



Virgin Money plc
28 St Andrew Square
Edinburgh
EH2 1AF

Mr Alex Chisholm
Chief Executive
Competition & Markets Authority
Victoria House
37 Southampton Row
London
WC1B 4AD

17th September 2014

Dear Mr Chisholm

Competition & Markets Authority (CMA) Consultation on personal current accounts and banking services to small and medium-sized enterprises

We welcome the opportunity to respond to the CMA's consultation on its provisional decision to make a market investigation reference (MIR) with respect to the markets in personal current accounts and banking services to small and medium-sized enterprises.

As a medium-sized challenger bank which has recently launched new personal current account products, we have a very real interest in this issue. We currently do not provide banking services to SMEs and have no plans to do so in the near future, and so have restricted our comments in the attached submission to the specific questions on the personal current account market.

We supported the CMA's provisional decision to make a MIR with respect to the personal current account market as well as the analysis which underpinned that decision. This analysis demonstrated that the personal current account market is not competitive and is not working in the interests of many consumers.

We are pleased that the CMA has given consideration, in the report accompanying the provisional decision, to a number of issues similar to those we raised in our submission such as

- the need to adopt a pro-competition approach to secure better outcomes for consumers in this market in the future;
- the lack of a level playing field in payment systems, given that smaller banks such as ourselves access the system via agency agreements with the large banks;
- the lack of transparency in personal current accounts and additional barriers to entry and expansion created by the free-if-in-credit model; and
- continuing low switching levels, despite the introduction of the new current account switching service.

We believe that, in order to create a dynamic and competitive market, it is essential to examine more urgently the case for account number portability, and open and fair access to a shared payments infrastructure to enable it. Not only would such an infrastructure make switching significantly easier and quicker, it would also bring wider benefits in terms of delivering cost efficiencies and improvements in anti-money laundering controls, provide increased reassurance for customers in the event of an individual bank failure and reduce reliance on the agency banking model.



We welcome the Government's decision to conduct a cost-benefit analysis and technical feasibility study of account portability and a common utility platform, to be undertaken by the Financial Conduct Authority (FCA). However, we think that this on its own is not sufficient to create a more competitive market and should be undertaken in parallel with other initiatives to address demand and supply-side problems identified by the CMA through a MIR.

However, we also note that the large incumbent banks continue to be sceptical about portability and would urge the CMA, when considering portability, to note the comments of the Parliamentary Commission on Banking Standards who stated:

We were concerned that the largest banks object very strongly to bank account portability. While there is some evidence that individual banks may have done some work on the costs of account portability, this does not appear to have been accompanied by a comprehensive consideration of all the benefits of portability. This gives the impression that their objections are instinctive and, arguably that they are opposed to any reform that could encourage competition.

The power of the effective oligopoly of the large banks was recognised by Sir Donald Cruickshank over 15 years ago. Sir Donald attributed the lack of competition in the personal current account market and the existence of strong barriers to entry and expansion to the concentration of the market in a small number of large banks. Subsequent studies have endorsed his findings around the lack of competition but, despite numerous initiatives to address specific issues in this market, the same fundamental problems around lack of competition and dominance of the market by a small number of large incumbent banks remain.

This would suggest that lack of competition reflects deep underlying problems in this market which cannot be solved by piecemeal or uncoordinated initiatives. Instead we need a comprehensive and all-encompassing examination of both the problems and potential solutions in this market if we are to address long-standing problems in the personal current account market. The CMA is, in our view, ideally placed to undertake this work.

We believe that the 'reference test' has been met, for reasons which we have outlined in greater detail in our response which is attached. We have also articulated the reasons why we believe that the CMA should reject arguments in favour of further delay. We therefore urge the CMA to exercise its discretion in this area and make a final MIR with respect to the personal current account market.

Yours sincerely,

Jayne-Anne Gadhia
Chief Executive Officer
Virgin Money

Competition & Markets Authority (CMA) Consultation: personal current accounts and banking services to small and medium-sized enterprises

1. Do you consider that the CMA's analysis of the suspected features of concern in the market for PCAs is correct?

1.1 We note that the CMA can only make a reference where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods and services 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.

1.2 We agree with the CMA's analysis that there are reasonable grounds to suspect that the personal current account market is not competitive and is not working in the interests of many consumers. This is because of a number of features which the CMA has identified and which they suspect may give rise to competition concerns, including:

- persistent levels of concentration and relatively stable market shares among providers;
- continuing high barriers to entry and expansion;
- relatively low levels of switching and shopping around by customers for alternative offerings; and
- lack of transparency in charging structures, particularly for overdrafts.

We also agree with the CMA's conclusion that:

These [the PCA and SME markets] remain sectors which do not appear to be functioning in the way we would expect of competitive markets. This leads to poorer outcomes for consumers –holders of PCAs and SMEs –and also, given the key importance of retail banking, to the wider economy...

Customer satisfaction scores for the four largest banks are below or around 60%, but despite this, there is relatively little customer shopping around or switching, leaving both the market concentrated and market shares of providers relatively stable over time.

We note, in particular, that the larger banks, with relatively lower satisfaction levels, have not significantly lost market share, while banks with higher satisfaction levels have not been able to gain significant market share, which is not what one would normally expect to find in well-functioning, competitive markets.¹

¹ CMA, *Consultation: personal current accounts and banking services to small and medium-sized enterprises – provisional decision on market investigation reference*, p3, 18 July 2014

- 1.3 The large incumbent banks have previously argued, in evidence to the Treasury Committee, the Independent Banking Commission and the Parliamentary Commission on Banking Standards that the personal current account market is competitive and delivers good outcomes for consumers. However, the CMA's analysis suggests that this is not the case and we agree with the CMA.
- 1.4 The CMA identifies customer inertia as an important barrier to entry and expansion in the personal current account market. We agree, but would argue that this inertia – which is not characteristic of consumer behaviour in other parts of the retail market – is a symptom of deeper underlying problems in the way in which this market operates and in consumers' understanding of it.
- 1.5 Surveys show that many consumers see little difference between banks, including in terms of personal current account provision. This perceived lack of differentiation stems, in part, from the prevalence of the free-if-in-credit model which continues to dominate the personal current account market in the UK.
- 1.6 We understand that the free-if-in-credit model serves some consumers extremely well, namely those consumers who do not go overdrawn and/or do not have large positive credit balances. But other consumers are not so well-served and can end up subsidising free provision for others.
- 1.7 The free-if-in-credit model is sustainable as a result of these cross-subsidies between consumers. As a result, the CMA has correctly posed the question on page 5 of the Consultation Paper as to whether "possible cross-subsidisation in the PCA market [which] may be distortive of competition". This echoes a point previously made by Sir Donald Cruickshank in evidence to the Parliamentary Commission on Banking Standards that:

A competitive market cannot sustain cross-subsidies between one class of customer and another, so if we have a competitive marketplace, these cross-subsidies will begin to erode and we will end up with, I believe, a simpler relationship between banks and their customers with transparency in pricing...

It is not free-in-credit. A competitive marketplace cannot sustain cross-subsidies between one class of customer and another. That is actually a good test of whether we have a competitive system, because cross-subsidies being sustained over many decades means that we do not².

- 1.8 Furthermore, the cross-subsidies in personal current accounts are opaque, given that the pricing structures, particularly around overdrafts and certain other charges, are themselves opaque. The resultant lack of price transparency, particularly because of the absence of headline fees under so-called free banking, makes it difficult for consumers to shop around or compare products, with the result that, unsurprisingly, switching levels remain low.

² Sir Donald Cruickshank in evidence to the Parliamentary Commission on Banking Standards, 24 October 2012, Q 185

- 1.9 Equally, market conditions, including the prevailing pricing structure, and the ability of the large incumbents to cross-subsidise investment in personal current account products and acquisition of personal current account customers from other parts of the business, makes it difficult for smaller banks and growing entrants to enter the market with new and innovative personal current accounts to customers.
- 1.10 The combined result is that, unsurprisingly, switching levels remain low, with the problem particularly acute for smaller challenger banks. This weakens competitive constraints in this part of the retail market further and helps to explain why the market lacks dynamism, why concentration remains high and why market shares of incumbents remain stable over time, despite their relatively low customer satisfaction levels.
- 1.11 Other concerns we have highlighted in a previous submission to the CMA, as well in evidence as to other bodies include:
- difficulties with access to the major payment schemes. The CMA has noted that this could be an issue and we believe that it is important for the CMA, working with the new payment systems regulator, to examine the extent to which the large incumbent banks, who are the principal users of the systems, but also co-operate as principal owners, have, or could, create barriers through their membership requirements for the major payment schemes or through the terms and conditions on which they offer indirect access to those schemes;
 - addressing low switching levels. We believe switching levels would be increased through the introduction of account number portability, which would further increase both the speed and ease of switching. We welcome the Government's decision to conduct a cost-benefit analysis and technical feasibility study of account portability. Moreover, the open and fair access to a shared payments infrastructure which is necessary to support account number portability would significantly reduce barriers to entry and expansion for smaller players and bring wider industry benefits, such as improved and more cost effective anti-money laundering controls on an industry-wide basis. This should offset the costs associated with a move to portability.
- 1.12 For the reasons given above, we agree with the CMA that the 'reference test' has been met with respect to the personal current account market.

2 Do you consider that the CMA's provisional analysis with respect to the exercise of its discretion to refer the PCA market is correct?

2.1 We note that, even where the 'reference test' has been met, the CMA must use its discretion as to whether it should make a MIR. We further note that the CMA must consider four particular criteria when exercising its discretion as to whether or not to make a MIR, and that these are:

- scale of the suspected problem and whether a reference would be an appropriate response;
- availability of appropriate remedies;
- whether undertakings in lieu of a reference (UILs) would address concerns; and
- alternative powers available to the CMA or to sectoral regulators.

Scale of the problem

2.2 The issues of concern in the personal current account market identified by the CMA are not new. Indeed, many were first identified by the Cruickshank review which the then Government commissioned in the late 1990s. Subsequently, numerous market studies and inquiries have come to the same conclusion, namely, that the personal current account market is concentrated, that competitive forces do not operate effectively and that this results in poor outcomes for many consumers³. This suggests that the scale of the problem in the personal current account market is of a deep-seated and persistent nature.

2.3 The deep-seated nature of the problems in this market are important because of the key role personal current accounts play in almost everyone's lives – allowing for payments to be both made and received and as a store for balances. There are, as the CMA notes, 65 million active PCAs in the UK and they generated revenues of £8.1 billion for providers in 2013.

Alternative remedies

2.4 We believe that appropriate alternative remedies exist to address the problems in the personal current account market which have been identified by the CMA. These, as the CMA notes, could be either behavioural or structural in nature or some combination of the two. We discuss these further in our answer to the third question.

³ OFT, Treasury Committee, Independent Commission on Banking, Parliamentary Commission on Banking Standards,

Undertakings in lieu (UILs) of a reference

2.5 There have been some positive developments in the market over the last few years –for example, the introduction of the Current Account Switching Service (CASS), the rollout, albeit slowly, of initiatives to increase transparency, including Midata, and the reduction of regulatory barriers to entry and expansion. Such measures, whilst welcome, have not succeeded in creating a more dynamic market where competition works in the interests of all consumers. As a result, based upon past experience, we do not believe that these deep-rooted problems can be successfully addressed through a voluntary or piecemeal approach. We would therefore urge the CMA to be cautious about an approach which is based upon undertakings in lieu of a reference.

Alternative powers

2.6 As discussed elsewhere in this submission, previous attempts to increase competition in the personal current account market have suffered from their ad-hoc and piecemeal nature. What is required now is for one organisation to undertake a comprehensive analysis of the personal current account market, rather than for responsibility to be spread across a number of competition and regulatory bodies.

2.7 We believe that the CMA is well-placed to undertake this role. It is an independent body, insulated from Government and other political pressures, as well as from the large incumbent banks. It has the skills, resources and experience across a broad range of sectors to take a comprehensive and joined-up approach to analysing this market, to identify and evaluate a range of possible pro-competition interventions, and to make judgements about which possible interventions are most likely to lead to a more competitive environment that delivers good outcomes for consumers.

2.8 Some have argued that, even though we believe the reference test has been met, the CMA should exercise its discretion and delay an MIR on the following grounds:

- that a number of initiatives designed to create a more competitive market are currently in the pipeline and these should be given an opportunity to succeed before concluding that a MIR is necessary; and
- that a MIR would add to the extensive burdens on banks which are already struggling to implement reforms in the wake of the financial crisis.

2.9 It is the case that a number of initiatives designed to create a more competitive market are currently in the pipeline. Both the OFT and the ICB had previously argued that these initiatives should be given an opportunity to succeed, before concluding that a MIR is necessary.

2.10 Whilst all these measures are to be welcomed, for reasons which we outlined in our previous submission, we agree with the CMA's provisional analysis that these do not constitute a sufficient reason to delay making a MIR. This is because:

- **Lloyds Banking Group (LBG) and Royal Bank of Scotland (RBS) divestments** which are still ongoing will add little to diversity in the marketplace and their ability to compete through innovative product offerings will be constrained by the limitations of the legacy IT systems they have inherited. To delay a MIR on these grounds would, in effect, reward LBG and RBS for their slow progress in completing the divestments. Additionally, as the CMA notes the two divestments are unlikely to reduce concentration levels significantly;
- As the CMA has noted, the **introduction of CASS** has not significantly increased switching levels. We remain unconvinced that a new switching service will in itself be sufficient to make a significant difference to switching levels and competitive forces in this particular market. We believe that account number portability, enabled by open and fair access to a shared payments infrastructure will create a more dynamic market and bring wider benefits to the PCA market as a whole. In our view, this should be addressed, not in isolation, but in parallel with other initiatives to address demand and supply-side problems identified by the CMA and its investigation of this market;
- A third reason cited for delay was to allow time to assess the impact of the **rollout of the transparency initiatives**. However, the OFT itself noted "slow progress" in this area in its 2013 review of the personal current account market. Again, we believe that the slow pace of progress in this area should not be used as an excuse to delay an MIR; and finally
- **The establishment of a new pro-competition conduct regulator** with a specific competition remit is a major step forward, but this represents a longer-term approach to making markets more competitive, given that such a cultural shift will take a long time to embed within the regulatory authorities. Again, we do not believe it is a sufficient reason to delay a MIR.

2.11 We recognise that a MIR could impose significant costs on the sector, but do not believe that this is a reason for not making a MIR or for delaying it. The gains to consumers and the wider economy from a genuinely competitive personal current account market would, in our opinion, far outweigh any time-limited increase in burdens on banks that result from a MIR.

3 Do you consider that a potential solution to any competition concerns identified may need to consider alterations to the structure of the markets in addition to (or in place of) remedies focussed on increasing customer engagement?

- 3.1 A comprehensive analysis of the market means that the CMA must examine the full range of potential remedies, whether behavioural or structural, which could help create a more competitive personal current account market. We believe that behavioural remedies have an important role to play in creating a more competitive market, but suspect that structural remedies might also be necessary to address deep underlying problems in this market.
- 3.2 We argued in previous submissions that it is worth examining the case for additional divestments that go beyond the current RBS and LBG divestments, which could reduce concentration levels and provide opportunities for new and growing entrants to build scale in the personal current account market. That said, we also recognise that these divestments have proved difficult to execute in practice.
- 3.3 There is a risk that some may propose superficially attractive structural solutions – such as price caps, price controls or restrictions on market shares. Whilst intended to benefit consumers, such remedies could have serious unintended consequences and could fail to deliver a more competitive market or be in the longer-term interest of consumers. However, we think that the CMA should explore whether there are alternative structural approaches which could reduce the power of the large incumbent banks to protect their incumbency advantages and which could genuinely facilitate greater competition in this part of the retail market.
- 3.4 Ultimately, as was the case with respect to interventions in the telecommunications and air transport sectors, we believe that a pro-competition approach, with limited and focussed intervention, is the best way to deliver sustainable and tangible benefits to consumers. A more competitive market in personal current accounts would provide consumers with a better and more diverse choice of products and services, would stimulate greater innovation than is currently the case whilst giving banks real incentives to increase efficiency, would reduce costs, and would support economic growth.