CMA Consultation: Personal current accounts and banking services to small and medium-sized enterprises

A Response from Paragon Bank – 15 September 2014

Introduction

About Paragon Bank

Launched in February 2014, Paragon Bank is a new British bank focused on expanding competition and choice in the UK banking market for consumers and SME (small and medium sized enterprise) customers.

Paragon Bank is a wholly owned subsidiary of The Paragon Group of Companies PLC, the UK's leading independent, buy-to-let lender and consumer finance specialist. Established in 1985, Paragon Group has over £10 billion of assets under management and has serviced more than 1.5 million customers. Paragon Bank is led by Managing Director, Richard Doe, previously Chief Executive of ING Direct UK, with an experienced banking and consumer finance management team and Board of Directors.

The development of Paragon Bank is a key element of Paragon Group's proactive growth strategy. Paragon Bank builds on the Group's heritage, model and resources - extending the Group's specialist lending expertise into new markets, leveraging its low-cost, centralised operating model to minimise start-up costs and enabling the Group to raise retail deposits to fund new lending.

Paragon Bank launched its first savings products to the public in June 2014. It has experienced positive demand for its savings products and will expand the range over time, building up its deposit base to fund the growth in lending.

In its first year, Paragon Bank will launch four product ranges – savings, car finance, personal loans and buy-to-let lending. It will concentrate its initial lending in areas where the Group has previous success and extensive experience.

Paragon Bank presently has no intention of launching either personal or business current accounts. Paragon is responding to the CMA consultation because of the important links between current accounts and the markets for saving and loan products, and because Paragon is one of the most recent entrants to the wider banking market and is thus ideally positioned to give its view on issues related to competition in the sector.

Paragon Bank is a member of the British Bankers' Association and contributed to its July 2014 policy paper on promoting competition in the UK banking industry.

Summary of response

Paragon endorses the BBA's assessment in its July 2014 study on competition in UK banking that there are four principal ways to encourage competition in the sector:

- reform of capital requirements so that challenger banks can lend using similar amounts of capital as large, established banks;
- ensure all regulation is proportionate and does not unintentionally favour the large, established firms;
- reform of the funding system so that schemes such as the FLS do not skew the market in favour of the big banks; and,
- ensuring access to the payments system is fair and prices are reasonable and transparent.

The common theme is one of ensuring a level playing field. As a new entrant to the banking sector, Paragon has not asked for special treatment but it is seeking to compete fairly with incumbents.

It is our belief that creating such conditions is the best means of fostering competition in banking. The CMA has to consider whether it has the remedies to affect these factors and whether a full scale 'phase 2' market investigation with all the uncertainty it could stimulate is necessary.

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

Paragon agrees with the CMA that different capital requirements for challenger banks versus the established banks is a barrier to the growth of the challengers. The use of standardised capital weights increases firms' costs and is particularly disadvantageous when lending to perceived lower risk borrowers. Resolving this discrepancy would do much to help challenger banks and new entrants compete effectively.

We also agree with other challengers that the costs for access to key inputs, such as the payments system can be excessive for smaller banks. In addition to the payments system, under the EMIR arrangements, banks will need to clear interest rate derivatives that they are required to use for risk management purposes centrally. The high fixed cost proposed for access to EMIR will be disproportionate to the level of use by smaller banks and, if left unchanged, will introduce a significant barrier to competition.

There are several points to note on the issues of switching, levels of concentration and stable market shares.

Firstly, we note that the UK is going through an exciting period of change in banking. There are numerous applications for banking licences currently being considered by the PRA under the streamlined authorisation process; established non-bank brands including retailers are introducing new services and products with potentially significant impact on the market; technological developments are facilitating the growth of online-only banks that offer consumers an alternative to the historically dominant branch-based model; and the government's Midata programme will provide data that consumers can use to find the best product and provider for them individually using price comparison tools.

Paragon has recently been through the PRA and FCA's authorisation process and can attest that whilst still a substantial exercise it is no longer the barrier to entry that it once was.

Secondly, Paragon urges the CMA to consider the many complexities of a consumer's financial services needs and decision-making processes, and the various markets for inter-linked products.

The PCA is intended as a utility product for regular payments, cash withdrawals etc. It is concerning that many consumers retain large cash balances in their PCAs in excess of their short term needs.

In addition, a high proportion of consumers take out saving and loan products from their PCA provider by default rather than shopping around for a better deal (as set out in the FCA's cash savings market study).

The type of consumer detriment that these behaviours result in has little to do with the market share of individual PCA providers. It is instead a consequence of a lack of consumer engagement in the banking and savings market exacerbated by a lack of easily understandable, standardised information enabling consumers to compare the costs on different PCAs; a failure to highlight the opportunity cost of maintaining large balances in PCAs or shop around for more suitable savings or loan products; and varying perceptions on the ease of switching.

Q. Do you consider that the CMA's provisional analysis with respect to the exercise of its discretion to refer the PCA market is correct? (CMA Consultation, Chapter 4)

As stated above, Paragon believes the most effective means of encouraging competition is to ensure a level playing field through reforming capital requirements and ensuring regulation and costs for access to key banking systems are proportionate. The CMA should consider whether it is best placed to effect such changes or whether the prudential and conduct regulators take the lead roles while working closely with the CMA.

While there is also a case that could be made for enhanced behavioural remedies as set out in the CMA paper, and specifically increasing transparency of account data, it might be quicker to agree these with incumbent banks than conduct a full phase 2 investigation.

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

There are several parallels between our comments on PCAs above and our view on the features of concern outlined in the CMA market study.

Technological developments and the relative retrenchment of mainstream banks from lending to SMEs has helped to encourage a raft of new entrants with varying business models. Alternative finance has started to play an important role, albeit from a small base. For example, the flow of lending through peer-to-peer platforms doubled in the first half of 2014 while invoice and supply chain finance is also growing as small firms increasingly look away from the high street banks for their finance needs.

As with PCAs, there is a strong trend for SMEs to take additional services from their business current account provider. In some senses it is more understandable given that having an existing long-term relationship gives the lender more information on which to base a responsible lending decision.

However, there are several interesting government initiatives, such as improving SME credit data sharing and referrals to alternative lenders, which have the potential to open up competition further although it is too early to confidently predict their impact. As with PCAs, the CMA should focus its considerations on how best to create a level playing field for all providers rather than looking at reforms that lead to more smaller but otherwise identical players.

Q. 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 a MIR) given by the banks?

Q. 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? (CMA consultation, paragraph 4.58 to 4.71 copied in Appendix Three below)

Paragon views the banks' UILs as a solid starting point for effective remedies. The CMA should consider these UILs in the context of the developments outlined above, such as the number of new entrants coming into the market, the impact of non-bank brand challengers and alternative lenders with innovative business models, and the Midata and SME credit data sharing programmes.

However, Paragon believes that the banks' commitments can go further. We reiterate our call for the CMA to consider how the PCA and BCA markets affect the markets for related products and vice versa. So, for example, under these proposals a consumer or a business customer might receive increased information about his or her account and its costs but still be reluctant to switch if all their other saving and loan products are with the same provider. We therefore call on the CMA to note recommendations we made in our response to the FCA's cash savings market study, which included the promotion of the ease and speed of switching saving products to match the emphasis placed on switching PCAs.

The CMA should also recognise that steps to level the playing field by addressing capital requirements, costs to access key inputs and regulation will lead to significant improvements in competition in the markets in a way that complements measures to enhance consumer engagement.

Q. 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?

Paragon Bank echoes the comments of the BBA when it says that banking in the UK is made up of many different but interrelated markets of which PCAs and SME BCAs are only two. Structural reforms to the sector, based on an assessment of current account markets and leading to smaller versions of the existing high street banks, are unlikely to deliver much diversity in competition, products and services.

The best way to create more beneficial competition in the market is to establish a level playing field for all players, and encourage or require banks to provide customers with information on their accounts in a more consistent, frequent and meaningful way.

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