PERSONAL CURRENT ACCOUNTS AND SME BANKING

Competition & Markets Authority Report 18 July 2014

Comments of the Campaign for Community Banking Services (CCBS)

Summary

For CCBS the CMA/FCA report is encouraging because it recognises fundamental problems with the market and provides a pathway to an essential full investigation which needs to address in detail a role for improved IBAAs in facilitating competition for SME business between the established banks as well as with challenger banks and new entrants, the inadequacies of post office outlets as bank branch substitutes and the important role banking centres and other forms of neutral shared use branches could deliver in opening up competition and reducing costs.

CCBS's experience of the banks' non- compliance with the 2002 undertakings indicates that the CMA should not accept the promise of undertakings as an alternative to a full investigation.

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The Campaign for Community Banking Services (CCBS) is a coalition of 20 national organisations which share concerns over, inter alia, the loss of suitable local access to banking services as bank branch closures accelerate (1200 communities completely vacated) and the decline in competitive choice of banking provider for branch dependent customers as communities are reduced to one bank (1000) or two (400). CCBS's primary interest lies with small businesses, third sector organisations and vulnerable individuals.

At a recent meeting of the CCBS Steering Group the CMA report was welcomed and the provisional decision to launch an in-depth investigation in the Autumn was unanimously supported.

Verbal and written evidence from CCBS was taken into account in the CMA report which recognised, for SMEs:

- The necessity of a network of local branches to be a significant competitor in the sector
- The cost and difficulty for smaller and newer banks to access payments systems key to BCAs
- The inadequacies of post office outlets as bank branch substitutes.

but the absence of reference to:

- improving competitive choice between the traditional banks in sole/dual bank sites, and
- the important role banking centres and other forms of neutral shared use branches could deliver in opening up competition whilst reducing costs

is regretted but the in-depth investigation provides the opportunity to consider these in detail.

It is proposed to comment briefly on the above in 3 sections: Inter Bank Agency Agreements (IBAAs), Post Office Banking and Shared Use Branches, ending with a view on undertakings.

INTER BANK AGENCY AGREEMENTS (IBAAs)

- Facilitate use of a local bank's counter by small business customers of other banks (**established, 'challenger'** and **new entrant**), thus creating and preserving competitive choice and helping to sustain existing branches and the communities they serve.

- Long overdue improvements to the operation, pricing and awareness of IBAAs, promised by the banks in 2003 (see chronology attached as Appendix 1) have not been implemented. Low awareness recognised by the CMA Report 5.71.

- The OFT 2007 report, quoted in 5.71, states "Historically smaller banks have seen IBAAs as inferior – gives the other bank's branch the opportunity to sell other products to the customer or ultimately to encourage the customer to switch to them" Is probably now outdated and merits further research for the following reasons:
  -cash and cheque handling at branches is now completely separate from the SME relationship responsibility and is likely to be dealt with as a commoditised product rather than as a marketing opportunity;
  -the success of Handelsbanken UK with the SME market, now grown to 178 'relationship centres', has been achieved whilst contracting **all** counter activity to HSBC branches under an IBAA.

- For the 1400 UK communities with only one or two banks represented, an improved IBAA service on "fair, reasonable and non- discriminatory terms", as originally sought by the Competition Commission in 2002, but never achieved, would facilitate competitive choice of banking provider for branch dependent SMEs amongst the traditional banks as well as the 'challengers', whose own branch national coverage is inadequate and geographically skewed, and new entrants.

- The proposed scope of the new Retail Payments Regulator, if constrained to the actual systems and leaving infrastructure to look after itself, appears inadequate to CCBS if the government's aims, of making the systems benefit **all** end users and facilitating competition by permitting open access to potential participants, are to be achieved. CCBS has made submissions to the regulator to the effect that IBAAs should fall within its remit as critical to the transactional banking needs of individuals, small businesses and 'third sector' organisations is the availability of convenient branches (not necessarily the account holding branch or bank) which can facilitate the deposit and speedy clearing of cheques received (and cash) and the transfer of the amount to the depositor's own branch/bank or, in the case of bill payment and many other uses, a third party account or the group account of a charity or number of business outlets. This is particularly important to businesses using overdrafts.

POST OFFICE BANKING

- Post Office Limited has 11000, mostly franchised, outlets in UK (ex NI) and offers a range of PO branded personal banking products in association with Bank of Ireland (UK). Additionally 95% of bank PCAs can make withdrawals across post office counters and 70% of bank PCAs can pay in cash, cheques have to be via sealed envelope, both incurring delays over credits made at branches of the account holding bank.

- Although usage figures disclosed by banks and PO Ltd appear significant, they are very small in relation to market size as most bank customers prefer the convenience of widely available ATMs and cashback: the service is invaluable however for vulnerable individuals and those using post offices for other services. Impact on post office counters is minimal.

- Business use is currently limited to Santander, mainly legacy customers of Alliance & Leicester – formerly PO Girobank, Co-operative Bank and more recently Yorkshire Bank following the closure of many of its branches outside the North of England. Around 100,000 business customers of these banks are able to use post offices and the impact generally is acceptable but problems for other post office users do arise in smaller outlets.

- However, the traditional Big 4 banks have over 5 million SME accounts between them plus an unknown number of club, charity and similar accounts. The thinking historically of Post Office Limited and the big banks has been that to extend post office counter access to all SME and 'third sector' customers of the major banks would be beyond the infrastructure capability of the post office network on grounds of space, security and staffing. To do so would have adverse service implications both for business banking users and those wanting to use post offices for other purposes.

- Accordingly CCBS was surprised to be informed earlier this year that the RBS/NatWest Group intends, when soon extending its present PCA withdrawals arrangements at post offices to include pay-in of cash and cheques, to include **all** SME and 'third sector' customers irrespective of size, structure and location.

- CCBS has voiced concern to the bank and to Post Office Limited about potential overload, security risks, poor service to business customers and adverse impact on other post office users especially as the service offered is intended to be universal and not restricted to locations where branches close in the future. It is feared that other major banks will want to follow the RBS/NatWest lead if their business customers demand it and that branch closures will be further accelerated irrespective of the standard of service delivered by the post office alternative: once a bank branch is closed and the premises sold there is no going back.

- The only downsides are restrictions on cash volumes (£1000 per transaction at open counter outlets) and 2 days delay in giving value for cheques and cash compared to using branches of the account holding bank. Unlike IBAAs, where high tariffs levied by the agent bank are generally passed on to the customer, RBS/NatWest absorbs the price charged by Post Office Limited and charges its customer the same agreed tariff as if its own branch had been used.

- For post offices to be considered an alternative when closing the convenient bank branch such limitations appear unacceptable and cash volume restrictions in particular are likely to become widespread as more of the post office network is converted to an open counters/no dedicated assistants model and many of the remainder will be too small to operate the business banking service comfortably. In major conurbations, where many bank branches have already closed, dispersal of demand amongst many post office outlets could help, together with post offices' longer opening hours, but in 'market towns' and similar where banks are actively closing branches and the post office has only one site the dispersal option is not generally available.

- From notices recently sent to RBS and NatWest business and 'third sector' customers re amendments to terms and conditions, it is apparent that the bank is working to a 1 October 2014 implementation date although neither bank nor Post Office Ltd have undertaken pilot schemes or impact studies. At the same time the rate of branch closures by NatWest and RBS has increased markedly relying on the offer of post office access.

NEUTRAL SHARED USE BRANCHES (Banking Centres and Community Banks)

- Basic counter and related services, to agreed operating standards, delivered by a third party provider(s) on behalf of participating banks through a variety of delivery channels – retail/social enterprise franchises, mobile vehicles, community banks and banking centres – as appropriate to each community and locality. The model, which uses existing common technology, can replace existing branches and make it cost -effective to establish an 'open to all' banking presence in new communities.

- Potential use of the format is not exclusive to replacing branded branches in socially deserving rural and urban communities, it also offers the prospect of multi-use by business and personal customers of traditional banks, challengers and new entrants in rural hubs, market towns and secondary/tertiary areas of urban conurbations as they are deserted by branded banks because of declining footfall: combining the demand from relevant sectors of the customer base of several banks makes for viability. The potential is at least 2000 sites.

- The format overcomes the infrastructure deficiencies of post offices and the perceived, although not proven, disadvantages of IBAAs. Shared use branches and IBAAs are complementary.

- The phased introduction of the format, as envisaged by CCBS, could yield savings of up to £1 bn per annum for the Big 4 banks as well as making a significant contribution to improving competitive choice of banking provider for branch dependent SMEs and individuals.

- The format is described in ‘Bank Closure Problems – One Solution Fits All’ November 2007. available at www.communitybanking.org.uk/reports.htm The benefits for banks, an illustration of a phased introduction and estimated cost savings is attached as Appendix 2 and available on the website as above.

UNDERTAKINGS v FULL INVESTIGATION

- CCBS’s poor experience of reliance on the banks’ compliance with the 2002 undertakings indicates that acceptance by the CMA of proposals by some banks for undertakings in lieu of reference for a full investigation would be unwise.

- In its report of 14 March 2002 the Competition Commission required the main banks to investigate use of existing branches on “fair, reasonable and non-discriminatory terms” by customers of banks without a local presence and to report findings in 1 year.

- The required ‘Branch Access Feasibility’ report of 14 March 2003 by the banks to the OFT rejected the case for a national scheme of branch access, claiming the need could be met by improvements to awareness and operation of existing inter- bank agency agreements (IBAAs). The logic of the report was deeply flawed statistically, understating the number of ‘no choice’ locations by a factor of 4 and the demand by a factor of at least 10 based on the banks’ own experience of a pilot in 2002.

- In August 2007 publication of OFT advice given to the Commission disclosed still only 25% awareness of IBAAs from which ‘many non-aware customers might gain’. Hardly surprising as even the modest March 2003 commitments to improve the awareness and operation of IBAAs were not honoured.

- The chronology referred to in the IBAA section of this paper is attached.

Campaign for Community Banking Services
www.communitybanking.org.uk
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APPENDIX 1

GOVERNMENT FAILS SMALL BUSINESSES AGAIN: THE IBAA SAGA

Nearly 1000 urban and rural communities in Britain offer no convenient choice of bank to those small businesses which are cash and cheque dependent – according to Federation of Small Businesses research nearly 60% of businesses visit a branch at least weekly; 10% do so every day. The number of communities so disadvantaged is set to increase as banks close neighbourhood branches in favour of investing in the 'retail experience' in high footfall multiple choice town and city centre sites.

In many other countries the competition authorities do not allow this absence of local market competition to develop. In the UK, government and the relevant authorities are culpable in their neglect which is graphically illustrated by the chronology below with regard to the failure to improve the awareness, operation and take-up of the little known IBAAs, the inter- bank agency agreements which facilitate use of a local bank's counter by small business customers of other banks, thus preserving competitive choice and helping to sustain those remaining branches and the communities they serve.

March 2000	Following Cruickshank's criticisms of banking competition, the Competition Commission was required to conduct an inquiry into small business banking.
14 March 2002	Government accepted the Commission's contentious conclusion that the banking market is national but required the main banks to investigate use of existing branches on 'fair, reasonable and non-discriminatory terms' by customers of banks without a local presence and to report findings in 1 year.
14 March 2003	The required 'Branch Access Feasibility' report by the banks to the OFT rejected the case for a national scheme of branch access, claiming the need can be met by improvements to awareness and operation of existing inter- bank agency agreements (IBAAs). The logic of the report was deeply flawed statistically, understating the number of 'no choice' locations by a factor of 4 and the demand by a factor of at least 10 based on the banks' own experience.
June 2003	Assessment of the above report by independent consultants to the OFT identified key omissions and suggested material improvements to the operation of the service, and its awareness level, and inclusion within a voluntary Code.
September 2003	OFT accepted delivery of the banks' report within the timescale (although statistically flawed, incomplete in coverage and minimalist in commitment to improvements) as compliant; passed to HM Treasury without comment.
November 2004	Independent reviewer of the Business Banking Code, Professor Elaine Kempson, recommended inclusion of an obligation to advise all business customers of IBAAs and how to apply to use them. The banks chose to ignore the recommendation without giving reasons.
January 2006	OFT commenced 3 year review of the banks' undertakings to the Commission.
August 2007	Publication of OFT advice given to the Commission discloses still only 25% awareness of IBAAs from which 'many non-aware customers might gain'. Hardly surprising as even the modest March 2003 commitments not honoured.
November 2007	New independent reviewer of the Business Banking Code, Mike Young, recommended inclusion of an obligation to outline IBAAs to relevant small businesses at account opening stage. The banks rejected the recommendation citing reasons irrelevant to its substance and intent.
21 December 2007	Competition Commission declined to take further action with regard to IBAAs following its review, re-stating its decision not to recognise a local market for banking competition and again claiming delivery of the 14 March 2003 (flawed) banks' report had fulfilled their undertaking.
2 April 2011	Treasury Committee recommended the Independent Commission on Banking to consider an improved Inter Bank Agency Agreement (and neutral shared branches) in its remit to promote competition in banking. The ICB failed to address the shortcomings of IBAAs and made no recommendations in this area in its final report.

CCBS Feb 2008 (Updated Sept 2011)

APPENDIX 2

BANKING CENTRES

Main Advantages for Banks

The advantages for the traditional banks of replacing lower footfall branded branches by combined banking centres © are potentially considerable, especially at a time when real innovation in branch delivery to recognise the changed market environment is overdue and they have to achieve a balance between significant cost reductions and maintaining service delivery.

- Savings of hundreds of millions of pounds in branch operating costs.(See attachment)
  S*haring costs of a common transactional capability, and related overheads, provided more cost-effectively by a neutral outsourcer handling larger volumes assisted by more intensive use of technology.*

- Property disposal; realisation of capital or rental saving.
  Large parts of existing premises no longer required for banking purposes following the centralisation elsewhere of back office, advisers, business managers, etc.

- Remove responsibility for cash, security and maintenance of premises.
  Banking centre premises and security would be responsibility of the outsourcer.

- Reduction in numbers of directly employed staff.
  Recruitment, training and retention of cashiering and similar staff would rest with the outsourcer; cost benefits from higher volumes and more intensive use of cashiering staff and technology would accrue to participating banks.

- Increased focus for sales and service staff.
  Directly employed sales staff would be relieved of distractions, concentrating on realising sales opportunities generated from direct enquiries, sales promotions, account queries and counter transaction information exclusively accessible by account holding bank's own staff.

- Facilitate opening for longer hours and at weekends.
  Contracts of cashiering and administration staff would be the responsibility of the outsourcer and would be expected to follow established retail practice; numbers of directly employed sales staff would be small and could be incentivised according to potential and demand

- A cost-effective means of serving existing and new 'social need' communities.
  Whether or not required by future legislation, some unprofitable branches in deprived and small rural communities are likely to be necessary: a basic version of banking centre technology and processes would enable such provision as it would in areas of housing expansion.

Source: 'Bank Closure Problems-One Solution Fits All' CCBS November 2007 which explains branch sharing models including banking centres and is available at: www.communitybanking.org.uk/reports.htm .

ESTIMATED SAVINGS IN BRANCH OPERATING COSTS

England, Wales and Scotland

Branch closures, particularly of 'last bank in town' by HSBC, and separation of TSB from Lloyds and Williams & Glyn's from RBS, since our original estimates were made make necessary a revised illustration combining Scotland with England & Wales.

Branch numbers for groups: Barclays, Lloyds (excluding Halifax) and RBS are taken as 1600 each including 400 'last bank' and 'dual bank' locations. HSBC's start point is assumed at 1200.

No. of communities	No. of Sites per bank	Net Saving per Branch	No. of Banks	Net Savingper annum	Leaving branches
Tranche 1 800	200 (soles)	Equal numbers cancel out*	x3**	NIL	1400 x 3 HSBC 1200 +800 shared
Tranche 2 400	200 (duals)	x £120K (£70K)	x 4	£40m	1200 x 3 HSBC 1000 +1200 shared
Tranche 3 200	200	x £250K#	x 4	£200m	1000 x 3 HSBC 800 +1400 shared
Tranche 4 200	200	x £300K#	x 4	£240m	800 x 3 HSBC 600 +1600 shared
Tranche 5 200	200	x £360K#	x 4	£290m	600 x 3 HSBC 400 +1800 shared
Tranche 6 200	200	x £430K#	x 3**	£260m	400 x 4 +2000 shared

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* Any additional staffing in Tranche 1 only to be offset by reductions elsewhere.

\# Tranches 4-6 increased progressively by 20% on Tranche 3, detailed as attachment, to reflect larger branch sizes.

** HSBC to negotiate on Tranche 1 (only 10% of 'last bank situations) but is included in Tranches 2 – 5 as full partner.

1) Capital realisations from surplus property disposals, where freeholds owned, will increase with each tranche.
2) Clydesdale, Yorkshire, TSB, Williams & Glyn's and others could become associate members of the scheme and generate usage income for the principals.

CCBS 20-2-14

ENGLAND & WALES

TRANCHE 3 ILLUSTRATION

	£000s P.A.	
Rent/Notional Rent	40	
Business Rates	20	
Staff Costs	250	8 x £25K inc pension, NIC, bonuses,etc
Heating, Lighting, Water	15	
Stationery, Consumables, Waste	15	
Security, Cash Transit	15	
Depreciation, Maintenance	30	Building & Equipment
Sundries	15	
	400	
	-150	Share of Banking Centre costs
	250	

Rent/Notional Rent based on a selection of mid-range bank branches offered at auctions.
Business rates assumed at 50% of notional rental value.
Staffing estimated by observation of mid-range branches. Other costs are estimates.

Estimates validated by media reports of savings/forecast savings on branch closures by banking and building society groups.

Banking Centre costs assumed at 1.5x branded branch costs reflecting the increase in capacity but offset by lower pay and benefits structure and budget approach to furnishings and other overheads in line with practice of local/regional building societies. Cost of Banking Centre shared by 4 banks.

CCBS

Revised October 2010