

Competition and Markets Authority (CMA) Consultation: Personal Current Accounts and banking services to small and medium sized enterprises (SMEs)

Response by Santander UK plc

1. Introduction

- 1.1 Santander UK plc (hereafter Santander), is pleased to respond to the CMA's consultation on its provisional decision to refer the UK markets for personal current accounts (PCA) and SME banking for a single in-depth market investigation.
- 1.2 Santander describes itself as a scale challenger: a bank with the product range, recognised financial services brand, branch network and multi-channel distribution capability to provide a strong alternative to the big four banks.
- 1.3 As a scale challenger bank in the UK market, Santander is strongly supportive of initiatives which seek to boost competition, choice for customers and which raise the profile of competitors other than the big four banks. We are therefore broadly supportive of a market investigation, provided the investigation is:
- **Proportionate** and appropriately targeted
 - **Clearly defined** in scope and terms of reference
 - Underpinned by robust and objective **economic analysis**
 - Based on **customer need** with **thorough testing of the effectiveness of any potential remedies**
- 1.4 Santander considers the CMA's decision to carry out a single in-depth investigation of the PCA and SME markets as a critical opportunity for the industry to work with regulators to address long standing concerns about competition; and, (should remedies be considered necessary) to impose measures that fully address these concerns without adding to the already considerable regulatory burden faced by banks on an on-going basis.
- 1.5 The UK banking market is a mature market which has recently seen new providers enter the markets for PCA and SME banking. Santander, TSB, Metro Bank, Tesco and Marks & Spencer provide alternative choices to the big four banks in the current account market. For SMEs, challengers such as Santander, Handelsbanken, Shawbrook and Aldermore, (in addition to alternative lending platforms), offer an alternative provider to the big four. However, other challenger banks have limited propositions concentrated in one or two areas. Santander have built a full SME product proposition to rival the big four, hence our description as a scale challenger.

2. Defining the problem

- 2.1 Despite new entrants, customer engagement in the PCA and SME markets remains low. The success of Santander's innovative 123 Current Account (more people are switching to Santander under the Current

Account Switch Service (CASS) than any other bank) provides evidence that increasing the number of entrants is not the sole solution to promoting competition, rather, competition will stem naturally when there is a sufficient degree of genuine innovation and service differentiation.

- 2.2 As noted by the CMA in its Consultation Paper, the UK banking sector has long been subject to findings that it lacks effective competition in successive reports by Sir Donald Cruickshank (2000); the Office of Fair Trading (2002 – 2013); the Independent Commission on Banking (2010); and the Parliamentary Commission on Banking Standards (2013).
- 2.3 In parallel with any forthcoming market investigation, Santander will continue to pursue our own initiatives to boost competition and improve outcomes for UK customers. Recent examples include our June 2014 announcement of a partnership with Funding Circle which will help provide small British Businesses with greater access to finance. The referral arrangement sees Santander signpost small business customers looking for a loan to Funding Circle, where they are better placed to help.
- 2.4 Internally, we have been considering ways to improve competition in banking for some time. We include two suggested measures which may reduce barriers to switching in the SME banking market at paragraph 5.7.
- 2.5 This response sets out:
 - Santander's position in the UK banking market;
 - Key principles for a successful and proportionate market investigation that will serve the long term interests of both consumers and the UK economy;
 - Santander's responses to the CMA's seven questions posed in the 18 July 2014 Consultation Paper (including suggestions to promote SME switching at paragraph 5.7)

3. Santander's position in the UK banking market

- 3.1 Santander has achieved organic growth in the UK SME banking market, expanding its market share from 1% in 2009 to 6% today. However, as the CMA notes, the UK is a market defined in general by the lack of such organic dynamism in market shares. We believe that our experience in growing market share may help shed some light on the issues under review by the CMA.
- 3.2 There is no question that Santander's national branch infrastructure and large investment in new regional presence plays an important role in organic growth. However, the success of Santander's 123 Current Account – the most popular new retail banking product in the UK and a key driver of large scale switching to Santander since the introduction of the seven day CASS switching target – suggests that product differentiation, coupled with ease of switching, is key.
- 3.3 Customers move banks when they see something better to move to. Encouraging banks to compete on product design, giving customers

better tools for comparing options and reducing the cost and hassle of moving banks should be the focus of the CMA's work.

Santander in the SME market

- 3.4 Santander is a relationship bank that provides retail and commercial banking services in the UK. Santander began offering commercial banking services following the acquisition of Alliance & Leicester in 2009. At this time, Santander had a market share of c.1%. As noted above, through organic growth by continuous investment, Santander has grown this market share to approximately 6% today.
- 3.5 Santander has increased its net lending to SMEs in every year since 2009. Most recently, net lending to businesses increased by 13% over the course of 2013. During this period, the bank also opened 16 new Corporate Business Centres and employed a further 147 relationship managers. We are also supportive of interim CMA findings showing businesses valuing their local branch – this complements our efforts to grow our numbers of local branch business managers.
- 3.6 Santander's ability to increase lending to SMEs throughout the "credit crunch" has been possible due to the local relationship-led model that is at the core of the bank's approach. Santander's locally-based relationship managers take time to get to know their customers supported by our unique credit partner model, to ensure they meet individual customer needs.
- 3.7 As a challenger in the SME market, it is often the case that customers we have lent to were first rejected for a loan from the big four banks. This was particularly common during the very early stages of Santander's growth when there was low awareness of our commercial banking services. Our efforts to build that awareness have required a period of sustained investment. Although we grew our customer base by helping businesses who had been previously rejected by the big four banks, we did so by having sensible risk parameters and our current NPL performance is one of the lowest in the sector.
- 3.8 Santander is an amalgamation of three former building societies. The approach of our legacy banks means that we have a high number of micro-businesses among our customer base who use our business current account and basic money management tools. While we are delighted to support these businesses and continue to do so, it has been Santander's strategy to build a full-service corporate and commercial bank which is able to serve the more complex needs of the UK's SME businesses (i.e. those with a turnover of c.£250k to c.£25m).
- 3.9 In our pursuit of this aim, we established Santander Corporate and Commercial Banking in 2009 and have grown our market share in this segment by 5% since 2009. This organic growth required a significant investment in our infrastructure, IT, products and marketing.¹

¹ Santander's internal definition of SMEs includes businesses with a turnover of up to £50mn

- 3.10 Santander is continuing to grow in the more established SME market as we pursue our aim of being the bank of choice for UK businesses and our wider corporate strategy of being a better balanced retail and commercial bank. Following the significant investment in the bank, we have now delivered on improving our customer proposition and the range of services we are able to offer. However, we are still some way from building the physical infrastructure and coverage necessary to compete with the big four banks. This is why we describe ourselves as a “scale challenger” in the market.
- 3.11 The Return on Equity (ROE) of any business needs to be above a certain hurdle, both to ensure its long term sustainability and for investors to be able to clearly assess and value the business model. Building the necessary infrastructure to compete in the SME banking market results in a time lag before returns can be made to make the investment worthwhile. Trade Association the Association of British Insurers commented in their December 2012 report, ‘Investibility of Banks’, based on investor research, that “failure to achieve at least cost of capital across the cycle is likely to lead to banks’ businesses being unsustainable in the longer term and will inevitably constrain asset growth and lending to the wider economy.”

Santander in the PCA market

- 3.12 In the PCA market Santander has focused on simplifying our products and promoting switching following the launch of our innovative 123 Current Account. The account includes a fee for customers to use, pays out up to 3% interest on balances between £3000 and £20,000 and provides cashback on monthly bills. The account has seen significant take up, recently passing the landmark of three million customers, with someone switching to Santander on average every two minutes.
- 3.13 In the last 24 months, customer satisfaction with Santander has continued to rise while complaints fall. The 123 Current Account proposition, and simplification and clarity of charges for overdrafts has supported these improvements. However, there is still more that we can do to promote switching in the Current Account market, which is why we are taking part in the Government’s MiData initiative.
- 3.14 From Santander’s experience CASS has been an effective industry-delivered initiative which has increased customer confidence in account switching. CASS enables seven working-day switching between accounts to take place, with a redirection of service which ensures that any payments made to or requested from the old account will be automatically redirected to the new account, for a period of 13 months from the switch date.
- 3.15 Since CASS was introduced in September 2013 250,000 accounts have been switched through the service to Santander. Almost one in four of those customers using the service to move bank have joined Santander – making Santander the destination of choice for customers switching their bank.

- 3.16 CASS is supported by world leading payment systems. In recent years the UK has benefited from additional large scale payment systems innovations such as Faster Payments, enabling people to transfer money between bank accounts within a matter of hours; and in April 2014, the launch of Paym, enabling customers to transfer funds or make payments using their mobile phone.
- 3.17 Continuing to develop innovations in payment systems is central to the success and stability of the UK PCA (and wider banking) market. Santander is supportive of improving access to payment systems for challenger banks to foster more competition. We would also note that any investment in the payments infrastructure must be made with a view to the long term economic health of the banking industry with costs spread fairly across all players.

4. Key principles for a successful and proportionate CMA investigation

Proportionality

- 4.1 To address long standing competition concerns fully, the CMA will need to work with other regulators and policy makers to ensure their work is complementary to existing initiatives and regulatory responsibilities. These initiatives and responsibilities include: the FCA's competition objective and own areas of market study such as cash savings, credit cards and wholesale markets; the work of the new Payment Systems Regulator; the implementation of ring-fencing under the Banking Reform Act; and the PRA's secondary competition objective. Any recommendations must be conceived and made in a way that is compatible with, and reinforces, outcomes from these parallel processes, many of which have similar objectives.
- 4.2 Throughout any investigation, we strongly encourage the CMA to take a proportionate approach which is mindful of regulatory overlap between authorities and the regulatory burden an investigation will place on banks during a period of unprecedented regulatory demand.
- 4.3 Our foremost priority is service to our customers, and so we remain concerned about the amount of management time and significant resource an investigation will require. To mitigate this, **we suggest the CMA works with the PRA and FCA at a senior level to coordinate the timing, content and depth of their information requests to firms.** For example, financial results periods should be avoided. This should also help regulators to make better use of the vast amounts of data provided to them.

Clearly defined in scope and terms of reference

- 4.4 The draft terms of reference as set out in annex B of the CMA's report, are extremely broad. As noted above, **we would encourage the CMA to adopt a proportionate approach to any investigation to minimise the burden on smaller banks, specifically taking account of their relative size and resource, which is small in comparison to the big four banks.**

- 4.5 While the draft terms of reference are broad in their substantive scope, we note the CMA's proposal to include SMEs with annual sales revenues not exceeding £25million. Santander is strongly supportive that any investigation into the market for SME banking focuses on the full scope of SME businesses with up to a £25m turnover. The market is just as concentrated throughout the different turnover segments, and it is only by a full examination of the whole market and its dynamics that we will be able to improve outcomes for SME customers.

Underpinned by robust and objective economic analysis

- 4.6 We welcome a market investigation on the basis it is carried out by competition experts and a team with a robust understanding of the complex nature of modern banking. Analysis of specific products or services should not be taken in isolation and there will be a need to acknowledge and understand the impact of underlying market dynamics and firm's broader business models on particular areas.
- 4.7 We would also suggest that the economic tools and measures used to analyse the market are consistent across the industry and that methodologies and the rationale behind findings are made fully transparent to investigation participants.

Based on customer need: thorough testing of any proposed remedies

- 4.8 We urge the CMA to consider (as a key strand of their investigation), the levels of actual customer need in the PCA and SME markets and to thoroughly test any proposed remedies and their likely effectiveness. This is fundamental to achieve greater engagement from consumers in both markets. For example, we would encourage the CMA to test any proposed remedies with PCA and SME consumer panels to understand whether or not they will influence their behaviour to change provider.

5. CMA Consultation Questions

PCA market

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

- 5.1 Santander considers the CMA's analysis of the suspected features of concern to be correct.

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

- 5.2 Santander considers the CMA's provisional analysis to refer the PCA market is correct.

SME market

Do you consider that the CMA's analysis of the suspected features of concern in the SME banking sector is correct?

- 5.3 Santander considers the CMA's analysis of the suspected features of concern to be correct.

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

- 5.4 Santander considers the CMA's provisional analysis to refer the SME banking market is correct.

Proposed Undertakings in Lieu

Do you consider that the features which the CMA has identified that may prevent, restrict or distort competition, are capable of being effectively and comprehensively remedied by UILs (undertakings in lieu of an MIR) given by the banks?

- 5.5 Santander does not consider the big four's proposals would comprehensively remedy the issues in these markets. Please see below.

Do you have any views on the CMA's provisional analysis regarding proposals for possible UILs being offered in principle by the four largest UK retail banks in relation to SME banking, particularly on the appropriateness, effectiveness and deliverability of such UILs?

- 5.6 We are supportive of the proposals put forward by the big four banks but do not consider these alone could substantially improve competition in the SME banking market.

- 5.7 Santander suggests two proposals to enhance competition and choice in the SME market:

- **End exit fees for SME customers:** to remove this barrier to switching, policymakers and regulators should consider prohibiting exit fees on loans for SME customers. Santander believes banks should be able to recoup the costs they face in setting up a loan – however, this could be done by reflecting the costs in the initial arrangement fee, leaving SME customers able to switch bank more freely (and be clear about they are paying).
- **Change the arrangements for transferring securities on SME loans:** this can lead to time lags for customers wishing to switch. We suggest an industry standardised fee for the work involved in releasing the security. We also believe the incumbent bank should be required to relinquish the security to the new bank within an agreed and industry defined timescale, such as 30 days, after which it should

indemnify the new bank to the value of that security. As a quid pro quo, the new bank should indemnify the incumbent bank for any items in clearing which have not been tied up at this point. Santander believes policymakers should consider enforcing this requirement as a means to promoting effective competition.

- 5.8 The undertakings in lieu suggested by the big four do not address the competition concerns identified in the CMA's Consultation Paper in relation to the PCA market. We consider the Government's MiData initiative to be a positive step forward to improve transparency in this space, however, switching remains low and this area warrants deeper analysis – particularly with regard to the demand side problems given the increased availability and choice available in current account offerings.

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 focused on increasing customer engagement?

- 5.9 Structural remedies may seem superficially attractive. However, they would inevitably be a further serious disruption to an industry which has yet to implement the ring-fencing changes proposed by the Banking Reform Act 2013. These significant structural changes take the form of multi-year projects, due for delivery by 2019, with a further review of their effectiveness in 2021. Structural remedies may also lead ultimately to increased costs for customers rather than reducing costs through choice and competition, and deter investors. Structural remedies and their unintended consequences may also prevent investment in innovation.
- 5.10 Moreover, they would not necessarily address the lack of variety in the UK banking market. Forced disposals may simply have the effect of creating new banks with the same cultural and commercial approach as their predecessor organisations. Measures to boost competition should instead focus on ensuring that customers are provided with new, innovative products and services, ease of comparison and the lowest possible frictional costs to moving.
- 5.11 Finally, we would note that structural remedies are not a silver bullet to increase participation, as deeply rooted cultural issues such as customer inertia must be acknowledged and addressed. A bank account is a necessity, but many people lack the confidence to engage fully with their finances. While banks should provide easy and transparent means for customers to engage, financial education also has an important role to play to ensure financial customers feel empowered to exercise their choices. We welcome that from September 2014, financial education in schools will be compulsory for 11 – 16 year olds as part of their citizenship courses with stronger links to the maths curriculum for all ages. We also suggest the CMA incorporates the key learnings of organisations such as the Money Advice Service, and relevant Cabinet Office and FCA findings from their behavioural economics research into issues relating to customer inertia.

6. Conclusion

- 6.1 Santander is supportive of the CMA's efforts to improve competition and to address competition in UK retail banking, in a definitive and proportionate manner. We look forward to engaging with the CMA in any subsequent Market Investigation and to exploring these issues further.
- 6.2 We recognise (and support) that the primary goal of a CMA market investigation is to improve consumer choice and welfare. However, it will be fundamental for the heavily regulated banking industry's long term economic health that the CMA considers carefully the implications of its work on banks' attractiveness as an investment proposition – as the industry competes globally for investment against other sectors and financial centres.
- 6.3 Any action by the CMA or other regulators should reflect and reinforce industry efforts already underway to make markets more competitive and to keep pace with the rapidly evolving innovation in digital development. Santander will continue to progress our own initiatives to improve competition and provide innovative products and services to our customers, so we can deliver the banking service which UK consumers deserve.

**Santander UK plc
17 September 2014**

[ENDS]