Orwell Group
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London 16th September 2014

Retail Banking Team
Competition and Markets Authority
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Dear Sir/Madam,

Re: Orwell Group's ('Orwell') response to the consultation about the need to maintain or enlarge the undertakings given by certain banks in 2002 following the Competition Commission's 2002 investigation into SME banking .

Orwell is a financial services group that owns two payment services providers, Orwell Union Ltd (FRN 533647) and Orwell Union Partners LLP (FRN 900122), both authorised and regulated by the FCA as Payment Institution and Electronic Money Institution respectively. Each company has a different business model that requires different levels of access to payments systems. Orwell Union Ltd has been in operation since 2010 whilst Orwell Union Partners LLP was authorised in November 2013.

Background information

Orwell Union Partners LLP ("OUP"), with headquarters in the UK, has three branches in Continental Europe: in France, Spain and Italy and will launch its services for the first time to the market in Q4 2014. These services can be defined as "Pan-European online, retail and business banking in open architecture". The services focus exclusively on the cash management function of banks and not on their credit activity, since OUP cannot provide credit.

We are pan-European because OUP will offer a service of BCA and PCA as a single entity across its countries of operation, initially in the four countries listed above but eventually in the whole of Europe. Any client of OUP after an on boarding process will be able to open BCA or PCA in any or all of the countries where OUP is present and manage them from a single access. In addition, all those accounts will enjoy standard features such as cash pooling and cash sweeps, and all payments services such as Direct Debits, Standing Orders and CHAPS, BACS and FTP in the UK and SCT and SDD in the SEPA area.

Also, clients will benefit from real-time payments and transfers across Europe amongst their own accounts and with other OUP clients, even when such transfers require a currency exchange transaction.

Beyond these services, our clients will benefit from innovative payment options such as conditional payments and conditional standing orders, budget services such as balance threshold notifications, expense limits and cash flow forecast etc.

The open architecture characteristics derive from the need to allow our customers access to third party products that can be linked to BCAs and PCAs, such as overdraft facilities, term

deposits, or AAA cash funds onto which clients can sweep accounts, overnight or for unlimited periods of time.

OUP services aim to revolutionise the retail banking sector by bringing, for the first time ever, a cross national current account service that aims to reduce the cost of banking and to eliminate the trading barriers derived from banking fragmentation.

Response to the consultation

Orwell has conducted significant research into retail and business banking for the past two years in view of designing and planning its own services. The situation described in the report about business banking is not uncommon in other EU countries either.

To put things in perspective, there are 8000 credit institutions in Europe yet consumers have, on average, just a handful of banks to choose from. The European banking industry is highly fragmented as a whole, yet in each of its *geographic units* it is very concentrated. Geographical units can be as large as the entire UK, or as small as a town in Germany.

This insight allows us to look at the problem and its solutions from a different angle.

The reason arising from the report that most likely motivates the lack of customers switching banks, is "thinking that all banks offer the same service, so why bother to change".

In economic terms the cost of switching is not perceived as being compensated by the value obtained by the switch, hence inertia prevails. Most switchers are either innovators, that is to say individuals or businesses managed by individuals who enjoy novelty and change, or are motivated by significant disappointments at their previous bank.

We can confirm the findings. Also as we anticipated we do have another view on the solution.

Before explaining these, we would like to agree with the undertaking in the sense that the less costly the switch the easier it will be to overcome the perceived value gap from the switch. That perfectly logical reasoning is still valid.

Such reasoning could be pushed even further aiming to reduce even more the perceived cost of switching. We think that in the sense of the initiatives, they would have an even greater impact if:

1. Bank account numbers had portability. This would eliminate the perceived risk of switching. Businesses would not have to review all their documentation, accounting systems, treasury management systems and contracts to update their account numbers post switch. The fear of making mistakes and the impact that payment delays and even lost payments may have on cash flow may well be a deterrent for switching, but the risk depends on the kind of business. Account number portability would also help to eliminate the need for CASS, since the switch would happen in the background and not by actually changing bank account numbers.
2. Price opacity could be overcome: also a key barrier. Nobody is able to compare a bank's prices in a coherent way. We have undertaken a study on retail and business bank pricing and found difficulty in effectively compiling the data and worse still, once compiled, the diversity of formats, strategies and pricings make it barely possible to compare. If we add the fact that businesses need to evolve over time, the kind of transactions on which a choice of bank is made today may not be relevant tomorrow.

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This opacity makes it very difficult to compare how much a business could save by switching banks.

As we introduced earlier, our point of view on the low switching ratios is the low value difference that businesses and individuals see in the offer of other providers. Value can be extracted in two ways:

1. By reducing the overall cost of the service, or
2. By providing a service that enables the business customer to grow and develop.

Whilst addressing the first point is important, we also think that with increased competition the 'price and switch cost' problem would be solved on its own.

We also think that the cycle mentioned in your report – a lack of new entrants reduces competition and therefore it does not incentivise customers to switch, which in turn does not incentivise the creation of new entrants as they see little market share available - does not really withstand testing. It may be possible to argue that potential new entrants are deterred by seeing a low level of switching but this may be because they do not think they will be able to offer any distinct value to trigger the switch. Offering low prices is their only real alternative along with some improvement to customer service, but then lower prices may jeopardise the financial viability of the new bank.

The real reason for the lack of competition in the retail and business banking sector is lack of service innovation.

Without innovation any new entrant will have a business model which will be equivalent to the incumbent, yet with reduced branch coverage. This is not enough to encourage customers to switch. This is well reported in your paper and a very clear proof of this lack of innovation.

Without service innovation the only real strategy left to new entrants is to focus on customer service, making the entire customer experience more pleasurable such as at Metro Bank. Yet the time it takes for traditional model banks to reach a number of branches that confers critical mass can be too long and/or it is too onerous.

Metro bank is a case in point. Its success in opening an average of 16,000 PCAs per month relies on better customer service and on capturing the frustration among the general public with incumbent banks. These customers will not find anything fundamentally different in terms of service but at least they will be treated well, and that is enough for them to make a change. While this emotional sale will have a certain appeal for a portion of the population it is a hard sale for businesses which are more focused on technical features, especially as the business grows and knowing that Metro's branch coverage will remain modest.

In our view it is this lack of innovation - which in turn is blocked by the entry barrier to access market and payment systems - that makes competition so low. Without innovation there is little differentiation in a market characterised by very high entry barriers, which slowly advances towards resembling a natural monopoly or in this particular case a natural oligopoly.

Consumers seem to be resigned to the 'me-too' kind of services offered by any bank and feel apathy about switching.

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The initiatives adopted to lower the barrier to obtain new banking licences are a good start, however in our view the traditional banking model of vertically integrated banks is obsolete and is an obstacle to innovation and competition.

We have explained that in every *geographic unit* within the EU we find the same oligopolistic situation. It is possible therefore to conclude that real competition will be created when these diverse banks are brought together to compete.

In the 'background' section of this answer to your consultation we have described our services which will be made available before the end of the year and for the first time to most of Europe. These are possible because we have acted upon the results of our observation. After analysing the reality of banking fragmentation we concluded that retail and business banking have not followed the evolution of other industries that have naturally broken down across the delivery chain so that each layer of service is unconstrained by the other. In the case of banking the two big building blocks are the credit function and cash management function of banks.

Your study separates both as well when referring to BCA and PCAs as different services to financing.

In this sense, past studies conducted by OFT show that SMEs in the UK increasingly buy financial products and services from different providers, so the provision of a BCA does not result in the same bank being the preferred choice to request a loan or even to grant it. Overdrafts are the only exception since they are intimately linked to BCAs. But even in this case, most overdrafts are requested as other banking services such as cash pooling are not available to SMEs who are then obliged to request overdraft facilities in one account when they have cash in another, simply because the set up of a cash pool facility is not available for SMEs in most cases.

The separation of cash management from credit into two different entities allows the former to extend cross border following the real need of most SMEs to grow and reach other markets. In the EU, where SMEs are so numerous but unfortunately suffer from the natural EU barriers to mobility, banking fragmentation is yet another barrier. Companies trading internationally either because they buy or sell products from or to other countries need to maintain BCAs in the countries with which they trade or for the needs of their local representative offices or operations.

Since the cash management function of banks is also their distribution channel, a separation of this function from the credit function in different entities means banks concentrated on the credit function can choose to distribute through many entities devoted to cash management and vice versa, customers of these new cash management functions will not have access to more products and services.

Specialisation leads to innovation. Lack of specialisation in cash management is the first obstacle to innovation. Your report explains that cash management is the key service that enables individuals and businesses financially. We are all high consumers of cash management (current accounts and payments) services but only occasionally of credit products.

I will not turn this paper into a recommendation of the right banking model, but instead focus on the barriers to innovation that exist in the banking industry. The key barrier to innovation is the difficulty new entrants have in accessing payment market infrastructures. Agency banking often results in new entrants, whether they are credit institutions or other authorised payment service providers having to adapt their business models to please direct participants. This stifles

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business models and business plans are watered down when having to curb innovative products and services. Incumbents control not only market share but also have the right of life and death of new entrants: they are given privileged access to any new entrant's plans, innovative ideas and expectations before they can actually launch their services to the market.

In this environment it is extremely hard to develop innovative products and services that will provoke a review of banking models to unleash the competition of so many existing players on a European scale.

Yours sincerely

Carlos Sanchez

CEO of Orwell Union Partners LLP