14.23 Figure 14.3 illustrates the changes to CASS governance under this remedy.

Figure 14.3: Changes to CASS governance



Source: CMA.
Note: Changes to current governance are indicated by dashed lines and text in bold italics.

Remedy design considerations

Changes to CASS corporate governance

14.24 In the design of this remedy, we considered the composition of the MC, its subcommittees/groups, the need for greater transparency around the decisions made in these and CASS performance against KPIs. Below we outline our decision on these elements of the remedy design.[10]

- *Composition of the MC and representation of a wider group of stakeholders' interests*

14.25 Although the responses we received did not in general raise concerns about the current voting structure of the MC, we consider that the CASS governance arrangements need to be strengthened to ensure a more strategic and customer-focused approach.

14.26 We have therefore decided to introduce measures to ensure that relevant stakeholders' interests are properly represented in the CASS decision-making processes. This can be achieved by having an independent Chair of the MC and opening up the membership of the MC and its sub-committees/groups to include independent members and representatives of relevant customer groups and intermediaries such as, for example, PCWs.[11] This will provide a more balanced representation of the views of a wider range of stakeholders in the CASS decision-making processes, and help ensure that the service is developed in the interests of customers both in the short and the long term.

14.27 Bacs' process of selecting the independent Chair of the MC should ensure that he or she is someone with strong reputation, customer focus and marketing/negotiation skills. It will also be desirable that the MC's Chair is invited to attend relevant meetings of Bacs' Board, where decisions related to CASS are to be discussed.

14.28 Bacs should also ensure that the new non-bank members that are inducted into the MC and its subcommittees/groups have suitable skills and experience to contribute effectively towards developing and implementing CASS's strategy and improving its performance.

14.29 We expect the independent Chair of the MC to ensure that views of all members of the MC (including non-banks) get adequate attention, and any differences of opinion are resolved through procedures specified in the MC's terms of reference through consensus or, if required, voting.

[10] See Appendix 14.1 for further details regarding the design of this remedy.
[11] These non-bank members should have full rights in respect of participating in the proceedings and decision-making of MC and its subcommittees/bodies.

- *Transparency*

14.30 Having greater transparency about the decisions made by the MC, as well as CASS's performance against prescribed KPIs will strengthen the CASS corporate governance.

14.31 Therefore, we have decided that Bacs should take steps to have greater transparency around the MC's decisions and decision-making processes, as well as CASS performance against KPIs. This could be achieved, for example, through regularly publishing the minutes of the MC along with a summary of the decisions taken by other subcommittees/groups reporting to it, CASS's performance in achieving its target KPIs on Bacs' website and also sharing these with the CASS regulator.[12,13] The independent Chair of the MC should also publish an annual report on Bacs' website detailing CASS performance and strategy. This report should also be provided to the CASS regulator once regulatory oversight of CASS has been introduced.

14.32 It is important that the new governance process and arrangements under this remedy are supported by a strong and effective Bacs management structure, including a strong CASS executive office. We therefore encourage Bacs to undertake a review of its organisation structure and implement any necessary changes so that the new CASS governance framework under this remedy can be further embedded.[14]

14.33 Bacs may also want to revisit the terms of reference of the MC in light of the reforms to CASS governance to be implemented through this remedy, so that they remain fit for purpose. The MC's terms of reference will also need to be agreed with the CASS regulator annually or periodically (see paragraph 14.44).

14.34 Overall, we believe that this remedy would both strengthen the incentives for the Bacs management team and the MC to ensure that CASS is run in the interest of customers on an ongoing basis.

[12] The information that is published can be subject to suitable redactions (for example, of commercially sensitive information).
[13] See paragraphs 14.35–14.45, where we discuss our measure to introduce regulatory oversight of CASS.
[14] CASS's day-to-day operations are supported by a team of five permanent Bacs staff based within its Product and Strategy team, which is led by Bacs' Director of Product and Strategy, who also sits on the MC. In addition, currently there are also four other non-permanent/contractual roles, which support the management of CASS at Bacs. These roles relate to accreditation, marketing, communications and research activities.

Regulatory oversight of CASS

14.35 The PSR[15] was established under the Financial Services (Banking Reform) Act (FSBRA) 2013 to regulate designated payment systems, of which Bacs is one, but the PSR does not regulate CASS or any other alternative switching schemes under FSBRA.

14.36 The FCA undertook a review of CASS[16] before the creation of the PSR, and has been engaging with Bacs over the implementation of the FCA's recommendations following its review.

14.37 The BoE oversees Bacs' operations, but this oversight is only in relation to the BoE's statutory responsibility to oversee certain payment systems and does not extend to directly overseeing CASS.

14.38 Our view is that there is merit in having a clear regulatory oversight of CASS to ensure that it is run in the interest of customers on an ongoing basis. This will help to ensure that the MC's decision making processes and membership are based on the principles of transparency, independence, diversity of views and adequate representation of a wider range of relevant stakeholders, as well as to ensure that the service is operated and developed in the interests of customers.

14.39 In implementing the switching provisions of the PAD, the government has made the PSR the competent authority for the designation of any alternative switching arrangements as alternatives to the switching process set out in the PAD. This will involve the PSR making a determination on whether any alternative switching arrangement meets the criteria of regulation 15 of the Payment Accounts Regulations 2015 (the PARs).[17,18] The PSR's powers and duties under the PARs apply to any alternative switching arrangement, which the PSR designates as such.

14.40 The FCA will have responsibility for monitoring whether all payment service providers who seek to rely on participation in an alternative arrangement to discharge their obligations under regulation 14 of the PARs are in fact a party to such arrangements.[19]

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[15] www.psr.org.uk.
[16] FCA CASS report.
[17] Transposing Article 10(1) of PAD.
[18] HMT (16 November 2015), Implementation of the EU payments accounts directive. Consultation Outcome, Section 3.
[19] ibid.

14.41 Given the PSR's role in designating alternative switching services under PAD, and its remit as the regulator of payment systems (including Bacs) in the UK, there is merit in extending its role to include oversight of CASS. This also aligns with the PSR's goals to promote competition and innovation and to ensure payments systems are operated and developed in the interests of the people and businesses that use them.[20,21]

14.42 Given the FCA's role, it is also well placed to assume the CASS oversight function. If the FCA were to be given this role, such an arrangement would lead to a more unified approach, as the FCA would undertake regulatory oversight of CASS as well as of the participating banks.

14.43 While acting on our recommendation to introduce regulatory oversight of CASS, HMT may consider this matter further, to decide on the most appropriate body to oversee CASS.

14.44 We envisage that regulatory oversight of CASS would be relatively light touch, and be limited to potentially include the following:

(a) Ongoing: review of, and report on CASS's performance against KPIs, for example awareness/confidence metrics, operational and accuracy indicators.[22]

(b) Annually/periodically:

(i) agree CASS's governance arrangements including KPIs, membership (subject to the changes we propose above in paragraph 14.26) and Terms of Reference of the MC, (subject to the changes we propose above in paragraph 14.31); and

(ii) agree CASS's annual and longer-term (eg three years) strategic plans.

14.45 Introduction of an effective regulatory oversight of CASS would enable the CASS regulator to review and report on governance and operations of CASS, and recommend appropriate action as necessary. For example, if the

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[20] See Payment Systems Regulator.
[21] It also complements the PSR's current focus and work agenda on governance of payment systems in the UK. In December 2015, the PSR published a report on Access and governance of payment systems.
[22] In respect of KPIs Bacs uses to manage CASS, it told us that the MC was responsible for the overall service and specifically the awareness and confidence targets as these were consumer-focused, In addition, there were a number of operational requirements of the service, for example adhering to the message response times which were monitored by a subcommittee made up of participant representatives. Further, Bacs told us that the Bacs board was responsible for the integrity of the Bacs system which underpinned the service infrastructure and ensured that the underlying communication channels and payments were processed in accordance with the scheme rules. There were a number of service KPIs around the redirection service which were monitored and managed by the board.

KPIs or the targets were not appropriate, or if they were not met, or if the MC's membership did not reflect a sufficiently wide range of stakeholders.

14.46 This will, in turn strengthen the incentives of the MC and Bacs' management team to continue to innovate and improve the switching process, and operate and develop the scheme in the interest of customers. It will also help in improving customers' confidence in the service.

Implementation issues, including timings

Method and time of implementation

14.47 The measures related to changes to CASS's corporate governance under this remedy should be implemented through seeking suitable undertakings from Bacs, since the measure only involves one party.

14.48 Bacs has indicated to the CMA that it is, in principle, willing to offer the required undertakings to implement this remedy.[23] We will consider issuing an order if we are unable to accept satisfactory undertakings from Bacs.

14.49 We expect CASS participant banks to fully support Bacs in the implementation of this remedy.

14.50 We expect the implementation of changes to CASS's corporate governance to be done within six months of the CMA's acceptance of undertakings from Bacs.

14.51 We have decided to make a recommendation to HMT to introduce regulatory oversight of CASS. As we have noted, the PSR and the FCA are two candidate organisations to oversee CASS, but it will be for HMT to consider this matter further, and decide which of these two bodies or other appropriate body would be best suited to provide regulatory oversight of CASS.

14.52 HMT may also want to consider whether the CASS regulator's powers need to be more general, ie to also cover other switching services that may emerge in the future, to ensure non-discriminatory treatment.

14.53 We have outlined in paragraph 14.44 broad principles about the regulatory oversight of CASS, but it will be for HMT to determine the precise scope of the CASS regulator's powers as well as the implementation timetable.

[23] See Bacs' further response to provisional decision on remedies.

Monitoring

14.54 The body which HMT designates as the CASS regulator should monitor the ongoing compliance with this remedy.

14.55 Until the CASS regulator is in place, we have decided that the CMA will monitor compliance with this remedy, through reviewing periodic reports to be provided by Bacs on how it has complied with the requirements of its undertakings.

Cost of remedies

14.56 We do not consider that Bacs will incur any material incremental costs from the measures we have set out in this remedy. While there may be additional administrative costs by, for example, having more members in the MC and subcommittees, we expect these to be relatively small, ie less than £50,000 a year.[24] Bacs has confirmed that the costs of this remedy would be met from within the existing operational budget for CASS.[25]

14.57 Further, we consider that the light-touch regulatory oversight of CASS as envisaged in this remedy will not impose any significant incremental costs on Bacs, the industry or the CASS regulator.

14.58 The costs of monitoring compliance with this remedy are also likely to be low since they will be based on reviewing, and in the case of the CASS regulator, reporting on periodic reports provided by Bacs on how it has complied with the requirements of the remedy.

The duration of the redirection period

Summary of the remedy

14.59 In our Remedies Notice, we noted that customers may be deterred from initiating the switching process because of the risk that payments made into their old account after the end of that period would be lost.

14.60 In its review of CASS[26], the FCA stated that there were some remaining operational issues with the service, the most significant being the risk of undermining confidence in the service when the redirection service ends (if

[24] RBSG agreed with the estimated costs of £50,000 a year. RBSG response to provisional decision on remedies, paragraph 4.3.
[25] Bacs response to the provisional decision on remedies, paragraph 2.2.
[26] FCA CASS report was published in March 2015.

third parties failed to update account details and incoming payments go missing). It argued that if this problem was not addressed, there was a risk that when the redirection period ended, the number of payments that failed to be redirected would cause detriment to those affected customers and could also be sufficient to undermine confidence in the service.[27]

14.61 The FCA also noted that despite the planned extension[28] to the redirection period to 36 months, the issue still remained.[29]

14.62 To address this issue, we have decided to introduce a remedy to extend the CASS redirection period based on a proposal[30] that is being developed by Bacs in conjunction with the industry.[31] This remedy is summarised in Figure 14.4.

Figure 14.4: Extending the CASS redirection period

We will seek undertakings from Bacs to the effect that:

Beyond the current 36-month CASS redirection period, after a PCA or BCA customer has switched account using CASS, it provides perpetual redirection for customers as long as they have had a redirected payment within the preceding 13 months.

This will mean that:

- for the first 36 months after switching, incoming and outgoing payments to (and from) a customer's old account will be redirected to their new account; and
- after the first 36 months, incoming and outgoing payments will continue to be redirected to their new account for a customer, if they have had a redirected payment within the preceding 13 months.[32]

We expect this remedy to be implemented within one year of the CMA accepting undertakings from Bacs.

[27] FCA CASS report, paragraph 1.7.
[28] Following the announcement in the 2014 Autumn Statement to upgrade CASS to include 99% of SMEs and an extension of the redirection service, Bacs extended the CASS redirection period from 13 to 36 months, and this extended redirection period was subsequently included in the CASS Guarantee at the end of March 2015.
[29] FCA CASS report, paragraph 1.7.
[30] See Appendix 14.2 for details.
[31] In its review of CASS (p59), the FCA made a recommendation that Bacs develops a proposal to mitigate the risk of the end of the redirection service undermining confidence in CASS.
[32] ie redirection will continue until such time as a period of 13 months has passed without any redirected payment.

How this remedy addresses the AECs and/or the resulting customer detriment

14.63 This remedy will provide further assurance to PCA and BCA customers (to the extent that CASS applies to BCA customers) in GB and NI that their payments will not go missing after switching accounts through the implementation of a form of 'perpetual' redirection of payments for users who may need it.

14.64 By instilling users with greater confidence in the switching process, we believe that this remedy will help in removing potential barriers that occur at the end of a customer's switching journey and reduce the incumbency advantages of the longer-established banks.

Remedy design considerations[33]

14.65 We considered two alternatives that had the potential to ensure, and provide assurance, that payments from a customer's old account do not go astray when they are redirected to a customer's new account:

(a) an extended redirection period within the existing CASS framework; and

(b) account number portability (ANP).

An extended redirection period

14.66 An extended redirection period strengthens the current CASS guarantee so that, beyond the current 36-month redirection period after switching their account, CASS will provide perpetual redirection of payments to the new account as long as customers have had a redirected payment within the preceding 13 months.

14.67 We preferred this option over an alternative approach of requiring unlimited redirection because although an unlimited redirection period would be attractive for customers, it will subject the payment systems to various operational risks, and could also have a negative impact on financial stability for the reasons detailed in Appendix 14.2.

- *Customer impact*

14.68 Overall, the evidence suggests that extending the redirection period would provide some further reassurance to customers. While unlikely to act as a

[33] For further details on design considerations for this remedy, refer to Appendix 14.2.

catalyst for customers to switch, it may act as a ‘hygiene factor’, and help reduce customers’ fears about the risks of switching using CASS.

14.69 Since our proposal is sufficiently close to an unlimited redirection (as it provides perpetual redirection for many customers beyond 36 months from the switch date), it is more likely to provide greater confidence in the switching process, particularly if it was effectively promoted by Bacs.

14.70 This measure would also help to ensure that our other remedies would be effective since switching customers would have few reasons to perceive that at the end of their switching journey payments would go astray, thus removing this barrier to switching.

- *Costs*

14.71 RBSG told us that the adoption of an indefinite redirection could lead to significant operational difficulties, even with the proposed 13-month time limit. It stated that the longer the period, the more data was required to be stored and the greater the cost for the banks. Further, RBSG noted that the existing marketing literature will need to be changed to reflect any revised redirection period, and this process could be more costly than the CMA has anticipated.[34,35]

14.72 Bacs told us that the current estimated central spend spanning 2016 and 2017 to deliver the incremental change to the CASS redirection service was in the order of £2.5 million. In respect of costs for CASS participants, Bacs stated that it did not monitor participant costs, but as a guide its experience suggested that central costs represented around 10% of the total industry-wide costs. On this basis, the total cost of implementing this remedy is likely to be around £25 million.

14.73 LBG estimates that it will cost them between £2 million and 5 million to implement this remedy.[36]

Account number portability

14.74 ANP is the ability for a customer to switch current account provider while still retaining the same banking identifier. This means that after having switched current accounts, all customers would not have to change any of the payment instructions associated with their account or inform payors.

[34] RBSG did not provide any specific cost estimates of implementing this remedy.
[35] RBSG response to provisional decision on remedies, p14.
[36] LBG response to provisional decision on remedies, paragraph 7.7.

Instructions for incoming payments could remain unchanged as the underlying infrastructure would route payments to the new account. Further, outgoing payments such as direct debits could also be pulled from the new account without interruption.

- *Customer impact*

14.75 To help us assess the effectiveness of introducing ANP we have considered the results from our omnibus surveys, the FCA's quantitative research and the FCA's qualitative research.

14.76 Taken together, the research evidence suggests that both our remedy and ANP could appeal to both PCA users and BCA users, and would be effective in addressing confidence in CASS. However, the incremental benefit of ANP over extending the redirection period is less clear. In particular, one of the reasons for ANP's popularity raised in the qualitative research was that it was a concept that was easier to grasp than other solutions. This suggests that if other remedies raise the awareness and understanding of the switching service, the difference in appeal between ANP and Bacs' proposed extension to the redirection period would fall.

- *Costs*

14.77 Based on the estimates detailed in Appendix 14.2, the cost of providing ANP (minimum £2–£3 billion) is likely to be substantially higher relative to our remedy[37] to extend the redirection period, and it will take in excess of five years for ANP to be implemented.

Conclusion on remedy options

14.78 Both ANP and our requirement for an extension to the CASS redirection period are ways of addressing the same underlying concerns relating to payments going astray in the switching process. ANP is generally easier for customers to grasp and tends to perform better in customer surveys.

14.79 However, in practical terms, extended redirection is able to reduce the risks of missed payments to very low levels. In effect, our proposal allows for perpetual redirection for customers who may need it.

14.80 As stated earlier, our remedy on extended redirection is also likely to cost substantially less to implement than ANP, and is also capable of much more

[37] See paragraphs 14.72–14.73.

rapid implementation, which is an important dimension of effectiveness. Further, there are fewer risks in implementing this proposal, given that it will be using a proven technology.

14.81 Taking all factors into account, extended redirection is effective in addressing barriers to switching and is clearly much less expensive and onerous to implement. Overall, it is a more proportionate remedy that would provide a low-cost, timely solution to improve this aspect of the AECs.[38] Our conclusion aligns with our guidelines for market investigations, which state that a proportionate remedy is one that is the least onerous if there is a choice between several effective measures.[39]

14.82 Further, when considered in conjunction with our overall package of remedies, we consider that this remedy will instil greater confidence in the switching process. In particular we note that our implementation of APIs[40] may result in an even more effective switching process in future.[41]

Implementation issues, including timings

14.83 We consider that accepting suitable undertakings from Bacs would be the most appropriate method of implementing this remedy.

14.84 Bacs has indicated to the CMA that it is, in principle, willing to offer the required undertakings to implement this remedy.[42] We will consider issuing an Order if we are unable to accept satisfactory undertakings from Bacs.

14.85 We would expect the banks that participate in CASS to fully support Bacs in its efforts to implement this remedy, for example by fulfilling their obligations which fall within scope of the redirection service.

14.86 We require implementation of this remedy within one year of accepting undertakings from Bacs.

[38] The PSR may want to reconsider ANP at a later date. We note that the PSR has set up an industry forum (Payments Strategy Forum or 'PSF') to develop and agree strategic priorities and how to best implement them. In the PSF's draft strategy published on 13 July 2016 it states that whilst further cost benefit analysis could be undertaken, the Forum considers this analysis unlikely to result in a recommendation to proceed with ANP, and at this stage the resource and time would be better invested in delivery of other solutions identified. Payment Strategy Forum's draft strategy, p17.
[39] The Guidelines, Part 4, paragraph 344(c).
[40] See our remedy on adoption of open API standards in Section 13.
[41] As noted by Professor Alistair Milne, account switching through aggregators could be a relatively gentle process, ie open up two accounts with two different institutions in one aggregator portal, set up a sweeping mechanism between the two accounts at different institutions and then gradually (with automation supplied by the aggregator) move instructions such as debit cards from one account to another. Professor Alistair Milne's response to the provisional decision on remedies, p4.
[42] See Bacs' further response to provisional decision on remedies.

14.87 The CMA will monitor compliance with this remedy, through reviewing periodic reports to be provided by Bacs on how it has complied with the requirements of the remedy.

Costs of remedies

14.88 As we outlined in paragraphs 14.71 to 14.73, the total cost of implementing this remedy is likely to be around £25 million. However, we note that LBG has estimated its own costs of between £2 million and £5 million.[43] On this basis we consider that the cost of implementing this remedy is likely to be around £25 million, and below £30 million.

14.89 We consider that the cost of implementing this remedy will be substantially lower than the other remedy options we considered.

14.90 We note that Bacs is already working with CASS-participating banks to introduce these changes, and therefore any incremental costs (beyond what Bacs and the industry may have already spent or planned to incur) associated with implementing this remedy can be expected to be minimal.

14.91 The cost of monitoring compliance is also likely to be low since it will be based on reviewing periodic reports provided by Bacs on how it has complied with the requirements of the remedy.

Provision of transaction history

Summary of the remedy

14.92 In our Remedies Notice, we noted that customers may be deterred from initiating the switching process since, once their old account has been closed, they may no longer have access to their transaction history.

14.93 In our qualitative research we found that one potential barrier to switching is that SMEs will lose access to their previous transaction history following a switch through CASS. This could potentially affect businesses' ability to apply for financial products in the future as they would not have proof of their transaction history.[44]

14.94 A customer survey commissioned by LBG found that customers believed that loss of history with their current provider was a potential barrier to them switching current accounts. It also found that keeping or having access to

[43] None of the other responses to our provisional decision on remedies provided a specific estimate of the costs of implementing this remedy.
[44] See Section 8.

transaction history (and relationship banking) had ‘broadest appeal’ for potential customers to switch their bank accounts, although this was stronger for customers who were already considering moving, rather than a trigger to move accounts. LBG did not conduct behavioural research to test these survey results. However, it believed that the conclusions of the survey did reflect the importance of transaction history to customers considering switching.[45]

14.95 To address this issue, we have decided to introduce a remedy to require banks to provide transaction history to PCA and BCA customers at the time of, and after closing their accounts. The remedy is summarised in Figure 14.5.

Figure 14.5: Providing transaction history to PCA and BCA customers

We have decided to make an Order requiring that PCA providers with at least 150,000 active PCAs in either GB or NI and BCA providers with at least 20,000 active BCAs in either GB or NI:

- At the time of closing a PCA or BCA, provide free of cost at least five years’ transaction history to their customers. This would be subject to an opt-out choice/decision made by the customers.
- Retain, at the minimum, transaction history over the previous five years for PCAs and BCAs after account closure, and provide it to ex-customers at their request, free of cost, or at a fee which should not be more than what would be payable under the Data Protection Act 1998 (DPA) (currently £10) or any legislation superseding the DPA.[46]
  - Example: if the date of the account closure is 31 December 2015, and the customer requests transaction history details on 1 January 2017 (one year after account closure), the bank would at the minimum be required to retain/provide the transaction history for the period between 1 January 2012 and 31 December 2015 (covering four years).

[45] LBG stated that, in particular, there were still a number of situations in which a customer may need access to historical bank statements (for example, when applying for a mortgage) to prove their income and/or allow a provider to assess affordability and verify monthly expenditure. Past statements for six months are usually required, and although former PCA providers will make bank statements available on request, the need to contact a former provider (and potentially pay a charge) introduces further hassle for a customer who has switched their account.

[46] Section 7 of the DPA provides rights to individuals in respect of personal data that the organisations hold about them. Organisations may charge a fee of up to £10 (£2 if it is a request to a credit reference agency for information about your financial standing only) for providing this information. Information Commissioner’s Office. The Data Protection Act.

- Publish on their website, their policy regarding retention of transaction history of old accounts, and the process and other requirements for requesting transaction history.

The transaction history would need to be provided to the customer within a reasonable period, but no later than seven working days after the customer has provided necessary identity/other documentation required by the bank for 95% of such requests and within 40 days for the other 5% of requests.

In respect of BCAs, this remedy will only apply to SMEs with an annual turnover less than £6.5 million at the time of closing their account.

We would expect the implementation of this remedy to be completed within 12 months of our final Order.

How this remedy addresses the AECs and/or the resulting customer detriment

14.96 This remedy would address the AEC by providing assurance to PCA and BCA customers who are considering switching, or have switched accounts, that their transactions history will continue to be available to them, thus reducing this barrier to switching in both GB and in NI.

14.97 It requires banks to retain and provide transaction history to customers both at the time of, and after, closing their accounts. The remedy also requires banks to publish on their website, their policy regarding retention of transaction history of old accounts, and the process and other requirements for requesting transaction history.

14.98 Several banks[47] told us that they already had a policy of providing transaction history to ex-customers. However, the number of years for which this facility was available varied between banks, and not all banks automatically provide transaction history to their customers when they close their account.

14.99 Barclays told us that it had a policy of providing transaction history to ex-customers on request. HSBCG stated that it had a policy to retain ex-customers' transaction history and provide it upon request from ex-customers.

14.100 According to our omnibus survey results, while the perceived benefit of having five years of historical transactions was relatively low for PCA users

[47] For example, Virgin Money, LBG, Santander, Nationwide, RBSG.

overall, it was higher for PCA users who had switched or considered switching, and those who used overdrafts.[48] Availability of historical transaction data seemed more important for BCA users.[49]

14.101 Section 7 of the DPA provides rights to individuals in respect of personal data that the organisations hold about them. However, we are of the view that by mandating the provision of transactions history at the time of switching or closing their account, our remedy makes it easier to receive transaction history than under the provisions of the DPA. It also provides further assurance to customers who are considering switching that they will continue to have access to their transaction history for a certain period of time after closing their accounts.

14.102 Our view is that being able to receive transaction history at the time of, and after, account closure can reduce the perceived or real risk of switching for customers switching both through CASS[50] or otherwise.[51]

14.103 Transaction history may be required as part of, for example, a mortgage application and while in the past customers may have retained hard copies of bank statements, as they are increasingly accessed online, fewer customers may retain them.

14.104 Further, this remedy will provide a minimum standard across the industry about access to transaction history, and help in reducing this barrier to account switching.

Remedy design considerations

14.105 We identified the following design parameters for the remedy:

(a) Should the provision of transaction history at the time of account closure be automatic or based on customers' request?

[48] 14% of PCA users said that they would be more likely to switch and the same proportion (14%) said that they would be less likely to switch if they received the statements See PCA survey, p129. 22% of PCA users who have switched or considered switching and 26% of overdraft users said they would be more likely to switch if they received five years of bank statements, while 7% of PCA users and 9% of overdraft users said they would be less likely to switch. See PCA survey, p133. However, this is against a backdrop of low switching rates. See Appendix 6.1.
[49] 24% of BCA users said that they would be more likely to switch if they received five years of bank statements as evidence of their transaction history and 10% said that they would be less likely to switch.
See SME survey, p36.
[50] Switching through CASS involves automatic account closure.
[51] Customers who do not use CASS to switch but decide to close their old account at the time of, or after switching.

(b) For how long should a bank retain, and provide, transaction history to ex-customers?

(c) Should banks be allowed to charge for providing transaction history to customers?

(d) What role, if any, should CASS play in the provision of transaction history?

14.106 We outline our decision regarding these design parameters below.[52]

Should the provision of transactions history at the time of account closure be automatic or based on customers' request

14.107 We have decided that banks should provide transactions history at the time of account closure, unless customers decide to opt out. Thus, the provision of transaction history will not be automatic but depend on the choice made by the customer. For example, providers could build the process of providing transaction history into their account closing procedures whereby customers are informed about this facility, allowing them to receive the transaction history or opt out.

14.108 The transaction history could be provided to customers in either physical or electronic format.

For how many years after account closure should the banks be obliged to provide transactions history

14.109 Our decision is that banks should retain transaction history covering the previous five years at a minimum for their PCA and BCA customers, and should provide it (unless customers opt out – see Figure 14.5 and paragraph 14.107) at the time of account closure. We consider that this would provide adequate assurance to customers and help to remove this barrier to switching. Regarding access to transaction history after account closure, ex-customers should be able to request transaction history from previous providers for the period when they were customers that falls within the last five years from the date of request.

Should banks be allowed to charge for providing transaction history?

14.110 We have also decided that customers should be able to receive (unless they opted out) their transaction history at the time of closing their account free of

[52] See Appendix 14.3 for further details on the design of this remedy.

cost. However, banks should be allowed to levy a charge if they so wished, when providing transaction history to customers after they had closed their account. This charge, however, should not be higher than what would be payable under the DPA (or any legislation which supersedes it) at the time (currently capped at £10).

Role of CASS in the provision of transaction history

14.111 Although building a capability to port transaction history in CASS and introducing the Credit Passport[53] could be attractive, we have concluded that the remedy we propose to adopt is a simpler and less onerous solution to effectively address customers' concern around losing access to their transaction history after switching accounts.[54]

14.112 Further, the sharing of PCA transaction data using APIs[55] may perform the function of the 'Credit Passport' proposed by TSB.

Implementation issues, including timings

Duration and timing of implementation

14.113 HSBCG suggested including a sunset clause for this remedy because access to transaction history may be available through other means in the future. It made a reference to the emergence of open data and API standards, whereby transaction history may become accessible via those channels without the need for customers to approach their former PCA/BCA provider directly.[56]

14.114 LBG supported using open APIs to allow customers to transfer their historical transaction history when they switched to their new provider to remove any perceived hassle factor and remove a potential reason why some customers might be reluctant to switch.[57]

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[53] Under the Credit Passport proposed, all PCA providers would be mandated to provide a centralised resource, such as an existing credit rating agency, with customers' account usage and transactional histories. The credit agency, when requested by the consumer, would make the data available, in a usable format, to any prospective alternative PCA provider. This would make it easier to assess an applicant's risk and affordability at the point of application or enquiry, thereby increasing the likelihood that a new provider will match a consumer's existing overdraft limit. TSB response to Remedies Notice, paragraphs 35 & 36, p7.
[54] This also aligns with our guidelines for market investigations, which state that a proportionate remedy is one that is the least onerous if there is a choice between several effective measures. *CC3*, Part 4, paragraph 344(c).
[55] See Section 13.
[56] HSBCG response to Remedies Notice, paragraph 133.
[57] LBG did not, however, support the use of credit reference agencies (CRAs) to act as the hub for customers' transaction history as they currently relied on a business model that typically charged customers between £10 and £15 a month for access to the data they held on customers.

14.115 Business Finance Compared told us that open APIs would enable this data to be transferred in a standard format to an intermediary (such as a PCW) or to the new provider where it acknowledged receipt of the data and securely stored this data on behalf of the SME. It noted that without this, there was an unintended consequence of passing sensitive data to SMEs who might not have the necessary knowledge and systems to store this data securely.[58]

14.116 We agree that in the future, transaction history may become accessible to customers through other means. However, it is not clear at this stage whether this will extend to transaction history once a customer has switched.[59]

14.117 We require this remedy to be implemented within 12 months of the CMA's final Order.

Which providers should be covered by this remedy

14.118 We require all PCA and BCA providers to be covered by this remedy subject to a de minimis threshold of 150,000 active PCAs and 20,000 active BCAs, thus covering the majority of active accounts and including larger providers in both GB and NI, while also excluding the large number of very small providers.

14.119 Further, this remedy will only apply to SMEs with annual turnover less than £6.5 million at the time of closing their account.

Monitoring of compliance

14.120 The CMA would monitor compliance with the requirements of this remedy through the provision of an annual compliance statement from banks.

Legal/regulatory issues

14.121 We also considered if there could be any legal or regulatory issues in relation to implementing this remedy.

14.122 A number of parties told us about potential issues around data protection and security while implementing this remedy.

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[58] Business Finance Compared response to Remedies Notice, p24.

[59] Should there be market developments affecting this remedy, it will always be open to the CMA to consider whether there has been any change of circumstances such that the order should be varied or revoked (see section 162 of the EA02).

14.123 For example, FSCP pointed out that although this remedy might give some consumers confidence to switch, it needed to be aligned with UK and EU data protection requirements.[60] RBSG made the point that measures would need to be in place to verify the identity of the customer before historical transactional data was released, and there might be data protection issues if customer data was retained for too long with no specific purpose.[61]

14.124 We note that the DPA requires that organisations do not hold records for longer than is necessary for the purposes(s) for which it is processed. However, we understand that pursuant to the MLR,[62] banks retain transaction history of their customers for five years.

14.125 Since our remedy does not require banks to retain customers' transactions data for any longer than what is prescribed by existing industry guidance on the MLR, we do not consider there are any regulatory issues or hurdles in implementing this remedy.[63]

Cost of remedies

14.126 We note that banks already have a duty to retain transactions data of customers for five years. We have decided to oblige banks to provide transaction history to customers at the time of account closure on the basis of an opt-out choice, and have also allowed the banks to charge a reasonable fee for providing it to ex-customers after closing their account. The costs of the remedy will be reduced given that providers have the choice between providing the statement in hard copy or electronically and are not required to provide it automatically but on an opt-out basis.

14.127 We have limited the coverage of this remedy to apply only to providers that have at least 150,000 active PCAs or 20,000 active BCAs, and further for the provision of BCA transaction history, to SMEs with annual turnover less than £6.5 million (at the time of closing of their account).

14.128 Overall, we expect the costs of implementing this remedy to be low.

14.129 Barclays submitted that since start-up and newer SMEs have the highest failure rates, the majority of new businesses would not benefit from business

[60] Financial Services Consumer Panel response to Remedies Notice, p6.
[61] RBSG response to Remedies Notice, p47.
[62] Paragraph 8.16 of the JMLSG guidance on prevention of money laundering/combating terrorist financing for the UK financial sector (revised November 2014) states in relation to Regulation 19(3) of the MLR: records of all transactions relating to a customer must be retained for a period of five years from the date on which the transaction is completed.
[63] We note that banks will need to continue to comply with the DPA.

data being kept for five years. It stated that implementing a remedy that would only be available for a maximum 40% of all SMEs would not be proportionate.[64] Even if only 40% of all SMEs benefited from this remedy, we consider this would be proportionate given that the costs of implementing are likely to be low. We discuss proportionality of our package of remedies as a whole in Section 19.

14.130 The cost of monitoring compliance with this remedy will also be low, being based on annual compliance statements provided by the banks to the CMA.

Measures to increase awareness of and confidence in CASS

Summary of remedy

14.131 The current account switching remedies that we have decided to introduce will be most effective if there is greater customer awareness of and confidence in the switching process. We have decided on the following measures to increase public awareness of the benefits of using CASS to change current account provider.

Figure 14.6: Measures to increase awareness of and confidence in CASS

We will seek undertakings from Bacs to:

- work with the participants of CASS to ensure their commitment to a long-term promotional campaign to first meet and then exceed the awareness and confidence targets agreed with HMT (or which supersede these), and to sustain these levels over time, and to develop its awareness and confidence metrics to measure customer understanding of the switching process;
- ensure that any future promotional activity reflects any changes made to CASS as a result of our remedy package (eg an increase in the redirection period), and aligns with our measures to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers in communicating to customers the security and convenience of using CASS to switch current accounts; and
- continue to target those customer groups that have low awareness of CASS and/or could benefit most from switching current account providers, notably SMEs, overdraft users, customers with high credit balances, the young and the financially disadvantaged.

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[64] Barclays response to Remedies Notice, paragraph 10.5, p24.

Our remedy to strengthen CASS's corporate governance will ensure that both Bacs and the participants of CASS are suitably incentivised to operate and develop the service in the interest of customers.

14.132 In our Remedies Notice, we proposed that in addition to communicating the benefits of using CASS to change current account provider, the remedy could also increase public awareness of the potential savings or rewards that could be obtained by switching.

14.133 We have decided that a general advertising campaign would not be effective in increasing public awareness of the potential savings or rewards that could be obtained by switching current account provider, because the value of any such rewards, whether financial or related to service quality, are likely to be specific to each customer, and therefore, difficult to communicate via a mass campaign.

14.134 We believe that the raising of awareness of the benefits of switching is better addressed under our measures to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers, where the message can be communicated to individual customers at times when they are more likely to be receptive to such messages.[65]

How this remedy addresses the AECs and/or the resulting customer detriment

14.135 We have found that, despite the introduction of CASS and its promotion by Bacs, customer awareness of and confidence in CASS is low, customers perceive that switching account is burdensome and there is a fear that something could go wrong. For example, our PCA survey found that 55% of customers considered that switching was a 'hassle' and 42% fear that something 'may go wrong'.[66]

14.136 The purpose of this remedy is to support Bacs in its ongoing efforts to increase customer awareness of and confidence in CASS, so that customers' concerns in relation to the convenience and security of switching no longer pose a barrier to switching current accounts in GB and NI.

[65] See Section 13.
[66] See Section 6.

Remedy design considerations

14.137 We summarise below our consideration of issues relating to the design of the remedy, covering:

(a) the effectiveness of raising awareness of the benefits of switching through mass advertising;

(b) the scale and duration of promotional activity required to sufficiently raise awareness of and confidence in CASS;

(c) whether there are any particular customer segments that should be targeted by such promotional activity;

(d) who should undertake and manage the promotional activity; and

(e) how the effectiveness of promotional activity should be measured.

14.138 We set out our detailed analysis of these design considerations in Appendix 14.4.

Benefits of switching

14.139 We have decided that the raising of awareness of the benefits of switching is better addressed under our measure to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers (as set out in Section 13). Under these measures, the rewards of switching can be communicated to individual customers at times when they are more likely to be receptive to consider switching provider. We intend for this measure to focus on communicating to customers the security and convenience of using CASS to switch current accounts to address customers' negative perceptions of the switching process.

14.140 We will seek undertakings from Bacs that its future promotional campaigns are aligned with our measures to increase customer awareness of the potential benefits of switching and prompt further investigation of other providers in communicating the benefits of using CASS to switch current accounts. For example, both the targeted prompts delivered to individual customers and Bacs' mass promotional activity could share common wording and messaging in explaining the security and convenience of switching current accounts using the service.

Scale and duration of promotional activity

14.141 We have decided we will seek a undertakings from Bacs that it works with participants to ensure their commitment to a long-term promotional campaign to increase levels of awareness of and confidence in the service, and to sustain these levels over time. These campaigns should also reflect any changes made to CASS as a result of our wider remedies package, for example an increase in the redirection period.

14.142 We also expect CASS participants to ensure their commitment to Bacs' efforts to promote CASS, and in particular, support a long-term promotional campaign to be undertaken by Bacs as envisaged in this remedy.

Target customer segments

14.143 Given the ongoing efforts of Bacs in raising awareness of CASS among those customer groups that have low awareness of CASS and/or could benefit most from switching current account providers, we have decided to seek undertakings from Bacs that it continues to target these customers in future promotional campaigns. Bacs could demonstrate its commitment to this by, for example, allocating a suitable proportion of its annual budget to targeting these key customer segments, and ensuring that its annual and longer-term business plans reflect this allocation.

Management of promotional activity

14.144 We think that Bacs is best placed to undertake the long-term promotion of CASS for the following reasons:

(a) Bacs assumed ownership of CASS when it launched in 2013 and it remains responsible for the development and management of the service.

(b) Bacs has been relatively successful to date in raising awareness of CASS, although further action is required to increase confidence in the service.

(c) Bacs appears committed to sustained public awareness activity.

Measuring effectiveness of promotional activity

14.145 We have decided to seek from Bacs undertakings to develop its awareness and confidence metrics to measure customer understanding of the switching process. Our measure to strengthen CASS's corporate governance will ensure that both Bacs and the participants of CASS are suitably incentivised to operate and develop the service in the interest of customers.

Implementation issues, including timings

Method of implementation

14.146 We have decided to seek undertakings from Bacs, as Bacs has already undertaken substantial work to raise awareness of and confidence in CASS, and it has committed to further promotional activity in 2016 and beyond.

14.147 Bacs has indicated to the CMA that it is, in principle, willing to offer the required undertakings to implement this remedy.[67] We will consider issuing an Order if we are unable to accept satisfactory undertakings from Bacs.

14.148 Our measure to strengthen CASS's corporate governance will further ensure that both Bacs and the participants of CASS are suitably incentivised to operate and develop the service in the interest of customers.

14.149 We think that the CASS regulator is best placed to monitor compliance with the remedy, as under our measure to introduce regulatory oversight of CASS (see Figure 14.2), we envisage that the CASS regulator will undertake an annual review of the CASS governance arrangements. This could involve an annual assessment of Bacs' promotional activity in relation to raising awareness of and confidence in the service, as well as reviewing and agreeing KPIs involving awareness and confidence targets.[68]

14.150 LBG told us that the remedy should not be perpetual, and should be subject to a mandatory review by the CMA five years after our overall package of remedies has been fully implemented.[69] As we have determined that ongoing promotional activity is necessary to sustain levels of awareness of and confidence in CASS over time (see paragraph 14.141), we think it is appropriate that Bacs remains committed to raising awareness of and confidence in the service over the long term. This remedy also aligns with our measures to reform CASS corporate governance and introduce regulatory oversight of CASS (see paragraphs 0 to 14.53).

[67] See Bacs' further response to provisional decision on remedies.
[68] Until HMT introduces independent oversight of CASS, we have decided that the CMA will monitor compliance with this remedy.
[69] LBG response to provisional decision on remedies, p15.

Funding

14.151 Regarding recovery of Bacs' costs, prior to the launch of CASS, Bacs agreed with HMT to fund the operational costs of the service via a fee of £5 split evenly between the old and new provider.[70] Bacs told us that at current volumes, this fee was adequate to cover the direct operating costs of the service, but it was insufficient to fund the level of central advertising considered necessary to reach the awareness and confidence targets.

14.152 Bacs told us that the service rules allowed for exceptional costs to be recovered via a call to all participants based on their share of the current account market (ie the number of current accounts eligible for the service). It told us that this mechanism was agreed during the development of the service and formed part of the Participation Agreement.

14.153 A number of parties have questioned the appropriateness of current funding arrangements:

- *(a)* Barclays told us that ongoing market costs should be reflected in an adjusted fee per switch figure.[71]
- *(b)* RBSG told us that further funding should be allocated based on net gains from switching, as this would align the costs with the beneficiaries of the service.[72]
- *(c)* Both HSBCG and LBG told us that annual spending on the promotion of CASS should be capped.[73]

14.154 Bacs told us that the application of a mechanism based on market share rather than switching volumes better reflected the role of CASS in promoting competition in the market by removing a perceived barrier to switching, and it also encouraged participants to improve their customer retention activities.

14.155 This view was supported by TSB, which told us that funding based on net gains from switching would unduly discriminate against those participants most successful in attracting switchers, or even risk deterring providers from actually competing for new customers.[74]

[70] It was also agreed that the level of the fee could not exceed £5 for the first five years of the operation of CASS.
[71] Barclays response to provisional decision on remedies, p13.
[72] RBSG response to Remedies Notice, p21.
[73] HSBCG response to provisional decision on remedies, p7 and LBG response to provisional decision on remedies, p15.
[74] TSB response to Remedies Notice, p8.

14.156 We think that the generation of additional funding based on market share is an appropriate mechanism, as it minimises barriers to entry by new providers and encourages providers to compete for new customers. Further, non-switchers also stand to benefit from increased competition in the market, and this also supports cost recovery on the basis of market share.

14.157 We do not think that it is necessary for us to set an annual cap on Bacs' promotional spend in relation to raising customer awareness of and confidence in CASS since participants can influence the spending on CASS promotion through the MC. This approach will help ensure that awareness and confidence levels are achieved in an efficient and targeted manner.

14.158 We therefore do not intend to seek any amendments to the CASS funding mechanisms as part of this remedy.

Cost of remedies

14.159 There will be three principal costs associated with this remedy:

- *(a)* The funding of a long-term promotional campaign to increase levels of awareness of and confidence in CASS and to sustain these levels over time, including the funding of additional promotional activity to target those customer segments that have low awareness of the service.
- *(b)* The development of the metrics used to measure customer awareness of and confidence in CASS.
- *(c)* Monitoring of compliance with and enforcement of the remedy.

Promotional activity

14.160 Bacs told us that participants had committed to spending £9.2 million in 2016 on central activities to increase awareness of and confidence in CASS (see paragraph 14.144(c)). The cost of future promotional activity beyond 2016 will not necessarily require the provision of additional funds; it may be that better outcomes can be achieved within similar scales of budget committed to in recent years. The cost is likely to be determined by the degree of activity required to sustain levels of awareness and confidence above and beyond 75%. This includes our intention to seek undertakings from Bacs to develop its awareness and confidence metrics to measure customer understanding of the switching process, and any additional promotional activity required to engage those target customer segments which have low awareness of CASS.

Development of metrics

14.161 Bacs told us that:

(a) it was due to commission further quantitative research to develop a more robust and insightful confidence measure;[75] and

(b) it was conducting research with the University of Bristol to define a more appropriate measure of the competitive environment that took account of levels of engagement, and that one such measure might be consideration of switching.[76] To date, Bacs' partnership with the University of Bristol has led to the development of a market dynamics model, which analyses, among other things, what triggers may be most effective in shaping customer behaviour and a customer's resulting decision to switch or remain with their current account provider.[77]

14.162 The costs related to the development of these metrics will be in line with Bacs' current plans. As such, we do not envisage our remedy to result in any significant incremental costs.

Monitoring and enforcement

14.163 The cost of monitoring compliance with and enforcement of the remedy is likely to be modest, initially by the CMA and later incorporated into the CASS regulator's review of CASS governance under our measure to address the service's governance.

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[75] Bacs response to Remedies Notice, p19.
[76] Bacs response to Remedies Notice, p197.
[77] Bacs response to the provisional decision on remedies, p2.

15. Additional remedies targeted at PCA overdraft customers

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Overview

15.1 A key objective of all our remedies is to address low customer engagement and barriers to searching and switching. These market features are present in the PCA and SME banking markets in both GB and NI. Our remedies aim to tackle these issues across all customer groups.

15.2 However, we found that the impact of these features is greater for overdraft users and even more so for unarranged overdraft users[1] (see Section 11). Also, the detriment of our AECs is higher for users of overdrafts, in particular of unarranged overdrafts.

15.3 Given the specific problems we have identified in relation to overdrafts, we have decided to introduce additional remedies targeted at overdraft customers (particularly unarranged overdraft customers) to address these issues and to reinforce the effectiveness of our other measures for this customer group. In combination with our other remedies, we expect these measures to increase competition and to improve the outcomes for PCA overdraft customers (who account for 45%[2] of all active accounts).

15.4 Overdraft users tend to be younger than PCA customers who do not use overdrafts, and tend to be employed. Customers who use only arranged overdraft facilities are more likely than other customers to have high income,[3] and be financially literate with a degree-level education. As for unarranged overdraft users, they are less likely to be low income customers than non-overdraft users (albeit only slightly less likely) but are more likely to be low income customers than arranged-only overdraft users.[4]

15.5 Comparing the characteristics of heavy[5] overdraft users with the characteristics of light[6] overdraft users, we found that the former are more likely to be employed and have higher income.[7] Apart from this difference, we did not find any other substantial differences between light and heavy overdraft users. The majority of overdraft customers are light users and most unarranged overdraft usage is of limited duration, being 3 or fewer days a month on average.[8]

15.6 These observations suggest that:

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[1] Similar concerns apply in relation to facilities such as Barclays' emergency borrowing facility, which in contrast to other PCA providers' unarranged overdrafts specifies a borrowing limit of the facility. See Section 6. We therefore include facilities such as Barclays' emergency borrowing facility within the full scope of our remedies that are targeted at unarranged overdrafts. For convenience, we use the term unarranged overdraft to refer to Barclays' emergency borrowing facility and other PCA providers' unarranged overdraft facilities (or unplanned or unauthorised overdraft facilities). Any other facility that raises similar concerns would likewise be within the scope of our remedies irrespective of terminology in order to minimise the risk of circumvention of the remedies by providers.
[2] See Section 6 and Appendix 6.5.
[3] See Appendix 6.5. High income is defined as net inflows of greater than £2,500 per month.
[4] See Appendix 6.5. Low income is defined as net inflows of less than £1,250 per month.
[5] Customers who used either an arranged or unarranged overdraft for nine months or more in 2014. We define a customer as being in overdraft for a month if the customer was in overdraft for at least one day in that month.
[6] Customers who used either an arranged or unarranged overdraft for eight months or less in 2014.
[7] See Appendix 6.5. Higher income refers to both medium income (defined as net inflows of £1,250 to £2,500 per month) and high income.
[8] See Appendix 6.4.

(a) Overdraft usage is not generally associated with low income, or other indicators of financial exclusion. This suggests that a significant proportion of customer detriment experienced by overdraft users, including by some heavier overdraft users, may arise from lack of awareness and engagement with their PCAs. Such detriment is potentially avoidable. Remedies that use available technology to support greater customer awareness and put customers in more control of managing their PCAs are likely to be effective in addressing this source of detriment.

(b) A significant proportion of unarranged overdraft use is short-term in nature. This suggests that the ability to incur an unarranged overdraft has some value to customers as a temporary, easily accessible, source of funding. Unarranged overdrafts can sometimes provide customers with more critical emergency financial cover, for example where the alternative might be missing important payments (with liability for any consequential penalties and/or potentially damaging a customer's credit score from such declined payments).

15.7 Taking into account these factors, we see a valid role for unarranged overdrafts as part of customers' credit options. Given this, we took care in developing our remedies not to restrict unduly the availability of this source of funding while still tackling the detriment that can arise from the absence of effective competition to attract overdraft customers.

15.8 The additional measures we have decided to take in relation to overdraft users, reflecting the above, are summarised as follows:

- To increase PCA customer awareness of, engagement with and management of their overdraft usage and charges, we are:
  - requiring PCA providers to automatically enrol all their customers into an unarranged overdraft alert;
  - requiring PCA providers to offer, and alert customers to the opportunity to benefit from, grace periods during which they can take action to avoid or reduce all charges resulting from unarranged overdraft use; and
  - recommending to the FCA that it undertakes further work to identify, research, test and, as appropriate, implement measures to increase overdraft customers' engagement with their overdraft usage and charges. This will be facilitated by an Order to require PCA providers to cooperate with the FCA in its research programme, including randomised controlled trials (RCTs).

- To limit the cumulative effect of unarranged overdraft charges, we are:
  - requiring PCA providers to set a monthly maximum charge (MMC) covering all unarranged overdraft charges (including debit interest). Disclosure of the MMC should be no less prominent than other overdraft charges. The level of the MMC will be set by each PCA provider and may be different for each of its PCA products; and
  - recommending that the FCA undertakes work to assess the ongoing effectiveness of the MMC and considers whether measures could be taken to further enhance its effectiveness (such as the introduction of rules, if appropriate, which could take the place of the MMC requirements set out above).
- To increase PCA customers' engagement with overdraft features, we are recommending that the FCA looks at ways for providers to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process.
- To address specific barriers to searching and switching for overdraft users, we are:
  - seeking undertakings from Bacs to work with CASS participants to review the account switching process, to ensure that PCA providers offer a firm decision on the overdraft offered after a customer has completed the PCA provider's application process but before they switch accounts; and
  - recommending that, following the introduction of open APIs, the FCA considers requiring PCA providers to offer online tools that indicate whether a prospective customer may be eligible for an overdraft.

15.9 These additional measures reinforce and are complementary to the remedies in Sections 13 and 14 prompting customers to consider switching; and making it easier for them to search among providers and products (including for overdraft features) and to switch. All these remedies are just as relevant to overdraft customers as others and are intended to work alongside the targeted remedies set out in this section to comprehensively tackle the AECs identified for PCA overdraft customers.

15.10 In developing our overdraft remedies, we have had regard to technological developments and the wider regulatory landscape.

15.11 While we have introduced specific measures for overdraft customers, our other remedies, particularly Open APIs,[9] as well as innovations in payment systems,[10] have the potential to enhance competition and improve outcomes for overdraft customers. These developments could increase the choice of credit products available to customers (effectively 'unbundling' credit from the PCA offering),[11] increase the scope for innovative money management services (eg facilitating the sweeping of funds between accounts to avoid overdraft charges), and/or increase customers' control over authorisation of card transactions at the point of sale. Furthermore, by providing secure access to customers' transaction data, open APIs will reduce the information disadvantage providers face in offering competitive arranged overdraft limits to new customers, and hence reduce overdraft customers' searching costs. These changes, which our remedies package will facilitate, can be expected to deliver new and enhanced mechanisms by which customers can be made better aware of and engage with their overdraft use, and can shop around more effectively. We have sought to keep our remedies sufficiently focused and flexible to complement such innovations, rather than crowding them out.

15.12 We have also taken into account the wider consumer protections across the regulatory landscape that will support our competition remedies. Our remedies package includes measures that address the AECs for overdraft users, including heavier overdraft users for whom we observe lower levels of switching and higher charges. In doing so we are mindful of the fact that some of these heavier overdraft users will be in financial difficulties. There is less scope for competition, and therefore for our investigation, to help such customers, particularly if they have reached an unsustainable level of debt. It is not in our remit to tackle the problems arising from over-indebtedness.

15.13 In this context we welcome the remit of the FCA to regulate providers of consumer credit, and the provisions its rules make to safeguard responsible lending and fair treatment of consumers, including those in financial difficulties (principles that are additionally embedded in the industry Lending Code). We also welcome the UK and EU initiatives to provide basic bank accounts to all customers not otherwise eligible for a bank account,[12] and other initiatives such as the November 2011 BIS/HMT review of consumer credit and personal insolvency[13] and the work of the UK's Financial

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[9] See Section 13.
[10] For example, work by the Payments Strategy Forum to respond to consumer and business needs in payment systems, including user needs for greater control, greater assurance and enhanced data. See the Payments Strategy Forum draft strategy published on 14 July 2016 for consultation.
[11] Cf. the OBWG report 'Introducing the Open Banking Standard', paragraph 6.1.3.
[12] See Section 3 relating to the Payment Accounts Directive and the Payment Accounts Regulations 2015.
[13] BIS/HMT Consumer Credit and Personal Insolvency Review: Formal Response on Consumer Credit.

Capability Board.[14] Similarly, we welcome recent moves by the financial services industry working alongside charities and customer groups to focus further on the complex and critical issue of how to support vulnerable customers.[15] We have been mindful, in designing our remedies, of the fact that these will be supplemented by existing additional protections for customers affected by financial difficulties or otherwise potentially excluded from the PCA market.

15.14 In the rest of this section we describe our additional overdraft remedies in more detail.

Measures to increase customer awareness of and engagement with their overdraft usage and charges

Summary of the measures

15.15 We have decided to require providers to automatically enrol PCA customers into an unarranged overdraft alert, as summarised in Figure 15.1. This remedy will ensure that customers are made aware, on a timely basis, of actual or attempted unarranged overdraft use,[16] and given an opportunity to take action to avoid or reduce the resulting charges. By empowering customers to make an informed and timely decision about their use of an unarranged overdraft facility and to manage the financial consequences of such use, customers will be able to engage more actively and effectively with their PCAs.

Figure 15.1: Summary of the overdraft awareness and engagement remedy

CMA Order

We have decided to make an Order to require PCA providers to enrol automatically all their customers, where feasible, to receive an unarranged overdraft alert.

- This alert will inform customers on a timely basis when they have exceeded, or are at significant imminent risk of exceeding, a pre-agreed credit limit. It will draw the customer’s attention to the risk of charges being incurred.

[14] See the Financial Capability Strategy for the UK.
[15] Specifically, the establishment of the first Vulnerability Taskforce and the publication of its report in February 2016, building on FCA research into vulnerable customers. See FCA Occasional Paper No. 8: Consumer Vulnerability, February 2015.
[16] References to unarranged overdraft usage (and resulting charges) for the purpose of this remedy, also cover the use of funds in excess of a pre-agreed credit limit (and resulting charges), such as the use of Barclays’ Emergency Borrowing facility. See the footnote to paragraph 15.2.

- Where customers are permitted to exceed a pre-agreed credit limit, PCA providers will further be required to specify and communicate a period of time (a 'grace period') during which no additional charges will result from this use if the account is returned to within its pre-agreed credit limit by the end of the grace period.

- As part of the unarranged overdraft alert, PCA providers will be required to communicate (whenever relevant) the time by which customers need to take action in order to benefit from this grace period. The content of the alert, including this time, must comply with legal and regulatory requirements for customer communications to be fair, clear and not misleading, and be compatible with providers' contractual terms and conditions, as well as regulatory requirements governing the provision of payment services including the timing at which fees and charges accrue. Furthermore, the time by which the alert is sent and the time communicated for action must allow customers a reasonable opportunity to take action to avoid or reduce charges.

- All UK PCA providers above a threshold of 150,000 PCAs (excluding accounts that do not charge customers for exceeding or attempting to exceed a pre-agreed credit limit, such as basic bank accounts) will be subject to this measure.

- A provider's auto-enrolment policy should enable PCA customers who wish to opt out of these alerts, to do so.

- These alerts must be available by text message or mobile banking app push alerts. To maximise the impact of this measure, we will require PCA providers to collect an account holder's mobile phone number during the account application process and in instances when an account holder updates their contact details.

For the purposes of this Order, the pre-agreed credit limit should be deemed to be £0 in cases where the customer has not arranged a credit limit with its PCA provider.

FCA recommendation

We have also decided to recommend to the FCA that it identifies, researches, tests and, as appropriate, implements measures to increase customers' engagement with their overdraft usage and charges.

As part of this programme of work, we recommend that the FCA considers:

(a) How PCA providers may be able to enhance the effectiveness of overdraft alerts, for example by changing the type, medium, content, timeliness and frequency of the alerts offered, and/or their auto-enrolment policies.

(b) The grace periods operated by PCA providers and the timings consequently communicated in alerts notifying customers of the opportunity to avoid or reduce overdraft charges.

(c) The set of alerts into which customers should be automatically enrolled by PCA providers.

(d) How to articulate the concept of available funds to customers, in particular whether this is inclusive or exclusive of an arranged overdraft.

To facilitate the FCA's further work, we have decided to follow the same approach as the prompts remedy in Section 13, which involves making an Order to require PCA providers to cooperate with the FCA in a research programme, including RCTs. We will permit PCA providers to modify or remove the unarranged overdraft alerts required under our Order, if the FCA requested them to do so as part of its testing.

Interaction between the CMA Order and our recommendations to the FCA

While we are taking actions ourselves as well as recommending actions to the FCA in order to achieve a timely solution, we recognise the need to avoid unnecessary regulatory duplication. We could remove all or part of our Order once the FCA has concluded its research and, subject to the results of this research, is ready to introduce its own measures to increase overdraft customers' engagement with their overdraft usage and charges.

How this remedy addresses the AECs and/or the resulting customer detriment

15.16 We have found that overdraft users in both GB and NI have limited awareness of and engagement with their overdraft usage, and that overdraft charging structures are particularly complex. We have concluded that, as a result of this, the competitive pressure on overdraft charges is low.[17]

[17] See Section 11.

15.17 PCA providers, in response to a series of government and regulatory interventions[18] and market developments,[19] have taken some steps to increase customer engagement on overdrafts. These include the use of alerts and the introduction of a 'retry' system to retry a payment before declining it due to insufficient funds.[20] Some providers alert customers of opportunities to take action before a payment is declined (ie during a 'retry period' under the retry system) or before overdraft charges are applied (ie during a 'grace period' as described further in paragraph 15.18) to avoid incurring unnecessary charges.[21]

15.18 Further steps to increase customers' awareness of, and engagement with, their overdraft usage and charges, including via alerts, will help address the AECs and the resulting customer detriment in the following ways.

(a) Greater awareness by customers of their overdraft use and its cost may prompt customers to consider whether they could get a better deal if they switch provider. This in turn will increase incentives for PCA providers to compete on overdraft charges. As Section 6 explains, overdraft users (particularly heavier overdraft users) often have the most to gain from switching their PCAs.

(b) Overdraft alerts may increase customers' awareness of and price sensitivity to their use of an overdraft facility. As set out in Appendix 6.4, 52% of overdraft users and 55% of unarranged overdraft users underestimated their usage by two or more months. This indicates that there is considerable scope for customers to become more aware of their overdraft charges, which in turn will increase the constraints on the level at which banks set such charges.

(c) We expect customers' increased awareness and price sensitivity resulting from overdraft alerts, and the associated reduction in usage, to directly and promptly reduce the detriment from the AEC in relation to

[18] See Section 6. For example, the November 2011 BIS/HMT review of consumer credit and personal insolvency: BIS/HMT Consumer Credit and Personal Insolvency Review: Formal Response on Consumer Credit.
[19] See Appendix 6.6.
[20] See FCA press release (7 June 2013): 'FCA secures commitment from high street banks to use a 'retry system' when processing payments to stop unnecessary penalty charges'. The 'retry' system applies to direct debits, standing orders and future bill payments (ie regular payments) where, if a customer does not have sufficient funds for the payment, the payment will be held in the system and retried later in the day. This gives customers an opportunity to make funds available to avoid a payment being declined. The following participants are currently signed up to a retry agreement with the Payments Council and the FCA: AIB, Barclays, BoI, Co-op Bank, Coventry Building Society, Clydesdale (Yorkshire Bank), Cumberland Building Society, Danske, Handelsbanken, HSBCG (including HSBC, first direct and M&S Bank), LBG (including Lloyds, Halifax, BoS), Nationwide, RBSG (including RBS, NatWest, Ulster, Coutts, Adam and Company and Isle of Man Bank), Santander, Tesco Bank, TSB and Virgin Money.
[21] See Appendix 6.6 for more information on industry alerts, and grace and retry periods.

overdraft charges. The FCA has found that signing up to text alerts alongside using mobile banking reduced the monthly unarranged overdraft charges incurred by customers by 24% on average (a reduction of around £11 each year per customer). The FCA also found that merely signing up to text alerts without mobile banking reduced monthly unarranged overdraft charges incurred by customers by 6% on average (a reduction of around £3 each year per customer).[22,23] Furthermore, these estimates do not take into account the significant wider benefits from increased customer engagement (eg the impact on switching) that can be expected to result from such alerts.[24]

(d) Alerts can be expected to be most effective where they include a call to action,[25] for example by referring to the period of time customers have to act to avoid or reduce overdraft charges (referred to for convenience in this section as 'grace periods'). The simpler the action required and the greater the incentive to act, the stronger the potential effect. A grace period offers a simple mechanism for action ('top-up your account by this time') and provides a clear incentive to act quickly ('avoid charges'). While providers generally operate grace periods, several do not alert their customers to this. HSBCG provided evidence showing that the impact of unarranged overdraft text alerts informing customers of a grace period was significant. Following the introduction of such alerts, the number of customers transferring funds on the first day they went over their arranged limit increased from 16% to over 50% for HSBC and the corresponding increase for first direct was from 32% to 74%.

15.19 While we welcome the actions taken to date, we consider that further measures are necessary to increase the levels of engagement of customers on their overdraft usage and charges. Appendix 6.6 shows that there is significant variation in providers' offerings, especially in relation to overdraft alerts, and absent automatic enrolment (which is rare) levels of take-up of alerts remain low. We believe that there is scope for further targeted intervention to improve the take-up and impact of overdraft alert services, given that customers' awareness of their overdraft usage is still low under the existing limited provision of alerts (covering around half of PCAs; see

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[22] See FCA (March 2015), *Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.* We only report results for Bank A. Note that these estimates refer to the average impact across all active PCAs that are eligible for unarranged overdraft.
[23] PCA providers have also provided us with similar evidence on the impact of overdraft alerts. LBG, through an RCT, found a 6% average reduction in unarranged overdraft charges for those customers it automatically enrolled in low balance text alerts (LBG Trials Report, slides 41–42). [✂]
[24] See Appendix 15.1.
[25] For example, see BIT's response to Remedies Notice, suggesting that messaging should include clear information about what the recipient needs to do as a result of a communication.

Appendix 15.1). PCA providers have conflicting incentives to innovate in these types of services due to the revenue they could lose from increased customer engagement.

15.20 Our remedy will ensure that PCA providers inform customers when they have exceeded, or are at significant imminent risk of exceeding, a pre-agreed credit limit. We refer to this alert as an 'unarranged overdraft alert'[26] in this section. Our remedy will also require PCA providers to alert customers (where relevant) of the opportunity to avoid or reduce charges (a 'grace period'), in order to strengthen the impact of the alert. By requiring providers to automatically enrol their PCA customers into the alert, we will ensure that as many customers as possible benefit from the remedy.

15.21 Our remedy will not require PCA providers to offer or alert customers to a retry period (as described in paragraph 15.17). However, we anticipate that such measures will continue on a voluntary basis as agreed between major providers and the FCA. We strongly support the retry system and are in favour of the provision of retry alerts continuing or expanding across the market. We consider that they are complementary to the alerts we are requiring and that the various forms of alerts can effectively co-exist to the benefit of customers.[27]

15.22 In light of the clear evidence of the effectiveness of unarranged overdraft alerts (see paragraph 15.18), it is important to ensure timely implementation of our remedy to enable customers to benefit sooner rather than later. Equally, we consider it important that these measures are developed in a way that maximises their impact and gives consideration to potential interactions between grace and retry periods.

15.23 We have therefore decided to implement this remedy in two complementary stages:

(a) A CMA Order requiring providers to implement an unarranged overdraft alert, which (where relevant) must communicate the opportunity to take action to avoid or reduce charges.

(b) A recommendation to the FCA to undertake further research to identify, test and, if appropriate, introduce measures to increase customers' engagement with their overdraft usage and charges.

[26] The scope of such alerts will include Barclays' 'Emergency Borrowing'. See the footnote to paragraph 15.2.
[27] For example, a retry alert could potentially function as an imminent unarranged overdraft alert for the purposes of our remedy, in cases where unarranged overdraft use is likely to be authorised even if the funds in the account remain insufficient when payment is retried. Furthermore, a grace period will not apply if the payment is declined, or sufficient funds are deposited to allow the payment to be made, when retried following a retry period.

15.24 In deciding to supplement our Order with recommendations to the FCA to undertake a wider programme of research that will support the aims of this remedy, we took the view that the FCA is best suited to this role for the same reasons set out in relation to its role in our prompts remedy in Section 13. In particular, it has existing expertise in conducting research, including RCTs, within the financial services sector.

15.25 Bearing this two-stage implementation in mind, our Order has been designed to retain some flexibility in how providers can implement the initial alert. Building this flexibility into our Order will enable providers to build on rather than replace existing measures should the FCA prescribe further requirements following its research programme. This provides for minimal duplication of effort and costs in the medium term while ensuring customers still benefit from market improvements in the shorter term. Given the variation and complexity of alert provision among providers, a flexible approach will also enable continued differentiation and minimise changes unless and until further research determines that a more detailed specification is worthwhile.

15.26 We received strong support from the majority of respondents to our provisional decision on remedies, both in favour of alerts (including grace periods) in general and of the recommendation to the FCA. Several respondents to our provisional decision on remedies particularly endorsed our preference to retain flexibility for providers. RBSG noted that this would minimise the impact on providers such as RBSG which had already invested in providing alerts functionality.[28] Virgin Money considered that an overly prescriptive approach would risk cutting across good practice in the industry.[29] Danske agreed that the CMA should not be unduly prescriptive, as it felt this would be burdensome to implement and monitor and could have the unwanted effect of stifling differentiation.[30]

15.27 StepChange[31] and the FSCP,[32] however, noted that the benefits of these alerts would be more limited for those without the financial means to act on them. We recognise that customers in financial difficulties may not be able to take advantage of grace periods, if they are not in a position to act following the notification. However, even these customers may benefit to some degree from the generally increased awareness of their usage such alerts will support and the downwards pressure that this remedy can be expected to

[28] RBSG response to provisional decision on remedies, paragraph 8.
[29] Virgin Money response to provisional decision on remedies, paragraph 69.
[30] Danske response to provisional decision on remedies.
[31] StepChange response to provisional decision on remedies.
[32] FSCP response to our provisional decision on remedies.

exert on unarranged overdraft prices. As noted in paragraph 15.12 the issues facing customers in financial difficulty are wide-ranging and do not primarily derive from the AECs identified. As a consequence there may be a need for other, more appropriate means of addressing these important issues.

15.28 Likewise, the FSCP considered that alerts would not assist those who are digitally excluded or do not wish to manage their finances in this way.[33] We consider that almost all customers (those who have mobile phones) will still benefit from greater awareness of their overdraft usage and charges via the alerts and, even if not using digital banking, will have opportunities to react to such alerts, for example by going into a branch.

15.29 We summarise below the design of our Order before discussing how this will be implemented alongside our recommendation to the FCA. Appendix 15.1 provides further details of the remedy design.

CMA Order – design considerations

15.30 We have considered the following design parameters for this remedy:

(a) The medium by which the alert should be delivered, and the auto-enrolment process. We have decided to require an alert by text message or, where customers are subscribed to mobile banking apps, push alerts from these apps. To maximise the impact of this measure, we will require PCA providers to collect an account holder's mobile phone number during the account application process and in instances when an account holder updates their contact details. Customers will be able to opt out of such alerts.

(b) When the alert should be triggered and sent, with a view to this occurring on a reasonably timely basis.

15.31 We have also considered the content of the mandated alert. Providers will be required to ensure that the alert provides, at minimum, the following information:

[33] FSCP response to provisional decision on remedies.

(a) the customer has exceeded, or is at significant imminent risk of exceeding, a pre-agreed credit limit, and could incur associated charges;[34] and

(b) (where relevant[35]) the customer has a grace period during which they have an opportunity to take action to avoid or reduce charges.[36] The alert must inform customers of the time by which they should take such action.

15.32 Our remedy will therefore ensure that customers become aware, on a timely basis, of their potentially costly PCA usage and of the grace periods available to them, which in many cases they are not currently alerted to. Providers must continue to provide grace periods for this purpose, during which their customers, by adding sufficient funds to their account, can reduce or avoid all charges relating to the use of funds in excess of a pre-agreed credit limit,[37] irrespective of the type of transaction causing that use. This includes, but is not limited to,[38] paid item, debit interest, daily and monthly charges.

15.33 We considered whether to place requirements on the grace period timings operated and communicated by providers, to safeguard customers' opportunities to take action. Our provisional decision on remedies proposed that providers' grace periods (as defined above, ie applying to all relevant charges including fees and interest) should operate until at least 5pm each day,[39] and that the time providers communicate to their customers to act should be no earlier than 2pm. While we recognised that 2pm was earlier than the grace periods in effect, we considered that this approach might be helpful in maintaining some flexibility for providers given the wide range of transactional and operational circumstances in which such an alert might apply, and as a result of this the potential need, in customers' interests, to manage interactions with retry alerts that have separate timing requirements.

15.34 However, we also consulted on the possibility of the communicated time varying depending on the circumstances in which the alert was sent. We sought views on this alternative approach, given that maximising the length

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[34] Based on the term proposed by the FCA for standardising terms under PAD or the equivalent final term that is implemented under PAD.
[35] Eg where a customer has exceeded a pre-agreed credit limit, or the provider anticipates permitting scheduled payments that will cause the account to exceed a pre-agreed credit limit.
[36] Including specific charges would be compatible with this measure but would not be a specific requirement.
[37] For the avoidance of doubt, this does not include charges incurred when a provider declines to offer an unarranged overdraft (such as unpaid item fees), which can separately be avoided via existing retry periods.
[38] In the event that other charges for using funds in excess of a pre-agreed credit limit are applied or introduced by providers.
[39] We note that additional obligations exist for debit interest under the Payment Services Regulations. This remedy does not affect PCA providers' obligations under those, or any other, regulations.

of time available for customers to take action after receiving an alert would be transparent and beneficial to customers.

15.35 We have reflected further on responses to these proposals alongside current industry practice, noting that:

(a) The evidence we have reviewed indicates that providers currently operate grace periods that end at different times ranging from 4.30pm to 11.45pm.[40] Similarly, they communicate a range of different times to their customers about when they must act in order to avoid charges.

(b) Parties were strongly supportive of allowing flexibility in the design and implementation of the Order, considering that, because alerts systems and the impact of the messages provided to customers are complex and vary among providers, further testing would be advisable prior to selecting any specific design over another. The risks of alerts fatigue, and of customer confusion depending on how various alerts interact within a complex range of usage scenarios, were raised.

(c) Parties stressed the importance of allowing providers to differentiate themselves through their alerts provision.

15.36 Having considered the above points, we have concluded that:

(a) Given the variation in industry practice, were we to specify particular grace period timings there is a risk of normalising a 'lowest common denominator' approach which might not be robust to future changes that could benefit customers (eg changes in technology), or may conflict with other regulatory requirements (in particular, the legislative framework governing the provision of payment services).

(b) Given the inherent complexity of how alerts operate and interact, the grace period timings operated and communicated by providers are an area that would benefit from further research before requiring any changes to industry practice. The FCA would be best placed to undertake this further research as part of the work we are recommending it undertakes for this remedy.

15.37 Taking the above into account, and in line with our general preference to adopt a flexible approach to this remedy ahead of the FCA's further work in this area, we concluded that instead of seeking to navigate a complex area by introducing design requirements which could inadvertently limit customer

[40] See Appendix 6.6. Where a range of times applies (eg for different charges) we refer to the earliest time.

outcomes, it would be more effective (and better allow for future developments) to rely on a principles-based approach focusing on desired customer outcomes.

15.38 We have therefore decided that the timing of the grace period will be determined by individual PCA providers,[41] subject to ensuring that the time by which the alert is sent and the time communicated for action must:

(a) allow customers a reasonable opportunity to take action to avoid or reduce charges and, in any event,

(b) meet the continuing obligations of providers to ensure their communications are fair, clear and not misleading in compliance with FCA rules[42] and consumer law;[43] and

(c) be compatible with their contractual terms and conditions, and regulatory requirements governing the provision of payment services, in respect of the timing at which fees and charges accrue.

15.39 While providers will individually need to assess the compliance of their alerts on the above basis, alerts that communicate the maximum time customers have to take action to avoid or reduce all unarranged overdraft charges are likely to be compliant with our remedy.

15.40 To maximise the benefits to customers resulting from our alerts including making them aware of grace periods, we are also recommending that the FCA considers grace period timings as part of the further work that we have asked it to undertake to enhance customer awareness and engagement with their overdraft usage and charges. In the meantime, we do not expect providers to change their current practices to the detriment of customers, ie by shortening/bringing forward existing practices. Should they do so, we would expect the FCA to take this into account in considering what further measures are necessary.

Implementation issues

15.41 We have considered the following issues in relation to the implementation of the remedy:

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[41] In so doing, they would have to take into account other legal obligations that exist for debit interest under the Payment Services Regulations. This remedy does not negate PCA providers' obligations under those, or any other, regulations.
[42] See CONC 3.3.1R.
[43] Relevant consumer law includes the Consumer Protection from Unfair Trading Regulations 2008.

(a) Method and timing of implementation.

(b) Monitoring of compliance with and enforcement of the remedy.

15.42 We discuss the above in the following paragraphs. We have also considered the remedy's interaction with existing and future laws and regulations and discuss this in Appendix 15.1.

Method and timing of implementation

15.43 As set out in paragraph 15.23, we intend to implement this remedy by way of a CMA Order supplemented by recommendations to the FCA to undertake research aimed at increasing customer engagement with their overdraft usage and charges. This parallel activity by the CMA and FCA will allow the research and testing necessary to enable the full potential of the measures to be realised while ensuring that, in the meantime, current best practice is quickly spread to the benefit of customers.[44] We have sought to minimise any potential duplication of costs by adopting a flexible approach in the design of the Order as explained in paragraph 15.25.

15.44 Nationwide argued in favour of waiting for the FCA to conclude its findings before requiring any specific alerts. Nationwide felt that this would allow all prompts to be tested as part of a broader package, increasing their effectiveness.[45] We consider that it is important to ensure rapid implementation of a core set of alerts as explained above, but that our recommendation to the FCA will still allow a suitable broader package of alerts to be tested, especially given the flexibility inbuilt in the design of our Order.

15.45 If, as a result of its work, the FCA introduces rules that supersede the CMA Order, the CMA could remove all or part of its Order as relevant, at the same time as the FCA rules come into force. In doing so, we recognise the need to avoid unnecessary regulatory duplication.

[44] We also considered whether to rely on voluntary cooperation from providers to implement the remedy. Our view is that this remedy should be applied as widely as reasonable, to address the AEC and customer detriment as fully as possible. As such, a voluntary approach (or seeking undertakings) would be less practicable. It would also create a risk that PCA providers do not fully implement the remedy, thereby reducing its effectiveness. Furthermore, if not included as mandatory within our remedies package, we consider that providers will have incentives to prioritise the mandatory elements of the package, reducing the likelihood that this remedy would be delivered on a timely basis.
[45] Nationwide response to provisional decision on remedies.

- *The CMA Order*

15.46 We have decided to issue an Order requiring PCA providers to enrol automatically all their customers, where feasible, into an unarranged overdraft alert as described in paragraphs 15.30 to 15.39.

15.47 The Order will include a de minimis threshold, so that PCA providers below a certain size will not be subject to the remedy. Our provisional decision on remedies consulted on whether such a threshold should apply, for example at 150,000 to 200,000 active PCAs.[46] We received representations in favour of a de minimis threshold. Handelsbanken urged us to set the threshold as high as possible, saying that such measures were less appropriate for providers such as itself with a more personal service.[47]

15.48 Having considered these representations, we have decided to apply a de minimis level of 150,000 active PCAs, excluding accounts that do not charge either for overdraft balances or for attempting to exceed a pre-agreed credit limit (such as basic bank accounts). This threshold:

(a) is set at a level which will cover the great majority of active accounts with overdraft facilities and includes larger providers in both GB and NI, while excluding the large number of very small providers. A higher limit would not achieve these aims; and

(b) is aligned with the de minimis threshold set for other PCA remedies,[48] hence allowing for a consistent approach to implementation across the remedy package.

15.49 We exclude accounts that do not charge either for overdraft balances or for attempting to exceed a pre-agreed credit limit, as the customer detriment arising from actual[49] or attempted unarranged overdraft use on such accounts will be limited.

- *The CMA's recommendation to the FCA*

15.50 We are also recommending that the FCA undertakes work to identify, research, test and, as appropriate, implement measures to increase overdraft customers' engagement with their overdraft usage and charges.

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[46] Using a common definition across providers.
[47] Handelsbanken response to provisional decision on remedies.
[48] Subject to the exemption for accounts that do not charge either for overdraft balances or for attempting to exceed a pre-agreed credit limit (such as basic bank accounts), which is relevant in the context of these overdraft remedies for the reasons explained in paragraph 15.49.
[49] For example in instances where a provider does not have discretion to decline a payment.

15.51 While the precise programme and timing of work would be for the FCA to determine, its work could, for example, explore additional measures to enhance unarranged overdraft alerts, including by enhancing the timings of operated and communicated grace periods; and/or to widen the set of alerts required of banks. Such additional measures could supersede or replace the unarranged overdraft alerts required by our Order. The FCA could also explore the effect of including or excluding the customer's arranged overdraft in the available funds communicated by providers.

15.52 To facilitate the FCA's research, consistent with the prompts remedy in Section 13, our Order will also:

(a) require all PCA providers subject to this remedy to cooperate with the FCA in its research programme, including any RCTs the FCA may wish to conduct as part of this. Providers will only be required to participate in the research programme if selected by the FCA; and

(b) permit PCA providers to modify or remove the unarranged overdraft alerts for a set of its customers if the FCA requested them to do so as part of its testing.

- *Time frames*

15.53 The CMA's recommendation to the FCA is effective as of the publication of our final report. In line with our statutory deadlines for remedy implementation, we expect that the CMA Order, including provisions relating to participating in testing with the FCA, will be made within six months of this final report.[50]

15.54 Our provisional decision on remedies proposed requiring providers to comply with the remedy within six months of the publication of the Order. LBG considered this to be reasonable.[51] Money.co.uk considered six months sufficient providing the requirements were clearly defined.[52] However, others expressed views that six months would be insufficient to set up or modify their alerts system, and to make the necessary preparations to roll out the changes. Danske,[53] Nationwide[54] and Barclays[55] were of the view that the IT

[50] As with the similar remedy for prompts (see Section 13), we expect the Order requiring providers to cooperate with the FCA and, if selected by the FCA, participate in the FCA's research (including any RCTs), to come into effect shortly after the Order is made.
[51] LBG response to provisional decision on remedies, paragraph 9.4b.
[52] Money.co.uk response to provisional decision on remedies.
[53] Danske response to provisional decision on remedies, paragraphs 5.8–5.11.
[54] Nationwide response to provisional decision on remedies, paragraph 5.3.
[55] Barclays response to provisional decision on remedies, paragraph 10.3.

changes needed would require substantial time to implement and/or test. [✂][56] highlighted the significant process changes and customer communications required to roll out auto-enrolment in particular. Parties suggested alternative time frames ranging from up to 24–36 months (for those currently without alerts functionality)[57] to at least 12–18 months (for those who would need to modify their enrolment processes and/or alerts functionality).[58]

15.55 PCA providers vary in terms of the extent and sophistication of their alerts systems and we recognise that providers with less advanced systems can be expected to require longer to comply as they will need to build core alerts functionality as well as tailoring such alerts to our requirements.

15.56 Parties also argued that the IT demands of this remedy, alongside the CMA's other remedies, other non-discretionary regulatory change requirements and the need to continue with critical business change programmes that could benefit competition and customers, would in practice require some additional time frame contingency to implement in parallel.

15.57 Taking the above points into consideration, we have decided to extend the implementation time frame for this remedy. We will allow PCA providers 12 months from the date the Order is published, to comply with it. Given that many PCA providers offer some form of alert already, albeit in most cases not on an automatically enrolled basis, we consider it feasible for compliance to be generally be achieved within this time frame.

15.58 However, we will consider allowing no more than a further six months for implementation in certain circumstances, in particular where providers do not currently have and will need to develop and introduce an alerts systems in order to comply with this remedy. Providers who consider they have a case for such an extension will have to apply for a derogation for this purpose. This application should be made within a week of the making of the Order, specifying the length of the extension sought, and must be accompanied by supporting evidence on why this would be strictly necessary.

Monitoring and enforcement

15.59 We intend to monitor compliance with our Order by requiring annual reporting from the affected PCA providers. Details of the reporting requirements will be finalised alongside our Order. However, we anticipate

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[56] [✂]
[57] RBSG response to provisional decision on remedies, paragraph 2. BoI response to provisional decision on remedies, paragraph 6.5.
[58] Danske response to provisional decision on remedies.

that the information requested in the reports could include: details of the auto-enrolment and data collection policies implemented and their impact; details of the alerts for which customers have been auto-enrolled; and information on the volume and frequency of, and reactions to, these alerts (including statistics on overdraft use).

15.60 We will ensure that providers comply with the provisions contained in the Order relating to participation in any research, including RCTs, undertaken by the FCA. We will continue to liaise with the FCA regarding the progress of its work programme following the recommendations of this investigation, in the normal course of our regulatory cooperation, and expect to obtain information regarding providers' non-compliance with the Order, if any, through this process.

15.61 For any measures subsequently introduced by the FCA, it will be best placed to monitor and enforce compliance.

Cost of remedies

15.62 The costs of the remedy relate to:

(a) the costs of implementing, monitoring and enforcing the Order; and

(b) the costs of the FCA's work further to our recommendation, including:

(i) the participation by PCA providers in research, including RCTs; and

(ii) the costs of implementing and, if applicable, supervising any measures subsequently introduced as a result of the FCA's findings.

15.63 As regards the Order, we consider its potential costs to be proportionate to the potential benefits to customers. Most PCA providers already offer some form of alert and operate grace periods. Hence, providers would typically only face incremental costs related to changing their alerts and/or grace periods (to the extent necessary to comply with our Order), and (where they do not currently do so) automatically enrolling their customers into our unarranged overdraft alert.

15.64 Such costs should be limited, in the main, to:

(a) IT development costs, where alerts functionality has to be introduced or enhanced, and/or to enable auto-enrolment.

(b) Other costs of automatic enrolment. This would include process changes (including staff training), the collection of relevant customer contact details and the bulk upload of these contact details. There would also be

operating costs associated with sending more alerts as a result of the increase in the number of customers registered for them.

(c) Customer communications, including changing customers' terms and conditions if required, and corresponding staff training/front office time with customers, as necessary. While not to be disregarded, this seems likely to be low and can largely be incorporated with careful planning into PCA providers' periodic updates of materials and training programmes.

15.65 We received few and variable estimates of the potential costs of this Order:

(a) RBSG estimated [✂].

(b) HSBCG estimated that the cost of auto-enrolling customers into unarranged overdraft alerts was between £[✂] and £[✂].

(c) Danske estimated the cost of sending out one communication to all customers requesting mobile numbers as around £200,000, and this would increase substantially were multiple communications to be required.[59]

(d) While the cost of setting up an alerts system may vary considerably among banks, depending on factors such as scope as well as the provider's IT infrastructure and resources, as an example Tesco spent £[✂] for this purpose.

15.66 The above estimates suggest that the costs of our Order are likely to be limited even taking into account that the costs will be higher for providers who do not currently offer alerts. We did not receive estimates from such providers for setting up an alerts system.

15.67 We consider that the benefits of our Order are significant (see Appendix 15.1) and will outweigh the costs. This is not only the case in the GB market but also in NI where some of the main PCA providers do not currently offer alerts. The costs will be higher for these providers but so will the benefits (because none of their customers are currently receiving any overdraft alerts). We therefore consider that the benefits of our Order will still outweigh its costs in both the GB market and the NI market. We illustrate this further below.

[59] Danske response to the provisional decision on remedies, p7.

15.68 Even using our conservative estimate of the direct benefits of overdraft alerts of £0.22 per month per customer,[60] the benefit over five years for customers of a provider not currently offering alerts but above our de minimis threshold of 150,000 PCAs would be at least £1.7 million.[61] For the same reasons as set out in Appendix 15.1, the overall benefits of the alert will be much higher. The conservative estimate above does not take into account the much greater impact of signing up to alerts when a customer also uses mobile banking (which, based on FCA research, could be more than double this estimate). Moreover, this estimate does not take into account the wider benefits from alerts contributing to higher engagement of overdraft users with their choice of PCA. These additional, wider benefits will be substantial given the significant potential gains from switching observed, particularly for overdraft users. We therefore consider that the benefits of our Order will outweigh its costs also in the NI market where some of the main providers do not currently offer alerts.

15.69 As regards our recommendation to the FCA, the costs relating to the FCA developing and implementing its measures will depend on the scope of the FCA's work and some of these costs will be shared with the prompts remedy in Section 13. The FCA will assess these costs against the benefits that its measures will be expected to deliver. This approach will ensure that any measures the FCA introduces are also proportionate.

Measures to limit the cumulative effect of unarranged overdraft charges

Summary of the measures we are proposing to take forward

15.70 Figure 15.2 summarises our requirement on PCA providers to limit the cumulative effect of unarranged overdraft charges.[62]

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[60] From FCA (March 2015), *Occasional Paper No. 10: Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.* Also see Appendix 15.1.

[61] As in Appendix 15.1, this takes into account that 93% of customers have a mobile phone to receive an alert and that 10% may opt out of the alert. As this is only an indicative and conservative estimate, we have not discounted these benefits over time.

[62] References to unarranged overdraft usage and resulting charges for the purpose of this remedy, also cover the use of funds in excess of a pre-agreed credit limit and resulting charges, such as for the use of Barclays' Emergency Borrowing facility. See the footnote to paragraph 15.2.

Figure 15.2: Summary of measures

We have decided to make an Order to require PCA providers in the UK to specify the maximum total charge that a customer could incur in any given month as a result of exceeding or attempting to exceed a pre-agreed credit limit.[63] All PCAs in the UK where a customer could incur a charge due to these circumstances would be subject to this requirement.[64] We refer to this requirement as a monthly maximum charge (MMC).[65]

PCA providers will be required to make disclosure of the MMC no less prominent than the presentation of other information on overdraft fees and interest. We will also consider requiring PCA providers to use a standardised term and definition to explain the MMC to customers. We will set out our proposals for this in the consultation on our draft Order.

We have also decided to recommend to the FCA that it undertakes work to assess the ongoing effectiveness of the MMC and considers whether measures (such as the introduction of rules if appropriate) could be taken to further enhance its effectiveness. To avoid unnecessary regulatory duplication, we could remove all or part of the Order once the FCA has concluded its work and is ready to introduce its own measures.

How this remedy addresses the AECs and/or the resulting customer detriment

15.71 Introducing an MMC helps address the detriment arising from the limited constraints on unarranged overdraft facilities,[66] in particular the significant charges that heavier unarranged overdraft users can build up over time.[67] The remedy does this by:

(a) requiring all PCA providers[68] to set a monthly cap on the charges a customer could incur in any given month as a result of exceeding or attempting to exceed a pre-agreed credit limit;

[63] This pre-agreed credit limit could be £0 if there is no arranged overdraft facility.
[64] Basic bank accounts would, for example, not be subject to this requirement.
[65] The MMC would apply to the use of an unarranged overdraft facility but it would also apply to other cases such as where a PCA provider does not extend an unarranged overdraft facility but charges for refusing a payment due to insufficient funds. The maximum total charge would include interest on unarranged balances, monthly charges, daily charges, paid and unpaid item fees and all other fees incurred in exceeding a pre-agreed credit limit.
[66] Including charges for refusing a payment due to lack of funds (ie unpaid item fees).
[67] For example, our analysis of the largest providers' most popular on-sale PCA products in GB and NI in Appendix 6.3 shows that in at least 1% of accounts the account holder incurred more than £100 in unarranged overdraft fees (excluding interest) in at least one month in 2014.
[68] For all PCAs, excluding basic bank accounts and other PCAs that do not have charges that result from exceeding or attempting to exceed a pre-agreed credit limit as explained in paragraph 15.104.

(b) addressing some of the complexity of unarranged overdraft charges by giving customers a single measure to make like-for-like comparisons on the caps set by PCA providers; and

(c) increasing customers' awareness of the potential cumulative effect of the charges incurred as a result of exceeding or attempting to exceed a pre-agreed credit limit. This in turn has potential to:

(i) increase customers' engagement with how they use their PCA so they can avoid these charges; and

(ii) help customers make more informed decisions, which may lead them, for example, to consider requesting an arranged overdraft (or requesting a higher arranged limit) and making use of other services that can help them avoid these charges (see paragraph 15.89).

15.72 The overall effect of MMCs will be to increase transparency about the potentially significant impact of unarranged overdraft charges. Increased transparency will put PCA providers under greater competitive and reputational pressure to limit the charges they impose on heavier users of unarranged overdrafts.

15.73 This remedy is targeted at heavier unarranged overdraft users who we have found face particular issues (as identified in our AEC findings in Section 11). While the impact of the MMC will be greatest for heavier unarranged overdraft users, information about MMCs will help all customers in considering their potential overdraft use and the attendant risks of unarranged overdraft charges.

15.74 While many providers now have some form of cap or caps on unarranged overdraft charges,[69] the charges that are included in the scope of providers' caps vary by PCA and are not always comprehensive and expressed as a single overall cap (see Appendix 6.3). By requiring all PCA providers to set a comprehensive, standardised, and comparable MMC figure, third parties (including PCWs and consumer groups, such as Which? and Citizens Advice) could help customers better understand the total charges each month that they are at risk of incurring if they exceed or attempt to exceed a pre-agreed credit limit. Customers could use MMCs as a factor when deciding whether to have an unarranged overdraft facility and in making comparisons between providers, either when opening a PCA or having experienced overdraft charges with an existing provider.

[69] As noted by some respondents to our provisional decision on remedies.

15.75 This remedy will complement other transparency measures – for example, the use of open APIs to enable customer-specific comparisons using customers' transaction data (see Section 13). It could extend the scope for effective comparison of these charges to customers who have not previously incurred high unarranged overdraft fees or who are reluctant to share their transaction data to make price comparisons. In this respect, we expect the introduction of MMCs to reinforce the downward impact on charges of our other measures.[70]

15.76 Some responses to our provisional decision on remedies included requests for us to make recommendations to the FCA to help heavy overdraft users in financial difficulties including setting a regulated upper limit on the MMC, introducing other forms of price control (see paragraph 15.93) and working with providers to extend earlier forbearance.[71] We fully appreciate that some heavy overdraft users are in serious financial difficulty and we understand public concern about such customers being unfairly penalised. However, it is not the role of this investigation to resolve the wider issues around over-indebtedness given that our powers are limited to addressing adverse effects on competition and the resultant customer detriment (as set out in paragraph 15.12).

15.77 Competition is unlikely to resolve the issues faced by customers that have reached an unsustainable level of debt. There therefore remains an important role for regulation to ensure that PCA providers and other credit providers offer sufficient support and forbearance for customers in financial difficulty. The FCA is well placed to consider these issues as it can look both at consumer protection and competition as well as having regard to all of the forms of consumer credit that heavy unarranged overdraft users may turn to.

15.78 In this respect, we welcome the FCA's and industry's work to promote responsible lending.[72] However, it is not appropriate for this investigation to make recommendations to the FCA on over-indebtedness given our focus on addressing adverse effects on competition and resulting customer detriment.[73]

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[70] This included our measures encouraging searching and switching and measures to incentivise providers to engage more effectively with their customers through greater prominence of service quality metrics for overdraft users.
[71] For example, see StepChange's response to provisional decision on remedies.
[72] See paragraph 15.12.
[73] The FSCP, in response to our provisional decision on remedies, submitted that lenders who repeatedly allowed their customers to go into, or stay in, unarranged overdraft were not lending responsibly. This is outside the scope of our investigation, but the FCA is well placed to look at such issues. Also see Appendix 6.4 for evidence on levels of unarranged overdraft lending.

15.79 We consider further below the arguments made by respondents to our provisional decision on remedies specifically in relation to introducing price controls on overdraft charges. This includes setting out the specific concerns raised about helping heavy overdraft users in financial difficulty.

Whether the MMC should have an upper limit set by a regulator, and/or whether to introduce other forms of price control on overdraft charges

15.80 Most parties have offered general support for the introduction of MMCs.[74] However, we received diverse views about whether or not to introduce a regulated upper limit on MMCs:

(a) Some parties supported such a regulated upper limit or other controls on unarranged overdraft charges.[75]

(b) Other parties supported the proposal to require PCA providers to set MMCs, but did not support a regulated upper limit.[76]

15.81 Those parties that supported additional measures to control unarranged overdraft charges questioned, in particular, whether an MMC without a regulated upper limit would sufficiently address the detriment incurred by heavier overdraft users. Points raised by these parties generally fell under the following two headings.

(a) Some parties noted the linkage between heavy overdraft use and financial difficulty. For example, Which? submitted that an MMC without a regulated upper limit would not address the problem of banks unfairly penalising a subset of customers in financial difficulty with high charges.[77]

(b) Several parties were sceptical about the extent to which heavier overdraft users would switch in response to our remedies including an MMC, submitting that a measure to control outcomes directly would be needed. Which? argued that our MMC remedy put considerable reliance on the pressures from switching. It was unconvinced that the remedy would be effective on the basis that heavy overdraft users were much

[74] Including LBG, HSCBG, Nationwide, TSB, Santander, Yorkshire Building Society, Virgin Money, Defaqto, Mogo, BGL, and StepChange.
[75] Including from Which?, Virgin Money, StepChange and the FSCP.
[76] Including HSBCG, LBG, RBSG, Nationwide, Santander, Yorkshire Building Society, BGL and PwC.
[77] Which? response to provisional decision on remedies.

less likely than average to switch[78] despite having had much greater financial incentives to do so.[79] Likewise, StepChange considered that it was not clear what competitive pressure customers facing high overdraft charges would exert on banks given the constraints and difficulties faced by those who were financially vulnerable.[80] Virgin Money also made similar arguments relating to overdraft users' inertia and barriers to switching.[81,82]

15.82 We have given these submissions thorough consideration, which we set out below.

Customers in financial difficulty

15.83 The over-indebtedness of some heavier overdraft users contributes to the lower switching rates of this customer group. As explained in paragraphs 15.76 and 15.77, it is not the role of this investigation to resolve the wider issues around over-indebtedness. We therefore focus the discussion below on those heavier overdraft users who have not reached an unsustainable level of debt and can therefore switch. In this context and in relation to addressing the AECs, we explain why we have not introduced price controls on unarranged overdraft charges.

Remedy effectiveness in relation to heavier overdraft users

15.84 We have considered further the arguments about the effectiveness of our remedies for heavier overdraft users in light of their lower switching rates compared to lighter overdraft users. We explain below how we expect our remedy package (including both the MMC and other measures) to address the AECs and reduce the resulting detriment encountered by heavier users of overdrafts, in particular unarranged overdrafts. This includes reducing the extent of unarranged overdraft charges that customers can incur. In this context, we note that:

(a) some of our measures are aimed at delivering better customer outcomes by encouraging switching including switching by heavier overdraft users; but

[78] To clarify, we have not specifically found that heavy overdraft users are much less likely to switch than average. Rather, we have found that: heavier overdraft users are less likely to switch than lighter overdraft users; and that the heaviest unarranged overdraft users are also less likely to switch than non-overdraft users.
[79] Which? response to provisional decision on remedies.
[80] StepChange response to provisional decision on remedies.
[81] Virgin Money response to provisional decision on remedies.
[82] Rachel Reeves MP has also written to the FCA with similar arguments about the effectiveness of MMCs without a regulated upper limit on the basis that heavier overdraft users are less likely to switch.

(b) other measures will enable customers, including heavier overdraft users, to get a better deal from their existing bank and therefore have little or no dependence on switching.

15.85 It is also important to consider the impact of our remedies taken as a package, rather than looking at the design of the MMC in isolation. We have identified a number of ways in which we expect the different elements of our remedy package to address the AEC and resulting customer detriment experienced by heavier overdraft users.

15.86 First, while we have decided not to regulate the level of the cap, our MMC remedy will limit the cumulative charges of heavier unarranged overdraft users. We expect the level of the MMCs that PCA providers set will be constrained by both competitive and reputational pressures as set out above at paragraphs 15.71 to15.75. This measure directly targets heavier unarranged overdraft users and has been designed to ensure that the caps set by PCA providers are determined on a consistent basis and cover all relevant charges.

15.87 Second, other elements of our overdraft remedies package will also benefit heavier overdraft users.

(a) Alerts have the potential to benefit all overdraft users including heavier overdraft users (see Figure 15.1). For example, LBG's trials found that automatic enrolment into text alerts saved the top 20% of fee payers 5% per month on average in unarranged fees ([£1 to £1.50] per month).[83] Such alerts benefit existing customers and do not depend on customer switching to deliver these benefits.

(b) Our recommendation to the FCA on overdraft eligibility tools and undertakings from Bacs to review the switching process for overdraft users are likely to help support heavier overdraft users to search and switch (see Figure 15.4).

15.88 Third, our foundation measures (see Section 13) and CASS reforms (see Section 14) will help heavier overdraft users identify and switch to better value accounts.

(a) There is scope for some heavier overdraft users to switch. This is demonstrated by the fact that the switching rates of some heavier overdraft users are comparable to or lower than non-overdraft users at some PCA providers (see the switching rates of customers who are in

[83] See LBG Trials Report, slide 42.

unarranged overdraft for between 8 and 14 days per month on average Appendix 6.1, Annex A).

(b) For those heavier overdraft users who are able to switch, there are significant opportunities to get a better deal (as demonstrated by our analysis of the gains from switching) and for our prompts to encourage them to seek these out.

(c) The CASS awareness measures will help address the perceptions among overdraft users that it is difficult to switch and we have specifically recommended that Bacs targets overdraft users in future CASS promotional campaigns (see Appendix 14.4).

15.89 One of our foundation measures – the prompt introduction of open APIs – is likely to have a number of beneficial effects on overdraft users, as explained in paragraph 15.11. These beneficial effects are just as applicable for heavier overdraft users. Open APIs will help heavier overdraft users to compare providers and switch PCAs as well as reduce their charges without switching PCA. They will do this by making it easier for customers, including heavier overdraft users, to control their account and share their account usage data with other PCA providers and with intermediaries. This in turn will enable customers to get a better deal from their banks in a number of ways:

(a) Intermediaries can use account usage data to help heavier overdraft users budget in a way that helps them avoid unarranged overdraft fees without switching PCA.

(b) Intermediaries can increase initial engagement among heavier overdraft users over their choice of PCA by:

(i) increasing heavier overdraft users' awareness of their overdraft usage (for example, by finding innovative ways to communicate this usage and related charges to them); and

(ii) offering new and growing channels through which PCA providers can target heavier overdraft users with offers.

(c) Having the ability to share account usage data will help heavier overdraft users make more effective comparisons, in particular by getting personalised estimates of different PCAs' total charges from comparison tools.

(d) Heavier overdraft users sharing their account usage data with other PCA providers will also reduce the information disadvantage faced by providers in offering competitive arranged overdraft limits to new customers, including through overdraft eligibility tools. This can benefit heavier overdraft users by increasing their choice of provider and reducing their search costs.

(e) Open APIs will also help intermediaries offer sweeping services and provide credit at lower cost to customers, which can help them avoid high unarranged overdraft charges without switching PCA.

15.90 We expect that the cumulative effect of these measures will be to increase the constraints on overdraft charges (both arranged and unarranged) to the benefit of all customers, even those that do not switch. We expect them to lead to substantial reduction in the detriment arising from the AECs that is experienced by heavier overdraft users in particular. Given the beneficial impact we expect our measures to have, we see relatively limited scope for a regulated upper limit or other forms of price control to further reduce customer detriment resulting from the AECs.

Additional risks and costs with a regulated upper limit

15.91 Imposing a regulated upper limit on the MMC, or otherwise controlling overdraft charges directly, would introduce a number of additional risks and costs. In particular, we have identified the following risks.

(a) **A regulated upper limit might normalise or validate a particular level, of the cap, reducing providers’ own accountability for the charges they impose.** As such, a regulated upper limit might incentivise some providers to set MMCs at the upper limit as opposed to competing down MMCs. A regulated upper limit could therefore result in higher MMCs than PCA providers would have set without such regulation. This could be exacerbated by practical difficulties in setting the level of the regulated limit. For example, difficulties in assessing the cost of offering unarranged lending could result in the regulated upper limit being higher than the MMCs some providers would have chosen to set themselves. Such difficulties include assessing the costs resulting from higher credit risks and assessing what contribution to common costs it is reasonable to reflect in unarranged overdraft charges.

(b) **There is a greater risk of reducing the availability and amount of unarranged lending offered to customers with a regulated upper**

limit.[84,85] For example, tight restrictions on unarranged charges may reduce the amount PCA providers are willing to lend on an unarranged basis, even for infrequent use. This risk would be greater with a lower regulated limit. The challenges inherent in modelling the balance of risks could end up with the regulated limit being set too high, further exacerbating the potential normalising effect of a regulated limit (set out at (a) above).

(c) **A reduction in the availability and amount of unarranged lending offered could have a significant adverse impact on customers.** As we explained in paragraph 15.6(b), unarranged lending can be needed for those requiring short-term access to emergency funds, for example to pay an important bill for which a missed payment could result in late payment fees, or adversely affect their credit rating. It can also help customers make important payments in situations when they do not realise that there are insufficient funds in their PCA.

(d) **The appropriate regulated limit may vary according to provider, customer or product** (for example, there would be a stronger case for a higher limit on PCAs that target wealthier customers if these customers would prefer to pay more if it offers them more flexible unarranged lending[86]). However, it would be impracticable for the regulated upper limit to vary in this way.

Additional considerations on other price control measures

15.92 We have also considered alternative measures that directly constrain overdraft charges. While the aim of such measures would be to improve the outcomes for unarranged overdraft users, there are significant risks that they would not achieve this in practice. This is because these measures have a greater risk of unintended consequences, in part due to them being less well targeted at heavier unarranged overdraft users than an MMC, with or without a regulated upper limit.

15.93 Alternative measures that we have considered include requiring PCA providers to set the same charges for arranged and unarranged overdrafts (proposed by Which?), applying the FCA's price cap on high-cost short-term

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[84] This risk is present to a much lesser extent for MMCs without a regulated limit for the reasons set out in Appendix 15.2.
[85] PCA providers have also confirmed this risk. For example, see responses to our Supplemental Remedies Notice from HSBCG (paragraph 51), LBG (paragraph 2.4) and TSB (paragraph 36).
[86] See Appendix 15.2 for further discussion of how MMCs without a regulated limit give PCA providers flexibility to set different limits on different PCA products.

credit to unarranged overdraft charges (proposed by the FSCP), capping overdraft charges at net additional administrative costs (also proposed by the FSCP) and regulating or prohibiting specific types of charges (eg for paid and unpaid items).[87]

15.94 These alternative forms of price control are more likely to reduce the credit risk that PCA providers are willing to take on and the amount of unarranged credit that they offer to all customers (who may value the flexibility to make emergency payments which PCA providers currently offer through their unarranged overdrafts as set out at paragraphs 15.6(b) and 15.7).

15.95 These alternative measures also pose a greater risk of other distortions to competition than MMCs as they would impose heavy restrictions on how PCA providers could compete with one another, including on diversity of pricing structures. For example, a requirement to set the same charges for arranged and unarranged overdrafts would incentivise PCA providers to increase arranged overdraft charges.

15.96 In contrast, MMCs are less likely to create distortions to competition as PCA providers have a variety of responses available to them to stay within an MMC. For example, PCA providers could limit the fees and interest they charge for unarranged overdrafts; they could offer higher arranged limits; and conversely, they could limit the credit available in specific circumstances (for example, where it would not be responsible to extend this credit further).

15.97 Because these other price control measures do not target heavier unarranged overdraft users, they also undermine the effectiveness of our remedies at increasing competition for overdraft users. They give overdraft users a weaker incentive to engage over their choice of PCA product and reduce PCA providers' incentives to compete for their custom.

Conclusions on introducing a regulated upper limit and other price controls

15.98 Based on the above assessment we have decided not to introduce a regulated upper limit on the MMC or other forms of price control on unarranged overdraft charges. This is for the following reasons.

[87] We also considered the FSCP's proposal for setting out charges by number of days in unarranged overdraft and Yorkshire Building Society's proposal to require PCA providers to charge interest or show the annual percentage rate (APR) of charges for overdrafts (APRs were also proposed by the Community Investment Coalition in response to provisional decision on remedies). The OFT's 2009 unarranged overdraft charging scenarios are similar to the FSCP's proposal and are already in place (see Section 6). We do not consider Yorkshire Building Society's proposals to be necessary given our remedies package. There may also be unintended consequences from restricting a range of overdraft charging structures, and comparing these charges through APRs would be difficult as the APR would depend on the pattern of overdraft usage.

(a) Introducing price controls would represent a significant additional constraint that would limit competition and its potential benefits to customers. This option should therefore only be taken forward if it was clearly necessary to address the AECs and likely to deliver significant incremental benefits to customers.

(b) We expect that our package of remedies, taken as a whole, will be effective at addressing the AECs and will reduce substantially the resulting customer detriment, including that experienced by heavier overdraft users (see paragraphs 15.84 to 15.90). In our judgement, and given the difficulties inherent in such an exercise, introducing price controls on unarranged overdraft charges is unlikely to deliver significant additional benefits to customers, once the impacts of our other remedies are taken into account

(c) There is a real risk of unintended consequences of imposing a regulated limit or other forms of price control (set out in paragraphs 15.91 and 15.92 to 15.94) which could easily outweigh any potential additional benefits of price controls.

(d) Consequently, we concluded that the case for imposing centralised price controls on unarranged overdraft charges was not sufficiently strong to justify the additional costs and risks associated with this further intervention.

Remedy design considerations

15.99 In Appendix 15.2 we also explain:

(a) how the design of the remedy reduces the scope for potential unintended consequences;

(b) why we are giving PCA providers the flexibility to set different MMCs for different PCA products;

(c) why we have chosen a monthly period over which the total maximum charge should apply;

(d) the charges to be covered by the MMC; and

(e) details of the communication and prominence of the MMC.

15.100 Regarding the charges covered by the MMC, this will include interest for the amount borrowed beyond a pre-agreed credit limit, as well as monthly charges, daily charges, paid and unpaid item fees and all other charges that a customer could incur as a result of exceeding or attempting to exceed a pre-agreed credit limit.

15.101 Regarding the communication and prominence of the MMC, we will consider standardising the term and definition that PCA providers have to use with customers when disclosing the MMC. This is to help facilitate like-for-like comparisons on the MMCs. We plan to use customer testing[88] to inform what term and definition to use and will set out our proposals on this as part of our consultation on the draft Order for this remedy.

Implementation issues

15.102 Having identified the role of existing regulation with respect to information on overdrafts and the limited information that needs to be specified and subsequently monitored (see Appendix 15.2), we have decided to make an Order to require all PCA providers to set and publish an MMC.

15.103 Given the issues relating to heavy unarranged overdraft users (set out in Section 11) and the important role that this measure has in limiting unarranged overdraft charges, we consider it necessary to ensure that this remedy applies to all PCAs where a customer could incur charges as a result of exceeding or attempting to exceed a pre-agreed credit limit.

15.104 We exclude PCAs that do not apply these charges, for example basic bank accounts, because for such PCAs there are no charges to limit. There is also little scope for customers to choose between a basic bank account and other PCAs, and therefore compare their MMCs. This is because PCA providers are only required to offer basic bank accounts to customers that are not eligible for a full-service account.[89]

15.105 Regarding timing, PCA providers will be required to introduce and publish details of an MMC to be effective six months after an Order is made. This approach allows for the detriment to heavier unarranged overdraft users to be addressed in a timely manner. We consider this timing to be feasible in light of the limited changes required by PCA providers (see paragraph 15.114) and the lack of concerns raised about the feasibility of this time frame in response to our provisional decision on remedies.

[88] See the Invitation to Tender for further information on the objectives of this testing.
[89] See HMT (15 December 2014), Revised basic bank account agreement.

Recommendation to the FCA

15.106 We have decided to recommend to the FCA that it undertakes work to assess the ongoing effectiveness of the MMC and consider whether measures (including the introduction of rules if appropriate) could be taken to further enhance its effectiveness.[90,91] To avoid unnecessary regulatory duplication, we could remove all or part of the Order once the FCA has concluded its work and is ready to introduce its own measures.

15.107 LBG submitted that the CMA should recommend that the FCA undertakes tests of the MMC in parallel with its introduction so that any adverse impacts are detected at an early stage. LBG also argued that the CMA should recommend that this review looks at both customer behaviour as well as any adjustments to pricing behaviour.[92]

15.108 For the reasons explained in Appendix 15.2, we consider the risk of unintended consequences of MMCs to be low. In particular, this is because some caps are already present, albeit that they vary in the charges they cover. Standardising and increasing the prevalence of these caps to increase transparency and facilitate like-for-like comparisons therefore results in low incremental risks of unintended consequences.

15.109 Given the low risk of unintended consequences and the FCA's expertise to determine the scope and timing of its work, we do not consider it necessary to prescribe to the FCA when and how to undertake its work on the ongoing effectiveness of the MMC. It is for the FCA to consider an appropriate time for when it can reliably assess the effect of MMCs. The FCA can consider LBG's arguments as part of the development of its work.

15.110 While we do not see a need to specify the timing and scope of the FCA's work in this area, further work by the FCA on MMCs will help to ensure the ongoing effectiveness of the remedy and may lead to the adoption by the FCA of enhanced measures. It also helps to mitigate the risk, albeit a low risk, of any unintended consequences.[93]

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[90] This work by the FCA would also complement the CMA's duty under section 162(5) EA02 to keep under review the effectiveness of orders made under this part of the Act.
[91] Santander, in its response to our provisional decision on remedies (paragraph 10.12), submitted that we should clarify that this recommendation did not include the FCA investigating the capping of overdraft fees. As explained in paragraph 15.98, we have not included as part of this remedy introducing a regulated upper limit on MMCs or any other form of price control to address the AECs we have found.
[92] LBG response to provisional decision on remedies, paragraph 11.2.
[93] Santander, in its response to our provisional decision on remedies, requested that we explained the merit of conducting a review of MMCs, paragraph 4.6(b).

Monitoring and enforcement

15.111 The Order will require annual reporting to the CMA for the purposes of monitoring and enforcement, for example confirming the introduction of the MMC; the level at which it is set for each PCA product; and that it is being communicated in a way that is no less prominent than other overdraft charges.

Cost of remedies

15.112 The costs of imposing an uncapped MMC remedy will be modest, comprising primarily changes to IT systems (to cap charges at the level each provider individually sets for each of its PCAs), and communication costs including the costs of modifying and circulating charges and overdraft information and terms and conditions, staff training costs to communicate these changes internally, and staff time to manage these changes (eg additional resources to respond to customer queries). There will also be some limited costs associated with work by the FCA to assess the ongoing effectiveness of the MMC and its consideration of whether measures (including the introduction of rules if appropriate) could be taken to further enhance its effectiveness.

15.113 Responses to our provisional decision on remedies generally did not raise concerns about the cost of this remedy. RBSG stated that it believed that the operational and cost impacts of this remedy would be limited, particularly for those banks that already provided customers with an MMC. It also submitted that there would be potential cost impacts if customer-facing material had to be amended.[94]

15.114 We concluded that for all PCA providers these modest costs are likely to be proportionate to the benefits of the remedy.

[94] RBSG response to provisional decision on remedies, p20.

Measures to encourage PCA customers to engage more with overdraft features

Summary of the measures

Figure 15.3: Summary of measures

We have decided to recommend that the FCA looks at ways for PCA providers to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process.

Relevant matters that the FCA may wish to consider in seeking to improve PCA providers' engagement and effective communication with their customers include:

(a) the availability of arranged and unarranged overdraft facilities and the distinction between these;

(b) the principal features of any overdraft facility which might include:

- fees and charges and the basis on which they would be incurred;
- the relevant credit limit; and
- interaction with different payment methods;

(c) the risks of exceeding an arranged overdraft limit or opting out of an unarranged overdraft facility (eg the potential consequences of payments being declined);

(d) the ability to either subsequently relinquish access to or apply for an overdraft facility;

(e) the alerts available to inform customers of their imminent or actual use of arranged and unarranged overdraft facilities; and

(f) the appropriateness of requiring customers to make a positive acknowledgement of the overdraft features included as part of an application for any new PCA.

How this remedy addresses the AECs and/or the resulting customer detriment

15.115 In our AEC findings (Section 11) we noted that overdraft users have limited awareness of and engagement with their overdraft usage, and that overdraft charging structures are particularly complex. We noted that this contributed to the weak customer response to differences in prices or service quality, and that this resulted in PCA providers' incentives to compete on prices, service quality and/or innovation being reduced.

15.116 Increasing understanding of the impact of having access to an overdraft facility (be that arranged or unarranged) would lead to greater engagement over customers' choices of PCAs and use of overdrafts, and increase competition over overdraft charges. However, the presentation and the content of any information provided to customers would be a key determinant of its effectiveness.

Existing information and choices

15.117 Most PCA providers allow customers to opt out of an unarranged overdraft (either by removing the unarranged overdraft facility from a PCA or by choosing a PCA product without an unarranged overdraft).[95] We asked PCA providers to provide details of the information on overdrafts provided on opening an account. We reviewed this information and found that there was a considerable amount of variation in the nature and presentation of this information.[96] In part this was determined by whether an account was opened online, in branch or over the telephone (which also affected whether information was conveyed orally or in writing).

15.118 For example, TSB asked customers whether they wished to have an arranged overdraft and set out the charges for using the unarranged overdraft and the function of unarranged overdrafts and the charges of the unarranged overdraft. As part of the application, the customer was required to make a combined declaration that they had agreed to the terms and conditions and that they understood the arranged overdraft and unarranged overdraft fees and charges.[97] Other examples include PCA providers making information on overdrafts available in writing or through videos, though these were not necessarily embedded in the main part of the application form.[98]

Remedy design considerations

15.119 In considering the design of the remedy we were conscious of the risks of any disclosure requirement being overly prescriptive or ill defined. We identified three principal consequences:[99]

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[95] See Section 6.
[96] Due to the nature of the information provided and different platforms for opening PCAs (in branch, online or telephone) it was not necessarily clear how information was presented in practice.
[97] A second tick box was also included relating solely to the privacy notice.
[98] In one case, an applicant would need to actively click into the 'important information' tab to display the information.
[99] This reflects responses to our Supplemental Remedies Notice (set out in Appendix 15.3).

(a) First, there is a danger of PCA providers providing customers with an excessive amount of information, which could disengage or confuse customers.

(b) Second, an overly prescriptive remedy could become outmoded as a result of technological or other developments.

(c) Third, in seeking to increase engagement with the choices available to customers in respect of overdrafts, that there might be some 'crowding-out' of other declarations as part of the account opening process.

15.120 We also considered whether customers should be required to make an acknowledgement of any information provided with respect to that customer's overdraft choice. This would be one way of ensuring customer interaction but not necessarily engagement. It could be seen as an ineffective 'tick box exercise'.[100]

15.121 Behavioural research and testing is therefore essential to inform the design of any measure to ensure that it genuinely does increase engagement and avoids unintended consequences.

15.122 We consider that the FCA is well placed to undertake this research (given, for example, its work on smarter consumer communications)[101] and testing for the same reasons set out in relation to its role in our prompts remedy. In particular, it has existing expertise in conducting RCTs, which would be an effective way of testing the impact of different types and designs of disclosures.

15.123 We therefore have decided to recommend to the FCA that it examine how, during the PCA opening process, PCA providers may be able to engage customers more in considering overdraft features and their potential relevance and impact, as set out in Figure 15.3.

15.124 In Appendix 15.3, we explain the development of this remedy and set out our consideration of responses to our provisional decision on remedies.

Implementation issues

15.125 As discussed in relation to prompts (in Section 13) and overdraft alerts (in Appendix 15.1), the provision of information to PCA customers is in part determined by regulation transposed from three European Directives: the

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[100] This has been identified as a barrier to effective communication in the FCA's Smarter Consumer Communications Discussion Paper.
[101] See the FCA's Smarter Consumer Communications Discussion Paper as above.

CCD, PSD and PAD. The first two of these are 'maximum harmonising', which means that member states may not introduce less or more restrictive or prescriptive regulations within the scope of the Directive.

15.126 Articles 41 and 42 of PSD and Articles 6 and 18 of CCD set out the information required to be provided at or before account opening. This includes information on account charges such as arranged and unarranged overdraft fees, credit limits, communication between bank and customer etc. The FCA will therefore need to consider where it can use its rule-making powers to implement this recommendation, ie where doing so would be consistent with these directives or would fall outside their scope. As demonstrated by the work the FCA has already undertaken on smarter consumer communications and the voluntary agreement on retries, there are a range of measures and initiatives that can be taken in the absence of rule-making that can be effective at increasing customer engagement. We do not therefore consider these directives to be an insurmountable barrier to the FCA taking action which it deems to be appropriate, in response to our recommendation.

Cost of remedies

15.127 We consider that the costs directly associated with our recommendation will not be significant. Depending on any actions that arise, this could involve PCA providers incurring costs, although any decision to propose further action would itself be subject to an evaluation of the costs versus the wider benefits that would be delivered.

15.128 Responses to our provisional decision on remedies generally did not raise concerns about the cost of this remedy. RBSG noted that the cost, timing and operational impacts were dependent on the findings of the FCA. It submitted that further engagement at account opening regarding overdrafts might require amendments to account opening processes and that this could take significant time.

Measures to facilitate account searching and switching

Summary of the measures

15.129 We have decided to implement the following measures, summarised in Figure 15.4, to address the additional barriers identified in Section 11 for overdraft customers: the uncertainty around the overdraft amount they would be offered if they were to switch to a new PCA provider; and the uncertainty surrounding acceptance and timing of an overdraft approval.

Figure 15.4: Summary of measures

We have decided to make a recommendation that, following the introduction of open APIs, the FCA considers requiring PCA providers to offer online tools that indicate whether a prospective customer may be eligible for an overdraft. We have also decided to seek undertakings from Bacs to work with CASS participants to review the account switching process, to ensure that PCA providers offer a firm decision on the overdraft offered after a customer has completed the PCA provider's application process but before they switch accounts.

How this remedy addresses the AECs and/or the resulting customer detriment

15.130 In Section 11, we note that there are additional barriers to searching and switching for overdraft customers. Some overdraft customers had concerns that they would not be offered the same overdraft limit by their new provider and some wanted to know in advance of an application if other providers offered the same or improved overdraft terms and conditions as their current provider.[102]

15.131 We also note that in some circumstances, a customer who had applied to a new provider may not know whether they would be granted an overdraft facility until the late stages of the switching process, by which time their old account may have been closed.[103]

15.132 We consider that these issues would be addressed if customers:

(a) had access to online overdraft eligibility tools[104] that could help customers searching for alternative PCAs to assess the size and nature of the overdraft facilities likely to be available to them through those PCAs; and

(b) were given a firm decision on overdraft facilities before closing their old account.

15.133 We have decided to, respectively, make recommendations to the FCA and seek undertakings from Bacs regarding the above, for the reasons summarised below which are explained in more detail in Appendix 15.4.

[102] See Section 6.
[103] See Section 6.
[104] Such a tool could be based on a quotation search (ie a 'soft' credit search) so as not to impair a customer's credit history.

Recommendation to the FCA on online overdraft eligibility tools

15.134 Our PCA omnibus and qualitative research suggested that having information on overdraft availability before deciding to switch would be helpful to customers facing this uncertainty, the more so the stronger the reassurances given or the ease of use, for example if the tool were integrated into a PCW.[105] However, some PCA providers raised concerns that the need to collect data from customers to inform such a tool, and potential limitations in its accuracy, could in practice deter rather than encourage searching and switching.

15.135 We consider that the ability to implement these tools effectively and the need to require providers to offer such tools will depend on market developments. In particular, the introduction of open APIs providing secure access to customers' data pursuant to our remedies could lead to significant improvements in the accuracy of overdraft eligibility tools with less reliance on customer input,[106] and may facilitate the emergence of such tools or the introduction of other market-driven innovations to address similar issues, that could negate a need for regulatory intervention.

15.136 We have therefore decided that requiring the provision of eligibility tools at this time, before technology that can be expected to support their effective delivery is fully available, could risk unintended consequences in dampening customers' appetite to switch and would not be in their best interests.

15.137 However, in light of the evidence that such tools, if appropriately implemented, could be effective in addressing the AECs identified for overdraft customers, we have decided to recommend that the FCA should consider, following the introduction of open APIs, whether it should require or take other measures to encourage PCA providers to implement an overdraft eligibility, or similar, tool. The FCA, as the sector regulator, is best placed to monitor market developments and come to a view as to whether, and if so when, future regulatory intervention may be appropriate.

15.138 We anticipate that the FCA will consider our recommendation at an appropriate time once open APIs have been introduced and embedded into the market.

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[105] 35% of PCA overdraft users said that being able to check what overdraft they were likely to be granted by the new bank before they decided to change bank would make them more likely to consider switching and 6% said they would be less likely to switch. See PCA survey, p310. Also see Optimisa Research report, p104.
[106] In terms of the reduced data they would be required to provide to use the tool.

Undertakings from Bacs

15.139 Many providers have told us that they already provide a firm decision on the available overdraft limit prior to a customer switching their account. However, research suggests that customers lack awareness of how the switching process works and there may in practice also be process gaps. These issues may reduce confidence in the experience and deter overdraft customers from switching.

15.140 Because Bacs has extensive knowledge of the switching process and is already intending to do work to promote CASS to overdraft customers among others, we consider that Bacs is best placed to examine this matter and to implement any enhancements to the switching process that it finds to be appropriate to address overdraft customers' concerns that they may not know the overdraft offered until after closing their old account. We have therefore decided to seek undertakings from Bacs (or failing that to issue an appropriate Order) to undertake further research and to work with CASS participants to introduce common processes that improve transparency in relation to the opening and closing of accounts.

15.141 We expect that Bacs will undertake its work within six months of the CMA accepting undertakings from it.

Cost of remedies

15.142 We consider that the costs directly associated with these measures will not be significant. Depending on the actions that arise from each of these measures, these could involve PCA providers incurring subsequent costs. However, any decision to propose further action further to these measures would itself be subject to an evaluation of the costs versus the wider benefits that would be delivered, to safeguard proportionality.

16. Additional SME remedies

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Overview

16.1 In Sections 13 and 14 we describe the three foundation remedies and the current account switching measures which will in themselves make a significant contribution to addressing the AECs that we have identified in SME banking.

16.2 In this section, we set out additional remedies which aim to address some specific market features giving rise to the AECs in the supply of SME banking services. Taken together, our remedies represent a coherent and effective package to address the AECs that we have found in SME banking.

16.3 The additional measures aim to:

(a) improve transparency of the cost of and eligibility for SME lending;

(b) facilitate comparisons of SME banking products; and

(c) make business account opening easier and improve the switching process.

16.4 In addition, we are making recommendations to the government to take action to promote greater competition in SME banking services; to enable ‘soft’ or quotation searches for SME lending products; to review the efficacy and impact of the commercial, technological and regulatory initiatives intended to facilitate the sharing of SME information; and to explore ways in which professional associations can channel advice on identifying and choosing providers and sources of finance to SMEs.

16.5 We found that there are barriers to searching for and comparing BCAs as well as switching BCA providers, and that this gave rise to an AEC in both GB and NI. BCAs have complex tariff structures and a multiplicity of charges, and there is variability in usage between SMEs, which adds to the difficulty of comparing BCAs because pricing models for BCAs are typically based on usage. There is also a lack of effective comparison tools available for SMEs.

16.6 Further, we found that there were strong linkages between BCAs and lending products, with nearly all SMEs seeking finance from their BCA provider and most doing so without shopping around. Publicly available loan information on both prices and eligibility is scarce and there are information asymmetries between an SME’s BCA provider and alternative lending providers. In combination, these features of the market give rise to an AEC in both GB and NI.

16.7 The three foundation remedies in Section 13 and the measures to improve the current account switching process in Section 14 we expect to have a widespread and positive impact on competition in SME banking and will address a number of features giving rise to the AECs that we found. However, we have identified features of the SME banking market requiring the adoption of additional remedies. These features are:

(a) the lack of publicly available information on the charges of SME banking products and the criteria for assessing loan eligibility;

(b) the absence of effective comparison tools serving the banking needs of diverse SMEs; and

(c) the difficulties SMEs face in opening new current accounts, which in turn can discourage them from considering switching.

16.8 We are therefore adopting additional measures to make it easier for SMEs to:

(a) access and assess information on providers' charges, the quality of their services and their lending criteria; and

(b) take action and switch to a new provider.

Access and assess information

16.9 We intend to improve SMEs' access to information by requiring all relevant lenders which provide unsecured loans and overdrafts to disclose on their websites, and make available to comparison sites, including the eventual Nesta[1] challenge prize winner or winners, information on the cost of borrowing. We will also require rates for these products to be disclosed in marketing and advertising materials when certain conditions are met. We will further require RBSG, LBG, Barclays and HSBCG to provide prospective borrowers with loan price and eligibility indicator tools. Such tools will enable SMEs to ascertain whether the provider would be likely to grant them a loan of the size and term requested, and will provide an indication of the rate at which they may be likely to do so. These two requirements will apply to unsecured loans and overdrafts of up to £25,000.

16.10 To make it easier for SMEs to assess providers' offers and to reduce the adverse effects of strong product linkages between BCAs and lending, we are bringing about the creation of one or more comparison tools where SMEs could compare providers' services. We also require banks to make available as open data their terms, including their charges and eligibility criteria for SME banking services.

16.11 We have considered a number of ways in which such a comparison tool could be created. We have decided that supporting the challenge prize to be undertaken by Nesta, accompanied by certain transitional, ancillary and

[1] Nesta is an independent charity and is developing a challenge prize to identify innovative and sustainable solutions to the problem we have identified as regards SMEs' access to information on banking products. Further details are provided in the section on measures to facilitate comparisons of SME banking products below.

safeguard measures, would offer the best prospect for achieving an innovative, commercially viable and sustainable solution.

16.12 In addition, to support the use of the loan price and eligibility tool and comparison tools, we recommend to HMT that it works with credit reference agencies (CRAs) and SME lenders to implement a mechanism for 'soft' searching to enable SMEs to obtain indicative price quotations and indications of eligibility without adversely affecting their credit rating.

16.13 We have also considered measures designed to make it easier for SMEs, banks and CRAs to share information between themselves through commercial networks, for example the business plans or credit ratings of potential borrowers. We concluded that recent regulatory changes, in particular the SBEE Act, and proposals for the creation of new commercial platforms and networks, could obviate the need for this intervention but that it was too early to draw a firm conclusion on the extent to which they fully address our concerns. We therefore recommend to HMT that it reviews the effect that these developments have had two years after the publication of our final report (ie in summer 2018).

16.14 To further facilitate the sharing of information, in our Remedies Notice we asked whether HMT should use the powers it has under the SBEE Act to require banks to pass to CRAs additional information on SMEs such as transaction data. We have decided not to adopt this remedy for two main reasons. First, since we published our Remedies Notice the relevant SBEE Act regulations have come into force, requiring providers to share SME data, through CRAs, with alternative providers. Second, our foundation measure to adopt an open API standard would enable SMEs to share their transaction information with intermediaries.

Switching provider

16.15 We found that the account opening process was a barrier to switching for some SMEs. To address this, we have decided to require BCA providers[2] to agree and adopt, subject to the CMA's approval, a core set of standard information and evidence requirements for BCA applicants. This may be achieved through an industry working group convened by the BBA and we would expect the FCA to be invited to this group as an observer. We have also decided to make a recommendation to the FCA that it does so.

[2] With at least 20,000 active BCAs.

16.16 We also envisage that our proposals on Open Banking will facilitate the secure transmission of data provided at the time of account opening in support of an application from an SME's existing bank to a new bank, which should further facilitate switching.

Conclusion on overview

16.17 These measures will, in combination, empower SMEs to make more informed choices and enable them to more easily identify a provider which meets their current account and lending needs and, if they so wish, switch their BCA to, or apply for a loan from that provider. This in turn should incentivise banks to more vigorously compete for BCAs and on loan prices and availability, delivering better value for SMEs.

16.18 The beneficial impact of our remedy package on SMEs is likely to be enhanced by steps to raise awareness among SMEs of the potential benefits to them of switching BCA providers. In this context, professional advisers, particularly accountants, play an important role in providing decision-making support to SMEs, including in respect of their choice of bank.[3] We therefore recommend to BEIS that it works with the British Business Bank (BBB) and professional associations to explore ways in which their members can channel advice on identifying and choosing providers and sources of finance to SMEs.

16.19 In response to our provisional decision on remedies, Barclays commented that the SME remedies package should be limited to those SMEs with a turnover of less than £6.5 million.[4] Our view is that there are not sufficient grounds for imposing a limit on the size of SME which can benefit from these remedies and we wish to address the AEC for all SMEs, up to a turnover of £25 million.

16.20 The remainder of this section sets out our additional SME remedies in detail.

Measures to increase transparency of the cost of and eligibility for SME lending

Summary of the remedy

16.21 We found that a combination of features in the provision of SME lending in each of GB and NI respectively give rise to AECs. These features include

[3] SME Research, Research Works.
[4] Barclays response to provisional decision on remedies, paragraph 1.4.

low levels of customer engagement in SME lending, with the great majority of SME customers going straight to their main bank when seeking finance.[5] We also identified barriers to comparing lending products. Prices and terms are complex and opaque, and there is a lack of effective comparison tools for SME products and services.

16.22 This subsection sets out our measures to increase transparency of the cost of lending and to promote greater SME customer engagement on the basis of the responses received to the provisional decision on remedies and on our further analysis and consideration. Figure 16.1, summarises the measures in regard to SME lending.

[5] Our surveys of SMEs found that around 90% of SMEs go to their main bank for each of overdrafts, general-purpose business loans and credit cards; 69% went to their main BCA bank for invoice discounting and factoring and 76% for commercial mortgages.

Figure 16.1: Measures to increase transparency of the cost of and eligibility for SME lending

We have decided to make an Order requiring all lenders that provide unsecured loans and overdrafts to SMEs to display on their websites rates showing the cost of these products up to the value of £25,000. These rates must be displayed in a form used under the existing (personal) consumer credit regime. This includes:

(a) showing a representative annual percentage rate (APR) for unsecured loans; and

(b) an effective annual rate (EAR) for overdrafts to enable SMEs to make comparisons on the total cost of credit.

To be considered representative, the rates that these lenders publish must be those at or below which the lender reasonably expects to offer credit to at least 51% of SME customers to whom they expect to offer these products. We additionally require contextual information on how the APR was calculated to be published for loans, and information reflecting additional charges to be published for overdrafts. Furthermore, lenders must make available these charges, terms and conditions, and how APR/EARs vary with loan size and length, as open data to third parties, such as comparison sites and finance platforms, including the eventual Nesta challenge prize winner or winners.

We further require that all lenders who advertise prices for unsecured loans and overdrafts to SMEs in marketing materials which *(a)* indicate a rate of interest or an amount relating to the cost of credit and/or *(b)* include a favourable comparison relating to the credit and/or *(c)* include an incentive to apply for credit or to enter into an agreement under which credit is provided should always do so using this same representative APR/EAR format, and display this in a prominent manner. This draws upon the existing (personal) consumer credit regime. These measures must be implemented within six months of the Order coming into effect.

We have also decided to make an Order requiring RBSG, LBG, Barclays and HSBCG to offer a tool in a prominent location on their websites to enable SMEs to obtain an indicative price quote and indication of their eligibility. This would cover all unsecured loans and overdrafts up to £25,000. Access to these tools must be made available to any two finance platforms designated under the SBEE Act for a period of three years and any two comparison sites, including the eventual winner or winners of the Nesta challenge prize, for a period of three years after the prize winners have launched their products in the market. These measures must be implemented within 12 months of the Order coming into effect.

How the remedy addresses the AEC and/or the resulting customer detriment

16.23 We found that SMEs typically sourced external finance from their main bank (ie their BCA provider) for three main reasons:

(a) Their BCA provider had more information (eg transaction history) to enable it to assess risk and price credit more accurately, and potentially make lending decisions more quickly.

(b) Applying for finance from other providers required time and effort[6] and was not appropriate when finance was needed at short notice.[7] We found that time spent searching and completing applications, including gathering the necessary documentation, varied significantly between lender and types of lending. For example, 46% of applications took less than 1 hour to complete but 9% took over 20 hours.[8]

(c) It was difficult for SMEs to compare prices and other terms across banks, as prices were opaque and lending products were complex.

16.24 The two measures we require as part of this remedy will address the AEC we have identified in SME lending in the following ways:

(a) Requiring lenders to publish rates and contextual information for unsecured loans and overdraft products will reduce the time and effort involved when SMEs search for loans and overdrafts, reducing search costs and promoting greater customer engagement.

(b) Requiring lenders to publish these rates in a standard format through APRs/EARs will allow SMEs to more easily compare between a wide number of different lenders and to better identify those products and lenders that offer the best value.

(c) The loan price and eligibility indicators developed by RBSG, LBG, Barclays and HSBCG will provide further clarity and certainty on the cost of lending, and the likelihood of being accepted in advance of an SME making a loan or overdraft application. This will provide greater confidence to SMEs when applying for a loan, particularly when applying to new providers, thereby helping to reduce the strong product linkages

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[6] Our survey of SMEs found that over a quarter of SMEs that applied for finance at their main bank did not consider other providers because of the 'hassle' or time associated with applying for finance (see Section 8).
[7] 24% of SMEs applied for finance at the time it was needed and a further 12% within two weeks of needing finance (see Section 8).
[8] See Section 8.

between BCAs and SME lending.[9,10] It is possible that the development of indicators by these banks will lead other banks to develop tools on their own accord leading to even broader transparency.

(d) The greater transparency on pricing and availability will provide strong incentives for lenders to compete on these factors, driving greater efficiency and innovation and delivering better value for SMEs.

Publishing rates for SME lending products

16.25 We found that that prices for loans for SMEs were not transparent. Unlike in personal lending or mortgages, where customers can look at published tables with the best offers or rates for these products, there were no such tables for SME lending products.[11] We found that where banks do publish rates, this is not done on a consistent basis, making it difficult for SMEs to compare across banks. For example, some lenders provide typical percentages or ranges, others provide a minimum ('from') rate.[12] Banks' views on the feasibility of publishing rates for some SME lending products in broadly the same way they do for personal lending are discussed in Appendix 16.1, as are the remedy design considerations involved in formulating this remedy.

16.26 As part of this remedy, and to complement other measures in ensuring the terms for products are made available in a meaningful way, we considered whether it would be feasible to require banks to publish rates for some SME lending products in broadly the same way they do for personal lending. This would increase price transparency and enable SMEs to make better comparisons between loan providers.

16.27 We have decided to require all relevant lenders[13] to publish certain information on the cost of credit for unsecured loans and overdrafts up to £25,000.[14] We have decided that they should do so in the form of representative APRs for loans and EARs for overdrafts, which are used

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[9] This should also reduce the costs for SMEs of obtaining quotes from several providers, which we mentioned was an aspect of the AEC related to the nature of demand for SME lending products.
[10] We have also decided to retain the bundling undertaking, provided by a number of banks in 2002, to mitigate the effects of the strong product linkages between BCAs and SME lending. See our decision on the review of the 2002 SME banking undertakings.
[11] See Section 8.
[12] See Section 8.
[13] Meaning those that provide unsecured loans and overdrafts to SMEs, for values under £25,000 and which fall within our ToR. See Appendix 1.1 for details of our ToR.
[14] We are therefore not requiring lenders to publish prices for other SME lending products such as secured loans, secured overdrafts, asset finance, invoice finance or trade finance.

under the UK consumer credit regime for personal customers.[15,16] Furthermore, banks will be required to always use the same format when publishing SME lending prices in marketing and advertising materials when certain trigger points occur. This would be in line with the provisions of the personal consumer credit regime which state that a particular format should be used whenever marketing or advertising materials activate designated triggers, such as if they quote a price or cost.[17]

16.28 We recognise that there are a number of factors which determine loan prices, and that this can lead to a significant price variation.[18] To make price information useful rather than overwhelming to SME customers, we have decided not to order lenders to publish full matrices of prices derived from the interaction of these variables. Instead we have decided to:

(a) require lenders to publish a representative APR for unsecured loans and EAR for overdrafts offered to SMEs of value up to £25,000, and to use this format when publishing SME lending prices in marketing and advertising material for these products when certain triggers are met;[19,20]

(b) require contextual information on how the APR was calculated to be published for loans, and information reflecting additional charges for overdrafts;[21]

(c) require lenders to make available to comparison sites and finance platforms data on how these representative rates change with loan and overdraft size (up to £25,000) and with loan term.[22] We note that this is the data behind simple calculators such as are offered for many

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[15] We note that this framework does apply to SMEs which are sole traders and to partnerships with three or fewer partners. However, we also note, first, that analysis by the FCA found that over half of all overdrafts and loans (55%) to SMEs fell outside the perimeter of the consumer credit regulation, having no protection at all (FCA discussion paper 'Our approach to SMEs as financial users', Annex 4, paragraph 40). Second, the FCA noted that with respect to financial promotions and communications, including the information that lenders are required to provide consumers, none of these are applicable to SMEs (including sole traders and partnerships with fewer than three partners) under some circumstances: 'CONC 3 rules on financial promotions and communications do not apply to financial promotions and communications which indicate clearly that they are solely promoting credit/hire for the purposes of a customer's business.' (FCA discussion paper 'Our approach to SMEs as financial users' Annex 4, paragraph 41.). This point is reflected in CONC 3.1.6.
[16] Under the UK consumer credit regime for personal customers, the standard information to be included in a representative example includes the rate of interest. Where the agreement provides for compounding (for example for overdrafts), the rate of interest should generally be the effective annual interest rate. See CONC 3.5.6G (2).
[17] We outline the triggers which should be used for this remedy in paragraph 16.33.
[18] In our Section 8, we noted: size of the loan; security; term; SME business sector; risk band of SME.
[19] Appendix 16.1 notes that a representative APR is one of the key pieces of information involved in a representative example, as used under the existing personal consumer credit regime.
[20] We outline the triggers which should be used for this remedy in paragraph 16.33.
[21] See paragraph 16.31 for further details.
[22] Of the factors which determine loan prices, the size of the loan and the term are the key factors which are relevant to all customers and for the products within scope. Each SME's business sector and risk band would mean that an advertised price would be relevant only to a subset of customers.

personal lending products.[23] These would allow customers (through comparison sites and finance platforms) to adjust the size of the loan or overdraft, and the term for loans, to see the representative rates relevant for the borrowing they require; and

(d) encourage these lenders to publish simple calculators, as described immediately above, on their websites.

16.29 To be considered representative, an APR/EAR should be the rate at or below which the lender reasonably expects to offer to at least 51% of SME customers to whom it makes offers resulting from the advertising or marketing. This approach comes from the existing (personal) consumer credit regime,[24] which is described in more detail in Appendix 16.1. In the case of the APR/EAR which we require to be published on the lender's website, this should be representative of the rate which the lender reasonably expects to offer SMEs who may see, respond to and be eligible for it. This rate should therefore be representative for the full range of SMEs to whom the lender would expect to offer the relevant products.

16.30 We recognise that ordering relevant lenders to publish key information such as representative APRs/EARs goes somewhat beyond the scope of the equivalent personal consumer credit regime, which specifies only the form in which lenders should publish prices if they choose to do so and when certain triggers are met. We consider that requiring lenders to publish prices for SME lending products is necessary to address the AEC we have identified, because so few banks currently do so.

16.31 We have also decided to require some additional contextual information in addition to the APR/EAR in order to ensure that SMEs viewing the rates on lenders' webpages are able to understand and compare them. For loans this is likely to include at a minimum the size and term of the loan associated with the representative APR. For overdrafts this is likely to include either a warning that additional charges will be involved, or information on these key charges.[25] We considered that some contextual information such as these likely minimum items would be necessary for SMEs to adequately understand and compare the rates we are requiring lenders to publish. We

[23] For reasons of practicability we consider that it may be worth limiting the number of loan and overdraft increments at which lenders are required to publish prices, in terms of loan/overdraft size, and loan term. This point was raised in Barclays response to provisional decision on remedies, p19. We will consult on this issue at the implementation stage of the investigation.
[24] See CONC 3. Consumer Credit sourcebook, FCA, 2016.
[25] See Appendix 16.1 for further considerations in this regard.

will consult upon the exact requirements at the implementation stage of the investigation.

Implementation issues for the publishing rates for SME lending products measure

16.32 We have decided that relevant lenders should publish pricing information required under this measure within six months of the Order being made.[26] We have decided that the APR/EARs should be used in marketing and advertising materials from this time as well.

16.33 In our provisional decision on remedies we said that banks should be required to always use the same format of APR/EARs when publishing SME lending prices in marketing and advertising materials, and that this would be in line with the provisions of the personal consumer credit regime which state that a particular format should be used whenever marketing or advertising materials quote a price or cost. We have considered further the existing personal consumer credit regime, and decided that APR/EARs should be used in marketing and advertising materials when broadly the same triggers are activated which require a representative example[27] or APR[28] to be used. More specifically APR/EARs should be used where the material:

(a) indicates a rate of interest or an amount relating to the cost of credit whether expressed as a sum of money or a proportion of a specified amount;

(b) includes a favourable comparison relating to the credit, whether express or implied, with another person, product or service; and

(c) includes an incentive to apply for credit or to enter into an agreement under which credit is provided.[29]

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[26] In our provisional decision on remedies we proposed this remedy should be taken forward within three months of the Order being made. Parties' responses were that this timing was insufficient. Barclays response to provisional decision on remedies (p18) suggested six months would be appropriate. This is consistent with our assessment of the arguments and evidence on timing put forward by parties. LBG's response to provisional decision on remedies (p26) suggested that 18 months would be necessary. This was based upon their needing to simplify their pricing model to comply with the remedy. As discussed in Appendix 16.1, we do not agree that this would be necessary, and so do not consider this timeframe is appropriate.
[27] CONC 3.5.3R (1).
[28] CONC 3.5.7R (1).
[29] Under the existing personal consumer regime there is also a trigger when a financial promotion 'states or implies that credit is available to individuals who might otherwise consider their access to credit restricted'. We decided not to include this, as it is not clearly related to the AEC we identified in SME lending.

16.34 The first of these triggers relates closely to our AEC by promoting transparency and comparability of prices or cost of credit. The second will address the AEC by promoting comparisons of cost of credit offered by lenders on a consistent basis. The third also relates to our AEC as it ensures that marketing materials which include incentives which affect the value or cost of the lender's offer will also contain a price which can be compared in a consistent manner.

16.35 One practical implementation issue we considered was the prominence which rates should be given in marketing and advertising materials where lenders would be required to publish them. We also decided that the rules on prominence[30] should be broadly the same as under the existing (personal) credit regime,[31] in particular that the representative APR/EAR must be given no less prominence that any of the trigger points mentioned above. To the extent that this requirement needs to be more specific we will address this at the implementation stage of the investigation.

16.36 Product and pricing data for overdrafts and unsecured loans should also be made available as open data to intermediaries – such as comparison sites and finance platforms – within six months of the Order being made. This should include all the information listed in paragraph 16.28 (a) to (c), above. We recognise that it may be challenging for lenders, and in particular smaller lenders, to provide a large number of pricing points reflecting combinations of overdraft and loan sizes and lengths.[32] We therefore intend to consult at the implementation stage of the market investigation on whether to include a minimum number of pricing points and what such a number could be.

Loan price and eligibility indicator

16.37 The requirement for lenders to publish rates for SME lending products will increase the transparency and comparability of prices in the market, increasing SME customers' ability to compare prices across lenders. This in turn will enable SMEs to get a better deal, either from a provider other than their BCA provider or from their BCA provider, as a result of the increased competitive pressure.

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[30] According to CONC 3.2.3G 'any information or statement included in a financial promotion or communication will not be treated as prominent unless it is presented, in relation to the other content of the financial promotion or communication, in such a way that it is likely that the attention of the average customer to whom the financial promotion or communication is directed would be drawn to it'.
[31] CONC 3.5.5R (5) in relation to the representative example and CONC 3.5.7R (2) in relation to APR.
[32] A suggestion to require a limited number of pricing points was made to us in Barclays response to our provisional decision on remedies (p19).

16.38 There are likely to be two benefits of an online loan price and eligibility indicator tool over and above this:[33]

(a) Not all SMEs will be eligible for the advertised price. In particular, up to 49% of SMEs may receive a higher price. The price and eligibility tool may provide SMEs with greater certainty on the final price that they are likely to receive.

(b) In Section 8, above, we noted that another reason why SMEs go to their main BCA bank is that they believe their main banks will be most likely to provide them with finance, contributing to these banks' incumbency advantage. If SMEs were able to find out easily whether banks other than their BCA provider were willing to give them a loan, it could reduce their main bank's incumbency advantage and increase SMEs' confidence in approaching lenders other than their main BCA provider for lending.

16.39 Under this remedy we are requiring specified banking groups to offer a tool on their website to enable SMEs to obtain a tailored 'price quote' and indication of eligibility. SMEs would enter some key information into the tool (discussed below in paragraph 16.50 and in Appendix 16.1), which would then allow them to obtain a tailored price quotation, along with information on the product, as well as an indication of whether they are eligible for particular lending products.

16.40 In our provisional decision on remedies, we identified a number of remedy design considerations with regard to the loan price and eligibility indicator tools. These cover both the scope and coverage of the tool and the specification of the tools format, and are outlined in detail in Appendix 16.1. Our final decision regarding these considerations is summarised below in terms of the scope and coverage of the tool and the format the tools should take.

The scope and coverage of the tools

16.41 In our provisional decision on remedies we proposed that the tools should cover unsecured and secured lending and overdrafts up to the value of £25,000 or potentially a higher value such as £50,000. We were aware of a

[33] Conversely, LBG's response to our provisional decision on remedies queried whether it was proportionate to require SME lending rates to be published in addition to our measure requiring tools to be made available by specified banks. We consider that it is proportionate as publishing prices will provide the benefits set out in paragraph 16.24 in addition to those provided by the tool, should not be significantly costly or onerous for lenders to undertake, and will also give significant coverage to the AEC in NI which will not be achieved by our measure requiring banks to develop tools, as the large banks for whom we considered it proportionate to require to implement the remedy do have less significant market coverage in NI.

number of potential challenges associated with including secured lending and so we welcomed views on this proposal. We also welcomed comments on whether it would be possible to include products up to a value of £50,000.

16.42 Parties' views were generally that secured lending was unsuitable for inclusion, for a range of reasons. For example, the increased information requirements could make tools complex[34] and difficult to use for SMEs, and the valuation of security frequently involves an element of judgement and/or the involvement of a relationship manager.[35] LBG considered that asset finance up to £25,000 could be included within scope of the tools.[36] We considered that this would not be necessary for the same reasons we decided to exclude it from our measure requiring lenders to publish prices for SME lending products (see Appendix 16.1). We have concluded that it may not be effective and would be unlikely be proportionate to include secured lending in the scope of the remedy. Therefore, we decided to include only unsecured loans and overdrafts within the scope of this remedy. We consider that banks will still be able to include secured lending if they wish to do so.

16.43 Parties' views were also generally opposed to our requiring the inclusion of products up to a higher value than £25,000, such as £50,000. Reasons for this were that the threshold should be consistent with our measure requiring the publishing of prices for SME lending,[37] and that most lending over £25,000 was secured,[38] meaning that there would be little increase in coverage of loans from extending the scope to £50,000 if secured lending were not included.

16.44 As we are not including secured lending in the products which tools are required to cover, there will be only limited benefits from increasing the value of loans and overdrafts to be included to a higher value such as £50,000 and that it would not be proportionate to do so. We found that increasing the value from £25,000 to £50,000 increased the proportion of unsecured loans covered by the measure by only nine percentage points, from 78% to 87%, and increased the number of overdrafts by only five percentage points, from 88% to 93%.[39] We therefore decided the scope of products for which lenders should be required to provide offers for through the tool should be limited to

[34] Barclays response to provisional decision on remedies, p20.
[35] RBSG response to provisional decision on remedies, p24.
[36] LBG response to provisional decision on remedies.
[37] Santander response to provisional decision on remedies, p26.
[38] LBG response to provisional decision on remedies, p30.
[39] Based on SME Finance Monitor and Charterhouse BBS 2014 data respectively. See Appendix 16.1 for further details.

£25,000, with this providing a considerable degree of coverage of SME lending.

16.45 We have also decided that the remedy will cover the following banking groups: Barclays, HSBCG, RBSG and LBG. This is a narrower set of banks than we proposed to require to develop tools in our provisional decision on remedies which additionally included Santander, Danske, BoI and AIBG.

16.46 Of this wider set of banks, first, we consider that it is not proportionate to require Santander to develop a tool. This is because better data is now available compared to at the time of our provisional decision on remedies and this shows Santander has a very small market share of SME lending at both GB and NI levels.[40,41] Second, following responses to our provisional decision on remedies[42] and further analysis, we consider that it is not proportionate to require Danske, BoI or AIBG to develop these tools as they are smaller lenders which means there is likely to be a disproportionate cost of their developing tools due to fixed costs that are unlikely to vary with bank size as well as less significant benefits which might be delivered by the tools.[43]

16.47 We consider that the AEC in SME lending will be adequately addressed in NI through our measure requiring the publishing of SME lending rates, described in paragraphs 16.25 to 16.36 above. We further consider that it remains proportionate to require Barclays, HSBCG, RBSG and LBG to develop tools as this will effectively address the AEC in SME lending in GB in a way which complements the measure to publish SME prices, as set out in paragraph 16.38 above, and is not disproportionate due to the large scale of SME lending activity in the GB market. Considerations on these points are discussed in more detail in Appendix 16.1.

16.48 We have set out a minimum scope for the tools in terms of coverage of product type and product size, and required a specific number of banks to develop tools. However, we note that banks developing tools would be free to refine their tools to include a wider range of products and that other banks

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[40] Santander made this point in their response to our provisional decision on remedies.
[41] Appendix 16.1 has further details on the data we have used.
[42] For example, Danske told us that it would be disproportionate to expect a small bank like Danske to implement in the same time frame as a large banks such as HSBC. Danske response to provisional decision on remedies, p11.
[43] The discrepancy between the size of the SME lending activities of the four banks we are requiring to develop tools and the those we are not requiring to develop tools can be clearly seen in terms of number of new loans granted at a UK level and the number outstanding SME loans at a UK level. The smallest of the four banks we are requiring to develop a tool had a market share in 2015 in terms of new loans of [10–20]%, while the largest of the NI banks we proposed to include at our provisional decision on remedies has a market share of [0–5]%.Similarly, in terms of the number of outstanding loans in 2015, the smallest of the four banks we are requiring to develop a tool has a market share of [10–20]%, while the largest of these three NI banks has a market share of [0–5]%. See tables in Appendix 7.1 for further details.

would also be free to develop tools. Indeed, if the tools we have decided to require are successful then there may be incentives for this to happen. In addition, SMEs in NI may be able to access the tools of banks based in the UK as some of these have a presence in NI as well. Furthermore, SMEs in NI may be able to use tools of banks based in GB to draw comparisons with the offers being made to them by lenders in NI.

16.49 We also decided to require that providers subject to our Order provide relevant access to any two finance platforms designated under the SBEE Act for a period of three years and any two comparison sites, including the eventual winner or winners of the Nesta challenge prize, for a period of three years after the prize winners have launched their products in the market. This will allow customers to access a range of lending offers in one location, such as comparison websites and finance platforms.[44]

The format the tools should take

16.50 We decided that the format and information input requirements for loan price and eligibility indicator tools should primarily be determined by banks themselves, but that they should work with comparison sites to develop certain minimum standards in this regard. At the same time, we note that lenders and comparison sites should also consider carefully the degree of information they require customers to input to the price and eligibility tool. This should strike a balance between requesting enough information to enable accurate quotes to be provided, and avoiding over-burdening users such that they would be discouraged from using the tools. We discuss these issues further in Appendix 16.1, including providing an example of a reasonable set of information inputs which tools may wish to require.

16.51 In terms of the outputs of the tool, we decided that the minimum information which should be returned to the SME customer should be:

(a) an indication of eligibility in a clearly understandable format, for example a percentage indicating the likelihood of being eligible for a given product at a given rate;[45,46] and

[44] We decided that banks should be able to choose between the two options we proposed for how this might work in practice in our provisional decision on remedies which both received positive consultation responses. These options are discussed in detail in Appendix 16.1.
[45] This is in line with our understanding of the format in which at least one existing lending platform displays eligibility information.
[46] We will consult upon the exact format to be used at the implementation stage of the investigation.

(b) an indicative rate including information in the same format as required in our proposed Order regarding the publishing of prices.[47] This is also used in the format the existing indicative offers are provided to customers by lenders who currently do so.

16.52 This information should be returned to the SME within a maximum of 24 hours. No parties disagreed with this proposal made in our provisional decision on remedies.

16.53 We decided that the relevant banks must give information to the SME at the time of application on the proportion of all customers using their tool who received an end quote that was the same, or within a given range (eg 10%) of the indicative quote (eg '90% of SME customers received an end quote within 10% of their the indicative quote') to give an incentive that quotes provided are meaningful.[48] We decided this approach has the advantage of allowing customers to have a very good understanding of the likely relative accuracy of the offers they were being provided, and avoids setting any rules on prices themselves. Further, this approach does not prevent banks from offering indicative prices different to their expectation of final process, if they choose to do so. See Appendix 16.1 for further details.

Implementation issues for the indicator tool

16.54 We decided that loan price and eligibility indicator tools should be developed, and made available, within 12 months of the Order being made, to address the AEC in SME lending as soon as is practicable.

16.55 A practical implementation issue we considered is the prominence and location which tools should be given on banks' websites. We have decided to require banks to display these tools, or links to these tools, in prominent positions. This might mean, for example, that links are no more than one click from the business banking homepage and are on the product pages for SME overdrafts and unsecured loans. We note that the FCA has guidance on prominence in the context of financial promotions.[49] Similar principles are likely to apply for the prominence of these tools, or links to these tools.

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[47] We note that this may differ somewhat from our Order regarding the publishing of prices as the APR/EAR given by the tool will not need to be as strictly representative as used under that remedy. Instead, see paragraph 16.53 for further discussion regarding how to ensure the price and loans eligibility indicators give meaningful quotes.
[48] This requirement was one of the options we proposed in our provisional decision on remedies to ensure the price and eligibility indicators give meaningful quotes.
[49] See Financial promotions – guidance, Prominence.

Monitoring

16.56 The above remedies involve outputs which are to be publicly displayed online, or reported directly to SMEs, and so market participants are likely to be able to achieve a considerable degree of monitoring themselves. We decided that monitoring of these remedies could therefore rely upon self-reporting to the CMA and monitoring by market participants. We consider that SMEs, comparison sites or other providers would have incentives to report to us any lack of compliance by other parties.

16.57 In addition, we also require a number of specific compliance reporting requirements:

(a) For the publishing of APRs/EARs, we require banks and lenders to send us a report each year outlining the prices they published, the format in which they did so, what proportion of customers received rates which were the same or better than the published rate and how they reached their reasonable expectations of the representative rates which they published. As mentioned in Appendix 16.1, we recognise that the process of deciding upon a representative rate may be more challenging for smaller lenders, and we will take this into account in assessing the reports we receive from them and their compliance.

(b) For the online tool, we require banks to send us the online location of their tools at the appointed time for these tools to go live.[50] As noted above, this should be within 12 months of the Order coming into effect. In addition, we require banks to provide us with information on the accuracy of their tools which they report to users, as set out in paragraph 16.53.

16.58 We consider that the CMA, as the body making relevant orders, is the most appropriate body to undertake these monitoring steps and because regulation of SME lending falls largely outside the scope of other regulators such as the FCA.

Cost of remedies

16.59 We did not receive further significant information on the cost to parties of publishing prices for SME lending products, in response to our provisional decision on remedies, but we do not expect it to be significant.[51]

[50] For example in the form of an internet link.
[51] LBG told us that it would be in excess of £[✂], but this was based on the assumption that it would have to significantly change its pricing model. As set out in Appendix 16.1, we not agree that this would be necessary.

16.60 We have received a range of estimates from parties regarding the costs of developing a loan price and eligibility indicator. These estimates varied quite considerably, and were provided to us with a number of different breakdowns. At least one party also mentioned that the exact scope of the tool, timeline over which it was developed, and manner in which it interfaced with third parties such as comparison sites, would affect the cost.

16.61 Estimates from parties which did not currently have an SME lending tool ranged between significantly higher than £75,000 to in excess of £1 million to £2 million.

16.62 HSBCG, which does currently have an online eligibility indicator tool (albeit one that does not give indicative price quotes), told us that its tool cost less than £500,000 to build. It envisaged that [✂]. It also highlighted that linking the tool to HSBC's central systems (which was currently not the case) [✂]. Cost estimates for linking tools to comparison sites would be £50,000 to £100,000 per comparison site.

16.63 As we have required a tool be developed with a narrower scope than was envisaged in our provisional decision on remedies, we consider the cost of this remedy should be lower than parties' estimates provided in response to our provisional decision on remedies. We also note that we are requiring fewer banks to develop tools than we had proposed in our provisional decision on remedies, so the overall cost will be lower.

Measures to facilitate comparisons of SME banking products

Summary of the remedy

16.64 We found that the ability of SMEs to make price comparisons between BCAs and between lending products is limited and noted, for example, the lack of comparison tools for SME banking services.

16.65 We set out below our final decision on measures to facilitate comparisons of SME banking products on the basis of the responses we received to our working paper[52] and our provisional decision on remedies and our further analysis and consideration. We are introducing the measures summarised in Figure 16.2.

[52] The role of comparison sites for small and medium-sized enterprises in addressing the adverse effect on competition.

Figure 16.2: Summary of the measures to facilitate comparison of SME banking products

We are supporting the Nesta challenge prize as a way of creating one or more commercially sustainable SME comparison tools.

We have decided to make an Order requiring RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG to:

(a) provide complete product specifications for all BCAs and SME standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, and terms and conditions for use by entrants to the Nesta challenge prize as and when reasonably required before, during and after the associated 'data sandbox';[53]

(b) contribute, in the proportions given in Table 16.1, to the costs of the Nesta challenge prize process. This will include funding Nesta's reasonable administrative costs, sufficient and appropriate prizes to encourage entry and participation and the costs arising from project delivery, including that of a data partner to project-manage the 'sandbox' exercise;

(c) do so within a time frame and in a manner agreed with Nesta and approved by the CMA;

(d) within one month of our Order being made and for a period of three years:

(i) make available through two or more of the finance platforms designated under the SBEE Act, details of their BCAs,[54] standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria; and

(ii) prominently display hyperlinks on their websites to the finance platforms on which their SME banking products are listed; and

(e) once the winner or winners of the challenge prize have launched their products in the market and for a period of three years:

(i) make available on two or more fair and independent comparison tools, one of which must be a Nesta prize winner, details of their BCAs, standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria; and

[53] A 'data sandbox' allows developers to experiment with potential new products using real (though anonymised) data in a controlled and safe environment.
[54] Where these sites currently provide, or will provide in the future, BCA comparisons.

(ii) display prominently on their websites hyperlinks to the comparison tools on which their SME banking products are listed.

We have also decided to make an Order requiring RBSG, LBG, Barclays, HSBCG and Santander to provide samples of customer transaction data necessary for use by entrants to the Nesta challenge prize as and when reasonably required before, during and after the associated 'data sandbox'.

We will also require, as a transitional measure, that existing supporters of Business Banking Insight (BBI)[55] ensure that BBI continues to collect and publish survey information which permits comparisons between providers on the basis of their service quality, by continuing its funding. We also require that RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG prominently display links to the BBI website. These requirements will fall away once the core SME service quality indicators are available (see Section 13).

Since the Nesta process will not be completed until at least 18 months after the publication of our final report, we think it is necessary to include in our package a number of ancillary measures, for example a CMA-nominated representative on the Nesta Prize Committee, to ensure that the process works as intended and a 'safeguard remedy' that would only take effect in the event that one of the trigger events occurred, namely *(a)* the Nesta process failed to produce a winner that met the assessment criteria, or *(b)* the sites resulting from the Nesta process were not found to be viable at the time of review by the CMA because they were not, for example, operationally and/or commercially viable and sustainable. This remedy would require the larger SME banking providers in GB and NI[56] to bring about the creation of an industry-funded SME comparison tool, to a specification approved by the CMA, and to make available on this comparison tool, details of their BCAs, standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria, and display prominently on their websites hyperlinks to the comparison tool.

In addition, to support the use of the loan and price eligibility tool and comparison tools including those emerging from the Nesta process, we are recommending to HMT that it works with CRAs and SME lenders to implement a mechanism for 'soft' searching to enable SMEs to obtain price quotations and indications of eligibility without the risk of adversely affecting their credit rating.

[55] A quality comparison service run by the FSB and BCC with support from Barclays, HSBCG, LBG and RBSG.
[56] RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG.

We also recommend to BEIS that it works with the British Business Bank and professional associations to explore ways in which their members can channel advice on identifying and choosing providers and sources of finance to SMEs.

How the remedy addresses the AEC and/or the resulting customer detriment

16.66 The AEC that we have found is that SMEs in GB and NI find it difficult to compare products and providers of banking services. As we noted in Section 8 there are very few commercial price comparison tools offering information on SME banking products. Moreover, regulatory initiatives aimed at facilitating comparisons between consumer products and providers have not been extended to SMEs. Midata, for example, does not cover BCAs and nor does the PAD.

16.67 This remedy is designed to bring about the creation of one or more comparison sites which make it easier for SMEs to undertake comparisons of price and service quality.

16.68 This remedy will ensure that new entrants and existing providers of SME banking services provide access to appropriate product information and customer data to enable intermediaries to provide bespoke comparisons using comprehensive product details and, with the adoption of our remedies on Open Banking, customers' transaction histories.

16.69 In addition, this remedy proposes transitional measures for the period before the Nesta remedy delivers its objectives, ancillary measures to help ensure the remedy works as intended, and a safeguard remedy in the event that obstacles emerge after the publication of our final report which result in no winners emerging or none of the winners being found to be viable at the time of a CMA review.

Overcoming obstacles to entry and expansion for SME comparison websites

16.70 The remedy is intended to address the obstacles we identified to SME comparison websites emerging 'organically'.[57]

16.71 In our working paper and our provisional decision on remedies we considered a range of options for bringing about innovative new entry and identified the Nesta process as offering the best prospect for delivering in a

[57] See Section 8 and Appendix 8.1.

timely manner an effective remedy through the entry or expansion of innovative SME comparison tools.

16.72 We thought that because it was driven by competition rather than regulatory design it was more likely to give rise to innovative solutions and could also provide SMEs with 'one-stop shop' tools which do more than simply offer price comparisons. These tools could include, for example, a smoother SME journey from compiling a shortlist of lenders and their terms, to a loan application, and the transmission of funds on the same platform.

16.73 Nesta has extensive experience of running large challenge prizes so is well placed to operate this challenge prize.[58] Nesta will be responsible for designing aspects of the prize such as:

(a) the nature of the prizes and in-kind support provided;

(b) the assessment criteria; and

(c) the composition of the judging panel.

16.74 We have been involved in discussions of all these aspects and will continue to be involved as the design of the challenge prize progresses.

16.75 In its response to our provisional decision on remedies, Santander raised concerns with the Nesta challenge prize. Santander argued that the remedy would not be effective, reasonable and proportionate, and might fall outside the scope of remedies the CMA could implement. In particular it said that uncertainty meant that there was a risk that the remedy was ineffective and it was not timely; the safeguard remedy meant there was a likelihood of a 'double remedy' and we had not considered other commercial comparison tools.[59]

16.76 Our guidance makes clear that the effect of a remedy will always be uncertain to some degree.[60] We have taken account of this risk in the design of this remedy and our decision to include a safeguard remedy. We have also considered the risks associated with the alternative remedy options and their effectiveness. We have concluded that pursuing the Nesta challenge prize as set out in this section will effectively address our AEC, and will be more effective than open APIs alone, because the prize fund will incentivise the development of innovative BCAs and SME lending comparisons, rather than other possible uses of open API data. It will also be timelier because

[58] www.nesta.org.uk/our-projects.
[59] Santander response to provisional decision on remedies, paragraph 2.5.
[60] The Guidelines, paragraph 335.

the 'data sandbox' will facilitate sophisticated BCA comparisons more quickly than will be possible with open APIs only. Regarding timeliness, any PCW remedy would take time to put in place. Our guidance recognises that some remedy options will have an almost immediate impact while the effect of others can take longer and we may select a package combining both types of measure, as we have done in this case. We have considered whether the safeguard remedy constitutes a 'double remedy' in paragraphs 16.135 and 16.137 and have considered other comparison tools in paragraphs 16.87 and 16.88. We have considered the cost of the remedy and whether it is disproportionate in paragraphs 16.138 to 16.142 and have concluded that it is not.

Provision of product and customer data

16.77 Comparison sites will help SMEs compare both BCAs and lending products. For such tools to function effectively banks will need to provide them with full specifications of all the BCA, SME standard tariff overdrafts and unsecured small business loan products up to a value of £25,000 they have available, and the terms and conditions under which they will be supplied to applicants.[61] We will require banks to do so.

16.78 In the case of both BCAs and SME lending products the reliability of the information that the designated finance platforms[62] and comparison tools are able to provide to SMEs will be greatly enhanced by their ability to access the SME's transaction history. This will enable them, for example, to estimate the costs of BCAs, which are typically charged on a per-transaction basis, and to more accurately assess the affordability of various lending products.

16.79 The effectiveness of this remedy will, therefore, be substantially enhanced by our open API standard remedy, discussed in Section 13, which will require banks to provide comparison tools and finance platforms with secure access to product data and customers' transaction histories. For this reason and because there is potential to share knowledge, a close working relationship between the Implementation Entity and Nesta will be mutually beneficial.

[61] The service quality data which Nesta applicants will also require will be made available under the measures outlined in the service quality remedy (See Section 13).
[62] In March's Budget 2016, it was announced that Bizfitech (which operates Business Finance Compared), Funding Options and Funding Xchange would be designated under the Small and Medium Sized Enterprises (Finance Platforms) Regulations 2015.

Transitional measures

16.80 Because the Nesta prize winner or winners will not be launched in the market for some time after the publication of our final report, we are adopting transitional measures to address our competition concerns in the interim.

16.81 These require the specified banks to make details of their BCAs, standard tariff overdrafts and unsecured small business loans available to two or more designated finance platforms within one month of our Order being made and for a period of three years, and prominently display hyperlinks on their websites to the platforms on which their products are listed.

16.82 Once the winner or winners of the Nesta challenge prize have launched their products in the market, and for a period of three years thereafter, the specified banks will be required to provide details of their BCAs, standard tariff overdrafts and unsecured small business loans to two or more comparison tools, one of which must be a Nesta prize winner, and to display prominently on their websites hyperlinks to the sites on which these products are listed.

16.83 By requiring banks to list their products on two or more websites in both cases we intend to create competitive tension between website operators over the commercial terms for their products' inclusion on the websites concerned.

16.84 We also require as a transitional measure that existing supporters of BBI ensure through their funding that BBI continues to collect and publish survey information until the core SME service quality indicators are available (see Section 13). This will ensure that a continuous supply of quality data is available for the Nesta challenge prize entrants.[63]

Ancillary and safeguard measures

16.85 Although we are confident that the Nesta challenge process will bring about the creation of a new SME comparison tool or tools, its results are currently not known. Accordingly we are putting in place measures to help ensure that the process works as intended, for example requiring CMA representation on the Nesta Prize Committee. Included in these measures is a safeguard remedy which would enable the CMA to require providers, in the event that no winners emerge or the winners are found not to be viable at the time of a

[63] As part of the assessment criteria, the Nesta challenge prize winner or winners will be required to include comparisons of service quality. This is likely to include data from our remedy to enable SMEs to make comparisons between providers on the basis of their service quality (see Section 13).

CMA review, to create and fund an SME comparison tool approved by the CMA.

Implementation considerations

16.86 Appendix 16.2 summarises the responses to our working paper[64] and includes more detail on the factors we considered when designing this remedy.

16.87 We considered whether any of the existing comparison sites were either currently, or could be supported to, address the AECs we found in the market. We considered:

(a) BBI. This is not a price comparison tool, but does offer comparisons of service quality. Although the BCC[65] told us that it was considering adding price comparisons to this site, this feature is not yet available and is essential for SMEs to be able to compare banking products. Furthermore, awareness of this site is low with only 6% of SMEs being aware of BBI.[66] We therefore considered that, while the ability to compare quality is important, this site had not demonstrated sufficient potential to satisfy us that it is likely to be effective at addressing the AEC we have identified, in particular enabling price and quality comparisons for SME banking products.

(b) Other comparison sites currently operating in the market. These include the designated finance platforms[67] and other operators[68] in the market. The majority of the newer platforms focus only on lending and do not cover other banking products such as BCAs. In our conversations with operators of these sites, we have found limited appetite to develop BCA comparisons because they cannot see a commercial gain. We considered whether it is possible to incentivise these sites to develop BCA comparisons. While providing data, particularly transaction data, to these sites,[69] either directly or as a result of our open API remedy, would enable them to develop more sophisticated BCA comparisons which may be more attractive to SMEs, we do not think this would be sufficient to create commercial incentives because of high upfront development costs relative to likely customer acquisition payments from banks. This

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64 Responses to our provisional decision on remedies are addressed throughout this section.
65 The BCC jointly runs BBI.
66 SME finance monitor.
67 Bizfitech (which operates Business Finance Compared), Funding Options and Funding Xchange.
68 Such as Better Business Finance, Business Moneyfacts, MoneySupermarket and Business Comparison.
69 As suggested in Santander's response to provisional decision on remedies, paragraph 2.5(d).

view was reinforced by the BBB which said that the designated finance platforms might not have the capacity to develop BCA comparisons, but entering the Nesta challenge prize could enable them to do this, specifically because the prize money would help to finance the development of the comparisons.[70] Where sites do offer BCA comparisons, these are unsophisticated 'best buy' type tables. It is unclear that providing data to these providers would be sufficient to incentivise them to develop more sophisticated comparisons.

16.88 We therefore concluded that, outside the Nesta challenge prize, it was not possible to sufficiently incentivise existing operators in the market to develop the type of comparison tool which would address our AECs.

16.89 In response to our provisional decision on remedies, some parties commented on the scope of this remedy.

16.90 Barclays and LBG said that the requirement for lending products to be made available on the tool should be limited to £25,000.[71] Given that this aligns with our decision for the loan price and eligibility indicator, we have accepted this suggestion. However, we would welcome tools which cover a broad range of lending, including larger loans and secured lending as these would add value for SMEs.

16.91 Barclays also said that the remedy should be limited to smaller SMEs such as those with a turnover of less than £2 million.[72] Our view is that larger SMEs may have some simple banking requirements for which comparison tools will be useful. They may also wish to use information from the comparison tools to inform price negotiations. In addition, our ToR and AECs include SMEs up to £25 million (see Appendix 1.1). Therefore we do not wish to exclude them from using these tools.

16.92 The Asset Based Finance Association said that comparison tools should include the full range of finance options.[73] We are not mandating this because we think there will be strong incentives for comparison tool operators to attract a variety of providers and types of products. Additionally, we think that our measures will increase traffic to these tools which will

[70] We note, however, that one respondent to our working paper, Business Finance Compared, said that it thought that, when split across winners, the prize fund was too small to create a sustainable PCW solution or robust platform.
[71] Barclays response to provisional decision on remedies, paragraph 16.3 and LBG response to provisional decision on remedies, paragraph 14.4.
[72] Barclays response to provisional decision on remedies, paragraph 16.4.
[73] Asset Based Finance Association response to provisional decision on remedies, p3.

incentivise providers, including asset finance providers, to use them for customer acquisition.

16.93 Danske said that it would be 'unable' to provide any information on standard tariff overdrafts and unsecured business loans for the 'data sandbox' or to make its products available on comparison tools.[74] We consider that, for this remedy to address problems in both GB and NI, large banks in either market should be required to provide product information to the data sandbox and to make their products available via finance platforms and comparison tools. For this reason, we have not adjusted our requirement to provide product data for the sandbox or comparison tools. However, in recognition that the banks subject to this remedy which primarily operate in NI are smaller than their GB counterparts, we have decided to withdraw the requirement on these banks to provide transaction data for the data sandbox. We think this will make the requirements on the NI banks more proportionate, without adversely affecting the usefulness of the data sandbox. We would welcome these or other banks voluntarily working with Nesta to provide transaction data for the sandbox.

16.94 LBG suggested that banks beyond the eight subject to our Order should be required to provide product data for the 'sandbox'.[75] While there are advantages to a broad range of product data being available in the sandbox, we do not think this is essential for comparison tools to be developed. Open APIs will provide a live stream of product data for a larger number of banks which entrants can use to develop their tools.

16.95 LBG said that a degree of standardisation of terms would be necessary for comparisons to be effective. [76] We think it would be desirable if this took place along similar lines to the standard definitions for PCAs which are required under PAD. It may be that this occurs as part of our open API remedy.

Creating an SME comparison website

16.96 In order to ensure the participation of the relevant parties for the duration of the challenge prize process we will take the steps set out below:

[74] Danske response to provisional decision on remedies, paragraph 8.2.
[75] LBG response to provisional decision on remedies, paragraph 14.6.
[76] ibid, paragraph 14.10.

(a) In respect of providers we will make an Order, requiring RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG to support the Nesta challenge process by:

(i) providing complete product specifications for all BCA and SME standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, and terms and conditions necessary for use by entrants to the Nesta challenge prize as and when reasonably required before, during and after the associated 'data sandbox';

(ii) contributing, in the proportions given in Table 16.1, to the costs of the Nesta challenge prize process. This will include funding Nesta's reasonable administrative costs, sufficient and appropriate prizes to encourage entry to and participation and the costs arising from project delivery, including that of a data partner[77] to project-manage the 'sandbox' exercise; and

(iii) doing so within a time frame and in a manner agreed with Nesta and approved by the CMA.

(b) We will also make an Order requiring RBSG, LBG, Barclays, HSBCG and Santander to provide samples of customer transaction data necessary for use by entrants to the Nesta challenge prize as and when reasonably required before, during and after the associated 'data sandbox'.

16.97 We encourage other banks which are not subject to our Order to be involved in the Nesta challenge prize process. There will be a reference group for the non-funding banks which will allow these banks to be briefed on developments. This reference group will have a nominated representative on the Prize Committee.

Funding obligations

16.98 In our provisional decision on remedies we said that we would require RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG to contribute, in proportion to their UK BCA share of supply, to the costs of the Nesta challenge prize process.

16.99 Taking into account responses to our provisional decision on remedies and having considered the issue further in light of those responses, we have

[77] The data partner would be appointed by an open procurement process run by Nesta.

decided to take into account providers' share of SME lending as well as their share of BCAs. This is because this remedy is designed to address issues in both markets. Furthermore, while there tends to be a correlation between market shares in BCAs and SME lending due to the linkages between the two markets, providers do not always have a similar market share in both markets.

16.100 We considered using:

(a) the share of BCA and SME lending revenue (ie UK-wide market shares by revenue);

(b) a combination of BCA volume share of supply and SME lending volume share of supply (ie UK-wide market shares by volume);[78] and

(c) an approach combining (a) and (b).

16.101 None of these approaches is perfect. Using market shares by value has some limitations in terms of the comparability of different banks' revenue figures and the difficulty of separating out revenues generated by larger loans (exceeding £25,000), which are not in scope for this remedy. In further communications with funding banks, a number objected to apportioning funding in this way.[79]

16.102 Using market shares by volume would require an assumption about the split between the two markets (BCAs and SME lending). We would adopt a 50/50 split to reflect a broadly similar level of total revenues in each market (£2.7 billion in the BCA market and £2.8 billion in the SME lending market[80] in 2014). However, this does not reflect the differences in revenue mix for each banking group, both in terms of mix between BCAs and SME lending, and also, for example, counting a rarely used BCA as equal to a BCA with thousands of transactions per year.

16.103 We have concluded that the best approach is (c) because combining the two methods gives the most balanced overall picture of providers' presence across the two markets on the evidence readily available. We agree with Barclays, which told us that a broad-brush allocation of funding would be simple, workable and more appropriate than using revenue data alone. It

[78] Barclays and HSBCG suggested this as a possible method to apportion funding.
[79] Barclays, HSBCG, LBG and RBSG. Barclays and HSBCG also suggested alternative methods to apportion funding. LBG submitted that while it supported apportioning funding by value (rather than volume) market shares, any such value market shares should be determined by customer balances (for BCAs) and lending value (for SME lending).
[80] Total revenue from interest and charges for general purpose business loans (including commercial mortgages) in 2014.

said that a broad allocation had previously been agreed in principle by 'participants in the Nesta prize fund'. This option also has the advantage of obscuring providers' confidential revenue and market share data.

16.104 This leads us to the funding allocation set out in Table 16.1 where the funding shares are calculated using an average of providers' market shares by revenue and by volume, rounded to the nearest 5%. The three NI-only banks (Danske, BoI and AIBG) have broadly similar UK-wide shares; we have split a 5% contribution equally between them, which more fairly represents their market presence than rounded figures (eg to the nearest percentage point) for each of them individually would have done.

Table 16.1: Share of contributions to the funding of the Nesta challenge prize

	%
Banking group	*Funding share*
RBSG	30
LBG	25
Barclays	20
HSBCG	15
Santander	5
The three NI-only banking groups	5

Source: CMA calculations using data provided by the eight providers.

Transitional measures

16.105 In order that the remedy functions as we intend, it is necessary to adopt a number of transitional measures to address the AEC prior to the completion of the challenge prize process. In addition, this will ensure that existing provision is maintained, particularly where this may be useful for Nesta challenge prize entrants.

16.106 The Nesta process is likely to take at least 18 months from its launch to the announcement of a winner or winners and the market introduction of prize winners at least a further six months. We therefore propose to adopt measures to address our concerns in the period between the making of our Order and the successful introduction of new comparison tools arising from the Nesta process to the market. These measures impose requirements on providers in respect of their relationships with finance platforms and existing SME comparison websites.

- *A requirement to make products available through finance platforms*

16.107 We will order RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG, within one month of the making of our Order and for a period of three years, to:

(a) make available through two or more of the finance platforms designated under the SBEE Act, details of their BCAs,[81] standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria; and

(b) prominently display hyperlinks on their websites to the finance platforms on which their SME banking products are listed.

16.108 In its response to our provisional decision on remedies, LBG said that all providers should be required to make products available through finance platforms.[82] Our view is that applying the measures in paragraph 16.107 to the eight listed banks will be sufficient to increase the numbers of SMEs using finance platforms, which will then incentivise other providers to use these sites as a means of customer acquisition. Operators of comparison tools will have incentives to offer as many products and providers as possible in order to attract customers.

16.109 Funding Options said that consideration should be given to where links to finance platforms were displayed on banks' websites so that the links were effective.[83] Our Order will require banks to display these links in prominent positions. This might mean, for example, that links are no more than one click from the business banking homepage and are on the product pages for BCAs, overdrafts and unsecured lending. We note that the FCA has guidance on prominence in the context of financial promotions.[84] Similar principles are likely to apply for the prominence of links to finance platforms.

- *Existing SME comparison tools*

16.110 Although we are promoting the development of new SME comparison services, rather than relying on existing ones, sites such as BBI[85] do provide a valuable service. Their funding could be withdrawn before other measures that we are proposing come into effect, including those arising from our remedy on service quality information set out in Section 13.

16.111 We therefore also require, as a transitional measure, that existing supporters of BBI ensure that BBI continues to collect and publish survey information which permits comparisons between providers on the basis of their service quality, by continuing its funding. RBSG said that it thought other larger

[81] Where these sites currently provide, or will provide in the future, BCA comparisons.
[82] LBG response to provisional decision on remedies, paragraph 14.14.
[83] Funding Options response to provisional decision on remedies, p4.
[84] Financial promotions – guidance, Prominence.
[85] Although it is not a price comparison website, BBI provides useful comparisons of service quality.

banks should also be required to provide support to BBI until the core SME service quality indicators were available.[86] Our view is that, as this is an interim measure, it is appropriate to limit the requirement to provide funding to those who currently fund BBI.

16.112 We also require that RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG prominently display links to the BBI website. These requirements will fall away once the core SME service quality indicators are available as specified by our service quality remedy (see Section 13). As part of the assessment criteria, the Nesta challenge prize winner or winners will be required to include comparisons of service quality. This is likely to include data from our service quality remedy. LBG said that we should oblige BBI to share its data with the Nesta prize entrants.[87] We do not think this is necessary as the BCC, which jointly runs BBI, has already indicated that it will continue to work with Nesta to ensure the best possible outcome for SMEs.[88]

Ancillary measures

16.113 Because the implementation of this remedy will take place largely after we have published our final report we propose to adopt measures to help ensure that it develops in line with our expectations but, if this is not the case, then a safeguard remedy is triggered.

16.114 In this context we considered four aspects of the Nesta process:

(a) project governance;

(b) project management;

(c) project implementation; and

(d) project review and safeguard remedy.

- *Project governance*

16.115 It will be necessary to maintain a CMA involvement with the Nesta challenge prize process after the investigation has finished in order to help ensure that the remedy works as intended. We think that this will best be achieved through the presence of a CMA-nominated representative on the Nesta

[86] RBSG response to provisional decision on remedies, p26.
[87] LBG response to provisional decision on remedies, paragraph 14.16.
[88] BCC response to provisional decision on remedies, p2.

Prize Committee. This view was supported by several respondents to our provisional decision on remedies.[89]

16.116 The purpose of the Prize Committee is to ensure appropriate governance and oversight of the Nesta challenge prize. The committee is also responsible for approving the assessment criteria and ensuring that due process is followed in judging the prize. The Prize Committee is likely to be made up of representatives from the FinTech and banking sectors, together with SME representatives.

16.117 The Nesta challenge prize also has a judging panel which will be made up of independent judges and assessors with relevant technical expertise, such as data security, user experience and SME business management.[90] This panel will evaluate the entrants at each of the milestones in the process and would award prizes.[91]

16.118 In response to our provisional decision on remedies, only Money.co.uk[92] suggested that CMA involvement in the judging panel would be beneficial, due to the knowledge held by the CMA, however it said that CMA involvement was not essential. We feel that there are other ways to feed our knowledge and experience into the process, such as through the Prize Committee. The other respondents who commented on CMA involvement in the judging panel said that it was not required[93] or had no strong views.[94]

16.119 Therefore we do not consider it necessary to have a CMA-nominated or approved representative on the judging panel, given that we can be involved in specifying the assessment criteria and will be represented on the Prize Committee, which will ensure that winning entries have been properly assessed against the criteria.

16.120 The nominated representative would have a good overview of the market for SME banking comparison tools. For this reason, we think that they would be able to identify if comparison tools are acting contrary to the interests of consumers, for example by listing products according to commercial

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[89] LBG response to provisional decision on remedies, paragraph 14.12. RBSG response to provisional decision on remedies, paragraph 14.1. HSBCG response to provisional decision on remedies, paragraph 73.
[90] Baringa's response to provisional decision on remedies (p5) said that SMEs should be included in the judging panel. Our view is that, as the assessment criteria and due diligence requirements will have a focus on SME user experience, and the judging panel will include judges with SME expertise, this will be sufficient to ensure that the winning tools deliver the necessary functionality to support the switching process.
[91] The awarding of prizes would be subject to the approval of the Prize Committee, however, their remit is to ensure that procedures are correctly followed, rather than to look at the detail of the comparison tools being considered.
[92] Money.co.uk response to provisional decision on remedies, p2.
[93] LBG response to provisional decision on remedies, paragraph 14.12 and RBSG response to provisional decision on remedies, paragraph 14.1.
[94] HSBCG response to provisional decision on remedies, paragraph 73(b).

relationships rather than objective criteria. If the nominated representative identified such behaviour, they would be well placed to refer it to the appropriate body for further investigation.

16.121 If, for some reason, at the end of the Nesta challenge prize process it failed to produce a winner that met the assessment criteria, the CMA-nominated representative would notify the CMA and this would trigger the safeguard remedy (see paragraphs 16.131 to 16.137).

16.122 We do not think it is necessary to appoint a monitoring trustee to report to the CMA during the challenge prize process as we have direct influence on it through the Prize Committee. Parties agreed with this approach.[95] LBG suggested that the representative on the Prize Committee stay in place beyond the end of the Nesta challenge prize to ensure that the remedies package was delivered.[96] Our view is that this is not required. However, as we explain in Section 19, we will establish a remedies implementation programme board to ensure the effectiveness of our remedies package is maximised, with an objective to address key arising issues affecting interdependencies between our remedies.

16.123 In our provisional decision on remedies we said we would consider obtaining assurances from Nesta to provide greater certainty that the challenge prize process will result in a winner or winners which meet our criteria within a certain timescale.[97] Since publishing our provisional decision on remedies, Nesta has given us regular updates, including copies of its project plans and budgets. We are confident that the challenge prize process is progressing well and will result in a winner or winners which meet our criteria within a reasonable timescale. As such, we do not currently anticipate that we will need to seek formal assurances from Nesta.

- *Project management*

16.124 The challenge prize process is intended to unlock creativity and stimulate innovation. However, this particular challenge prize is a large project, certainly compared with others that Nesta has undertaken in the past, and will need to be closely managed given the number of participants, the complexity of the products involved, the dependencies in terms of data

[95] RBSG response to provisional decision on remedies, paragraph 14.1 and LBG response to provisional decision on remedies, paragraph 14.12(b).
[96] LBG response to provisional decision on remedies, paragraph 14.12(b)(ii).
[97] We are aware that the Nesta challenge prize process will depend on the availability of API data and this is reflected in its timescales.

delivery and the requirements of the regulatory environment in which it will take place.

16.125 Accordingly, Nesta will have to provide or procure suitable and sufficient project management resource and expertise in order to bring the necessary discipline to the process and ensure its successful conclusion. Such resource could be provided by Nesta from its own resources or from a third party, for example a consultancy or professional services firm.

16.126 We have reviewed Nesta's project plans, including its proposals to ensure adequate project management resource. From this review we do not consider we need to mandate that additional resource or expertise are required for the Nesta challenge prize process.

- *Project implementation*

16.127 Following the announcement of the winner or winners of the challenge prize there will be a period during which the successful entrants attempt to commercialise the concept or prototype they have developed.

16.128 In Section 11 we noted that many SMEs go to their PCA provider for their BCA and nearly all of those who seek business loans turn to their BCA provider without looking at alternative lenders. This current lack of shopping around means that the potential number of SMEs that a comparison tool could expect to visit its site is limited. That being so, banks are currently unlikely to view comparison tools as an important sales channel.

16.129 Accordingly, it will be necessary to help potential entrants get their product off the ground and therefore we will order RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG, once the winner or winners of the challenge prize have launched their products in the market and for a period of three years, to:

(a) make available on two or more fair and independent comparison tools, one of which must be a Nesta prize winner, details of their BCAs, standard tariff overdrafts and unsecured small business loan products up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria; and

(b) display prominently on their websites hyperlinks to the comparison tools on which their SME banking products are listed.

16.130 In its response to our provisional decision on remedies, LBG said that all providers should be required to make products available through comparison tools.[98] Similar to our requirement for banks to list on finance platforms, our view is that applying the measures in paragraph 16.129 will be sufficient to direct enough SMEs to comparison tools to incentivise other providers to use these sites as a means of customer acquisition. Operators of comparison tools will have incentives to offer as many products and providers as possible in order to attract customers.

- *Project review and safeguard remedy*

16.131 We expect the combination of measures we have described here to be sufficient to ensure that this remedy is effective and to result in commercially sustainable and innovative comparison tools for SMEs. In particular, a staged assessment process and targeted in-kind support will help ensure that the challenge prize winners meet the required standards, including ongoing sustainability. However, we recognise that the eventual outcome of the Nesta process will not be apparent for perhaps two years after the publication of our final report and will be dependent on a number of factors, such as technological developments, that are themselves currently subject to rapid change and some uncertainty.

16.132 In their responses to our provisional decision on remedies, LBG and RBSG agreed that a safeguard remedy was needed.[99] Barclays,[100] however, did not think that a bank-created comparison tool would be satisfactory for reasons of credibility and the permanent funding requirements of a comparison tool. It said that we should reconsider existing tools in the market and those about to be launched to understand whether they better met the needs of SMEs. As discussed in paragraph 16.87, our view is that these tools currently do not meet the needs of SMEs. Should the Nesta challenge prize not result in viable winners, we would need to be certain that our AEC could be addressed in another way.

16.133 Therefore, we will include a safeguard remedy in our Order, which requires the larger SME banking providers in GB and NI[101] to bring about the creation and funding of a new SME comparison tool, through a more traditional procurement process, to a specification approved by the CMA, including measures to ensure the independence of the site. We will also require these banking providers to make available on this comparison tool, details of their BCAs, standard tariff overdrafts and unsecured small business loan products

[98] LBG response to provisional decision on remedies, section 14.
[99] LBG response to provisional decision on remedies, paragraph 14.12 and RBSG response to provisional decision on remedies, paragraph 14.2.
[100] Barclays response to provisional decision on remedies, paragraph 16.7.
[101] RBSG, LBG, Barclays, HSBCG, Santander, Danske, BoI and AIBG.

up to a value of £25,000, including prices, fees, terms, conditions and eligibility criteria, and display prominently on their websites hyperlinks to the comparison tool.

16.134 The safeguard remedy would be triggered in two situations:

(a) First, the safeguard remedy would be triggered if, at the end of the Nesta challenge prize process, it failed to produce a winner that met the assessment criteria. In this situation, the CMA's nominated representative would notify the CMA which would, in turn, trigger the safeguard remedy.

(b) Second, in the event that the Nesta process does produce one or more winners, the CMA would review the outcome of this element of our remedies package once the winner or winners have begun trading and after sufficient time has passed to enable a reliable assessment of their business prospects. We think that a period of 12 to 18 months after their commercial launch would be needed before such a review could be conducted. If this review finds that no tools resulting from the Nesta process were viable at that time (because they were not, for example, operationally or commercially viable and sustainable), the CMA's ability to implement the safeguard remedy would be triggered.

16.135 LBG said that we should clearly define the criteria for the activation of the safeguard remedy in the event that no tools resulting from the Nesta process were viable at the time of review.[102] We will further consider the criteria for triggering the safeguard remedy during the remedy implementation stage.

16.136 In response to our provisional decision on remedies, Santander said that it thought the safeguard remedy posed the risk of being a 'double remedy'.[103] We do not think this would not be the case. The safeguard remedy would only be triggered in the unlikely event that the Nesta challenge prize failed to result in a viable winner or winners. If the safeguard remedy were triggered it would, therefore, be the sole remedy to the AECs we found. We do recognise, however, that this could occur after the banks had funded the Nesta challenge prize process. However, as outlined in paragraph 16.141, we do not think the combined cost of the challenge prize plus the safeguard remedy is disproportionate.

[102] LBG response to provisional decision on remedies, paragraph 14.12.
[103] Santander response to provisional decision on remedies, paragraph 2.5(c).

16.137 We acknowledge that parties have raised concerns about the ongoing funding for this site.[104] Our view is that, after an initial period, it is likely that funding for the maintenance of this site will be largely, if not wholly self-supporting, from the commercial relationships between banks making their products available on the site and the site itself. We would expect banks to make up any shortfall.

Cost of remedies

16.138 The Nesta challenge prize has a proposed prize fund of up to £5 million to be directed towards a combination of in-kind support for entrants and cash prizes. Nesta will also necessarily incur administrative costs and, perhaps more significantly, costs in managing the 'data sandbox' exercise which may require the procurement of external technical, project management services. We do not think that the total cost of the Nesta project to providers would exceed £10 million.

16.139 Santander said that the requirement to fund the Nesta challenge prize was a 'significant diversion' of its limited resources.[105] Our view is that Santander should be required to participate and contribute funding to the Nesta challenge prize because it is a significant provider of BCAs, having a volume market share of [5–10]% in 2015. However, we also note that it has a smaller volume share of SME lending ([0–5]%) in 2015. As this remedy is designed to equally address issues in both the BCA and SME lending sectors, we think it is appropriate to reflect different shares of BCA and SME lending by taking the approach outlined in paragraphs 16.98 to 16.104.

16.140 BoI said that the scope and cost of the project could be primarily determined by the larger banking groups and, as such, the contributions from the NI banks could be 'excessive' in absolute terms. To prevent this it suggested that the total cost is capped for NI banks.[106] Given that we do not think the total cost will exceed £10 million and as NI banks' shares of contributions will be relatively small we do not think a further cap is necessary. Furthermore, Nesta, with input from the CMA, will decide the scope and cost of the challenge prize and the banks will have equal opportunity to be involved, so the bigger banking groups will not have undue influence in the process.

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[104] Barclays response to provisional decision on remedies, paragraph 16.7, RBSG response to provisional decision on remedies, paragraph 14.2 and Santander response to provisional decision on remedies, paragraph 2.5(c).
[105] Santander response to provisional decision on remedies, paragraph 2.8.
[106] BoI response to provisional decision on remedies, paragraph 4.2.

16.141 Should the safeguard remedy be required, we anticipate that its cost will be in the range of £1–£2 million, with it likely to fall somewhere close to the middle. Our estimate has been informed by the CMA's estimate of the costs for creating a similar site in the payday lending market investigation, where it concluded that the costs would not be more than £1 million.[107] We think that creating a site for SME banking would likely be more expensive due to the range and complexity of products involved.

16.142 We do not think that the net costs to banks of listing their products on finance platforms and, subsequently, Nesta prize winners' websites would be significant. Because of the way our remedy has been specified, platform commission rates will be commercially negotiated between each bank and platform or comparison tool and could thus be expected to reflect the value to providers of listing on these sites.

Additional measures to facilitate comparisons of SME banking products

Availability of 'soft' searches

16.143 One potential consequence of greater transparency and shopping around is that the number of SMEs searching for lending products and undergoing credit checks from CRAs is likely to increase.

16.144 Currently, when credit checks are undertaken by CRAs, a record is frequently left on the SME's credit file. Without the ability for banks to conduct a 'soft search', there is a risk that SMEs might find that shopping around negatively affects their credit rating and, when actually applying, they might be offered worse terms or prevented from obtaining a loan.

16.145 We are therefore recommending to HMT that it works with CRAs and SME lenders to enable soft searches or quotation searches to take place for SME lending products. This is because:

(a) a number of parties have told us that this is an issue and have been generally supportive of a solution in this area;

(b) it appears technically possible: we understand that at least one CRA, Equifax, is currently able to provide 'soft' searches for SMEs;

(c) for personal customers, a soft credit check already enables banks to use limited information about the customer (typically name, date of birth and

[107] Payday lending market investigation final report, footnote 933.

a short address history) to check their credit history and therefore provide an indicative quote and likelihood of acceptance; and

(d) within SME lending, even when records are left on credit files from searches relating to indicative offers, we understand that lenders typically interpret information themselves.

16.146 Our view is that HMT is best placed to take this recommendation forward. It has been involved with similar initiatives in the area of consumer lending and is already working with CRAs under the SBEE Act. We would expect HMT to start to undertake this work shortly after the publication of our final report.

16.147 Barclays suggested that our concerns about shopping around potentially negatively affecting SMEs' credit ratings could be more directly addressed by limiting or removing lenders' ability to take recent search activity into account in their risk and pricing models.[108] Our view is that soft searching is a better solution because it indefinitely excludes searching activity from credit ratings.

16.148 In responding to this proposal, parties raised some issues which HMT should consider in its review.

(a) The accuracy of the search results and any resulting eligibility indicator or quotation will depend on both the quality[109] and quantity[110] the data input.

(b) Santander said that the review should consider other data-sharing initiatives, the costs (specifically that lenders could be required to pay twice – once for a soft search and then for the full search) and data protection restrictions, for example whether consent is required from all directors of a business.[111]

Providing SMEs with expert financial advice

16.149 Our research and other evidence we have received suggests that SMEs tend not to seek external financial advice when acquiring banking services and when applying for finance but instead go straight to their bank.

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[108] Barclays response to provisional decision on remedies, paragraph 16.9.
[109] RBSG response to provisional decision on remedies, section 17.
[110] LBG response to provisional decision on remedies, paragraph 16.3.
[111] Santander response to provisional decision on remedies, paragraph 14.8.

16.150 Qualitative research undertaken for us by Research Works[112] indicated that the advice of accountants, for example, while being trusted, was not sought very frequently and our quantitative research among SMEs reinforced this conclusion. Only 1 to 2% of SMEs overall cited advice from accountants as being important in their choice of a BCA provider though this rose to 6% among start-ups.[113]

16.151 Survey research commissioned by the BBB[114] indicated that fewer than one in five SMEs had ever sought external advice when applying for finance,[115] 2% talked to an accountant first when considering raising finance but 54% spoke first to their bank.[116] Only half of those who said they were willing to take external advice were also willing to pay for it.[117]

16.152 The Institute of Chartered Accountants in England and Wales (ICAEW) referred us to the SME Finance Monitor which suggested that SMEs were somewhat more likely to seek advice when applying for larger loans. 30% of SMEs sought advice for loans in excess of £100,000 and 26% for loans of between £25,000 and £100,000, but only 9% sought advice for loans of £25,000 or less.[118] To put this into context, the BBB survey found that 71% of SMEs who had sought finance in the previous three years had borrowed £25,000 or less.[119]

16.153 Professional advisers could help SMEs make informed choices when acquiring financial products and in particular when applying for finance. For example, they could direct SMEs to comparison tools where they can compare a range of products, rather than going straight to their bank.

16.154 We considered some current initiatives intended to help provide advice to SMEs.

16.155 The ICAEW referred to its Business Advice Service whereby businesses can access a free advice session with member firms across the UK. It also told us that its Business Finance Guide,[120] produced in association with the BBB, had been extremely successful and that an interactive version of the guide was currently in preparation.

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[112] SME Customer Research, July 2015.
[113] SME follow-up survey results, August 2015.
[114] 2015 Business Finance Survey, British Business Bank, February 2016.
[115] ibid, slide 23.
[116] ibid, slide 11.
[117] ibid, slide 24.
[118] Advice prior to overdraft or loan application, Q3 2014-Q4 2015, SME Finance Monitor.
[119] 2015 Business Finance Survey, British Business Bank, February 2016, slide 10.
[120] This is available both on the ICAEW's and the BBB's websites.

16.156 BIS launched the Growth Vouchers Programme in England on 27 January 2014.[121] The aim of the programme is to encourage small businesses to access expert, including financial,[122] advice which could help them grow, and through an RCT to provide robust estimates of its success in helping small businesses grow. The initial results of the RCT were published in February 2016. When the programme closed for applications in March 2015, over 28,000 businesses had successfully enrolled and three-quarters of these businesses received a voucher that offered up to £2,000 to cover half the costs of buying strategic business advice from private sector suppliers on the Online Marketplace.[123]

16.157 We think that initiatives like these will complement the remedies that we have decided to adopt. We are therefore recommending to BEIS that it works with the BBB and professional associations to explore other ways in which their members can channel advice on choice of providers and sources of finance to SMEs.[124] We anticipate that this advice would focus on raising awareness of our remedies package and recommending that SMEs search and switch their financial products.[125] We expect BEIS to be able to start to undertake this work relatively shortly after the publication of our final report.

Measures to reduce incumbency advantages by increasing the sharing of SME data

Summary of the remedy

16.158 Our additional SME remedies described above are currently limited in scope to lending products with a value of up to £25,000, so they do not directly address the barriers to lending for SMEs seeking higher-value loans. Although we expect the market for larger loans to benefit from the increased engagement of SMEs following the implementation of our remedy package, price indicators or comparison tools in themselves would be of limited assistance for SMEs seeking larger loans.

16.159 There are, however, ongoing commercial, technological and regulatory developments, such as that arising from developing open API standards and

[121] Growth Vouchers Programme Evaluation, Cohort 1 – Impact at six months.
[122] ibid. The take-up of advice on raising finance compared with other topics is shown in chapter 3.
[123] ibid, p10.
[124] We will also discuss with the bodies responsible for business policy in the Devolved Nations the potential for equivalent initiatives.
[125] While there is a role for advisers to recommend particular products via commercial relationships, we think that these relationships will develop as searching and switching becomes more normal in the SME banking sector. Therefore we do not see a role for BEIS to promote these kinds of relationship.

the SBEE Act, which are likely to facilitate the greater sharing of SME information in support of higher-value loan applications.

16.160 These developments will allow SMEs greater choice of lender, as providers other than their BCA provider will be able to more easily assess their creditworthiness and provide an indicative lending decision. However, these developments will require time to fully meet their objectives of wider SME data sharing. We have therefore decided to introduce the measure summarised in Figure 16.3.

Figure 16.3: Measures to reduce incumbency advantages by increasing the sharing of SME data

We have decided to make a recommendation to HMT to review the efficacy of the ongoing commercial, technological and regulatory developments aimed at facilitating the greater sharing of SME data in two years following the publication of our final report (ie the summer of 2018).

If HMT finds that these developments have not progressed sufficiently to enable the sharing of SME information to allow SMEs to submit multiple finance applications, we recommend that HMT establishes a working group to progress this objective.

How the remedy addresses the AECs and/or the resulting customer detriment

16.161 As noted above, our remedies on SME lending do not directly address the barriers to lending for those SMEs seeking larger amounts of finance. For those SMEs, providers require more information to satisfy their credit risk assessment, and therefore, they are unable to currently provide indicative lending decisions.

16.162 Further, we have found that where those SMEs have access to a relationship manager, they are more likely to negotiate either the price or term of the loan, which although largely beneficial for SMEs, has implications on the ability of SMEs to obtain clear pricing information.[126]

16.163 In our Remedies Notice, we proposed a measure to build on existing HMT commercial open data and data-sharing initiatives to establish networks through which commercial information could be shared between SMEs and financial services providers.[127]

[126] See Section 8.
[127] Remedies Notice, p37.

16.164 For those SMEs requiring higher-value finance, the sharing of the key business and financial information required by providers to provide an indicative lending decision, would be particularly beneficial:

(a) The information will be available to and accessible by all eligible providers, thus reducing the information asymmetry between the SME's BCA provider and other prospective providers, and allowing the others to price more accurately and quickly.

(b) SMEs will be able to submit multiple applications at once, thus saving them time and effort.

(c) Following the provision of an indicative lending decision, SMEs will have access to pricing information across multiple providers, similar to that provided via a comparison tool for smaller finance requirements.

16.165 The sharing of information in this manner would likely be more effective than the provision of a portable credit history, as required under the 2002 SME banking undertakings,[128] for the following reasons:

(a) The relevant transactional information is accessible to SMEs at all times and they are not required to request it from their existing BCA provider.

(b) The information is accessible to all prospective lenders, allowing SMEs to automatically submit multiple applications at once (as opposed to manually submitting individual applications to each provider).

Remedy design considerations

16.166 We summarise below our consideration of issues relating to the design of the remedy, covering:

(a) the type of information required by a provider to issue an indicative lending decision to an SME;

(b) the feasibility of sharing a common set of information that would allow providers to issue an indicative lending decision to SMEs; and

(c) the recent commercial, technological and regulatory developments that are likely to facilitate the sharing of SME information.

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[128] Clauses 15 and 16 of the behavioural undertakings require the providers subject to the undertakings (upon request from any of their SME customers) to provide, free of charge, an up-to-date credit history to any other bank as requested by the customer. The banks are not obliged to provide more than two such credit histories for free over a period of 12 months. We have decided to release this undertaking. See our final decision on the review of the 2002 SME banking undertakings.

16.167 We set out our detailed analysis of these design considerations in Appendix 16.3.

Type of information required for an indicative lending decision

16.168 The type of information that providers would require to issue an indicative lending decision would be dependent on the provider's requirements, the individual circumstances of the SME and the type of finance that they required, but would likely include the following information:

(a) background information about the SME, such as information about senior management;

(b) financial information, such as historical accounts and forecasts;

(c) the reason for the finance requirement;

(d) the amount of finance required;

(e) the type of finance required;

(f) the structure of the debt (ie the term and the amortisation/repayment profile); and

(g) details of the security being provided (if applicable).

Feasibility of a common information set across providers

16.169 The type of information required by providers to issue an indicative lending decision is much narrower in scope than that required to perform a credit risk assessment for the purpose of a firm lending decision. The standardisation of credit risk assessment among providers is neither likely nor desirable.

Recent and ongoing commercial, technological and regulatory developments

16.170 There are a number of commercial, technological and regulatory developments that are likely to facilitate the sharing of SME information, which should enable SMEs to consider a wider pool of providers when seeking finance, including higher-value loans.

16.171 This suggests that initiatives designed to facilitate the greater sharing of SME information, which could be used to support multiple finance applications, could emerge out of the normal competitive process.

Implementation issues

16.172 We have decided not to adopt a remedy that imposes additional data-sharing obligations on SME lending providers. The commercial, technological and regulatory initiatives discussed above are likely to facilitate the greater sharing of SME information, thus enabling SMEs to take steps to consider alternative lenders when seeking finance.

16.173 Instead we are recommending to HMT to undertake a review of the efficacy and impact of these developments. This should take place in two years following the publication of our final report (ie the summer of 2018) to allow sufficient time for the development of these initiatives.

16.174 If HMT finds that the developments have not progressed sufficiently to enable the sharing of SME information to allow SMEs to submit multiple finance applications, we recommend that HMT establishes a working group to progress this objective.

16.175 HSBCG queried whether the review should take place in four years so as to allow some of the developments to become established. HSBCG was concerned that if a review was conducted too soon, there was a risk that it would be difficult to conduct a balanced assessment of the impact of the various significant and interrelated commercial, technological and regulatory developments.[129]

16.176 We think that it is appropriate for HMT to conduct a review in two years, as if HMT finds that commercial, technological and regulatory developments have not progressed sufficiently to enable the sharing of SME information to allow SMEs to submit multiple finance applications, it is important that it can intervene expediently to drive the process forward.

Cost of remedies

16.177 There will be no immediate costs associated with the implementation of this remedy, as we have decided that HMT's review should take place in two years.

16.178 To the extent that HMT finds that the market has not developed sufficiently, the associated cost of any subsequent initiative will depend on the extent of the intervention required to allow SMEs to share their information in a manner that enables them to consider multiple finance providers.

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[129] HSBCG response to our provisional decision on remedies, paragraph 86.

Measures to make account opening easier and improve the switching process

Summary of the remedy

16.179 We have highlighted that for SMEs, the account opening process can be lengthy, onerous and time consuming depending on the complexity of the businesses,[130] and noted that this reflected, in part, banks' processes for undertaking anti-money laundering, counter-financing of terrorism (AML/CFT) and consumer due diligence (CDD) such as Know Your Customer (KYC) checks.[131]

16.180 The Research Works SME qualitative research identified three barriers to BCA switching: comparing providers, making an application to a new bank and the switching process itself.[132] Those who saw the application process as a barrier to switching also tended to see themselves as time-poor. Typically, this group had little appetite for the perceived complexity of the application process which, for some, was a barrier to switching in its own right.[133]

16.181 We have concluded that the account opening process is a barrier to switching for some SMEs. To address this issue, we have decided to introduce a remedy to standardise and simplify BCA opening procedures.

16.182 In our provisional decision on remedies, we proposed to require BCA providers to agree and adopt, a standard form setting out a core set of questions, and evidence requirements for opening a BCA. After considering the responses and the progress made by Project Bulldog[134] in relation to this remedy, we consider that the focus of this remedy should be on the core set of standard information and evidence requirements to open a BCA rather than having a standard account opening form or a common set of questions.

16.183 The remedy is summarised in Figure 6.4.

[130] See Section 8.
[131] ibid.
[132] We are addressing the issue of comparing providers earlier in paragraphs 16.64–16.157 and improvements to the switching process in Section 14.
[133] Research Works, Qualitative research report, paragraph 4.3.2.2.
[134] Project Bulldog involved Oliver Wyman working with the BBA and the major banks, the main objective of which was to explore possible convergence of BCA application requirements.

Figure 6.4: Remedy to standardise BCA opening procedures

We have decided to make an Order to require BCA providers with at least 20,000 active BCAs to agree and adopt, subject to the CMA's approval, a core set of standard information and evidence requirements for SMEs opening a BCA.

We envisage that the an industry working group convened by the BBA[135] will:

(a) agree a core set of standard information and evidence requirements to open a BCA, in accordance with the FCA's guidelines, relevant regulations and industry guidance;[136]

(b) specify the categories of SMEs which the core set of standard information and evidence requirements should apply to, and the categories of SMEs, which ought to be excluded from the scope of this remedy;

(c) prescribe where the core set of standard information and evidence requirements (including, where appropriate, proposed changes to these) for opening a BCA will be made available (eg online) along with clear terminology, instructions and guidelines, including what will be required for verification, either in person at a bank branch, or online or via the telephone;

(d) develop guidelines regarding how banks promote and communicate the requirements for opening a BCA to SMEs in light of this remedy;

(e) devise a governance mechanism for a periodic review of the core set of standard information and evidence requirements, for example in light of any regulatory developments; and

(f) propose a timetable including key milestones for implementing this remedy.

We expect the BBA-convened industry group to invite the FCA to attend its meetings as an observer, and we have recommended to the FCA that it does so.

We expect the BBA-convened industry group to present its proposal to implement this remedy covering points (a) to (f) above to the CMA within one month of our final report or soon thereafter.

We will consider appointing a suitable Implementation Trustee (whose services will be paid for by providers covered by this remedy, and with a mandate approved by the CMA) to oversee the implementation of this remedy, if the industry group is

[135] The BBA is the leading trade association for the UK banking sector with 200 member banks.
[136] For example by the Joint Money Laundering Steering Group (JMLSG). JMLSG is an industry-led body that gives practical assistance in the interpretation of the Money Laundering Regulations (MLR) and defines good industry practice. It is made up of the leading UK trade associations in the financial services industry.

unable to produce a proposal that is acceptable to the CMA within one month of our final report or soon thereafter.

We require this remedy to be implemented within 12 months of our final Order but will consider requests for extension to this deadline.

How the remedy addresses the AEC and/or the resulting customer detriment

16.184 This remedy will lower barriers to switching by making the account opening process simpler. It requires BCA providers to agree and adopt a core set of standard information and evidence requirements for SMEs opening a BCA.

16.185 This will help in harmonising information and evidence required by banks to undertake essential CDD, thus simplifying the BCA opening procedures.[137] Further, it will enable SMEs to know in advance what information 'refresh' is likely to be necessary in respect of fulfilling KYC checks while switching accounts, thus making the switching process less onerous.

16.186 This remedy will enable collection of consistent data by providers at the time of opening a BCA, and also facilitate sharing of this data (at an SME's request) between banks and/or with the customer at the time of switching. The development of open APIs will help in enabling secure sharing of data collected at the time of opening a BCA between banks, which will facilitate the account opening process, and therefore switching.

16.187 In particular, our measures to develop and require the adoption of open API standards set out in Section 13 will enable banks, when requested to do so by a customer, to share their data with a third party. Thus, an SME opening a BCA with a new provider could instruct their old bank to transfer relevant information to new banks where they were seeking to open a BCA.

16.188 Overall, we consider that our remedy, which takes into account banks' requirements as well as obligations under Money Laundering Regulations 2007 (MLR) and other regulations, will help in simplifying the BCA opening procedures and addressing the AEC.[138] It will be best if this remedy is developed and implemented by an industry-led initiative.

[137] We note that information that a bank seeks from a business customer at the point of account opening is for variety of reasons, including but not limited for the purpose of complying with MLR.
[138] Although our omnibus survey results suggested that requiring all banks to use the same application form and standardise their evidence requirements may not appeal to users, this may be down to the respondents being confused by the lack of clarity in what standardising requirements would entail.

Remedy design considerations

16.189 We summarise below our consideration of issues relating to the design of the remedy covering:

- *(a)* Applicability: which parts of the BCA opening process should the remedy apply to?
- *(b)* Scope/coverage: to what types of SME should the remedy extend to?
- *(c)* The desirability of having an outcome measure on the length of the BCA opening process.

16.190 We set out our detailed analysis of these design considerations in Appendix 16.4.

Applicability to BCA opening process

16.191 We have decided that only those activities which relate to the completion of the BCA opening 'form'[139] and provision of the required supporting evidence should be standardised at the industry level. Standardising the processing[140] of the BCA opening application by the banks, and other account onboarding processes[141] are either not practicable or desirable due to regulatory, competition or other reasons.

16.192 This remedy would require BCA providers to adopt a core set of standard information and evidence requirements for opening a BCA, which could be, if required, supplemented with additional questions or information, thus allowing for specific risk and strategy differences between banks.

16.193 A core set of standard information requirements would also enable capture of consistent data needed to open a BCA across the industry. However, the mechanism for capturing and sourcing the standard information will continue to provide opportunities for innovation by banks, and this information could be collected at different points in banks' processes and by using different methods, for example directly from Companies House.[142]

[139] We recognise that for many providers, not all information is collected through a 'BCA opening form' but is provided by the customer or sourced by the providers through other means, for example verification through Companies House.
[140] This includes carrying out necessary AML compliance activities and CDD checks (which might include seeking further information and evidence as necessary and appropriate in the circumstances of a specific application).
[141] For example issuing debit/credit card, cheque book, providing online access, communicating details about account features, facilities.
[142] In some instances, this may also include collection of information soon after the account has been opened.

16.194 The operationalisation of the remedy will require providers to capture standard information provided by the customers to open a BCA. This may be achieved through having common data fields,[143] which will also facilitate the sharing of this information between banks through, for example, open APIs.[144]

16.195 It will be desirable that questions asked by providers to collect the core set of standard information to open a BCA are broadly consistent across the industry. However, we recognise that providers can have different communication styles with customers, and subject to ensuring consistency in the standard information collected, should continue to have flexibility around how these questions are asked, the exact wording, and as stated earlier, the method of collection of standard information.

16.196 The core set of standard information and evidence requirements specified should be sufficient to allow a customer to open a BCA in most circumstances. While developing its proposal for CMA's approval, the BBA-convened industry group should aim for a minimum amount of core information and evidence requirements for opening a BCA, taking into account their regulatory duties, for example regarding AML. However, banks should have the flexibility of asking additional questions in specific circumstances, for example where additional AML checks were required or related to additional services or account features.[145]

16.197 The proposal we seek from the BBA-convened industry group to implement this remedy should also allow for adequate flexibility for banks so that they can continue to innovate to make the account opening process easier for BCA customers. For example, the industry group may consider whether banks should have flexibility not to gather specific standard information other banks may reasonably require to open a BCA. Any such flexibility should be given in order to avoid the implementation of the remedy harming innovation or lengthening banks' existing account opening procedures, but without undermining the benefits of the remedy.

Scope/coverage

16.198 We expect the coverage of the remedy to extend beyond SMEs with simple ownership structures, for example sole traders, although we recognise that it will be difficult for all categories of SMEs to be covered by this remedy.

[143] Although not necessarily using the same collection method or channel.
[144] See Section 13.
[145] We note that there will be incentives for banks not to ask excessive number of additional questions to make the process easier for their customers.

16.199 The BBA-convened industry working group should make a recommendation to the CMA on segments of the SMEs that ought to be taken out of the scope of the remedy.

The desirability of having an outcome measure on the length of the BCA opening process

16.200 Due to the practical difficulties in prescribing an outcome measure or a target for average time it takes a bank to open a BCA, we have decided not to mandate this as part of this remedy.

16.201 We note that this aspect of the account opening process is addressed in our remedy to enable consumers and SMEs to make comparisons between providers on the basis of their service quality as set out in Section 13.

Implementation issues, including timings

Composition and the terms of reference of the industry group

16.202 HSBCG told us that the Project Bulldog working group (with representatives from Barclays, LBG, RBSG, Santander, HSBCG as well as the BBA) were close to agreeing a core set of approximately 55 questions, comprising a sufficient set of questions regarding financial crime and money laundering for standard due diligence to be fulfilled and enable the BCA to be opened in the vast majority of cases. It stated that the Project Bulldog working group was of the view that the core set of standard questions would cover the vast majority of BCA applications by different types of SME (regardless of what type they are).[146]

16.203 Similarly, LBG informed us that it had participated in Project Bulldog and noted that in particular, since March (2016):[147]

(a) the five participant banks continued to make good progress in identifying common aspects of their BCA opening processes and the associated evidence requirements during the Project Bulldog workshops held in April and May 2016;

(b) there was significant convergence of requirements for sole traders and single director companies, as well as some convergence for simple

[146] HSBCG response to provisional decision on remedies, paragraphs 79 & 81.
[147] LBG response to provisional decision on remedies, paragraph 15.4.

partnerships and other limited companies (for which the participating banks' requirements were more diverse); and

(c) the output of Project Bulldog was being transferred to the BBA to enable continued development in line with the CMA's proposed remedies.

16.204 However, RBSG told us that the need to reach consensus on complex issues of scope and timing, as well as the substantive issues, including a core question/answer set, was likely to prove extremely challenging.[148]

16.205 The BBA informed us that the initial phase of Project Bulldog had been paused, and the next step was for it to convene an industry working group to consider the project report submitted by Oliver Wyman with an objective of developing a proposal to be submitted to the CMA for implementing this remedy. The BBA also told us that it would be circulating this report to the 'challenger' and NI banks and invite wider participation in the industry group.

16.206 According to LBG, it will be critical that the industry group has appropriate governance and sufficient authority to ensure the cooperation of all BCA providers. It considered that the industry group should be established by CMA Order, and a suitably qualified and independent individual (paid for by providers and with a mandate approved by the CMA) should act as its Chair. Further, it stated that the CMA Order should also require BCA providers to comply with the decisions of the industry group.[149]

16.207 We consider that an industry group convened by the BBA will be a suitable means of building on the outputs of Project Bulldog, and producing a proposal for CMA's approval to implement this remedy.[150] This industry group would need to have a wider participation and effective governance to ensure that the views of major as well as smaller providers and those from NI are adequately reflected. It would also benefit from suitable involvement of and communication with potential entrants to the BCA market as well as SME trade bodies.

16.208 LBG highlighted the need for BCA providers to have an ongoing obligation to cooperate since BCA opening requirements changed over time to allow for the common forms to be updated.[151] It stated that the CMA Order should

[148] RBSG response to provisional decision on remedies, paragraph 15.2.
[149] LBG response to provisional decision on remedies, paragraph 15.23.
[150] The CMA would need to approve any proposal that is developed, to ensure that the AEC is addressed.
[151] LBG submission on the interaction between the SME remedies and existing SME initiatives, paragraph 3.33(b).

provide for the industry group to be reconvened as required to oversee any changes (eg due to changes in legislation).[152]

16.209 We recognise that the core set of standard information and evidence requirements to open a BCA will need to be reviewed periodically, for example to take into account changes in regulation, in particular the AML regime.[153] We have therefore invited the BBA-led industry group to propose a mechanism for such a review to the CMA. This review mechanism is intended to ensure that the core set of standard information and evidence requirements remain consistent across banks, and not to require every change that an individual bank wants to make to its BCA opening process to be agreed by all banks. The proposed changes and updates to the core set of information and evidence requirements should also be in the public domain.

16.210 RBSG told us that this remedy would require the involvement and support of bodies such as the FCA, the government and input from the JMLSG. LBG told us that the development and implementation of this remedy would be facilitated by the involvement of the FCA.

16.211 We note that the FCA is responsible for supervising how banks comply with the MLR and that they have systems and controls to mitigate the risk that they may be misused for the purposes of financial crimes of all kinds.

16.212 We have therefore decided to make a recommendation to the FCA that it attends the BBA-convened industry group as an observer. The FCA has told us that it will be willing, if invited, to observe the discussions at the proposed industry group.[154]

Method and timing of implementation

16.213 The purpose of this remedy will be adequately served if BCA providers with a minimum of 20,000 active BCAs per provider are required to implement this remedy. This will cover the majority of active accounts, including larger providers in both GB and NI, while excluding the large number of very small providers.[155]

16.214 As we have noted, the initiative by the BBA to convene an industry group to build upon the work done as part of Project Bulldog is a suitable means to

[152] LBG response to provisional decision on remedies, paragraph 15.25.
[153] For example, the UK must implement the European Fourth Anti-Money Laundering Directive into UK law by June 2017, which is intended to further embed the risk-based approach across Europe.
[154] The industry group should also coordinate its work with other relevant bodies, for example the JMLSG.
[155] Other banks will be free to adopt the core set of information and evidence requirements, and also feedback their comments to the BBA-led industry group.

make a proposal to the CMA to implement this remedy. We also encourage the BBA to work with banks and other relevant bodies (for example, the FSB, Bacs) to develop an effective communication strategy to inform SMEs about the requirements for opening a BCA once the remedy has been implemented.

16.215 Regarding the timing of implementation, we recognise that it would be subject to specific details to be agreed in the proposed industry group, for example the categories of SMEs to be covered by the common BCA opening form.

16.216 LBG stated that it would be feasible for the industry group to agree standard question types and guidance materials for UK domiciled firms that were sole traders, partnerships, or single director Limited Companies within three to six months of the establishment of the industry group. It said that industry-wide implementation should then take place within a period of time defined by the industry group – sufficient time would be needed to ensure that the standard question types and guidance materials could be incorporated into providers' BCA opening processes appropriately.[156]

16.217 RBSG considered that further engagement was needed with banks and the BBA before any timetable was mandated by the CMA given that the scope of the remedy would benefit from further clarification before any timetable could be meaningfully agreed.[157] It stated that the successful roll-out of this remedy would depend on the ability of all banks to agree on and then implement harmonised account opening procedures, and this would require time to be built into the process to allow proper discussion of the issues followed by a period of implementation. RBSG had significant concerns that the CMA expected banks to provide an initial proposal to cover the detailed ToR of the industry group only one month after the final report.[158]

16.218 LBG considered that it was feasible for providers to present individual or joint proposals to the CMA regarding the composition and governance of the industry group within one month of the CMA's final report. However, it stated that given the wide range of participants in the industry group, it might be challenging to finalise standard question types and guidance materials until the industry group had been established (with appropriate powers) by CMA Order, and its Chair had been appointed.[159]

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[156] LBG response to provisional decision on remedies, paragraph 15.27.
[157] RBSG response to provisional decision on remedies, p2.
[158] Ibid, paragraph 15.2.
[159] LBG response to provisional decision on remedies, paragraph 15.26.

16.219 Barclays told us that the changes to core account opening systems were incredibly complex to ensure that changes were handled responsibly, successfully and at no detriment to the customer. Further, the process to mobilise a change would include agreeing funding and securing resource ahead of the necessary analysis and design to understand the full impact, both technically and operationally, and even a small change would need to be applied across the entire estate and the subsequent impact to service would need to be assessed.[160]

16.220 HSBCG stated that the work plan produced by Oliver Wyman to meet the CMA's timelines (as specified in our provisional decision on remedies) could be achievable provided there was industry support, and that HSBCG was very keen to move forward this project at pace.[161] It also stated that there was merit in one body, such as the BBA, having oversight of the progress of the implementation of the remedies package (of SME-specific remedies) to ensure that all was on track and where necessary help unblock any problems.[162]

16.221 RBSG also stated that the BBA was best placed to progress this remedy. In particular, it noted that while it was appropriate to build on the work under-taken by Project Bulldog to date, this involved only five banks and that a wider industry consensus would be required in order to progress this remedy.[163]

16.222 Since progress has already been made in developing the core set of standard questions especially for sole proprietorships and single director companies through Project Bulldog, it looks feasible for the BBA-convened industry group to build upon this work, and present its proposal to implement this remedy to the CMA within one month of our final report or soon thereafter.

16.223 We may consider appointing a suitable Implementation Trustee (whose services will be paid for by providers covered by this remedy, and with a mandate approved by the CMA) to oversee the implementation of this remedy. For example, we may consider this if the industry group is unable to produce, within one month of our final report or soon thereafter, a proposal that is acceptable to the CMA. Further, as we explain in Section 19, we will establish a remedies implementation programme board to ensure the

[160] Barclays response to provisional decision on remedies, paragraph 18.17.
[161] HSBCG response to provisional decision on remedies, paragraph 84.
[162] ibid, paragraph 12.
[163] RBSG response to provisional decision on remedies, paragraph 15.4.

effectiveness of our remedies package is maximised, with an objective to address key arising issues affecting interdependencies of our remedies.

16.224 We will require BCA providers covered by this remedy to implement it within 12 months of our Order being made, but will consider requests for extension to this deadline.

Monitoring compliance

16.225 The monitoring of compliance with this remedy can be done according to the usual CMA monitoring mechanism through banks and/or the BBA providing periodic compliance reports to the CMA.

16.226 After a core set of standard information and evidence requirements to open a BCA have been approved by the CMA and implemented by the industry, these will need to be reviewed periodically through an appropriate governance mechanism.[164] The BBA-convened industry group should develop a governance mechanism for such a periodic review, and include it in its proposal to the CMA.

Cost of remedies

16.227 RBSG told us that coordinating the implementation of this remedy across the industry could be complicated, expensive and time-consuming.[165]

16.228 It also told us that that while Project Bulldog had made good progress in exploring where banks might be able to converge, this had only taken place between five banks and had so far only developed a de minimis question set covering micro-SMEs. Reaching a wider industry consensus that necessitated the new involvement of a much wider group of stakeholders on the standard set of core questions to a level acceptable to the CMA could be expected to be complex and time-consuming.[166]

16.229 Clydesdale told us that from a practical and technical perspective there would inevitably be some costs associated with forms and process changes, website amendments, legal and compliance oversight, staff training and distribution costs.

[164] For example, by a standing committee of the BBA to which the FCA should be invited as an observer.
[165] RBSG response to Remedies Notice, Section 3.6, p39.
[166] RBSG response to provisional decision on remedies, paragraph 15.2.

16.230 LBG stated that there was likely to be significant commonality between providers regarding the data and information they required for BCA opening purposes.[167]

16.231 As we have noted, progress has already been made on this remedy through Project Bulldog driven by a number of BCA providers working with Oliver Wyman and the BBA. Further, this remedy does not require banks to standardise their AML compliance activities, and it may be possible for businesses too complex to benefit from greater standardisation to be taken out of scope of this remedy.

16.232 So, while there may be some additional costs for the banks to implement this remedy, we do not consider that these would be particularly onerous.[168]

16.233 The costs of monitoring compliance with this remedy are also likely to be low since monitoring will be based on banks and/or the BBA providing periodic compliance reports to the CMA.

[167] LBG submission on the interaction between the SME remedies and existing SME initiatives, paragraph 3.29.
[168] We note that in response to our provisional decision on remedies, we did not receive any specific estimates of the costs associated with implementing this remedy.

17. Other remedy options

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17.1 In our provisional decision on remedies we set out remedy options that we were not minded to pursue. These were:

(a) measures to address perceived distortions arising from the widespread use of FIIC accounts, including the proposal to oblige providers to offer minimum interest rates on outstanding balances in current accounts;

(b) structural remedies, and in particular further divestitures from the larger banks; and

(c) requiring providers to establish customer challenge groups (CCGs).

17.2 In this section we explain why we have decided not to include these in our package of remedies. In doing so we address the comments received from those parties that argued in favour of these remedies being put in place either in response to our Remedies Notice and/or in response to our provisional decision on remedies. A group of 'challenger' banks also requested that the CMA consider a number of further possible remedies relating to funding and taxation,[1] which we have considered as part of our analysis of these issues in Section 9. Variants on remedies we are taking forward are discussed in the relevant sections.

Measures that would address perceived distortions arising from the widespread use of FIIC accounts

17.3 In response to our Remedies Notice many respondents commented that FIIC accounts are in fact not free, even when the account is in credit, as the customer implicitly pays through interest forgone on the credit balance. Further, RBSG[2] and TSB[3] said that FIIC distorted customer perceptions of the costs of banking and that the perceived lack of benefits from switching

[1] Challenger banks submission.
[2] RBSG response to Remedies Notice, p4.
[3] TSB response to Remedies Notice, paragraph 24.

was exacerbated by the misunderstanding that banking was free. The FSCP told us that cross-subsidisation, coupled with a lack of transparency in banks' pricing structures and contingent charges, obscured the true cost of having an account.[4] A number of parties reiterated their concerns to us in response to our provisional decision on remedies.[5]

17.4 We agree with the general thrust of these points and consider that the use of 'free if in credit' is an unhelpful misnomer. Indeed, the costs of an FIIC account are not only limited to interest forgone on credit balances, but also can include fees such as foreign transaction fees and same-day bank transfer fees, using for example Clearing House Automated Payment System (CHAPS) to transfer large amounts of money.

17.5 One respondent, Virgin Money,[6] submitted that the prevalence of FIIC in the PCA market was a major contributor to the low levels of switching and that it additionally led to significant cross-subsidies. Virgin Money further submitted that the CMA should seek to introduce remedies that would address the problems it associated with FIIC, through encouraging a market-driven move away from FIIC, with this being preferable to regulatory intervention. Specifically, Virgin Money proposed:

(a) the imposition of limits on charges found to be excessive, unfair and/or regressive; or, if this was not possible

(b) a requirement on banks to pay credit interest on PCAs at or above a minimum level.

17.6 Virgin Money further submitted that the CMA should explore ways in which PCA providers could be encouraged to reduce their reliance on complex and opaque fees and charges, and to compete on headline charges that were clearer and easier for consumers to understand.[7] It reiterated these points in its response to our provisional decision on remedies, stating that it continued to believe that FIIC was the root cause of the low levels of customer engagement and that a move away from FIIC would lead to simpler and more transparent pricing. Virgin Money was disappointed that the CMA had not chosen to pursue remedies that directly encourage such a move.[8]

17.7 We are of the view that it is not necessary to impose limits on charges (beyond our remedy to require banks to set an MMC for unarranged

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[4] Financial Services Consumer Panel response to Remedies Notice, p1.
[5] For example, FSCP response to provisional decision on remedies, p1 and Community Investment Coalition response to provisional decision on remedies, p2.
[6] Virgin Money response to Remedies Notice; Virgin Money supplementary response to Remedies Notice.
[7] Virgin Money supplementary response to Remedies Notice, paragraph 30.
[8] Virgin Money response to provisional decision on remedies, paragraphs 11 & 12.

overdraft usage) or require banks to pay credit interest. This is for two main reasons.

17.8 First, as we set out in Section 6, we have not found that the FIIC model, in itself, is the cause of the lack of customer engagement we observe. Therefore seeking to restrict the offering and use of FIIC accounts would be unlikely to address the competition problems we have identified. In this context we noted that:

(a) switching rates in other countries where FIIC is not the prevailing model for the provision of PCAs, eg the Netherlands, does not suggest that customer engagement is higher under alternative pricing models; and

(b) similarly, switching rates in the BCA market in the UK, which is not an FIIC model, are similarly low to those we observe in PCAs.

17.9 Second, our package of remedies will increase the pressure on banks to compete on charges and fees, and increase the transparency of their charging structures.

17.10 For example, in relation to overdrafts we have decided that PCA providers should provide additional information to users to manage their exposure to unarranged overdraft charges and fees (see Section 15). Similarly, easier comparison with 'reward accounts' or other PCA products which pay interest on positive balances, will make customers more aware of the benefits available elsewhere or that they are foregoing interest on FIIC accounts. More broadly our measures to prompt users to consider alternative products and providers; and to enable easier comparison of PCAs through the adoption of an open API standard and the provision of open data, will in combination increase the transparency and awareness of charging structures, including allowing for the comparison with accounts where better rates of interest are available. Our measures will also help customers make an active and informed choice as to whether a FIIC PCA or another type of PCA is the right product for them.

17.11 It may be the case that our measures could lead customers to switch to interest-paying PCAs or to avoid unarranged overdraft charges and other fees to such an extent as to reduce the prevalence of FIIC accounts. For the avoidance of doubt, we would not consider such an outcome, in itself, to be unwelcome if this were driven by competitive market dynamics, and on this we are in agreement with Virgin Money.

17.12 However, we do not consider that the erosion of the FIIC model should be an objective in itself. Any concerns we have with the FIIC model are not the charging structure in itself, but the absence of transparency about its implicit and explicit costs to customers and the real difficulties customers face in making comparisons with other types of account and in moving to different providers. These are all issues that we are tackling directly with our remedies. If, once these underlying issues have been addressed, some customers continue to make an active and informed choice to use this type of FIIC account, then the justification for second-guessing these choices and constraining them through regulation is weak.[9]

17.13 Moreover, introducing regulatory requirements with the specific objective of driving out the FIIC model could have distributional impacts that many would consider undesirable. A requirement for interest to be paid on credit balances could, for example, result in banks recovering the costs of operating PCAs from monthly fees.[10] The customers who would gain most from such a change would be PCA users with credit balances sufficiently large for the interest payments to exceed the monthly fees, while those with small credit balances would face fees in excess of their interest receipts and would be worse off.[11] It is by no means clear that such a distributional outcome should be actively pursued as an end in itself through a regulatory approach.

Structural remedies

17.14 In our Remedies Notice we considered that structural remedies would be neither effective nor proportionate in addressing the competition problems we had identified, in particular issues derived from weak customer engagement. A consequence of this is that longer-established banks, with larger market shares, have a larger base of established customers and are likely to have a higher proportion of inactive customers. We considered that structural remedies to break up a large bank would not address the fundamental issues we had identified; the creation of two smaller banks, each with a high proportion of inactive customers, would not in itself lead to the AECs we found being addressed. Instead we considered that measures directly targeting the underlying causes of the AEC – ie by improving customer

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[9] Ffrees noted in its response to our provisional decision on remedies that, subject to a level playing field, the model of the banks needed to be changed or disrupted by innovation, technology and free-market economics, not by regulatory intervention, which it noted might itself have unintended consequences for the very people that it sought to help. However, it proposed that banks should no longer be allowed to call their standard accounts 'free if in credit'.
[10] For example, LBG's response to our provisional decision on remedies (paragraphs 19.4 & 19.5) noted that an alternative model to FIIC might include higher credit interest rates, lower overdraft fees and the introduction of monthly fees or transaction charges, which it stated would not be an outcome welcomed by customers.
[11] In response to our provisional decision on remedies (p1), Christians Against Poverty expressed its support that the CMA was not abolishing the FIIC model, stating that many of its clients and other consumers would find it unaffordable to pay even a small fee for a PCA and requiring them to do so could increase the chance of financial exclusion for the poorest.

engagement and facilitating switching – are much more likely to be effective in addressing the competition issues we had identified, and at lower cost.[12]

17.15 Most respondents to our Remedies Notice either agreed with, or did not comment on, our proposal not to consider structural remedies further. However, one respondent, Nationwide, suggested that the CMA undertake further work on the issue of market concentration and consider again whether structural remedies should be adopted. In particular, Nationwide submitted that incumbent providers benefited from scale advantages, which were exacerbated by the weak customer response we identified, which in itself was exacerbated by their large back-book of customers who were likely to be less engaged. Nationwide told us that these factors added to the difficulties of smaller banks to attract customers and win additional market share.[13]

17.16 Further, Nationwide was concerned whether the CMA's proposed remedies to address weak customer response would have a sufficiently immediate impact and questioned whether the recent divestments (of TSB from LBG and Williams & Glyn from RBSG) were necessarily good indicators of the costs and time of divestments. It argued that the market now had experience of how to deal with divestments in the banking sector and could deliver them more efficiently.[14]

17.17 In response to our provisional decision on remedies some parties thought that the CMA should reconsider the need for structural remedies.[15] However, some parties agreed that structural remedies would be costly and/or not effective as they would not increase the likelihood of customers to switch.[16]

17.18 Having considered these responses we remain of the view that structural remedies would not be effective or proportionate.

17.19 On the points submitted by Nationwide, we agree that longer-established providers benefit from a larger customer base, many of which will have been customers with the provider for a prolonged period of time and may be less engaged than more recent customers. Nevertheless, divestment of a large longer-established bank could well simply create two smaller banks with low

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[12] [✂]
[13] Nationwide response to Remedies Notice, Appendix, paragraphs 2.5–2.9 & 4.3.
[14] Nationwide response to Remedies Notice, Appendix, paragraph 4.4.
[15] See responses from the Forum of Private Business, New Economics Foundation and Nationwide which reiterated that the CMA had ruled out structural remedies too hastily. Nationwide stated (paragraph 2.14(ii)) that when the time and costs of divestments were compared with those for organic growth, there was less justification for the conclusion that the time and costs of divestiture were particularly high and that the CMA should also take into account the fact that its remedies package was not expected to have 'full initial impact' until mid-2019.
[16] See responses to our provisional decision on remedies from LBG, paragraph 19.6, and RBSG, p32.

customer engagement and this would not address the AECs we have found. A divestment might induce some additional customer engagement on a temporary transitional basis, particularly among customers who saw themselves as having been transferred against their will to a 'new' bank, but this is clearly not a very desirable way of inducing greater sustained customer engagement.

17.20 We also note that the divestment of Williams & Glyn from RBSG has yet to take place and the divestment of TSB from LBG is still relatively recent.[17] The evidence from these recent banking divestitures suggests that a divestment remedy would be very costly, both for the provider being divested and for customers. In this context, we consider Nationwide's submission that the costs of and time period to implement any future divestment would be lower/shorter than past examples to be optimistic: most of the factors which influenced the costs of the Williams & Glyn and TSB divestments remain. Therefore, we would not expect the costs or time associated with any further divestments to be significantly different. This remains the case even taking into account that the full initial impact of our remedies will not be for a number of years.

17.21 Our remedies, taken together with the important technological changes already affecting retail banking markets, could nonetheless result in significant changes to the structure and operation of retail banking markets. The combination of data sharing through open APIs alongside a more informed and engaged customer base resulting from our remedies, has the potential to facilitate the entry and expansion of providers and intermediaries using fundamentally different business models to traditional banks.[18]

17.22 These developments have the potential to open up retail banking markets to new forms of competition that could lead to new entry, introducing additional supply-side constraints. These changes in supply-side constraints will not necessarily be limited to traditional 'bank' business models. The combination of technological changes and the changes motivated by our remedies could enable the provision of banking services from suppliers from other financial services sectors, or indeed other sectors from outside of financial services. This type of structural change is more likely to result in sustained and transformative improvements to competition, innovation and customer

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[17] TSB has subsequently been acquired by Spanish banking group, Sabadell, in 2015.
[18] New Economics Foundation disagreed that the key lever for change was customer behaviour rather than the structure of the market (see its response to our provisional decision on remedies). It stated that genuine competition and choice required a diversity of providers for consumers to choose from, rather than simply a larger number of major players following the same business model, and that it was this lack of diversity which was a key factor behind the lack of customer engagement. For the reasons set out above we consider that our remedies package, in particular open APIs in combination with our measures to increase customer engagement, may well lead to an increase in providers offering different business models.

welfare than the creation of another one or two smaller ‘traditional’ banks. It is for this and the other reasons described, that we have decided not to pursue divestitures.

Establishment of customer challenge groups

17.23 Which? in its response[19] to our Remedies Notice proposed requiring providers to establish customer challenge groups (CCGs). Which? described this remedy as being part of a broader effort to put mechanisms in place to support a culture shift in banking that focused on the needs of customers. Which? stated:

> For example, this remedy could involve:
>
> - Each bank being required to establish an independent customer challenge group to hold it to account on its engagement with its customers;
> - The challenge group publicly reporting to an independent body on the quality of the bank’s engagement with customers and whether customers’ views have been fully taken into account;
> - Developing reputational, financial and/or procedural incentives based on the challenge group’s report;
> - Holding the bank to account for enabling the challenge group to undertake its work drawing on the appropriate information and skills, and being able to demonstrate its independence; and
> - Holding each challenge group to account for discharging its role effectively and independently.

17.24 We considered whether the addition of such a remedy, or a variant thereof, to our package of remedies would materially increase its effectiveness. Which? noted in its response that CCGs had been used in other regulated sectors. Most prominent of these is in the water sector where as part of the most recent price control review, the water industry regulator, Ofwat, required each of the monopoly water companies to establish CCGs. We are also aware that a similar approach has been used in the airport sector, where statutory advisory bodies were required to engage with airport

[19] Which? response to Remedies Notice, pp2–3.

management and to make recommendations to the boards and executive on proposed airport developments.

17.25 Having considered whether the establishment of CCGs should be a regulatory requirement for retail banks in the UK, we have decided not to include this within our package of remedies. In particular, while we recognise the potential benefit of such a requirement for regulated monopoly companies, such benefit is much reduced for companies operating in markets that have scope for competition.

17.26 As explained in our evaluation of the effectiveness and proportionality in Section 19, we consider that our package of remedies, taken together, will be effective in delivering a more competitive environment, where banks will have more incentives to focus on the needs of their current and prospective customers. Different banks may choose to act on these incentives in different ways. Some may choose to increase their customer focus by putting in place a CCG, or something similar to it. Others may decide to invest heavily in customer research, to improve their product offering or radically simplify their charging structure. We do not see a need to specify a 'one size fits all' approach to how providers in a more competitive environment should seek to meet customers' demands.

17.27 Moreover, there currently exists the potential for consumer and other bodies to assess and comment on how banks engage with and treat their customers, with this being enhanced by the additional information we are requiring providers to make available.

17.28 Which? expressed its disappointment that we were not planning to adopt this remedy, explaining that CCGs were an example of a mechanism that had been used to provide an ongoing basis for firm awareness of and responsiveness to customer views to be tested in contexts where competition between firms alone was unlikely to be sufficient.[20] As set out above, we considered the possible benefits of this remedy but we are of the view that our package of remedies will lead to increased competition between banks alongside greater levels of customer engagement, and that this will in turn lead to a greater focus on the needs of customers without needing to specify any mechanism such as CCGs for doing so.

17.29 Overall, we consider that any incremental benefit from requiring banks to establish CCGs, over and above the benefits arising from our remedies

[20] Which? response to provisional decision on remedies, p1.

package, would be limited and as such we have decided not to adopt this remedy.

18. Relevant customer benefits

18.1 In deciding the question of remedies, the CMA may 'have regard to the effect of any action on any relevant customer benefits (RCBs) of the feature or features of the market or markets concerned'.[1] RCBs are defined in EA02 and are limited to benefits to relevant customers in the form of:[2]

(a) lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market(s) to which the feature(s) concerned relate); or

(b) greater innovation in relation to such goods or services.

18.2 EA02 provides that a benefit is only an RCB if the CMA believes that:[3]

(a) the benefit has accrued as a result (whether wholly or partly) of the feature(s) concerned or may be expected to accrue within a reasonable period of time as a result (either wholly or partly) of that feature or those features; and

(b) the benefit was, or is, unlikely to accrue without the feature or features concerned.

18.3 We have invited parties to inform us of any RCBs to which we should have regard.[4]

18.4 No party submitted any evidence about any RCB. We consider that most of the features we have identified are unlikely to provide benefits to customers. For example, we would not expect RCBs to arise from features such as the lack of customer engagement and/or barriers to switching and searching.

18.5 However, we found that there were linkages from the provision of PCAs to BCAs, with 51% of start-up SMEs going to their PCA provider for their BCA, and 36% doing so without searching at all. One implication of this is that upfront competition for PCA customers could be important to providers, for example, competition for Student/Graduate accounts could result in a longstanding customer relationship covering a number of accounts. We are aware that if our remedies are effective in diluting these linkages, then this might result in weaker incentives on suppliers to compete for first-time PCA customers. This could manifest itself in a number of ways, including less attractive offers for new customers, for example the withdrawal of free

[1] EA02, section 134(7).
[2] EA02, section 134(8)(a).
[3] EA02, section 134(8)(b).
[4] See Remedies Notice, Supplemental Remedies Notice and provisional decision on remedies.

overdraft provision in student accounts. To the extent there would be a reduction in some providers' incentives to compete due to a weakening of linkages, we expect that this will be more than outweighed by the increase in competition and rivalry between providers for new and existing customers, which will arise from our package of remedies.

18.6 We have similarly considered whether our remedies, if they are effective at increasing switching by BCA customers and in diluting the linkages we found between BCA and SME lending, could result in weakened competition for start-up SMEs. This might be, for example, through a reduction in the length of the free banking period typically provided to start-up SMEs when they open their BCA. As set out in Section 8 we do not find that that competition for start-up SMEs is particularly intense, because SMEs are far from fully engaged in the market, with many SMEs either not searching, or not comparing fees across banks, at start-up stage. Therefore, any reduction in competition for start-ups arising from the weakening of linkages between markets, and any resulting reduction in customer benefit, is likely to be limited given that such competition is not particularly intense at present. Moreover, our package of remedies is intended, among other things, to make it easier for start-up SMEs to find BCAs that best meet their needs. Therefore, similar to the case for PCAs, we expect any reduction in competition for start-up SMEs arising from the weakening of linkages between markets to be more than offset by the increase in competition and rivalry that will arise from our package of remedies.

18.7 We have concluded that there are no significant RCBs that might be lost as a result of introducing our package of remedies. Consequentially we see no need to modify our remedy package to take account of RCBs.

19. Effectiveness and proportionality of the package of remedies

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19.1 Based on our assessment of remedies in Sections 13 to 18, we have decided to introduce the package of remedies summarised below. In our judgement, this represents as comprehensive a solution as is reasonable and practicable to the AECs and resulting customer detriment that we have found. Our remedies package is as follows:

(a) Cross-cutting foundation measures to address important underlying causes of the AECs we have found in both PCA and SME banking markets:

(i) Requiring the largest PCA and BCA providers to adopt and maintain common API standards for APIs with full read and write functionality on PCA and BCA transaction data sets, through which they will share data with other providers and third parties.

(ii) Requiring the largest PCA and BCA providers to release and make available through open APIs, and to maintain as open data: product information on prices, charges terms and conditions, and customer eligibility criteria in the case of loans, for all PCA products and all relevant SME banking products; service quality indicators specified by the CMA; and appropriate reference data such as branch and ATM location, and branch opening hours.

(iii) Requiring PCA and BCA providers to display prominently core indicators of service quality, with the data collected and published biannually and made available as open data to third parties.

(iv) A recommendation to the FCA to require PCA and BCA providers to publish and make available to others, including as open data, additional objective measures of service performance, encompassing their PCA, BCA and SME lending products and principal sales/delivery channels.

(v) A recommendation to the FCA: to undertake a research programme, in conjunction with a selection of PCA and BCA providers to identify those prompts that are most likely to increase customer awareness of the potential benefits of switching and prompt customers to consider their banking arrangements; subject to the results of the research programme, to implement a series of prompts to be communicated to customers; consider the extent to which the content and presentation of prompts should be standardised; and to monitor the effectiveness of the prompts and redesign them as and when necessary.

(vi) Requiring PCA and BCA providers to cooperate with the FCA in the research programme at (v) directly above, including RCTs, to identify those prompts that are likely to be most effective in changing customer behaviour.

(vii) Requiring BCA providers to send prompts to those SMEs not covered by the FCA's powers.

(b) Measures to improve the process of switching current accounts and customers' awareness of this process:

(i) Seeking undertakings from Bacs to strengthen the corporate governance of CASS by having an independent chair of its management committee, broadening the membership of its management committee and relevant subcommittees and increasing transparency of its decisions and performance against KPIs.

(ii) Seeking undertakings from Bacs to increase customer awareness of and confidence in the switching process.

(iii) A recommendation to HMT to enable regulatory oversight of CASS.

(iv) Seeking undertakings from Bacs to enhance the CASS redirection process such that beyond the current 36-month redirection period, if an account has a redirected transaction within a 13-month period, redirection will continue.

(v) Requiring PCA and BCA providers to make transaction history available to customers at the time of, and after, closing their accounts.

(c) Measures to increase customer awareness of and engagement with their overdraft usage and charges and to reduce the detriment arising from overdraft usage:

(i) Requiring PCA providers to automatically enrol all their customers into an unarranged overdraft alert.

(ii) Requiring PCA providers to offer and alert customers to the opportunity to benefit from grace periods during which they can take action to avoid or reduce all charges resulting from unarranged overdraft use.

(iii) A recommendation to the FCA to identify, research, test and, as appropriate, implement measures to increase overdraft customers' engagement with their overdraft usage and charges. This will be supported by a CMA Order requiring PCA providers to cooperate with the FCA in its research programme including RCTs.

(iv) Requiring PCA providers to set a monthly maximum charge (MMC) covering all unarranged overdraft charges (including debit interest). Disclosure of the MMC should be no less prominent than the disclosure of overdraft charges. The level of the MMC will be set by each PCA provider and may be different for each of its PCAs.

(v) A recommendation to the FCA that it undertakes work to assess the ongoing effectiveness of the MMC in (iv) and consider whether measures could be taken to further enhance its effectiveness (such as the introduction of rules, if appropriate, which could take the place of the MMC).

(vi) A recommendation to the FCA that it looks at ways for providers to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process.

(vii) A recommendation to the FCA to consider whether, following the introduction of open APIs, it should require PCA providers to offer online tools that indicate whether a prospective customer may be eligible for an overdraft.

(viii) Seeking undertakings from Bacs to work with CASS participants to review the switching process, to ensure that PCA providers offer a firm decision on the overdraft offered after a customer has completed the application process but before they switch accounts.

(d) Measures to increase the ability of SMEs to compare BCAs and SME lending products, and improve BCA opening procedures:

(i) Requiring SME lending providers to publish on their websites, and release as open data, their charges, terms and eligibility criteria for the provision of SME unsecured loans and overdrafts of up to £25,000 and for the largest SME lending providers in GB to develop and publish a price and eligibility indicator tool for unsecured loans and overdrafts.

(ii) Measures to provide for the creation of a website (or websites) whose function it will be to enable comparisons between rival providers of SME banking services, including BCAs and lending products. We propose to adopt the Nesta challenge prize approach to deliver this. This will be supported by a 'safeguard remedy' whereby the larger SME banking providers in GB and NI will be required to bring about the creation of an industry-funded SME comparison tool, to a specification approved by the CMA, if necessary.

(iii) Requiring banks to agree and adopt a core set of standard information and evidence requirements for SMEs opening a BCA. This is intended to make the BCA account opening process less onerous, more simple and standardised. This may be achieved through an industry working group coordinated by the BBA.

(iv) A recommendation to the FCA to attend the industry working group anticipated in (iii) as an observer.

(v) A recommendation to HMT that it works with CRAs and SME lenders to develop mechanisms to allow for 'soft searching' for lending products for SMEs.

(vi) A recommendation to HMT that it reviews the efficacy and impact of the measures implemented under the SBEE Act and ongoing commercial, technological and regulatory initiatives intended to facilitate the sharing of SME information.

(vii) A recommendation to BEIS that it works with the British Business Bank and professional associations such as the Institute of Chartered Accountants in England and Wales (ICAEW) to explore ways in which their members can channel advice on choice of providers and sources of finance to SMEs.

19.2 In our assessment of the effectiveness of this package of remedies, we consider below:

(a) how the package of remedies addresses the AECs and/or the resulting customer detriment; and

(b) other aspects of the effectiveness of our package of remedies.

How the package of remedies addresses the AECs and/or resulting customer detriment

19.3 In Sections 13 to 16 we discussed the rationale for each element of our package of remedies. In this subsection we summarise how the elements of the remedies package work together to remedy the AECs that we have found, and/or the resulting customer detriment. We consider the impact of the remedy package on the PCA, BCA and SME lending markets.

Effectiveness in addressing the AECs and/or the resulting customer detriment in relation to the provision of PCAs

19.4 We consider first how the package of remedies addresses the features of the market that restrict competition between providers of PCAs. We set out in Section 11 our AEC findings. In relation to PCAs the features are:

(a) Barriers to searching – accessing and assessing information on PCA charges and service quality.

(b) Barriers to switching PCAs.

(c) Low levels of customer engagement.

(d) Incumbency advantages.

Barriers to searching – accessing and assessing information on PCA charges and service quality

19.5 Our package of remedies provides PCA customers with additional means with which to make comparisons of charges and service. The elements of our package of remedies that address these features most directly are those that require:

(a) the adoption of an open API standard through which open data (product and service information and customer transaction data) will be shared, with the necessary security standards;

(b) the requirements to make service quality information available; and

(c) the adoption of an MMC to increase transparency of the potentially significant impact of unarranged overdraft charges.

19.6 First, as we noted above in Section 13, the requirement for the adoption of open API standards and open data, can be expected to reduce very substantially the friction involved in customers searching and comparing PCA providers. This will happen by enabling providers of price comparison services to offer simple, quick and reliable comparisons between banks and by allowing customers to assess different options available in the market on the basis of their own transaction history. This remedy will also address the issue we have identified of customers being restricted in their ability to compare potentially complex charging structures of different PCAs, in particular for overdrafts. Moreover, the adoption of open API standards and open data is likely to facilitate the emergence of new providers with different business models, offering innovative solutions for PCA customers.

19.7 Second, we have found that the quality of service from providers is a key consideration for customers, in addition to prices, when they are thinking about switching their PCA. Therefore it is important that PCA comparison tools are able to include the provision of service quality data, in a consistent manner, across the variety of PCA products and providers available in the market. Requiring PCA providers to collect and make available service quality information both on their own website and on an open data basis will facilitate the emergence of comparison tools that not only include comparative information on prices, but also quality of service.

19.8 Third, requiring PCA providers to set an MMC can be expected to help address the complexity of overdraft charges by enabling easier comparison of the highest unarranged overdraft charges that heavier overdraft users may incur.

Barriers to switching PCAs

19.9 Barriers to switching are addressed most directly by those elements of our package of remedies which provide:

(a) improvements to the process of switching current accounts, including reforms of and enhancements to CASS governance and the operation of the switching process itself, and requiring Bacs to increase customer awareness of and confidence in the switching process; and

(b) measures to address the barriers to switching for customers with overdrafts.

19.10 First, at the time of the establishment of CASS, the primary focus was on ensuring that the operation and switching process was rigorous, in order to ensure that the risk of failure, and associated undermining of industry and public confidence would be minimised. However, now that CASS is established, we consider that changes should be made to the CASS governance structure, including to provide for effective regulatory oversight. This combination of measures would provide far greater incentives for CASS to be operated in the interests of customers, including strengthening incentives for ongoing innovation and improvement.

19.11 Second, we will seek undertakings from Bacs that it will take the steps necessary to increase customers' awareness of and confidence in CASS. These will include: the development of a long-term promotional campaign; targeting those customer groups with low awareness and/or that could benefit most from switching; and developing suitable awareness and confidence metrics. These requirements, together with our measures on CASS governance, will help ensure that both Bacs and CASS participants are suitably incentivised to operate and develop the service in the interests of customers.

19.12 Third, we have identified specific improvements to both CASS and the switching process to be taken forward, relating to the length of the CASS redirection period and the provision of transaction history to customers who have switched provider (whether or not they have done so through CASS). These measures will help to address both real and perceived risks of customers switching provider, further helping to build confidence in the process.

19.13 Fourth, to address additional barriers to switching for those customers with overdrafts, we will seek undertakings from Bacs for it to review the PCA opening and switching process to ensure that providers offer a firm decision on the overdraft offered, prior to switching a customer's account.

Additionally, the development of an open API standard and the provision of open data provides an opportunity for the commercial development of effective overdraft eligibility tools to provide prospective customers with an indication of their overdraft eligibility during the search process. With open API standards currently not yet available, it is not appropriate for us to put such a requirement on providers at this point in time. Therefore we are making a recommendation to the FCA to consider whether to introduce such a requirement at the appropriate time, if it has not been delivered by market developments.

Low levels of customer engagement

19.14 While the remedies mentioned above will address the barriers to searching and switching for PCA customers that we have identified, it is important to supplement these with measures aimed directly at increasing customer engagement. This is because customers need to be sufficiently engaged in the market to consider whether they are using the correct products to meet their needs before they begin to undertake the searching part of the customer journey. Therefore, in addition to the measures above, we are introducing measures to prompt customers, both periodically and following the occurrence of specific events, to review their existing banking arrangements. These prompts are intended to increase customer engagement and to encourage customers to compare different available offers in order to ensure that they are receiving the best value product for their own needs and requirements.

19.15 We are recommending that the FCA undertakes a programme of customer research and testing with PCA providers of a range of potential periodic and event- or situation-based prompts. The purpose of this work programme is to ensure that the suite of prompts that providers are required to introduce, are those that are most likely to have the greatest impact in stimulating customer engagement and searching. In doing this, we recognise that the effectiveness of the prompts will be maximised once all elements of the package are in place and the results of the testing should be interpreted in this light. To ensure that any testing covers a sufficient number and range of PCA providers and their customers, we are requiring providers to participate in and to cooperate with the FCA's testing programme.

19.16 Further, our remedy to make available transaction data via open APIs will also address low customer engagement by enabling the development of comparison services and other online tools which will help customers to more easily understand and estimate their potential gains from switching.

19.17 In addition, we have decided that further complementary remedies are required to improve customer engagement of overdraft customers, particularly users of unarranged overdrafts. Customer engagement is particularly low in respect of unarranged overdrafts, in part because usage of unarranged overdrafts takes place outside of a pre-agreed credit limit and because customers who use these facilities may not have planned to do so.

19.18 We are therefore introducing additional measures to increase customer awareness of and engagement with their overdraft usage and charges, and to help customers engage with and manage their overdraft usage. We will do this through requiring providers to enrol customers automatically on to timely alerts to inform them when they begin using an unarranged overdraft, and requiring providers to offer and inform customers of grace periods during which they can take action to avoid or mitigate unarranged overdraft charges. We are additionally making a recommendation to the FCA that it undertakes further work to identify, research, test and, as appropriate, implement measures to increase customer engagement with the overdraft usage and charges. To ensure that any testing covers a sufficient number and range of PCA providers and their customers, we are requiring providers to participate in and to cooperate with the FCA's research programme.

19.19 Further, we are requiring providers to set a monthly limit on the unarranged overdraft charges that can be levied on a customer. This measure will increase engagement through greater transparency for those customers that utilise unarranged overdraft facilities and directly address the detriment arising from the low engagement. Providers have a range of potential commercial responses to the requirement to introduce such a limit, which would enhance competition for this group of customers. As this measure includes ensuring effective communication of the monthly limit to customers, we are including a broad requirement on providers as to the nature of that communication. We are also recommending that the FCA undertakes a review of the ongoing effectiveness of this measure and to consider whether there is a need for specific amendments or additional measures which could supplement our measure.

19.20 These measures will both enhance competition and directly address the customer detriment arising from the lack of competition for overdraft users, in particular users of unarranged overdrafts.

Conclusions on the impact of our remedies package on PCA markets

19.21 When taken together, our remedies will increase engagement by customers with their PCA(s), increase their awareness of charges and encourage them to better make use of their account, and make it easier for customers to compare alternative offers and to switch. This will reduce customer acquisition costs (and therefore incumbency advantages) and increase pressure on PCA providers to compete on price, service and innovation in order to retain existing customers and attract new ones. This will also mean that banks will increasingly compete on merit, with those that provide better value in terms of price, quality and innovation being better able to attract and retain customers and further grow their business. This will benefit new entrants and smaller banks seeking to grow their customer base and expand. Over time this will also increase the constraint posed by new entrants and smaller banks on larger established banks as well as to increase the constraints these larger established banks impose on each other. Our measures on overdrafts will additionally help to directly address the customer detriment associated with overdraft charges. All of the remedies will operate throughout the UK, and therefore address the entire geographic scope of the AECs.

Effectiveness in addressing the AECs and the resulting customer detriment in relation to the provision of BCAs

19.22 We now consider how the package of remedies addresses the features of the BCA markets that restrict competition. We set out in Section 11 our AEC findings. In relation to BCAs the features are similar to those for PCAs:

(a) Barriers to searching – accessing and assessing information on BCA charges and service quality.

(b) Barriers to switching BCAs.

(c) Low levels of customer engagement.

(d) Incumbency advantages.

(e) Linkages between PCAs and BCAs.

Barriers to searching – accessing and assessing information on BCA charges and service quality

19.23 With the exception of the additional overdraft remedies (which apply to PCAs, but not BCAs), similar measures to those we are introducing for PCAs to address the barriers to searching that we have found there, will also address the barriers to searching for BCAs. The measures will work in a similar way as for PCAs, with the combination of our package of remedies providing additional means for SMEs to make comparisons of charges and services. The requirement for the development of open API standards and open data, combined with the provision of information on the quality of services from different BCA providers, will help to enable the development of effective comparison tools.

19.24 However, additionally for SMEs, we recognise there are particular factors which have limited the development of effective comparison tools. This is for a variety of reasons, including the diversity of SMEs and their resultant different banking requirements. In recognition of this, some industry participants have initiated the Nesta challenge prize to incentivise the development of effective comparison tools. This is an important mechanism by which commercial providers will be able to deliver effective comparison tools for SMEs. We are requiring the larger banks in GB and in NI to support the initiative, through funding and making data available during and beyond the Nesta challenge prize process. Further, we are requiring the same banks to list their relevant SME products on at least two designated finance platforms, and at a later stage, on at least two PCWs.

19.25 The above measures, when taken together will reduce the barriers to searching, helping start-ups to identify the best value BCA for their needs, as well as helping established SMEs to search for alternative banking arrangements.

Barriers to switching to alternative providers of BCAs

19.26 The barriers to switching BCAs are similar to those identified for PCAs. The main differences are the feature identified for PCAs related to overdraft users (which we did not find in relation to BCAs), and the sometimes lengthy, onerous and time-consuming account opening process for BCAs. The measures we have outlined above to address the low customer confidence in CASS, by improving the process for switching current accounts through the reforms to the governance of CASS and increasing awareness of the switching process, will equally address the barriers to switching we have found in relation to BCAs.

19.27 In addition, we are requiring BCA providers to agree and adopt a core set of standard information and evidence requirements (both to be approved by the CMA) for SMEs opening a BCA. This measure will lower barriers to switching by making the account opening procedure simpler. This measure will be further enhanced by the development of open APIs discussed above, which will enable the automatic and secure sharing between banks of core information and evidence requirements, which would obviate the need for an SME to provide this information to a new provider, and therefore facilitate switching.

Low levels of customer engagement

19.28 As with PCAs, while the package of remedies will help to address the barriers to searching and switching we have identified, there is currently low engagement of SMEs in the markets, partly explained by the lack of triggers for SMEs to consider their banking arrangements. To address this, we are recommending that the FCA undertakes a programme of customer research and testing with BCA providers, of potential periodic and event-based prompts for SMEs. This will help ensure that the suite of prompts, and the form of these, that providers are required to introduce, are those that are most likely to have the greatest impact in stimulating SMEs' engagement in the market and searching for alternative BCAs. To ensure that any testing by the FCA covers a sufficient number and range of BCA providers and their customers, we are requiring providers to participate in and cooperate with the FCA's testing programme.

19.29 The transaction data shared via open APIs and the emergence of effective PCWs arising from the Nesta challenge will also enable SMEs more readily to understand and estimate their gains from switching.

Linkages between PCAs and BCAs

19.30 The measures to address barriers to searching and switching, and to prompt customers and SMEs to more actively engage in the current account market, will additionally act to weaken the linkages present between PCAs and BCAs. As customers become more accustomed to considering their PCA options and switching PCA provider, we expect that start-up SMEs will be increasingly likely to consider alternatives to their PCA provider. Moreover, with more tools available to compare price and service of different BCAs, this will also work to weaken the linkages between PCAs and BCAs. This is because start-ups will have more information on which to choose a BCA.

19.31 Similarly, requiring providers to adopt simplified and standardised account opening procedures should act to further weaken the identified linkages, as standardised procedures may also reduce the advantage the PCA provider has with respect to an account holder seeking to establish an SME and open a BCA, for example, in the case of sole traders.

Conclusions on the impact of our remedies package on BCA markets

19.32 When taken together, our BCA remedies will increase engagement by SMEs with their BCA, make it easier for customers to compare alternative offers and to switch, and reduce the strength of linkages between PCAs and BCAs. This will reduce customer acquisition costs (and therefore incumbency advantages) and increase pressure on BCA providers to compete on price, service and innovation in order to retain existing customers and attract new ones. This will also mean that banks will increasingly compete on merit, with those that provide better value in terms of price, quality and innovation being better able to attract and retain customers and further grow their business. As is the case in the PCA market, and in combination with the outcomes we expect there from our package of remedies, this will benefit new entrants and smaller banks seeking to grow their customer base and expand. Again, we expect that over time this will increase the constraint posed by new entrants and smaller banks on larger established banks as well as increase the constraints these larger established banks impose on each other. All of the remedies will operate throughout the UK, and therefore address the entire geographic scope of the AECs.

Effectiveness of remedies in addressing the AECs and resulting customer detriment in SME lending markets

19.33 We now consider how the package of remedies addresses the features of the market that restrict competition between providers of SME lending products. We set out in Section 11 our AEC findings. In relation to the provision of SME lending the relevant market features are:

(a) Barriers to comparing SME lending products.

(b) Strong linkages between BCAs and SME lending products.

(c) Information asymmetries between an SME's BCA provider and other providers of lending products.

(d) The nature of demand for SME lending products.

(e) Incumbency advantages.

Barriers to comparing SME lending products

19.34 Our measures will address the barriers to comparing SME lending products. These measures will enable SMEs more easily to access information on SME loan and overdraft terms and conditions. We achieve this in part through requiring lenders to publish representative prices for unsecured loans and overdrafts up to £25,000, as well as more information on the availability of loans through the requirement for the largest SME lending providers in GB to develop a price and eligibility indicator tool for unsecured loans and overdrafts up to £25,000. Further, enhancements to comparability will be achieved by requiring banks to make available through open data information on their service quality, charges, terms and conditions for loans and overdrafts, as well as the outcome of the Nesta challenge prize. Together these measures will facilitate the creation of digital comparison tools to enable SMEs to compare lending products.

19.35 Our recommendations to HMT will further enhance the ability of SMEs to search for SME lending products. A review by HMT of the impact of the measures in the SBEE Act and of other ongoing commercial, technological and regulatory initiatives intended to facilitate the sharing of SME information will help to secure and maximise the potential benefits of these developments. Aligned with this is our recommendation to BEIS that it works with the British Business Bank and professional associations such as ICAEW to explore ways in which their members can channel advice on choice of providers and sources of finance to SMEs.

19.36 These measures, when taken together will reduce barriers to searching and comparing, helping SMEs to search alternative lending opportunities.

Strong linkages between BCAs and SME lending products and information asymmetries

19.37 In Section 8 we found that there are strong linkages between the provider used by an SME for its BCAs and the lender it subsequently uses. For example, we found that around 90% of SMEs go to their main bank for overdrafts, general purpose business loans and credit cards and that around 60% of SMEs considered only one provider when seeking lending. These linkages have been identified in previous investigations. For example, as a result of the 2002 SME banking investigation the largest banks provided undertakings to prohibit the tying of SME loans with BCAs, which we have decided to retain.[1] Our measures to address barriers to searching will additionally act to weaken the linkages present between BCAs and SME lending as well as undermine the information asymmetries present between an SME's BCA provider and other providers of lending products. For example, requiring larger banks in GB to develop and publish online a loan price and eligibility tool will help to increase confidence among SMEs in applying for a loan from a provider other than their BCA provider. Similarly the inclusion of lending products within the scope of the Nesta prize challenge will encourage SMEs to search the market for the right finance provider and will make this easier to do.

[1] See Review of 2002 SME banking undertakings, paragraphs 4.17–4.20.

Nature of demand for SME lending products

19.38 Our remedies relating to a loan price and eligibility tool will reduce the cost of obtaining multiple quotes. In addition, the recommendations to HMT to review the impacts of the measures in the SBEE Act, as well as reviewing ongoing commercial, technological and regulatory initiatives intended to facilitate the sharing of SME information, will help to secure and maximise the potential benefits of these developments. Combined with information sharing via open APIs our remedies will assist SMEs in gathering the financial information required to apply for a loan and assist lenders in providing a decision more quickly.

Conclusions on the impact of our remedies package on SME lending markets

19.39 When taken together, our SME remedies will increase engagement by SMEs in lending markets and increase the ability for SMEs to compare lending products. This will reduce customer acquisition costs (and therefore incumbency advantages) and increase the pressure on BCA providers and other SME lending providers to compete. This will also mean that providers will increasingly compete on merit, with those that provide better value in terms of price, quality and innovation being better able to attract and retain customers and further grow their business. This will benefit new entrants and alternative providers of finance seeking to grow their customer base and expand. As is the case for PCAs and BCAs, this will increase the constraints posed by new entrants and alternative lending providers on the established banks, as well as increase the constraints that the established banks impose on each other. All of the remedies will operate throughout the UK, and therefore address the entire geographic scope of the AECs.[2]

Other aspects of the effectiveness of our remedies package

19.40 In evaluating the effectiveness of our package of remedies, we have considered the following further factors set out in our guidance:

[2] One exception to this is the loan price and eligibility indicator tools which we are requiring the four largest banks in GB to develop. We consider that it is not proportionate to require the NI banks to develop these tools in addition to our other SME lending remedies as they are smaller lenders which means there is likely to be a disproportionate cost of their developing tools due to high fixed costs that are unlikely to vary with bank size and because the benefits they produced would also be lower. SMEs in NI will be able to compare lending products through the prices we are requiring lenders to publish, and may be able to access the tools of banks based in the UK as some of these banks have a presence in NI as well. Furthermore, SMEs in NI may be able to use tools of banks based in GB to draw comparisons with the offers being made to them by lenders in NI.

(a) The extent to which the remedies are capable of effective implementation, monitoring and enforcement.

(b) The timescales over which the remedies will take effect.

(c) The consistency of the remedies with existing and likely future laws and regulations.

(d) The coherence of our remedies taken together as a package.

Implementation, monitoring and enforcement

19.41 Our detailed consideration of how each individual measure could be implemented, monitored and enforced is set out in our assessment of each remedy in Sections 13 to 16.

19.42 We have also given thought to the implementation of our remedies package taken as a whole. This is of particular significance for this investigation because of the way in which several of our remedies interact with and reinforce each other. Moreover, a number of our remedies require the co-ordination of banks to ensure that common processes and approaches are adopted. We have explained in Sections 13 to 16, where relevant, how such coordination will be achieved. For example, in Section 13 we explain that we will establish an Implementation Trustee and Implementation Entity to coordinate banks in the implementation and maintenance of open banking standards. In Section 16 we explain that we will be looking to the BBA to coordinate the banks' implementation of the measure requiring the standardisation of BCA opening.

19.43 Some respondents to our provisional decision on remedies highlighted the interaction of the different remedies, in particular with the development of common API standards and open data and suggested that coordination of the remedy implementation process would be required. We agree that there are a number of potential risks (as well as opportunities) to remedy implementation arising from the interrelated nature of the remedies package.[3] Therefore, in order to maximise the effectiveness of our package of remedies, we will establish a remedy implementation programme board to coordinate the various bodies charged with taking forward implementation of our remedies. Participants in the remedy implementation programme board

[3] The interrelated measures are data sharing (provision of transaction history, SME loan and overdraft pricing data) through open APIs, and the other measures that will rely on these to some extent: the Nesta challenge prize, standardisation of BCA opening procedures, collection and publication of service quality metrics and the provision of an SME loan price and eligibility tool.

will include the CMA, the Implementation Trustee, Nesta, BBA, FCA and HMT.

19.44 The CMA will determine the precise membership and terms of reference of the remedy implementation programme board shortly, but a key objective will be to identify and address any material arising issues involving interdependencies for remedy implementation. This could, for example, include the approach to API standards, security issues and the sharing of sandbox data with participants in the Nesta challenge prize. The remedy implementation board will be chaired by the CMA, and responsibility and accountability for remedy implementation will remain with the CMA.

19.45 Our package of remedies includes measures which we will be implementing ourselves, by making Orders and accepting undertakings, and also measures which will be implemented by making recommendations to other bodies. To monitor compliance with the CMA Order and undertakings we will require relevant parties to submit a compliance report to the CMA.[4] We would also expect clear examples of non-compliance to be detected and reported to the CMA by competitors, customer groups or other affected parties. The implementation of each specific remedy may be summarised as follows

(a) We will require, by CMA Order, the largest PCA and BCA providers in GB and in NI to take the actions necessary to develop an open API standard and open data to allow third parties access to product information, service quality metrics and transaction data. Further, we will require all PCA and BCA providers, by CMA Order, to publish service quality metrics to enable PCA, BCA and SME lending comparison. It will be transparent from compliance reports if any of the relevant providers are not complying with these Orders.

(b) We are recommending to the FCA to undertake a research programme to develop the series of customer prompts that will be most effective in increasing customer engagement in retail banking markets. The scope of this programme includes PCAs and BCAs as well as prompts related to PCA customers' overdraft use. This recommendation will be supported by a CMA Order to require providers to participate in the FCA research and to send the switching prompts to customers. The FCA has considerable experience and expertise in conducting such research and so is well placed to undertake this recommendation.

[4] For many remedies these should apply to all PCA or BCA providers above the de minimis threshold – see Section 12.

(c) We will seek undertakings from Bacs for it to introduce improvements to the governance and performance of CASS, as well as to introduce improvements to the CASS process. This includes changes to CASS governance arrangements; measures to increase the awareness of and confidence in CASS, targeting specific customer groups; as well as measures to extend the CASS redirection period. The undertakings are related to issues within the direct influence of Bacs. It will be transparent from compliance reports whether Bacs is compliant with these requirements.

(d) We are recommending to HMT that it provides for an existing authority to have appropriate regulatory oversight of CASS. In addition, to reduce some of the perceived risks of switching PCA or BCA provider, we are requiring by CMA Order that all PCA and BCA providers allow for the provision to customers of their transaction histories. It will be transparent from compliance reports if any provider is not complying with this requirement.

(e) We are requiring PCA providers, by CMA Order, to introduce an unarranged overdraft alert and automatically enrol their customers in it. As part of this alert we propose that PCA providers should also inform customers of the period within which they have an opportunity to transfer money into their PCA to avoid/reduce overdraft charges. It will be transparent from compliance reports if any provider is not complying with this requirement. We are also recommending to the FCA that it undertakes work to identify, research, test and, as appropriate, implement measures to increase overdraft customers’ engagement with their overdraft usage and charges. As with the prompts referred to in paragraph 19.415(b) above, the FCA’s testing of overdraft engagement measures will be supported by a CMA Order. The FCA’s experience and expertise in conducting research and testing means it is well placed to undertake this proposed recommendation.

(f) We are requiring PCA providers, by CMA Order, to set an MMC for unarranged overdraft charges and for this to be disclosed in a no less prominent manner than the presentation of other information on overdraft fees and interest. We are also recommending that the FCA undertakes work to assess the ongoing effectiveness of the MMC. It will be transparent from compliance reports if any provider is not complying with this requirement and the FCA’s experience and expertise means it is well placed to undertake this recommendation.

(g) We are recommending to the FCA that after open API standards have been introduced, it reviews whether banks should be required to provide

an overdraft eligibility tool. As sectoral regulator, the FCA is best placed to review whether such an eligibility tool should be required. We will also seek undertakings from Bacs for it to work with CASS participants to review the switching process to reduce the risks for overdraft customers of not having a firm offer on overdraft from their prospective new supplier before switching. It will be transparent from compliance reports whether Bacs is complying with this requirement.

(h) We are recommending to the FCA to consider whether changes to the PCA opening process could be introduced to engage customers more in considering overdraft features. This would include whether customers should, as part of the account opening process, be required to make a positive acknowledgement of the overdraft features in a new PCA. The FCA's experience and expertise in conducting research and testing means it is well placed to undertake this recommendation.

(i) We are requiring, by CMA Order, the largest BCA and SME banking providers in GB and NI to support the Nesta challenge prize process in developing a comparison tool(s) for SMEs, covering BCAs and lending products. These will cover the provision of data; providing funding to facilitate the Nesta challenge prize process; and requiring providers to list their products on designated finance platforms and at a later stage, on at least two PCWs. It will be transparent from compliance reports, as well as ongoing feedback from the progression of the Nesta challenge prize, if any provider is not complying with these requirements. Further, we are requiring as a 'safeguard remedy' the larger SME banking providers in GB and NI to bring about the creation of an industry-funded SME comparison tool to a specification approved by the CMA.

(j) We are requiring, by CMA Order, all lenders within our ToR that provide unsecured lending and overdrafts under £25,000 to SMEs to publish loan and overdraft price data and, the largest SME lending providers in GB to develop and publish a price and eligibility indicator tool for unsecured loans and overdrafts. It will be transparent from compliance reports if any provider is not complying with these requirements. Further, we are recommending to HMT to work with others to enable SMEs to undertake 'soft searches' for lending products.

(k) We are requiring, by CMA Order, all BCA providers to agree and adopt a core set of standard information and evidence requirements for SMEs opening a BCA to enable easier switching between BCA providers. This may be achieved through an industry working group coordinated by the BBA. We are also making a recommendation to the FCA to attend the anticipated industry group as an observer. It will be transparent from

compliance reports if any provider is not complying with this requirement.

(l) We are recommending to HMT to undertake a review in two years' time of the impact of the measures in the SBEE Act as well as ongoing commercial, technological and regulatory developments in the area of sharing SME data to help ensure that the potential benefits from these measures and developments are realised to their maximum extent. HMT is the government department best placed to undertake such a review and propose actions to address any issues identified.

(m) We are recommending to BEIS that it works with the British Business Bank and professional associations such as ICAEW to explore ways in which their members can channel advice on choice of providers and sources of finance to SMEs. BEIS is the government department best placed to work with these bodies to identify the best way to channel such advice to SMEs.

19.46 In the light of the above assessment, we have concluded that each of the measures is capable of effective implementation, monitoring and enforcement. In reaching this view we note that our package of remedies contains a number of recommendations; primarily to the FCA, but also to HMT and BEIS. This is appropriate to the particular facts and circumstances of this investigation. In particular, the ongoing regulatory role of the FCA means that it is best placed to integrate many of the further actions necessary to address the AECs with its other interventions and potential future interventions in these retail banking markets. We also envisage that over time, as the remedies become embedded and/or subject to review by the FCA, the FCA will introduce its own rules and measures to supersede these measures, where that is appropriate. In such circumstances we would expect to review the relevant Order or undertaking and revoke/release it if the statutory test for doing so is met. It will be a matter for the FCA, HMT and BEIS to decide whether and how to implement our recommendations, and over what timescales (subject to the application of sections 140A to 140H of FSMA to the FCA where they apply).

The timescales over which the remedy measures will take effect

19.47 In evaluating the timescales over which the remedy measures within our package of remedies are likely to take effect we have considered:

(a) the time that it is likely to take to implement the remedy measures; and

(b) the time that it is likely to take for the remedy measure, once implemented, to remedy the AEC and the resulting customer detriment.

Time taken to implement the remedy measures

19.48 The time taken to implement the remedies following this retail banking market investigation will depend, in part, on whether the CMA is taking action itself, or recommending action to be taken by others.

19.49 Where the CMA is taking action itself, the implementation of remedies following a CMA investigation typically involves two stages. In the first, the CMA typically makes an Order.[5] This usually involves a period of informal consultation with relevant parties, followed by a formal public consultation, as specified in Schedule 10 to the Act. The CMA must make a final Order within six months of the date of the publication of the final report. The CMA may extend this six-month period by up to a further four months if it considers that there are special reasons why a final Order cannot be made within the statutory deadline.[6] In the second stage of implementation, the parties subject to any Order take the action required by the CMA within the period specified in the Order.[7]

19.50 We expect to put in place an Order in relation to those measures that the CMA implements within the statutory six-month period from the date of this final report. We expect to accept undertakings from relevant parties as soon as is practicable after publication of this final report.

19.51 For most of the remedies that we are implementing ourselves by CMA Order or undertakings an additional transitional period has been provided, to enable parties subject to the Order or undertakings to make the necessary changes to comply with the Order or undertakings. In deciding on the length of such transition periods, we have had regard both to the practicalities of putting the specific measure in place as well as the interdependencies between our remedies.

19.52 This results in a staged implementation process that we expect to be substantially complete within two years of publication of this final report (ie

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[5] It is also possible for the CMA to seek and accept undertakings (see the Guidelines, paragraphs 92 & 93). We consider that this is not practicable for most of remedies in this investigation given the large number of parties from whom undertakings would need to be sought, although there are some remedies for which we are seeking undertakings, namely in relation to CASS.
[6] EA02, section 138A. These time limits do not apply to any further implementation required after undertakings have been accepted or an Order made.
[7] There is a similar two-stage process for undertakings. The first stage involves us publicly consulting on the undertakings being offered, followed by acceptance of the undertakings. In the second stage of implementation of the undertakings, the parties giving the undertakings take the action required to comply with them.

by summer 2018).[8] For each of the specific remedies which will be implemented by CMA Order or undertakings, we have decided to allow the following the transitional periods:

(a) **Development and adoption of an open API standard**. We will require the largest banks in GB and the largest banks in NI to provide third party access to product information and reference data through open APIs by 31 March 2017; to provide access to service quality metrics in line with the requirements of the service quality metrics remedy (see below); and to provide full read and write functionality and to make available through open APIs PCA and BCA transaction data sets, no later than January 2018.

(b) **Service quality metrics**. We will require all banks to make available the core metrics as detailed in Section 13 within a period no greater than 18 months from the date of the Order.

(c) **Prompts**. We will require all banks to cooperate with and participate in the FCA's research and trialling of prompts (including on overdraft engagement measures) with this coming into effect shortly after the Order is made. We also expect in advance of the Order, for banks to work with the FCA to undertake preparatory work for the research and trials on a voluntary basis. Further, we will make an order to ensure that prompts for SMEs resulting from this programme will be extended to SMEs that fall outside of the FCA's regulatory boundary, but within our terms of reference. This Order would be effective from the same date as the equivalent FCA rules came into effect.

(d) **CASS redirection period**. Bacs will be required to have implemented the changes to the redirection period, within a period no longer than 12 months from the undertakings being accepted.

(e) **CASS governance and awareness**. Bacs will be required to have made the changes to the CASS governance within a period of six months of the undertakings being accepted. Further, we would expect it to start incorporating changes into its approach regarding CASS awareness and confidence shortly after the undertakings have been accepted.

(f) **Transaction history for customers**. We will require all PCA and BCA providers to provide customers at the time of closing an account, their transaction history for a minimum period of five years and additionally

[8] We provide an overview of the remedy implementation process and our recommendations in Appendix 19.1.

require banks to retain transaction history and provide to customers at their request for up to five years, with this coming into effect within a period no greater than 12 months from the date of the Order.

(g) **Overdraft alerts and grace periods**. We will require all PCA providers to introduce an alert to inform PCA customers when they are entering their unarranged overdraft and that they have a grace period within which they can take action to avoid or reduce the associated unarranged overdraft charges, with this coming into effect within 12 months of the Order being made, although we will consider allowing an additional period of no more than six months for implementation in certain circumstances, in particular where providers do not currently have and will need to develop and introduce an alerts systems in order to comply with this remedy.

(h) **Monthly maximum charge**. Our requirement for all banks to introduce an MMC on their PCAs, and this to be communicated to customers in a no less prominent manner than other PCA overdraft charges information, will come into effect within six months of the Order being made.

(i) **Provision of a firm decision to a customer prior to the switching of account provider**. Bacs will be required to work with CASS participants to review the switching process, within a period of six months of the undertakings being accepted.

(j) **The development of a comparison site(s) for SMEs**. The requirements for the largest banks in GB and the largest banks in NI to fund the Nesta challenge prize process and additionally to make data available before, during and beyond the Nesta challenge prize process, will come into effect shortly after the Order is made. This will be supplemented by requiring these same banks to list their relevant SME products on at least two designated finance platforms, with this coming into effect within one month of the Order being made. Further, we require these same banks to list their relevant SME products on at least two PCWs, one of which is the Nesta challenge prize winner, with this coming into effect within a short period of the conclusion of the Nesta challenge prize process.

(k) **The publishing of SME lending product prices, and development of price and eligibility indicator tools**. We will require all SME lenders to publish prices for unsecured loans and overdrafts, and to make these available to third parties. We expect this measure to be implemented within six months of the Order coming into effect. Further, we will require

the largest banks in GB to place on their websites loan price and eligibility indicator tools, and make these available to two or more price comparison sites, including the eventual Nesta prize winner(s). This measure must be undertaken within 12 months of the Order being made.

(l) **BCA opening procedures.** Require all banks to agree and adopt a standard form and evidence requirements for opening a BCA. We expect banks to propose to the CMA a standard form within one month of our final report or soon thereafter, with implementation of the form coming into effect within 12 months of the Order being made.

19.53 The timescale for implementing the measures where we are making a recommendation will be a matter for the bodies to which we make the recommendation – in this case either the FCA, HMT or BEIS. Our current expectations in relation to these measures are as follows:

(a) **Prompts research**. We have recommended to the FCA that it undertakes a programme of research into customer prompts. Based on our discussions with the FCA and our understanding of its previous similar research we would expect that the FCA would be in a position to have completed its testing and analysis of the results of its testing between 15 and 18 months of our final report (between nine and 12 months of our Order being made). We further expect there to be a period of around six months for the FCA to incorporate the remedy into its rules (by summer 2018), around two years after the publication of our final report.

(b) **Service quality metrics**. We have recommended to the FCA to require providers to publish, and make available to others as open data, additional measures of service performance encompassing providers' PCA, BCA and SME lending products and principal sales/delivery channels. We expect that this part of the remedy would be implemented within one to two years after the publication of our final report.

(c) **Regulatory oversight of CASS**. We have recommended that HMT give an authority powers to allow it to have regulatory oversight of CASS in the way that is necessary to maximise the effectiveness of CASS in promoting competition. We are hopeful such changes can be made within a year of publication of our final report.

(d) **Customer overdraft and grace period alerts**. We have recommended to the FCA that it identifies, researches, tests and implements appropriate measures to increase customers' engagement with their overdraft usage. Potentially this could be included in, or run in parallel

with, the research and testing work on customer alerts which we are also recommending that the FCA undertakes.

(e) **Monthly maximum charge for overdrafts**. We have recommended to the FCA that it undertakes work to assess the ongoing effectiveness of the MMC and consider whether measures could be taken to further enhance its effectiveness. It is for the FCA to consider an appropriate time for when it can reliably assess the effect of MMCs.

(f) **Overdraft eligibility checker**. We have recommended to the FCA to consider requiring PCA providers to offer online tools indicating a customer's overdraft eligibility. However, the need for such a requirement may be superseded by market developments following the introduction of APIs (and our package of remedies). We would expect the FCA to consider whether such a requirement is necessary following a suitable timescale following the introduction of APIs.

(g) **Customer engagement on overdrafts at account opening**. We have recommended to the FCA that it looks at ways to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process. We would expect the FCA to start to undertake this work shortly after the publication of our final report.

(h) **'Soft' searches for loans**. We have recommended to HMT to work with CRAs and SME lenders to enable SMEs to undertake 'soft' searches for loans, without adversely affecting their credit ratings. We would expect HMT to start to undertake this work shortly after the publication of our final report.

(i) **Sharing of SME data**. We have recommended that HMT undertake a review of the commercial, technical and regulatory developments in the area of sharing SME data and that this review is within two years of our final report.

(j) **Increasing SME awareness of searching and switching**. We have recommended to BEIS that it works with SME advisory bodies and other relevant professional associations to explore ways in which their members can channel advice on the choice of providers and sources of finance for SMEs. We would expect BEIS to be able to start to undertake this work relatively shortly after the publication of our final report.

19.54 As well as the Orders, undertakings and recommendations, we also expect there to be commercial market developments that will occur following the implementation of our remedies package. We are uncertain as to which of these potential commercial developments will materialise and when, but there is clearly scope for our package of remedies to facilitate such developments. Potential areas in which we might expect our remedies to stimulate commercial developments include the emergence of 'credit passports' where open API standards and open data will allow market participants to develop platforms to allow for the sharing of customer data, opening up the opportunity for rival suppliers to compete for customers and for customers to switch to suppliers that better meet their needs, offering better value.

Time taken for remedy package to take effect

19.55 As can be seen from the preceding discussion, we expect all of our remedies to be in place within around two years of our final report, with a number of important measures coming into force sooner than this. We have most control over the timing of those measures that we are implementing ourselves through accepting undertakings or making an Order, though we have consulted with the bodies to whom we have made recommendations, including regarding timescales.

19.56 Even after a measure has been introduced, including any transitional period, it will take some further time for the introduction of the measure to have its full impact on the market. In addition, many of the measures in our package of remedies are interrelated and integrated with each other. This means that the total potential benefits that will arise from the package will only be realised once the full package is in place and the market has a period of time in which to adapt and respond to the new competitive pressures and commercial opportunities that they will present.

19.57 As we set out in Section 13 the foundation measures are of particular importance to the overall effectiveness of our package of remedies. The combination of open API standards, customer prompts and enabling service comparisons underpins many of our other measures, including by:

- enabling customers to compare PCAs, BCAs and SME lending products (with the latter being enabled through the Nesta challenge prize and the the overdraft and SME loan price and eligibility indicator tools); and

- enabling the sharing of SME data to allow for greater rivalry between suppliers of SME banking products.

19.58 These foundation measures rely on a combination of CMA Orders on parties as well as our recommendations to the FCA being acted upon to deliver the outcomes we envisage. These measures will also take the longest period to introduce fully – in all cases we expect implementation to be completed during 2018. Likewise, we currently expect the Nesta challenge prize to run until mid-2018, which will then be followed by a period to bring the successful products of the winner or winners to market.

19.59 By contrast, there are other measures in our package that will be able to begin to address the AECs and the associated detriment in advance of these foundation measures becoming effective.

19.60 For example, the changes to CASS governance (and its work on increasing awareness and confidence in CASS) will be required within six months of the undertakings from Bacs being accepted. We would expect tangible benefits from these changes to start to materialise relatively quickly after implementation. We similarly expect this to be the case for the changes to the switching processes we are requiring. Further, the changes to CASS governance will also help ensure that the switching service is more responsive to customer needs and more focused on ensuring that CASS operates in a way that seeks to maximise the benefits of competition and increased rivalry for the benefit of customers. CASS will be able to deliver some of these benefits in the shorter term, but these will be enhanced further once the full package of remedies is in place and once customers become more accustomed to and aware of the changes in the market that the remedies will stimulate.

19.61 In addition, we are requiring banks to introduce measures to address directly the detriment associated with customers' use of unarranged overdrafts, both through the introduction of an MMC and the use of alerts and grace periods. These similarly will be introduced within six and 12 months respectively after our Order is made and we expect these to quickly impact customers' usage of their unarranged overdrafts.

Conclusion on timescales for remedies to address the AEC

19.62 We conclude that our package of remedies will begin to have a beneficial impact on competition and customer welfare within around 12 to 18 months after our final report and to deliver substantial beneficial impacts for all customer types within around two to three years of this final report.

19.63 The full benefits of our package of remedies will, however, only be realised once all elements of the package are effectively implemented. As explained above, some of our remedies have relatively long implementation timescales, in part due to the need for other bodies to undertake further work following our recommendation, or because of the need for ongoing cross-industry work on technical standards, or in the case of the Nesta challenge prize, to allow this initiative to run its course. Therefore, the full impact of our remedies is likely to be seen from around early-2019. We expect that the beneficial effects of our remedies will continue to grow beyond this time: as customers become more engaged in the markets and become more aware of the potential benefits of shopping around and switching; as rivalry between suppliers increases; and as new, disruptive business models are developed to find innovative ways to meet consumers' and SMEs' banking needs.

Consistency with existing and likely future laws

19.64 As part of our consideration of the design of each of the remedies in our package, we have considered the risk of any of these remedies being inconsistent with other relevant laws and regulations applicable to UK retail banking markets. We have particularly focused on the interaction between our remedies and EU legislation;[9] data protection legislation; consumer legislation; and future legislative programmes.

19.65 In relation to the switching prompts to increase customer awareness and overdraft alerts, we have carefully considered data protection issues and, in particular, whether these necessarily amount to direct marketing. We believe that they do not. We will continue to work with the FCA and the Information Commissioner to ensure that these remedies are implemented in a way that is compliant with data protection regulation. We also considered whether switching prompts and our overdraft remedies were incompatible with the Payment Services Directive (PSD) and the Consumer Credit Directive (CCD). We believe that the measures we have developed are compatible but note that the FCA will need to take account of the scope of PSD and CCD when using its rule-making powers.

19.66 The Payment Accounts Directive (PAD) will require standardised terminology to be used by banks in communication with customers as well as an annual statement of fees. We have taken this into account when developing our remedies. However, as PAD is a minimum harmonisation directive, it allows member states to go further than its requirements.

[9] Following the recent UK referendum on whether the UK should leave the EU it is possible that there could be changes to the regulatory framework that applies to retail banking in the UK in the future. However, the UK currently remains bound by its EU treaty obligations and Article 50 of the Treaty on European Union contemplates a process under which, from the date the UK gives notice under that Article, the UK would remain a member of the EU for a period of at least two years. Many of the relevant European laws have been transposed into UK law and would not be automatically repealed on the UK leaving the EU.

19.67 We designed the information-sharing remedy via open APIs to take account of the Second Payment Services Directive (PSD2), once it comes into force, by specifying that the open API standard developed should be compatible with PSD2. We have also aligned the timing of our remedy with the transposition of PSD2 required by January 2018.[10] We note that any information sharing will need to comply with data protection laws and we encourage providers to continue to work with the Information Commissioner in that respect.

19.68 We also took account of the SBEE Act in relation to our package of SME remedies. In particular, we took account of the regulations that HMT has already put in place, namely the Small and Medium Sized Businesses (Credit Information) Regulations 2015 and Small and Medium Sized Businesses (Finance Platform) Regulations 2015 which came into force on 1 January 2016. These respectively require banks to share certain information with other providers through CRAs and designated banks to refer SME customers that they reject for finance to finance platforms that can match the SME with a designated alternative finance provider. When designing our BCA account opening remedy, we also had regard to the current and future AML regulations.

19.69 We also considered the DPA and AML regulations in relation to the remedy requiring PCA and BCA providers to provide transaction histories to customers at account closure and retain and provide, on request, transaction histories for five years following account closure.

19.70 In light of the above, we have concluded that our package of remedies, and the elements within it, are consistent with current and expected laws and regulations applicable to the domestic retail banking markets.

Coherence as a package of remedies

19.71 It is clear from the discussion of the individual measures which we have included in our remedies package that the remedies are highly integrated and that there are a number of interdependencies and linkages between the various measures, as well as synergies, which will enhance the impact of the overall package of remedies. The integrated nature of the measures also means that the impact of the overall package would be increased once all of the measures are put in place. There are several aspects to this.

[10] The requirement to implement PSD2 into UK law within this time frame continues to apply.

19.72 First, our measures work together to increase customer engagement and reduce barriers to searching (for PCAs, BCAs and SME lending) and switching (for PCAs and BCAs) in markets where these have traditionally been very low, and make them more comparable to markets where competition is more effective. This increased customer engagement will help to drive dynamic benefits including competitive responses from providers and ongoing technological innovation, which are difficult to measure but very important in delivering better outcomes. This is achieved by a combination of our remedies working in conjunction with each other. Our measures will also work alongside and build on other initiatives from the government such as the OBWG established by HMT, which published a report on its work in February 2016, and from industry, such as the Nesta challenge prize and the initiative to develop a common BCA opening form and evidence requirements.

19.73 Second, our measures work together to weaken the linkages between PCAs and BCAs, and between BCAs and SME lending. This will happen by facilitating easier comparison of different providers and products, as well as reducing the incumbency advantage of the PCA provider (in the context of BCAs) and the BCA provider (in the context of SME lending) through requirements such as adopting a core set of standard information and evidence requirements for SMEs opening a BCA, and the provision of customers' transaction history. These measures will supplement the measures to enhance engagement, searching and/or switching, which will also act to weaken the linkages we identified.

19.74 Third, our measures work together to enable PCA customers to better manage their exposure to overdraft usage and associated charges, particularly those associated with unarranged overdrafts. Again our measures to enhance customer engagement, searching and switching are important here, allowing customers to choose the best account for their requirements. Our measures to improve the switching process for overdraft customers should also make it easier for customers to switch if they decide to do so. These measures are further supplemented by specific measures to help overdraft customers better manage their overdraft usage and charges through the requirement on banks to provide alerts and to notify customers of grace periods, as well as our requirement for banks to set an MMC for unarranged overdraft charges.

19.75 Fourth, our measures work together to reduce information asymmetries and incumbency advantages by addressing barriers to searching and weakening product linkages. For example, our remedies such as those ensuring the development of open API standards, together with ongoing industry developments such as the measures implemented under the SBEE Act as well as ongoing commercial, technological and regulatory initiatives will further reduce information asymmetries, for example through increased sharing of SME information. Our measures together reduce incumbency advantages.

19.76 We therefore conclude that the combination of our measures represents a coherent package of remedies, whose elements are mutually reinforcing and integrated.

Conclusion on effectiveness of remedy package

19.77 Based on the above assessment, we have concluded that the package of remedies represents an effective solution to the AECs and resulting customer detriment that we have found in GB and NI.

Proportionality of our package of remedies

19.78 The UK retail banking sector is not only important in its own right, but also has a wide-ranging and significant impact on the functioning of the UK economy. The retail banking markets that are the focus of this investigation enable individuals and businesses to store money; underpin transactions for the exchange of goods and services; and provide funding for SMEs to invest in and grow their businesses. An improvement in the functioning of retail banking markets will yield benefits both within those markets and to the wider economy.

19.79 In the UK there are more than 70 million active PCAs, with 97% of adults having a PCA. Together these PCAs generated revenues of around £8.7 billion in 2014.

19.80 There has been a steady increase in the number of SMEs since the financial crisis in 2008. In 2014, there were over 5 million SMEs in the UK, which accounted for 99.9% of all UK businesses. There are around 5.5 million BCAs, which generated approximately £2.5 billion in revenues in 2014. The total stock of outstanding general purpose business loan balances at the end of 2015 in the UK was £96 billion with a further £9billion[11] of invoice finance loans and £25 billion[12] of new asset finance loans.

19.81 The cost of ineffective competition in retail banking markets is high and extends across market boundaries. Without effective competition, the costs

[11] Based on data from the Asset Based Finance Association (ABFA) show that there were approximately 42,000 SMEs with invoice finance agreements in place at the end of the first quarter of 2015.
[12] According to figures from the FLA, over £25 billion worth of new asset finance loans (excluding high-value items).

of banking will be higher, increasing the costs to consumers and SMEs of accessing and using their own money, making transactions and of borrowing. Our remedies will help deliver more competitive retail banking markets to the benefit of SMEs and personal customers through:

(a) improved ability of customers to make comparisons;

(b) an easier and less risky switching process in which customers have greater confidence;

(c) greater levels of consumer and SME engagement;

(d) weakening of the linkages between PCAs, BCAs and SME lending;

(e) weakening of information asymmetries between an SME's BCA provider and other lenders; and

(f) addressing the incumbency advantages enjoyed by established banks

19.82 We are required to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the AECs we have found and any resulting detrimental effects on customers.[13] As part of this, we are mindful of the need to ensure that our package of remedies is proportionate.

19.83 In this section, we summarise our assessment of whether our package of remedies, taken as a whole, is a proportionate response to the problems we have found. We do this by reference to the following questions:[14]

(a) Is the package of remedies effective in achieving its aim?

(b) Is the package of remedies no more onerous than necessary to achieve its aim?

(c) Is the package of remedies the least onerous if there is a choice?

(d) Does the package of remedies produce adverse effects which are disproportionate to the aims?

Effective in achieving its aim

19.84 For the reasons set out in the effectiveness discussion above (paragraphs 19.3 to 19.77) we concluded that our package of remedies will be effective in its legitimate aim of remedying the AECs and the customer detriment that is

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[13] EA02, section 134(6).
[14] The Guidelines, paragraph 344.

likely to continue to result from the AECs if their underlying causes are not addressed.

No more onerous than necessary to achieve its aim

19.85 In assessing whether the package of remedies is no more onerous than necessary, we considered:

(a) whether each measure within the proposed package of remedies is necessary to remedy the AECs that we have provisionally found; and

(b) whether the design of each remedy measure within the package of remedies is no more onerous than it needs to be.

Is each element of the package of remedies necessary?

19.86 In developing our package of remedies we are aware that the retail banking markets that are the focus of this investigation have been the subject of a number of past interventions, introduced over many years. Our analysis has indicated that the impact of these various measures has not been as great as might have been envisaged, contributing to the persistence of the competition problems that we have identified. An example is the introduction of CASS in 2013, which while it has delivered a switching process which works, was not introduced alongside other effective measures to increase wider customer engagement in the PCA and BCA markets.

19.87 This experience of piecemeal reform has been an important consideration in our decision to develop and introduce a comprehensive, integrated and mutually reinforcing package of remedies that will create a seamless switching process, complemented by measures to increase customer engagement and prompt customers to switch or secure better value from their existing PCA, BCA or lending provider.

19.88 We have explained above in paragraphs 19.71 to 19.76 how the remedies we are putting in place work closely together to address the problems we have identified.

19.89 The impact of our measures will be experienced at all stages of the customer journey, including:

(a) a customer’s initial engagement in the market, through prompts;

(b) enabling greater and easier comparison, through for example the development of APIs, the provision of service quality information, the development of SME comparison tools, the enabling of the sharing of

SME information and the provision of SME loan price and eligibility indicators;

(c) helping customers to get a better deal from their existing bank, for example through internal switching facilitated by (a) and (b) above, by avoiding unnecessary overdraft charges through overdraft alerts and grace periods and limiting the cumulative extent of unauthorised overdraft charges as a result of the MMC; and

(d) making it easier to switch PCAs and BCAs through the reforms to CASS governance and processes and requiring the development of a common BCA application form.

19.90 In this way, each of the measures makes an important contribution to the effectiveness of the package as a whole and we expect the impact of our proposed combination of remedies to be greater than the sum of its parts.

19.91 We have also taken care to ensure that we are not putting in place remedies that would not be effective or proportionate. For example, as explained in Section 14, we are not taking forward potential changes to CASS which would have required Bacs to transfer continuous payment authorities on debit cards when switching through CASS. Also, we have decided in our parallel review of the 2008 NI PCA banking Order to revoke all of the measures in that Order. Similarly, as part of our other parallel review, of the 2002 SME banking undertakings, we have decided to release all but one of the measures in those undertakings as these are no longer required or have been superseded by the measures we are now introducing as part of this investigation.

Is the design of each remedy measure within the package of remedies no more onerous than it needs to be?

19.92 Our detailed consideration of the design and implementation of each of the measures is set out in Sections 13 to 16.

19.93 In reaching our decisions on remedy design, we have sought to avoid imposing costs and restrictions on parties that go beyond what is needed to achieve an effective remedy.

19.94 For a number of remedies – including the requirement to work to develop and to adopt open API standards to share data; the requirement to participate in the Nesta challenge prize and to list SME banking products on at least two websites – we have decided to impose requirements on only a subset of providers, with this being limited to the larger banks in GB and NI, ensuring that our remedies cover a critical mass of the market. Similarly, the requirement to develop and publish an online SME loan price and eligibility tool only applies to the larger banks in GB. This is a change from our provisional decision on remedies where we additionally proposed that the three largest NI banks should also be subject to this requirement. However, as explained in Section 16 we are now not requiring these banks to introduce a loan price and eligibility tool, for reasons of proportionality. We consider that NI customers can still benefit from the requirement for the largest GB banks to develop and publish a loan price and eligibility tool.

19.95 In relation to our other remedies we have decided that while the measures should apply generally, there are smaller PCA and BCA providers for whom specific remedies should not apply. For a number of remedies we have decided to set de minimis thresholds to determine whether a provider is to be subject to our measures.[15] Further, we have decided that certain 'private banking' services will not be subject to our measures.[16]

19.96 We have also avoided over-specifying our remedies, where this is not necessary for their effectiveness. For example, we have decided not to set a cap on the level of the MMC that we are requiring for PCA unarranged overdraft charges. Instead, as explained in Section 15, allowing providers to set the level of the MMC will achieve the aims of this remedy, while limiting or avoiding potential unintended consequences associated with the more intrusive approach of capping this charge and will ensure that banks remain accountable for their charges to customers.

19.97 For a number of our remedies we have decided to make a recommendation that others consider in the future whether further measures are required, rather than for the CMA to introduce measures now. An example of this approach includes our recommendation to the FCA to assess market developments following the introduction of APIs and whether there should be a requirement introduced on PCA providers to develop and introduce an overdraft eligibility tool. In these cases, we have been aware of the need for other interventions to take effect and the potential for market-based solutions to emerge in response to these earlier interventions.

19.98 In developing the design of the remedies we have considered whether measures should include a 'sunset' provision, to limit the duration of the remedy by reference to a specific future date or event. Further, for other potential remedies, we have recognised the merit in signalling now that they should be subject to a review in the future. For some remedies, or parts of remedies, this involves a recommendation to the FCA to undertake customer

[15] See Section 12.
[16] See Section 12.

research or testing once the remedy has been introduced to assess whether the effectiveness of the measure can be improved, for example our remedies for unarranged overdraft alerts, the communication of grace periods and the MMC.

Least onerous if there is a choice

19.99 If the CMA is choosing between two remedy measures which are both effective, it should choose the remedy measure that imposes the least cost or is least restrictive.

19.100 In addition to the measures included in our package of remedies we considered alternative ways of addressing the AECs and/or customer detriment. These included measures we put forward ourselves for consideration and other measures that were put to us by parties in response to the Remedies Notice and Supplemental Remedies Notice. Our consideration of these alternatives is set out in Sections 13 to 17. We have found that a number of these alternative measures would be of limited effectiveness and/or would not be required to address the AECs given that we are adopting other less intrusive measures in our package of remedies.

19.101 We rejected remedies which we found might be effective but more costly than the measures we are adopting. For example, we considered but rejected a requirement for the introduction of account number portability (ANP). While we considered that ANP would help to address the perceived and real risks faced by customers and SMEs when switching PCA or BCA provider, we preferred the more timely and much less costly alternative of requiring improvements to the existing CASS system.

19.102 In our consideration of the range of potential remedies we identified or had suggested to us, we were unable to identify an alternative package of measures that would be both less onerous while still effective in remedying the AECs. However, in developing our package of remedies, we have taken care to avoid including measures that did not make a material contribution to remedying the AECs as set out in paragraphs 19.86 to 19.91.

Does not produce adverse effects which are disproportionate to the aim

19.103 We considered whether the package of remedies, or any specific measure within it, was likely to produce adverse effects which were disproportionate to the aim of remedying the AEC and/or the resulting customer detriment.

19.104 In reaching a judgement about whether to proceed with any particular remedy, we have considered its potential effects, both positive and negative, on those persons most likely to be affected by it. We have paid particular regard to the impact of the remedies on customers. We have also had regard to the impact on those parties subject to them and on other affected parties, such as other businesses (eg potential entrants, or firms active in upstream or downstream markets), government and regulatory bodies and other monitoring agencies.[17]

Benefits of the remedies package

19.105 Measures to improve customer engagement are at the heart of our remedies to make retail banking markets work better and deliver better outcomes for consumers and SMEs. Our measures will work at several stages in the customer experience to increase the competitive pressure on banks:

(a) By empowering consumers and SMEs to make better-informed decisions at the time of first choosing an account; this is particularly important for start-up SMEs, which account for a large proportion of BCAs and currently have limited information about the service and quality of different BCAs.

(b) By encouraging switching (or the threat of switching) to lower-priced and/or higher-quality products by PCA and BCA customers. This may involve a customer switching entirely from one provider to another (full switching), opening a new account while retaining the old account (partial switching or multi-banking) or switching to a different account with their existing provider (internal switching). Customers can benefit from each of these forms of switching.

(c) By empowering SMEs and providing them with new tools to compare loan terms and conditions across providers.

(d) By increasing overdraft users' awareness of their usage and of the charges they could incur, including the cumulative charges they may incur in unarranged overdraft charges, and giving them tools to manage their account usage more actively.

19.106 The combined impact of these measures will be to increase the pressure on banks to compete by lowering their prices, improving those aspects of service which are valued by customers, and through innovation. As customer engagement increases, banks will be under more pressure to improve their offering in order to retain existing customers and attract new ones.

[17] The Guidelines, paragraph 348.

19.107 The increase in customer engagement and additional availability of data will reduce the incumbency advantage enjoyed by established banks, and will create an environment which will give more opportunities for expansion by small banks and banks with a better offering, and for new players to come into the market, including from the FinTech sector. Over time, this is likely to increase the competitive pressure on banks and to facilitate further technological change, allowing for new business models and approaches to develop. This in turn will enable PCA customers and SMEs to meet their banking needs in new and more efficient ways.

19.108 As we expect our remedies to harness technological developments to stimulate further innovation to the benefit of customers, the precise impacts of our remedies package are inherently difficult to predict or quantify. We do not expect these benefits to be solely measured by an increase in switching rates. While switching rates may well increase, we expect a considerably broader range of beneficial impacts to materialise. These could include:

- the emergence of new money management tools, allowing customers to better manage their current account usage including overdrafts, improving SMEs access to lending and more efficient management of broader banking relationships;

- greater levels of rivalry between providers, actively competing for new customers and to retain their existing customers;

- the emergence of new retail banking business models, products and services, including the introduction of innovative approaches to pricing and customer service;

- a greater focus by providers on the provision of improved service quality, demonstrated by improvements in service quality scores over time;

- greater levels of customer satisfaction and customer willingness to recommend their bank to others;

- a weakening of the linkages between PCAs and BCAs, and between BCAs and SME lending, demonstrated by a reduction in the proportion of start-up SMEs automatically choosing their PCA provider as their BCA provider and SMEs using a broader range of providers of SME loans; and

- greater levels of customer awareness of, satisfaction with and confidence in CASS and the opportunities for switching.

19.109 These impacts will not emerge immediately; we expect them to build over time, resulting in increased competition, providing benefits to all types of customers. Improvements of this nature in the functioning of GB and NI retail banking markets will have both direct and indirect benefits both within those markets and to the wider economy.

19.110 In Section 11, we concluded that, while we were not able to quantify the detriment associated with the AECs we had identified, we expected that this detriment would be substantial, particularly in view of the long-lasting dynamic benefits that increased competition would deliver.

19.111 We now discuss more specifically how customers will benefit from our remedies and the order of magnitude that such benefits are likely to take.

How customers are likely to benefit from our remedies

19.112 We expect increased customer engagement to bring about a more competitive environment, in which an increasing number of PCA and SME banking customers switch products and providers and become better able to manage their use of their banking products, including usage of overdrafts. In turn, banks will need to adjust their charging structures and service levels to succeed in this more competitive environment.

19.113 In addition, we expect our remedies, particularly in relation to open APIs and the other measures that build on that remedy, to promote greater innovation and dynamic benefits.

19.114 While we are not able to quantify all of these benefits precisely, we expect them to be substantial. This is because of the scale and significance of retail banking markets both to their customers and to the wider economy (see paragraphs 19.78 to 19.80). In this context, we note that:

(a) PCA, BCA and SME lending markets generated revenues of £8.7 billion, £2.7 billion and £2.8 billion[18] respectively in 2014 in the UK. Any reduction in prices (through reduction in charges or through increase in rewards, cashback and/or interest on credit balances) as a result of more competition will therefore have a large impact in monetary terms. For example, a reduction in charges, or increase in rewards to customers, of only 1 to 2%, would deliver customer benefits of the order

[18] See section 2.

of £100–£300 million per year across these three markets in GB, and of the order of £4–£10 million per year in NI.[19]

(b) The competitive pressure on banks is currently weak, due to high barriers to searching and switching, the linkages between PCAs and BCAs, and (in the case of SME lending) the linkages between BCA and SME loans. In this context, our package of remedies has the potential to drive important changes in banks' strategies for acquiring and retaining customers.

(c) Quality of service, innovation and development of new business models are of particular importance at this point in the development of UK retail banking markets.[20] Beyond any financial gains from switching and from increased price competition, increased quality of service and innovation is likely to result in very significant and long-lasting benefits to personal customers and SMEs.

19.115 While we are not able to quantify all the beneficial impacts accruing from increased competition, we illustrate below the order of magnitude of some of the potential gains to specific customer groups who are likely to benefit directly from our remedies.

Scale of direct benefits to PCA customers

19.116 We expect that PCA customers will be better able to assess which products are best for them and choose better value accounts, leading to direct benefits, in terms of price and/or in the quality of service received.

19.117 These direct benefits will be realised in a variety of ways. This includes through increased switching (including internal switching and partial switching) and also because customers will make better-informed decisions on which product to choose when first opening a PCA. It may take some time for the full increase in switching rates to materialise, but we expect benefits from increased switching and more effective customer search to be long-lasting. We also expect benefits to be realised by PCA customers from being able to make better decisions, even at current levels of switching. This is because customers who are currently inclined to switch will now have

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[19] We did not obtain total revenue data separately for GB and NI. Based on data on number of PCAs, BCAs and SME loans in GB and NI, GB accounts for approximately 97% of UK volumes, and NI accounts for approximately 3% of UK volumes. We have used these broad splits in order to calculate potential benefits for GB and NI separately.
[20] For instance, our PCA customer survey (p36) found that quality of staff and customer service were the most important factors for customers (83% essential or very important), ahead of any monetary aspects. Similarly, our SME follow-up survey found that service attributes and service quality were very important factors to SMEs when choosing a bank (see Section 8).

better tools to assess which product to switch to and as a result will realise higher gains from switching.

19.118 We also expect that customers will be able to get a better deal from their existing provider: for example, customers who better manage their overdraft usage as a result of our remedies will gain directly from reduced exposure to unintentional overdraft charges and we expect the introduction of MMCs to benefit heavy unarranged overdraft users directly.

19.119 We have undertaken further analysis to estimate the potential direct gains to customers from switching, which is one of the more readily quantifiable sources of customer benefit.

19.120 Gains from switching give an estimate of the magnitude of the static harm to customers arising from lack of switching and from customers lacking the tools to choose the best account for their needs. They can therefore be interpreted as an indicator of the direct benefits that will arise for customers who choose better value accounts as a result of our remedies, although they do not take into account any improvements in quality of service. Our analysis estimates that, in GB, if PCA customers switched to a cheaper product for them, annual savings would be on average £92, ranging from £65 on average for customers who do not use an overdraft to £130 on average for overdraft users.[21,22] In NI, annual savings would be on average £66, ranging from £43 on average for customers who do not use an overdraft to £124 on average for overdraft users.[23]

19.121 We expect that our remedies, by encouraging more switching by PCA customers, including through partial switching and internal switching, will benefit directly those customers who switch. While we cannot accurately predict the impact of our remedies on switching rates, even modest increases from the current low levels of switching will result in substantial benefits to consumers given the size of potential gains from switching to customers.

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[21] Gains from switching are calculated here as average gains from switching to the five cheapest products, smoothed over five years, for standard and reward customers. See Section 5 for further details.
[22] These are gains from switching to/from standard and reward accounts. Gains from switching to/from packaged accounts tend to be higher, however in order to estimate the gains from switching to/from packaged accounts, we made additional assumptions on the value to customers of the benefits from packaged accounts, which may not be reflective of the true value customers place on the benefits and their usage of them. For these reasons, we adopted a cautious approach of using the gains from switching to/from standard and reward accounts.
[23] Results for NI are less robust, because the underlying customer transactions data for NI customers was incomplete in some respects and so we have had to make adjustments for this in order to produce price estimates.

19.122 Tables 19.1 and 19.2 below show the potential benefits to PCA customers who switch following our remedies, under different assumptions about the increase in switching rates, for GB and NI separately. For example, if, as a result of our remedies, 1.4 million more PCA customers switched accounts than is currently the case in GB, and 36,000 more PCA customers switched accounts in NI, ie an increase in switching rate of two percentage points in GB and NI, overall direct gains for these customers would be of the order of £127 million per year in GB and £2.4 million per year in NI.[24]

19.123 We expect that our remedies will result in lasting benefits from increased switching rates. In the examples above, even under modest assumptions[25] about the increase in annual switching rates (between two and three percentage points), direct gains from switching would be of the order of £600 million to £1 billion over five years in GB, and £12–£18 million in NI. These figures are conservative: in particular, we cautiously assume that customers accrue benefits from switching only in the first year, when in practice customers switching are likely to accrue benefits over longer periods of time. In practice, this means that overall direct benefits over a five-year period are likely to be substantially in excess of the estimates above.

Table 19.1: Illustrative examples of gains from switching PCAs – GB

			£ million
Increase in switching rate (percentage points)	*Number of additional PCA customers switching**	*Average annual gains†*	*Overall gains over five years assuming the increase is sustained***
1	690,000	63.5	317.4
2	1,380,000	127.0	634.8
3	2,070,000	190.4	952.2
4	2,760,000	253.9	1,269.6
5	3,450,000	317.4	1,587.0

Source: CMA analysis based on pricing and usage data provided by PCA providers.
* Based on 69 million active PCAs in GB in 2015.
† Average annual savings of £92 per account, calculated as average gains from switching to the five cheapest products, and smoothed over five years, for standard and reward accounts in GB; see Section 5.
**Overall gains over five years differ from (average annual gain x 5) due to rounding of annual gains.

[24] These are benefits only for one year and are therefore conservative, as a customer who switched in one year is likely to benefit from this switch over several years given the long-term nature of banking. For the purposes of these indicative calculations, we assume cautiously that customers would accrue benefits only in the first year.
[25] While this would represent a comparatively high increase in switching given the current low levels of switching, we consider that this is a modest assumption once our remedies are taken into account. Moreover, there will also be direct benefits to consumers at current levels of switching, because those who switch will be able to better assess which product to switch to, as will those first opening an account.

Table 19.2: Illustrative examples of gains from switching PCAs – NI

			£ million
Increase in switching rate (percentage points)	*Number of additional PCA customers switching**	*Average annual gains†*	*Overall gains over five years assuming the increase is sustained***
1	18,000	1.2	5.9
2	36,000	2.4	11.9
3	54,000	3.6	17.8
4	72,000	4.8	23.8
5	90,000	5.9	29.7

Source: CMA analysis based on pricing and usage data provided by PCA providers.
* Based on 1.8 million active PCAs in NI in 2015.
† Average annual savings of £66 per account, calculated as average gains from switching to the five cheapest products, and smoothed over five years, for standard and reward accounts in NI; see Section 5.
**Overall gains over five years differ from (average annual gain x 5) due to rounding of annual gains.

19.124 Over time, the direct gains from switching measured by this kind of calculation might reduce. This is because, over the longer term, we would expect banks to reduce prices as competition intensifies. As such, the potential gains for individual customers from switching might reduce, although there will be wider benefits to all consumers as a result of this intensification of competition.[26] This might reduce the direct gains from future switching as measured by this type of calculation, but it clearly does not reduce the expected overall benefits when compared to the situation prevailing at the time of this final report (and absent our remedies).

19.125 Banks may respond to increased competition by changing their pricing or product structures (for instance, by offering more fee-paying reward accounts). In the longer term, the benefits of the remedies may therefore be experienced by customers in a different way from the gains from switching that we have quantified. This type of increased pressure on banks to offer their customers better value for money and to innovate as a result of our remedies means that customers are likely to benefit more widely than just those who choose to switch.

19.126 We also expect direct benefits to overdraft users from our overdraft remedies package (additional to the direct gains from switching). In 2014, 45% of all PCA customers used overdrafts to varying degrees.[27] Total fees and charges on overdrafts paid by PCA customers were of the order of £2.9 billion in 2014 in the UK, with £1.7 billion accounted for by arranged overdraft charges and the remaining £1.2 billion for unarranged overdraft charges and fees. We therefore expect significant direct benefits to PCA

[26] We note, however, that the calculations above are based on a number of conservative assumptions, for example, they do not take into account the benefits to customers who switch beyond the first year of switching.
[27] See Appendix 6.5.

customers who will be better able to manage their overdraft usage, and reduce incidence of charges, through our overdraft remedies package.

19.127 The FCA and LBG undertook separate studies of the impact of text alerts on unarranged overdraft charges. The LBG study found that text alerts reduced monthly unarranged overdraft charges by 6%. The FCA study found that signing up to text alerts reduced unarranged overdraft charges by 6% on its own, and that the combined effect of signing up to text alerts and mobile banking was a reduction in these charges of 24%.[28] Taking a lower bound of 6% gives an indicative estimate for the reduction in unarranged charges of the order of £31–£35 million per year in the UK as a result of our remedy to enrol automatically customers into an unarranged overdraft alert, or £155–£175 million over a period of five years.[29] These estimates are conservative, as they do not take into account the larger impact of signing up to alerts when a customer is already using mobile banking. Given that many PCA customers already use mobile banking, and that usage will continue to grow, overall benefits are likely to be significantly higher.[30] Moreover, these estimates do not take into account the wider benefits from alerts contributing to higher engagement of customers with their choice of PCA. Though we were not able to calculate the impact of alerts separately for GB and NI, we would expect benefits per customer to be higher on average in the NI market, because four of the NI banks (AIB, BoI, Danske and Ulster) do not currently offer any overdraft alerts.[31]

19.128 In relation to heavy unarranged overdraft users, we found that, in 2014, there were over half a million instances where customers incurred cumulative unarranged overdraft charges in excess of £100 in a month, and over a million instances where customers incurred unarranged charges in excess of £75 in a month in the UK.[32] The MMC has the potential to directly reduce cumulative charges paid by such customers.

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[28] FCA occasional paper No.10 (March 2015), *Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour.*

[29] Appendix 15.1 explains how we estimated these benefits; we only calculate benefits for customers who are not already enrolled in overdraft alerts. Similarly, we discount benefits to take into account that some customers do not have mobile phones. The lower bound of £31 million assumes that 10% of PCA customers opt out of these alerts, which is in line with the opt-out rates in LBG's trial, and the £35 million estimate assumes no opt outs.

[30] According to the FCA study, customers signing up to mobile banking alone reduces unarranged overdraft charges by 8%. If they also signed up to text alerts, the FCA found the total reduction in these charges to be 24%. This suggests that the effect of signing up to text alerts on customers already using mobile banking would be a 16% reduction. This is much higher than the 6% reduction we have used in our estimates.

[31] See Appendix 6.6.

[32] See Appendix 6.3 for details. This is a lower bound estimate of the number of instances where customers incurred more than £75 or £100 in unarranged charges in a month.

Scale of benefits to SMEs

19.129 In relation to BCAs, we expect direct benefits from our remedies to accrue to SMEs who switch BCAs following our remedies, as well as to start-ups who will be able to make a better-informed decision on which BCA to choose as a result of the availability of more effective price and service comparison tools. We expect that our remedies will have a particularly strong impact on the BCA market: given, in particular, the lack of effective comparison tools for SMEs to assess which BCA to choose, and additional barriers to switching compared with PCAs including the implementation of AML requirements and to the perception that switching is risky.

19.130 In Section 7, we found that there was significant variation in monthly charges between banks, indicating substantial gains from switching BCAs for SMEs. We undertook indicative analysis and estimated, based on our BCA pricing analysis, that in GB, SMEs would save approximately £77 per year on average on their BCA if they were to switch. In NI, we estimated that SMEs would save approximately £112 per year on average on their BCA if they switched.[33]

19.131 Tables 19.3 and 19.4 show, based on these average figures, the potential gains from increased switching by SMEs in GB and NI. For example, if as a result of our remedies 98,000 more SMEs switched BCAs than is currently the case in GB, and 3,00 more SMEs switched BCAs in NI, representing an increase in switching rates of two percentage points in GB and NI, the direct gains for these SMEs would be of the order of about £7.5 million per year in GB, and £0.4 million in NI. Over five years, even under modest assumptions on the increase in annual switching rates (between two and three percentage points), direct gains from switching would be in the region of £35–£60 million in GB and £2–£3 million in NI. These figures are very conservative, as they only take into account the gains in the first year when one would expect SMEs to benefit from switching for multiple years. They also are likely to significantly underestimate any direct gains to SMEs, due to the conservative assumptions in order to derive these estimates, and because of the importance to SMEs of service quality in choosing a BCA, which is not taken into account in these estimates. In practice, direct gains from switching are therefore likely to exceed these conservative estimates.

[33] Due to the assumptions in the BCA pricing analysis, this is likely to be a conservative assumption, as it does not take into account any period of free banking that an SME would get if it switched to another bank.

Table 19.3: Illustrative examples of gains from switching BCAs – GB

			£ million
Increase in switching rate (percentage points)	*Number of additional SMEs switching BCAs**	*Average annual gains*	*Overall gains over five years assuming the increase is sustained***
1	49,000	3.8	18.9
2	98,000	7.5	37.7
3	147,000	11.3	56.6
4	196,000	15.1	75.5
5	245,000	18.9	94.3

Source: CMA analysis.
* Based on 4.9 million active BCA accounts in 2015 in GB.
† Based on average gains from switching of £77 per account switching; see Section 7.
**Overall gains over five years differ from (average annual gain x 5) due to rounding of annual gains.

Table 19.4: Illustrative examples of gains from switching BCAs – NI

			£ million
Increase in switching rate (percentage points)	*Number of additional SMEs switching BCAs**	*Average annual gains*	*Overall gains over five years assuming the increase is sustained*
1	1,700	0.2	1.0
2	3,400	0.4	1.9
3	5,100	0.6	2.9
4	6,800	0.9	3.8
5	8,500	1.0	4.8

Source: CMA analysis.
* Based on 170,000 active BCA accounts in 2015 in NI.
† Based on average gains from switching of £112 per account switching; see Section 7.
**Overall gains over five years differ from (average annual gain x 5) due to rounding of annual gains

19.132 In addition, we expect that our remedies will enable start-ups to make better-informed decisions on their BCA provider, and this will increase the direct gains from our remedies. Table 19.5 below shows potential gains to start-ups from making a better-informed decision. For instance, if only 20% of all start-ups chose BCAs which are better value for their needs as a result of our remedies, the total direct gains would increase by about £5 million per year. If 30% of all start-ups chose BCAs which offer better value for their needs as a result of our remedies, the total direct gains would increase by about £8 million per year. Over five years, even under modest assumptions on the proportion of start-ups who make better-informed decisions on their BCA (20 to 30%), this would amount to in the region of £27–£40 million of further benefits to SMEs.[34]

[34] We only have UK-wide data, and therefore do not distinguish here between GB and NI.

Table 19.5: Illustrative examples of gains to start-ups

Proportion of start-ups making better-informed decision (%)	*Number of start-ups**	*Average gains over one-year period (£m)†*	*Overall gains over five years***
10	34,600	2.7	13.3
20	69,200	5.4	26.6
30	103,800	8.0	40.0
40	138,400	10.6	53.3

Source: CMA analysis.
* Based on 346,000 new businesses in the UK 2013. See Appendix 8.1. This likely underestimates total start-ups opening a BCA in any given year as it does not include businesses not registered for VAT.
† Based on gains from switching of £77 on average per year; see Section 7.
**Overall gains over five years differ from (average annual gain x 5) due to rounding of annual gains.

19.133 We were not able to conduct similar analysis for SME loans, largely due to the nature of SME loan pricing which makes it difficult to compare prices on a like-for-like basis. However, given in particular the strong linkages we have found between BCAs and SME loans, with 90% of SMEs currently obtaining a loan from their existing BCA provider, and given the lack of comparison tools currently available, we consider it is likely that there will be large financial gains to be made for SMEs if they are able to compare loan prices more easily, and further substantial benefits from being able more easily to access loans. The wider benefits for all SMEs arising from increased competition driving down loan prices are also likely be large.

Summary of scale of benefits to PCA customers and SMEs

19.134 Overall, these illustrative examples suggest that direct static gains from switching PCAs and BCAs, and from better management of overdraft usage, will be very substantial, and of the order of £150–£250 million per year in the UK.[35,36] We expect these benefits to persist and to accumulate to an amount in the order of at least £700 million–£1 billion within a period of around five years.

19.135 We note that these are illustrations of some of the direct benefits from switching and better management of overdrafts and are based on conservative assumptions.[37] These estimates also do not take into account any direct gains as a result of increased ability for SMEs to choose better-

[35] These figures are derived by adding up the direct gains calculated above for PCAs and BCAs switching in GB and NI, under assumption of 2 to 3% increase in switching rate, as well as our estimates for the gains from better management of overdrafts and from start-ups making better-informed decisions on their BCA.
[36] Of which direct benefits from switching PCAs and BCAs in NI are of the order of £2.5–£5 million per year.
[37] In particular, we note the modest assumptions made on the impact of alerts on unarranged overdraft charges, and on the increase in the proportion of PCA and BCA customers who will choose a better-value account through increased switching, as well as on the average gains from switching for those who switch which are only calculated over one year when we would expect customers to benefit from switching over several years given the long-term nature of banking. In addition, we have not sought to quantify benefits arising at constant switching rates, given that customers who switch and those who first open an account will have the tools to make better-informed decisions.

value loan prices more easily, and further substantial benefits from being able more easily to access loans, which we expect to be substantial.

19.136 More importantly, though we were not able to quantify these, we expect substantial long-lasting dynamic benefits from our remedies, through the increased pressure on banks to improve their quality of service, to innovate and to compete on prices. As an illustration, and focusing just on price effects, even a small reduction in charges, or increase in rewards to customers, of only 1 to 2%, would deliver customer benefits of the order of £100–£300 million per year across PCAs, BCAs and SME loans in GB, and of the order of £4–£10 million per year in NI.

19.137 These wider and long-lasting dynamic benefits are particularly relevant given the scope for our remedies, particularly in relation to open API standards, to accelerate technological progress in the UK retail banking sector and to harness this change to the benefit of PCA customers and SMEs.

Costs of the remedies package

19.138 We have set out our view of the costs associated with each of the individual remedies in Sections 13 to 16 above. These incorporate our consideration of the views of parties received in response to our provisional decision on remedies.

19.139 Many of our remedies are variations of or extensions to current or previous industry, regulatory or government initiatives. They therefore impose limited additional costs on firms and target existing expenditure more effectively, in the interests of consumers and SMEs. For example:

- *(a)* The development of open API standards and open data. This seeks to progress the OBWG initiative, developing a delivery and funding framework, requiring bank participation and setting well-defined delivery timescales. Obligations consistent with our remedies will (even given the recent EU referendum result) be required by PSD2 in two years' time and our measures are focused on ensuring that customers derive the maximum benefit from these obligations.

- *(b)* The provision of quality of service data. This builds on the data already collected and used by providers, but requires this to be expanded in scope and for the information to be made available to third parties, in order that it can be incorporated into comparison tools. This extension will enable consumers and SMEs to make better-informed decisions about the provider of their banking services.

(c) Customer prompts and alerts. This builds on and improves regulatory and industry initiatives such as the requirement for banks to provide customers with an annual statement. Our remedy will make these and other prompts more widespread and effective through upfront research and testing. It also builds on the provision by some banks of text alerts to prompt customers about their account usage, allowing them to better manage their fees and charges.

(d) The Nesta challenge prize. This is building on an industry initiative to encourage the provision of a comparison tool for SME banking and ensuring that this also adequately incorporates the provision of comparative information on service quality, as well as ensuring coverage of SME lending products.

(e) Reforms to CASS governance and increasing customer awareness and confidence in CASS. These measures will take the governance and performance of CASS to the next stage of development, from ensuring it was operationally sound when the service was established, to ensuring that it evolves in a way that its incentives become aligned with promoting competition, securing greater awareness and confidence and operating in the interests of customers.

(f) The requirement for providers to provide transaction history to customers at the time of, and after, closing their accounts and the changes to CASS processes to extend the CASS redirection period. The measures build upon the existing policy of many providers on the provision of transaction history for their customers and upon developments already initiated by CASS on extending the redirection period.

(g) Introduction of a standard BCA opening form. This builds on an industry initiative and ensures it will be rolled out across all providers.

(h) Provision of overdraft alerts and information on grace periods. This builds on industry and regulatory initiatives. This includes the roll-out by some providers of overdraft alerts to help customers better manage their overdraft usage and to reduce or avoid associated fees and charges, as well as the FCA's work with banks to develop retry periods.[38] Our measures will ensure that these beneficial alerts are provided by all PCA providers, customers are made aware of grace periods and that these evolve over time with market and technological developments, under the review of the FCA.

[38] See Section 15.

(i) Unarranged overdraft MMC. This builds on industry initiatives whereby some providers have introduced their own arrangements to limit the aggregate amount of fees and charges that customers can accumulate within a month, but additionally requires the introduction of such a limit in a consistent manner by all providers and that it be communicated to customers.

19.140 By building on existing developments, we have been able to establish 'proof of concept' and ensure that the additional or 'incremental' costs of our remedy package are kept as low as possible. Taking this approach has allowed us to derive the maximum benefit from the work that has already been undertaken and to take into account what we have learnt from that work.

19.141 Similarly, a number of these remedies apply across PCAs, BCAs and SME lending, reducing the incremental cost of the remedy across the different markets but also rendering it difficult to apportion costs to each. For example, data sharing via open APIs where PCA, BCA and SME lending data will be shared via the open APIs developed but the primary cost of the remedy resides in developing the API; and the Nesta prize challenge, which applies to BCAs and SME lending. In the same way, the incremental costs of complying with the remedies across GB and NI is also often expected to be low and there are benefits to having a consistent regulatory regime across the UK. Where we considered the costs disproportionate, for example in relation to the loan price and eligibility tool, we limited the remedy to only the largest GB providers.

19.142 For our remedies associated with open API standards and open data, we have specified the timetable for delivery of these and the requirements replicate to some extent the requirements of complying with PSD2. We have noted that the timetable for the first release of open data should not present providers with a major problem as this gives rise to no security or privacy concerns and most of the data is already in the public domain, albeit hard to access.

19.143 Further the 'read-and-write' API functionality poses challenges, including privacy concerns, which have associated costs in order that these concerns be properly addressed. They also raise issues of security and fraud prevention. However, our remedy does not require providers to adopt these relevant measures any sooner than they are likely to be obliged to under PSD2. Therefore, while the cost of the remedy is likely to exceed that of the costs of complying with PSD2, the difference in cost is likely to be small, particularly relative to the benefits of greater competition and innovation associated with the prompt implementation of this key measure.[39] We consider it unlikely that the total costs of support in cash or kind for the Implementation Entity, Implementation Trustee and the procurement of data services involved in operating a data 'sandbox' would exceed £20 million.

19.144 Our remedy relating to service quality information requires banks to supplement existing consumer and SME surveys and data and to make these available to customers and third parties. We have estimated the incremental costs of the additional surveys to be in the region of £1 million a year, with the costs split between providers. The incremental costs associated with making a wider variety of service quality data available will likely be minimal, and largely associated with one-off costs to ensure consistency of definitions. The costs associated with making the data available to customers and third parties would also be relatively low, as this can be incorporated into providers' periodic updates of their websites and publication materials.

19.145 Our remedy to introduce customer prompts will require costs to be incurred during the design and testing phase and when the prompts are implemented. On the design of the prompts, costs will be associated with the FCA's research and testing programme, both the costs to the FCA and the costs to the providers participating in the testing. It is not yet possible to determine a precise estimate of the costs of the FCA's research and testing programme, but we do not expect this to be overly burdensome.

19.146 The requirements for the implementation of the prompts will be informed by the results of the FCA's research and testing programme, and the costs will be largely driven by the required changes to providers' IT systems and wider communications infrastructure to deliver the prompts, as well as changes to the design of marketing and customer information publications. The magnitude of the implementation costs will be better understood once the FCA has completed its research and testing, and will be a relevant consideration for the FCA when it makes its decision as to which prompts and forms of prompt to require banks to introduce. The FCA will assess the costs of potential prompts against the benefits of the introduction of the prompts as part of our overall package of remedies. This assessment will

[39] Barclays submitted in its further response to our provisional decision on remedies that the costs of implementing open APIs are only considered as incremental costs over and above those incurred to implement the changes under PSD2, but it is not clear that the benefits are treated in a similar way. While we agree that PSD2 will be implemented and yield some benefits, we consider that our remedy will create benefits over and above these by having a common API standard. Further, we do not consider that PSD2 on its own would create the benefits we have listed in this Section given these arise from the operation of our remedies package as a whole.

take place in the context that the other elements of our remedies package are in place.

19.147 Nevertheless, we note that banks, as well as providers of other financial services, and providers of products and services in other sectors frequently update their publication materials and increasingly update their IT systems and communications systems in order to meet growing customer demand for more timely information. Indeed we have noted in the design of our remedies that many banks themselves have undertaken such changes and made the required investments to engage more frequently with their customers. They also need to conduct staff training regularly. Any estimate of costs associated with the implementation of specific prompts would be additional to these generally incurred costs. We envisage the incremental costs to BCA providers of sending prompts to SMEs not covered by the FCA's powers to be minimal, as these customers represent a small proportion of SMEs.

19.148 A number of our measures will change the operation of CASS, provide transaction information to customers who have changed provider and introduce reforms to how CASS is governed:

(a) Changes to the operation of CASS. We are seeking changes to the CASS redirection period, which as we have noted is a logical extension of the operation of CASS, with this having been discussed between CASS participants, and reforms proposed. Bacs has indicated that the changes to the redirection period might involve costs to it of around £2.5 million. Bacs has told us that a rule of thumb for total industry-wide costs would be a magnitude of ten of its own costs. Taking this rule of thumb, together with the submission from LBG which estimated the cost to it of implementing this remedy of between £2 and £5 million, we expect industry-wide costs of around £25 million and no more than £30 million. We note that Bacs is already working with CASS-participating banks to introduce this change and as such the full cost would not be attributable to our remedy.

(b) Provision of transaction histories to customers. We are requiring changes to the process for PCA and BCA providers to provide transaction histories to customers who have switched provider. This is already provided by many banks, albeit in a potentially inconsistent and non-comprehensive manner. We expect the additional costs of these changes to be minimal. Banks are already required to retain customer transaction data for a period of five years, the same period as we are requiring. Therefore any costs would be limited to interactions with customers, training of staff and retrieving the relevant requested data.

(c) Changes to CASS governance and increasing customer awareness of and confidence in CASS. We are seeking changes to CASS governance, including the provision of regulatory oversight, and measures to increase customer awareness of and confidence in CASS. We do not expect the changes in CASS governance to incur significant costs. These are largely related to changing the organisation of the CASS management committee and with supplementing membership of various CASS committees with independent members in order to ensure that non-bank influence is incorporated into the development of CASS and its decision-making process. Similarly, we do not expect the costs associated with the provision for regulatory oversight to be substantial. While we consider it essential for such oversight to exist in order to help ensure that CASS is operated in ways best designed to promote competition in PCAs and BCAs and to operate in the customer interest, this can be achieved with a relatively light-touch approach. Any costs incurred by the authority overseeing CASS would be recovered directly from Bacs, which in turn will recover these from CASS participants.

(d) Bacs and participants currently undertake substantial investment in seeking to ensure high levels of customer awareness of and confidence in CASS. This includes spend on advertising, as well as developing understanding of the CASS guarantee and the process by which the switching process occurs. Bacs has told us that CASS participants have already committed to spending £9.2 million in 2016 on central activities to increase awareness of and confidence in CASS. Further Bacs has recently established a working group with CASS participants to develop its approach to targeting specific groups of customers, for example SMEs. Our proposals in relation to customer awareness and confidence will not necessarily require the provision of additional funds; it may be that better outcomes can be achieved within similar scales of budget committed to in recent years. However, even if our proposals do require additional funds in order to make CASS more effective, the additional costs would be significantly outweighed by the benefit that would be realised.

19.149 We have set out a number of measures related to overdraft usage, including to enable PCA customers who use overdrafts to better manage their unarranged overdraft usage charges and to require PCA providers to limit the unarranged overdraft charges that they impose on customers:

(a) To require PCA providers to enrol automatically all their customers into unarranged overdraft alerts. Additionally we are requiring that such alerts include informing customers of the PCA provider’s grace period in which the customer can reduce or avoid unarranged overdraft charges if

they take action to move money into their relevant PCA. Most providers already provide some form of alert and operate grace periods so providers would typically face incremental costs related to changing their alerts and/or grace periods to comply with our Order and automatically enrolling their customers into our unarranged overdraft alert. Estimates provided by some parties suggest that the incremental costs of the alert remedy are likely to be limited even taking into account that the costs will be higher for providers who do not currently offer alerts.[40]

We are also recommending to the FCA that it identifies, researches, tests and, as appropriate, implements measures to increase overdraft customers' engagement with their overdraft usage and charges. We have suggested that this includes it considering how PCA providers may be able to enhance the effectiveness of overdraft alerts. The costs relating to this, which we expect to be small relative to the potential benefits to customers, will depend on the scope of the FCA's work and some of these costs will be shared with the customer prompts remedy (see paragraphs 19.1435 to 19.1457).

(b) To require PCA providers to set an MMC for unarranged overdraft charges. The costs of imposing the MMC remedy would be small. They will comprise primarily changes to IT systems (to cap charges at the level each provider individually sets for each of its PCAs for those who do not currently offer the service), and communication costs. These communication costs could include the costs of modifying and circulating charges and overdraft information and terms and conditions, staff training costs to communicate these changes internally, and staff time to manage these changes, for example determining at what level to set the MMC for each type of account and additional resources to respond to customer queries. There will also be some limited costs associated with work by the FCA to assess the ongoing effectiveness of the MMC and its consideration of whether measures (including the introduction of rules if appropriate) could be taken to further enhance its effectiveness.

(c) Measures to facilitate searching and switching for PCA overdraft customers. We are recommending to the FCA to consider requiring all PCA providers to offer online tools indicating a prospective customer's overdraft eligibility. Further we will also seek undertakings from Bacs to work with CASS participants to review the account switching process to ensure that PCA providers offer a firm decision on the overdraft offered

[40] We are providing for an extended transitional period of no longer than an additional six months in certain circumstances, in particular where providers do not currently have and will need to develop and introduce an alerts system in order to comply with this remedy.

after a customer has completed the PCA provider's application process but before they switch accounts. The costs directly associated with these measures will not be significant. Depending on the actions that arise from each of the recommendation and review, these could involve PCA providers incurring costs, although any decision to propose further action would itself be subject to an evaluation of the costs versus the wider benefits that would be delivered.

(d) Measures to encourage PCA customers to engage more with overdraft features. We are recommending to the FCA to look at ways to engage customers more in considering overdraft features and their potential relevance and impact, during the PCA opening process. The costs directly associated with these recommendations will not be significant. Depending on any actions that arise, this could involve PCA providers incurring costs, although again, any decision to propose further action would itself be subject to an evaluation of the costs versus the wider benefits that would be delivered.

19.150 We have set out a number of measures to facilitate the comparison of SME banking products, to promote increased engagement of SMEs and to standardise and simplify BCA opening procedures. These are:

(a) For the larger banks in GB and in NI to support the Nesta challenge prize including through the provision of customer transaction and other data and the provision of funds to meet the cost of the process. We do not expect that the costs of the Nesta challenge prize – of £5 million to fund the prize, plus additional administrative and participation costs – would exceed £10 million, to be shared among the affected banks. As part of this remedy we have also included a requirement for a safeguard remedy. Our estimate of the costs of this safeguard remedy, should it be required, is in the range of £1–£2 million. This estimate has been informed by the CMA's estimate of the costs for creating a similar site in the payday lending market investigation, again as a safeguard remedy, where it concluded that the costs would not be more than £1 million.

(b) For the larger banks in GB and in NI to list their products on two or more designated finance platforms and subsequently the Nesta challenge prize winner platform. We do not expect the costs associated with this measure to be significant. In particular, because of the way our remedy has been specified, platform commission rates will be commercially negotiated between each bank and platform or PCW and could thus be expected to reflect the value to providers of listing on these sites.

(c) Ongoing funding of the underlying survey of the BBI site until the core SME service quality indicators, as specified by the service quality remedy, are available. We do not expect any additional costs to arise from the requirement to continue with the BBI site; this is an ongoing project which absent our remedies we would expect banks to continue to commission and fund. In any case we would not expect the costs of this to be too substantial, and would be time-limited in duration.

(d) To require all lenders that offer loans and overdrafts up to £25,000 to display the rates for these on their website. Further, we are requiring the larger banks in GB to develop and offer on their website an SME loan price and eligibility indicator tool, covering all unsecured loans and overdrafts up to £25,000. To provide support to these measures we are additionally recommending to HMT that it works with CRAs and SME lenders to develop mechanisms to allow for 'soft searching' for lending products by SMEs.

We do not expect the costs associated with requiring banks to display their loan and overdraft rates on their websites to be significant as these changes could be incorporated into periodic updates of websites and marketing materials. Similarly, we would not expect the cost of HMT working with CRAs and SME lenders to explore the potential for soft searches to be significant.

We expect the costs of developing a loan price and eligibility tool to be more significant, with this being one of the reasons for limiting this to the largest banks in GB. The range of estimates of costs that parties have provided to us indicate that the costs of this measure could be between £100,000 and £2 million for each of the four providers that would be required to develop a loan price and eligibility tool. This suggests a possible range for the cost of this measure to be between under £1 million up to around £8 million.

(e) To require banks to develop and adopt a standard BCA opening form and evidence requirements to standardise and simplify BCA opening procedures. This builds on an ongoing industry initiative to develop a common BCA opening form. While there may be additional costs for banks to implement this remedy, these are unlikely to be significant.

(f) HMT review of sharing of SME data. We are recommending that HMT reviews the efficacy and impact of the measures under the SBEE Act and ongoing commercial, technological and regulatory initiatives intended to facilitate the sharing of SME information. Any immediate costs associated with the implementation of this remedy will be limited,

incurred by HMT. To the extent that HMT finds that the market has not developed sufficiently, the associated cost of any subsequent initiative will depend on the extent of the intervention required to allow SMEs to share their information in a manner that enables them to consider multiple finance providers. We would expect that HMT will consider the magnitude of any costs, alongside the benefits, when making its decision on what, if any, subsequent initiative should be introduced.

(g) BEIS to work with the British Business Bank and professional associations such as the ICAEW to explore ways in which their members can channel advice on choice of providers and sources of finance to SMEs. We would not expect the costs to be significant.

19.151 In summary, because we have sought to build on industry, government and regulatory initiatives wherever possible, few of our individual remedies will require affected parties to incur significant incremental costs in the context of the size and significance of retail banking markets. Moreover, our approach to monitoring compliance with the remedies (see paragraph 19.41) means that associated costs of this will be limited. In light of the assessment we have conducted above, we consider that the overall incremental costs associated with introducing our remedy package are likely to be modest, potentially in the range of around £75–£110 million, mostly consisting of upfront, one-off costs, in comparison with the level of ongoing adverse effects and detriment that is associated with the AECs we have found.

Balance of the benefits and costs

19.152 The analysis above indicates that the benefits of the package of remedies are likely to exceed the costs by a substantial margin.

19.153 We have concluded in paragraphs 19.112 to 19.114 that the dynamic benefits of our package of remedies will over time be substantial and long-lasting, through their impact on increasing competition on prices, services and innovation. In part this is because of the size of the retail banking markets which are the focus of this market investigation, as well as their importance to the wider economy. This means that even those measures that we expect to have a relatively small impact on the functioning of retail banking markets will have an associated significant benefit in absolute terms. While we could not quantify all of the beneficial effects of our remedies, particularly the very important dynamic benefits associated with increased innovation, we estimate that the more easily quantifiable direct benefits from our remedies are more likely than not to be at least in the region of £150–£250 million per year in the UK.[41] These are conservative estimates on the direct gains from switching PCAs and BCAs and from better management of overdrafts, and importantly these do not take into account any direct gains from SMEs being able to more easily access loans and choose better-value loans as we were not able to quantify these.

19.154 Further, we expect our remedies package to have a positive impact on the efficient functioning of retail banking markets. Of particular importance in this regard are: our measures to increase banking customers' levels of engagement and ability to compare offers through the development and introduction of APIs, the provision of quality of service information, the introduction of a package of customer prompts and the development of the Nesta challenge prize for SME banking. In combination with all of the other measures in our package, we expect these remedies to have a substantial overall benefit both to banking customers and to the wider economy.

We are also introducing measures that will more directly address the customer detriment associated with the AECs we have found. In particular our package of remedies related to overdrafts will both limit the level of overall cost of using an unarranged overdraft, as well as making it easier for these customers to manage their overdraft use, enabling them to better manage their fees and charges. The benefits that we estimate from these specific measures will be lower than some other measures, in part reflecting the lower numbers of customers that are directly impacted. However, they will nevertheless help to directly address the detriment incurred by those PCA customers that use overdrafts, in particular those who are heavy users of unarranged overdrafts. They will also contribute to increasing incentives on providers to compete on prices, services and innovation through their impact on customer engagement.

19.155 We have conducted our comparison of costs and benefits in the round across the various markets we have investigated. This is in light of the interconnected nature of the costs and benefits across the three product markets (PCA, BCA and SME lending) and the two geographic markets (GB and NI), as well as the scale of the enduring benefits of the remedies (including both the direct benefits and the dynamic benefits). This interdependence makes it impracticable to seek to allocate costs and benefits with any precision to individual markets. Most banks in the GB PCA market are also active in the other markets and given the extent of common costs for a number of remedies, this will reduce the incremental costs of

[41] This would therefore represent benefits in excess of £0.7 billion over five years, and potentially reaching and exceeding £1 billion over five years, although we expect benefits from our remedies to continue to accumulate beyond this, in particular because of the dynamic benefits from increased competition.

implementing the remedies in the other markets. As for the benefits, most are likely to fall into the GB PCA market because of the size of this market in comparison to the other markets. This is not to say that the benefits from our remedies in other markets than the GB PCA market are not large: for instance in SME banking markets benefits of our remedies are likely to be high in proportion to the size of the markets. This is because of the wider economic benefits of a thriving SME sector and the additional problems we found in the SME markets. These additional problems include the strong linkages between BCA and SME loans and the additional difficulties SMEs face in comparing BCAs and loans and switching BCAs.

19.156 We expect that the direct, static benefits of the remedy package will be at least in the region of £150–£250 million per year post implementation (see 19.134).[42] We expect these benefits to persist and to accumulate to an amount in the order of at least £700 million–£1 billion within a period of around five years. In addition to these direct gains, we expect further very substantial dynamic benefits from our remedies, through the increased pressure on banks to improve their quality of service, to innovate and to compete on prices. We concluded that these ongoing benefits are substantially in excess of the likely implementation costs of around £75–£110 million, which will predominantly be upfront, one-off costs.

19.157 In light of our comparison of likely benefits and costs, we concluded that the remedy package is unlikely to give rise to adverse effects that are disproportionate to its legitimate aim of remedying the AEC and resulting customer detriment.

Conclusion on proportionality

19.158 In light of the above assessment we have reached the conclusion that our package of remedies represents a proportionate solution, as well as an effective one, to the AECs and the customer detriment that results from them.

[42] These do not take into account direct static benefits for SMEs being able to compare loans and access loans more easily.

20. Our decision on remedies

20.1 We have decided to introduce the package of remedies summarised in paragraph 19.1.

20.2 This represents as comprehensive a solution as is reasonable and practicable to the AECs and resulting customer detriment that we have found.