

# SME banking behavioural undertakings of 2002

Report on compliance

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The Competition and Markets Authority has excluded from this published version of the market study report information which it considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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## Summary

1. In 2002, following a Competition Commission investigation into banking services for small and medium-sized enterprises (SMEs), nine banks (two of which have since merged) agreed, inter alia, that they would no longer, except for in specific circumstances, oblige an SME customer to open or maintain a business current account (BCA) with them in order to obtain a business loan or business deposit account. This practice, commonly known as ‘bundling’, became prohibited by the terms of the agreement provided by the banks – the so-called ‘behavioural undertakings’.
2. The following eight banks are currently prohibited from bundling under the terms of the behavioural undertakings: AIB Group (UK) plc (known as First Trust Bank or First Trust as used within this report); Bank of Ireland; Barclays Bank plc (Barclays); Clydesdale Bank plc (Clydesdale), HSBC Bank plc (HSBC), Lloyds TSB Bank plc (now part of Lloyds Banking Group and known in this report as Lloyds), Northern Bank Limited (now known as Danske Bank) and the Royal Bank of Scotland Group (RBS) which includes Ulster Bank Limited (Ulster Bank) in Northern Ireland.
3. As part of its work in conducting its SME banking market study in late 2013, the Office of Fair Trading (OFT) became aware of concerns which suggested that certain banks may be bundling BCAs with loans to SMEs in a manner which may have breached the behavioural undertakings. Following its own initial enquiries into the matter, in December 2013 the OFT began an investigation into whether the relevant banks were complying with the behavioural undertakings.
4. In March 2014, the OFT agreed a package of measures with all eight banks designed to assess overall levels of compliance with the behavioural undertakings while also improving the awareness of all relevant bank staff in relation to the limitation on bundling. As part of these measures, the banks agreed to undertake a detailed annual audit of their systems and procedures for ensuring compliance. In July 2014, the CMA received the results of each bank’s first audit.
5. On the basis of these audits and information gathered during the OFT’s and CMA’s investigation, the CMA has concluded that two banks – First Trust and HSBC – have breached the behavioural undertakings by having told some SMEs that they needed to open a BCA with the bank in order to get a business loan. These breaches seem to have occurred through failures in each bank’s systems and procedures for ensuring that staff members do not bundle BCAs with loans. As a result, the CMA has decided to issue First Trust

and HSBC with written directions designed to improve their ability to comply with the behavioural undertakings.

6. The CMA has concerns in relation to RBS's compliance. On the basis of evidence disclosed in RBS's audit report on the outcome of a mystery shopping exercise, there are grounds for considering that there may have been an instance of non-compliance with the bundling prohibition – namely the instance of one 'fail' identified out of 14 initial phone calls to RBS call centre staff, representing a non-compliant answer. Given both the relatively small scale of the issue identified, and the fact that subsequent retesting of affected lines did not show non-compliance, the CMA does not consider that it would be proportionate to take enforcement action in respect of this single instance.
7. The audits carried out by RBS and Barclays show that the level of awareness among relevant staff at these two banks, of their specific obligations under the behavioural undertakings, is relatively low.
8. All eight banks are taking steps to address the issues that have been identified in their audit reports and to improve their systems and procedures for ensuring compliance with their obligations under the behavioural undertakings. All eight banks will report again to the CMA on their compliance with the undertakings by July 2015, setting out:
  - (a) what policies, practices and procedures are in place to secure compliance;
  - (b) the level of awareness of relevant staff with the behavioural undertakings; and
  - (c) other evidence suggesting the presence or absence of actual or suspected non-compliance with the behavioural undertakings.
9. In the meantime, the CMA encourages any SME customers, or relevant organisations, to get in contact with any concerns they may have in relation to any of the banks' compliance with the behavioural undertakings at the following email address: [SMEbundling@cma.gsi.gov.uk](mailto:SMEbundling@cma.gsi.gov.uk)

# 1. Background

## The SME banking behavioural undertakings

- 1.1 In 2002, following a Competition Commission report on the SME banking sector,<sup>1</sup> nine clearing banks provided a set of behavioural undertakings to the Secretary of State for Trade and Industry and the Chancellor of the Exchequer in order to encourage competition in the SME banking sector with a view to remedying the concerns outlined in the Competition Commission's report.<sup>2</sup>
- 1.2 Overall, the 2002 behavioural undertakings were designed to improve transparency on prices, facilitate the switching of BCAs and restrict the 'bundling' of products in certain circumstances.<sup>3</sup> Further information on the entire set of behavioural undertakings can be found in Chapter 11 of the CMA's July 2014 market study report into banking services to SMEs.<sup>4</sup>
- 1.3 These behavioural undertakings were reviewed by the OFT in 2007, at which time no changes to them were recommended as they were judged necessary to facilitate the development of competition in the market. Moreover, no evidence of compliance concerns was found. Following the OFT's review, the Competition Commission decided to remove almost all of a separate set of undertakings which had also been agreed in 2002 and concerned the prices charged to SMEs by certain banks in England and Wales (the so-called 'transitional undertakings').<sup>5</sup>

## The undertaking prohibiting 'bundling'

- 1.4 Clause 17 of the behavioural undertakings is as follows:

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<sup>1</sup> Following a complex monopoly reference made by the Secretary of State and the Chancellor of the Exchequer under the Fair Trading Act 1973.

<sup>2</sup> The undertakings were provided to the Secretary of State for Trade and Industry and the Chancellor of the Exchequer under section 88 of the Fair Trading Act 1973.

<sup>3</sup> The relevant banks signed two sets of behavioural undertakings in 2002. The first set, entitled 'Behavioural Undertakings – Others' contains the limitation on bundling obligation which is the subject of this report. The second set of behavioural undertakings, entitled 'Behavioural Undertakings – Switching', concerned BCA switching processes between the banks and does not form part of our current review.

<sup>4</sup> [www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk](http://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk).

<sup>5</sup> [http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.offt.gov.uk/shared\\_offt/register\\_of\\_orders\\_and\\_undertaki/CC-final-decision-SME-bank.pdf](http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.offt.gov.uk/shared_offt/register_of_orders_and_undertaki/CC-final-decision-SME-bank.pdf).

## Limitation on bundling

17(1) - Subject to clause 18 below, the Bank shall not directly or indirectly require, agree (other than in respect of integrated products) or threaten to require, as a condition of the granting, maintaining or servicing of any business loan to, or the opening, maintaining or servicing of any business deposit account for, any SME that SME should open or maintain any business current account with the Bank.

- 1.5 This clause prohibits each bank which gave the undertaking requiring (either directly or indirectly) an SME customer to open or maintain a BCA with that bank as a condition for the granting of a loan or business deposit account to that SME customer. In the rest of this report, this restriction on the behaviour of the banks will be referred to as the 'bundling prohibition'.
- 1.6 The bundling prohibition does not, however, restrict the relevant banks' ability to offer to SME customers 'integrated' products that feature both a BCA and a loan or a business deposit account provided that these products are also available separately (Clause 17(2)). Furthermore, the behavioural undertakings allow the banks to provide incentives to an SME customer to agree to open a BCA at the same time as that SME customer is granted a business loan or opens a business deposit account. The behavioural undertakings also allow the banks to require an SME customer to hold a BCA with the bank as a condition for granting a loan or business deposit account in circumstances where the bank concerned also takes a fixed charge over the book and other debts of the SME customer. These exceptions are outlined in clause 18 of the behavioural undertakings.

## Legal framework

- 1.7 The bundling prohibition continues to be in force by virtue of paragraph 15 of Schedule 24 to the Enterprise Act 2002 (EA02).
- 1.8 Clause 28 of the behavioural undertakings provides that the CMA may, if it is of the 'reasonable view' that a bank has failed to comply with its obligations under the undertakings, issue the bank with 'reasonable written directions' in order to secure compliance.<sup>6</sup> Its terms are as follows:

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<sup>6</sup> Although the undertakings refer to the 'Director General of Fair Trading' as being responsible for monitoring compliance with the undertakings, this should now be read as the 'CMA' given the provisions of section 3(6) of the Enterprise Act 2003 the Enterprise and Regulatory Reform Act 2013 (Competition) (Consequential, Transitional and Saving Provisions) Order 2014.

## Compliance with these undertakings

28 – If the Director is of the reasonable view that the Bank has failed to comply with any of its obligations under these undertakings, he may from time to time, in respect of such obligations, give reasonable written directions to the Bank:

- to take such steps within the Bank's competence as may be specified or described in the directions for the purpose of carrying out or securing compliance with these undertakings; or
- to do or refrain from doing anything so specified or described which it might be required by these undertakings to do or to refrain from doing.

1.9 The CMA also has the power, under section 94(6) and (7) of EA02,<sup>7</sup> to enforce the undertakings in Court by seeking an injunction against a bank's non-compliant conduct.

## Relevant banks

1.10 The following eight banks are currently subject to the bundling prohibition: AIB Group (UK) plc (known as First Trust Bank or First Trust as used within this report); Bank of Ireland; Barclays Bank plc (Barclays); Clydesdale Bank plc (Clydesdale), HSBC Bank plc (HSBC), Lloyds TSB Bank plc (now part of Lloyds Banking Group and known in this report as Lloyds), Northern Bank Limited (now known as Danske Bank) and the Royal Bank of Scotland Group (RBS) which includes Ulster Bank Limited (Ulster Bank) in Northern Ireland.

1.11 Whereas nine banks originally agreed to the behavioural undertakings, two of these banks, HBOS Plc and Lloyds TSB Bank plc, subsequently merged to become Lloyds Banking Group.

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<sup>7</sup> See paragraph 15 of Schedule 24 of the Enterprise Act 2002, as amended.



## **2. Initial investigation into compliance**

### **SME banking market study and initial concerns on compliance**

- 2.1 The CMA's recently concluded SME banking market study was originally initiated by the CMA's predecessor body, the OFT, in June 2013. Given the relevance of the behavioural undertakings to the market study's focus, as part of its market study work the OFT decided to review the behavioural undertakings with a view to assessing their continued appropriateness.
- 2.2 During the early stages of the OFT's market study, the Federation of Small Businesses communicated to the OFT its concern that, based on anecdotal evidence provided by its members, some relevant banks might not be complying with the bundling prohibition contained within the behavioural undertakings. At a later date, in November 2013, the OFT also reviewed a business loan comparison table produced by a third-party organisation (Business MoneyFacts) which indicated that HSBC granted its small business loans only to those SME customers which also operated a BCA with HSBC.
- 2.3 In the context of a request for information made to the banks for the purposes of the market study, the OFT case team noted that certain statements made in the responses of some banks gave rise to possible concerns over compliance with the bundling prohibition. In October 2013, the team requested that certain banks (including the four largest banks: Barclays, HSBC, Lloyds and RBS) provided the terms and conditions of their business loan products. Although a review of these terms and conditions in November 2013 did not indicate non-compliance with the bundling prohibition, a subsequent review of these banks' websites identified a statement on HSBC's website (HSBC's 'online virtual assistant' tool as also discussed in paragraph 3.23 below) which appeared non-compliant with the behavioural undertakings.

### **OFT compliance investigation**

- 2.4 On the basis of its initial evidence gathering, on 5 December 2013 the OFT decided to assess overall levels of compliance with the bundling prohibition by writing to each of the relevant banks and requesting information on their systems and procedures for ensuring compliance. Following receipt of the relevant banks' responses in December 2013, the OFT made further enquiries of the relevant banks during January and February 2014. The overall results of this investigation are outlined in the following sections.

## ***Suspected breaches of the bundling prohibition***

### *First Trust*

- 2.5 In its response to the OFT in December 2013, First Trust stated that it had identified six specific instances where the bank's loan facility letters stipulated that the SME customer had to open a BCA in contravention of the bundling prohibition. These incidents related to a specific lending scheme initiated at the bank. First Trust informed the OFT that four of these loans had been drawn down and that, subsequent to the OFT's letter, the bank had written to all six affected customers telling them that they were under no obligation to operate or hold a BCA with First Trust.
- 2.6 In a subsequent response to the OFT in February 2014, First Trust stated that, as far as it was reasonably practical to be so, First Trust was satisfied that the six cases already identified represented the entirety of its affected SME customers.

### *HSBC*

- 2.7 HSBC's initial response to the OFT in December 2013 indicated that, as a result of certain technical requirements operating in the bank's IT system, its small business loan product could not be drawn down into a non-HSBC BCA held by an SME customer.
- 2.8 HSBC stated that its general policy was not to require SME customers to open or maintain an HSBC BCA in order to obtain a loan or business deposit account. This policy is made clear in its branch procedures manual (which, although written for the branch network, is accessible to all staff via HSBC's Intranet and is frequently used as a point of reference for non-branch staff). However, HSBC outlined how it had identified another internal staff instruction manual which made reference to HSBC's preference for establishing [X] when dealing with SME customers. HSBC stated that it would undertake further work to assess what effect such guidance may have had on staff members' understanding of the bundling prohibition.
- 2.9 In a subsequent response to the OFT in February 2014, HSBC said that it had always been, and remained, its policy not to require an SME customer to hold an HSBC BCA in order to operate a loan account or business deposit account (subject to the exceptions set out in the behavioural undertakings). HSBC also outlined a number of interim findings from its internal investigation:
- Referring to its previous statement about technical requirements in its IT system (see paragraph 2.7 above), HSBC explained that while funds from

its small business loan product could not be directly drawn down into a non-HSBC BCA held by an SME customer, an 'IT workaround' solution had been put in place within the relevant IT system since 2003 which did allow funds to be transferred to a non-HSBC BCA. Although practical instructions for relevant staff on how to implement this procedure had been available within internal guidance, in April 2011 these instructions had been erroneously removed.

- An ongoing inspection of staff policies and guidance documents had revealed further references to the desirability of HSBC staff pursuing [✂] in relation to SME customers. In practice, HSBC stated that this had led to confusion among its staff about their obligations under the bundling prohibition. Such confusion was evidenced in a survey of 50 frontline staff typically dealing with new-to-bank SME customers which showed that:
  - 21 of these staff (ie 42%) believed that SME customers needed a BCA with HSBC in order to obtain a loan from the bank.
  - 7 of these staff (14%) also appeared to have previously told a customer that a BCA with HSBC was required to take out a loan. HSBC later clarified that among these seven staff, up to three may have legitimately informed a SME customer of this requirement given the exceptions in clause 18 (meaning that at least four staff members (ie 8%) required or threatened to require the SME customer to take a BCA with a loan against the bundling prohibition).

Overall, most staff surveyed could not, however, recall ever encountering a new-to-bank customer seeking a general purpose business loan without also wishing to open a BCA.

- One HSBC business deposit account product – the 'Business eSaver' (introduced in December 2005 and withdrawn from sale since 2006) – was a niche online-only saving product that could only be applied for by customers who were already registered for Internet banking with HSBC (which required either an HSBC BCA or business deposit account). HSBC told the OFT that it was of the view that the Business eSaver did not create risk to the fulfilment of the objectives of the bundling prohibition, as the Business eSaver amounted to an integrated product in substance, similar to those expressly permitted by the behavioural undertakings. Furthermore, the product could be accessed by SME customers who had registered for online banking via their business deposit account rather than a BCA.

2.10 As a result of its internal investigations outlined above, HSBC informed the OFT that, on the basis of its survey of a sample of frontline staff members who would be applying the relevant policies and procedures in practice, HSBC had concluded that:

‘... in some situations its staff will have given SME customers the impression that a BCA was required in order to obtain a general purpose business loan from HSBC’.

HSBC also stated that it was:

‘able to ascertain that some staff will in fact have informed SME customers that it was a requirement to take out a BCA in order to obtain a business loan’.

HSBC told the OFT that it believed that the incidence of such situations was likely to be very low, as it is rare in practice for a new-to-bank customer to seek a general purpose business loan without wishing also to obtain an HSBC BCA.

#### *HSBC ‘action plan’*

2.11 In February 2014 HSBC provided the OFT with an action plan designed to remedy the issues that it had identified. This plan included amending its internal staff guidance to clarify how HSBC’s preference for [✂] should only be achieved by staff in compliance with the bundling prohibition. The action plan also outlined HSBC’s intention to roll out mandatory training on the bundling prohibition for its staff in order to ensure future compliance. HSBC’s July audit report, discussed in paragraphs 3.23 to 3.30 below, has provided an update on HSBC’s progress on implementing its action plan.

### **Product design**

2.12 During the OFT investigation, the OFT corresponded with RBS in relation to certain loan products that it provided. In summary, following detailed clarifications, the OFT concluded that these specific products fell outside the scope of the bundling prohibition as defined in the behavioural undertakings. However, the initial uncertainty over the products’ status, and the length of time taken to clarify their correct status in relation to the bundling prohibition, indicated that the practical application of the bundling prohibition to these specific products was not clear and may not have been fully considered.

## ***Variation in systems and procedures to ensure compliance***

2.13 Over the course of its investigation, the OFT was able to discern differences in the systems and procedures maintained by each bank to ensure compliance with the bundling prohibition. In the OFT's view, some banks maintained better systems for ensuring compliance than others; this was especially the case in relation to staff training and monitoring where a few banks were able to demonstrate more robust monitoring procedures and point to more recently devised training courses or staff circulars that incorporated specific information on the bundling prohibition. For instance, we note that in documentary material sent to the OFT in December 2013, Lloyds was able to demonstrate that it had maintained appropriate staff training procedures that covered the bundling prohibition. In contrast, some banks could not demonstrate that specific communications on the bundling prohibition had been made to relevant staff since the behavioural undertakings were first agreed.

### ***March 2014 agreement***

2.14 While there was evidence of good practice at some banks, the OFT's compliance investigation had identified suspected breaches of the bundling prohibition when two banks had tested staff awareness and reviewed case files (ie HSBC and First Trust). However, the OFT determined that it was necessary to undertake a more comprehensive review of the compliance approach across all banks; this was in order to ensure that the OFT could be in a position to understand fully the effectiveness of compliance approaches across all the banks and be well placed to take action to address any concerns found. As a result, the OFT concluded that overall levels of compliance with the bundling prohibition would be assisted if banks initiated a more in-depth review of their practices and if they were to issue a reminder of the banks' obligations under the 2002 undertakings to relevant staff.

2.15 On 11 March 2014, the OFT agreed a package of measures with all the banks subject to the behavioural undertakings that sought to achieve two main objectives: to improve awareness of the bundling prohibition among relevant staff in the short term and, in the longer term, to assist the CMA in assessing overall levels of compliance with the bundling prohibition on an ongoing basis. This March 2014 agreement included obligations providing that:

- All banks should provide a written annual reminder on the bundling prohibition to all their relevant staff<sup>8</sup> dealing with SME customers to ensure

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<sup>8</sup> Under the terms of this agreement, 'relevant staff' were defined as being all staff who are responsible for the marketing and sale of business loans and business deposit accounts.

that they are aware of the bank's obligations and the seriousness with which they are treated by the bank.

- Each bank must, via its internal audit function, conduct an annual review of compliance with the bundling prohibition. The first such audit report was to be prepared by 11 July 2014 and submitted to the CMA so it could decide whether any further action should be taken against individual banks.<sup>9</sup>

2.16 Following the March 2014 agreement, the OFT and then the CMA worked with the banks to produce a set of high-level principles to guide the focus and manner of their internal auditors' investigations.

2.17 On 11 March 2014, the OFT also announced that the CMA would be completing the SME banking market study. In its public statement,<sup>10</sup> the OFT summarised the progress of its compliance investigation in the following terms:

the OFT is currently reviewing undertakings given by various banks following the Competition Commission's investigation in 2002. As part of that review the OFT has received concerns about failure to comply with those elements of the undertakings, which prevent banks from requiring an SME to take out a BCA in order to obtain a business loan (that is 'bundling' of BCAs with business loans). The OFT considers that compliance with these undertakings is important as they are designed to help providers to compete effectively in SME banking.

The OFT's investigations into those concerns with the various banks are not yet complete and will be continued for some months by the CMA. Whilst the OFT has seen examples of good compliance with the undertakings, there is also evidence of some need for improvement and for the banks to monitor compliance.

The banks in question have worked with the OFT to agree a package of measures intended both to improve information provided to staff in the banks dealing with SME customers and to help the CMA to assess compliance with the undertakings through annual compliance reviews.

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<sup>9</sup> Before accepting such a proposal, the OFT sought specific assurances as to the level of independence of the internal audit functions of each of the banks. Moreover, each bank agreed to conduct the audit in line with the principles of the Professional Code of Conduct of the Chartered Institute of Internal Auditors.

<sup>10</sup> <https://assets.digital.cabinet-office.gov.uk/media/533550c5e5274a566000000b/sme-updates.pdf>.

Following the first compliance review, the results of which are due in July, the CMA will determine next steps in light of information on details of the compliance by each of the banks. The CMA will then decide on any action that should be taken on any failure to comply in relation to any particular bank.

### **3. Audit reports**

- 3.1 In accordance with the March 2014 agreement, the CMA received all the relevant banks' audit reports by 11 July 2014. The CMA then carefully reviewed each report and sought (sometimes detailed) clarifications from the relevant banks where necessary.
- 3.2 While all the relevant banks have met the provisions of the March 2014 agreement, a degree of variation has been seen in the investigation methodologies employed by each bank's internal auditors for testing compliance with the bundling prohibition. In many instances this was due to data and system constraints operating on the internal auditors which differed between each bank. The CMA therefore cannot compare the findings of the audit reports in a simple, like-for-like manner. However, given that these reports are produced by each bank's independent internal audit function, the CMA has been able to draw certain conclusions from each report, especially when viewed alongside the OFT's previous compliance investigation, and these are set out in Chapter 4 below.

#### **Summary of audit report findings**

- 3.3 A high-level summary of each bank's audit report is provided below with a particular focus on any issues that internal auditors may have identified. Following each summary, the audit report's own conclusion on the bank's level of compliance with the bundling prohibition is provided.

##### ***Bank of Ireland***

- 3.4 The audit report notes that no specific communication or training on the bundling prohibition had been provided to SME relationship managers at the Bank of Ireland until a communication in April 2014 (made pursuant to the March 2014 agreement with the OFT). Internal auditors interviewed 31% of the bank's relationship managers and found that all these members of staff were aware of the bundling prohibition and that relationship managers did not feel that product bundling had been a practice or part of the culture at the bank. Internal auditors also conducted a walkthrough of the account-opening process and found no technical constraints which prevented a loan account or a deposit account from being opened on a standalone basis.
- 3.5 Internal auditors reviewed 46 out of [redacted] relevant loans<sup>11</sup> since January 2010 and did not identify evidence of a practice of product bundling. Internal

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<sup>11</sup> Loan files where a BCA was opened by the customer within one month of the loan account opening date.



auditors did undertake further investigation into two cases where the initial review of the conditions on the credit facility letters gave rise to concerns that product bundling had potentially occurred in these instances. In the first of these cases, internal auditors confirmed that the decision to reduce the arrangement fee for the loan in return for the transfer of the SME customer's BCA fell within the exemption provided in clause 18.2 of the behavioural undertakings. In the second case, internal auditors stated that a condition specifying that the SME customer should transfer their BCA to the Bank of Ireland could be put down to human error – a conclusion which is supported by documentary evidence indicating that the SME customer in question first approached the bank with the intention of transferring its BCA to the Bank of Ireland. However, the Bank of Ireland's internal auditors stated that it was not feasible to independently validate this conclusion due to the lapse of time since loan approval.

#### *Audit report conclusion*

- 3.6 The Bank of Ireland audit report concludes that, on the basis of its review, no evidence was found indicating a practice of product bundling at the Bank of Ireland. However, the report also states that given certain data and system constraints, internal auditors can only provide limited assurance that the bundling prohibition has been fully complied with. The report recommends a number of improvements intended to strengthen the ability of the bank to monitor its compliance with the bundling prohibition and further work to improve the robustness of the bank's next audit report.

#### **Barclays**

- 3.7 Barclays' internal auditors used targeted sampling to assess the knowledge and awareness of the bundling prohibition among relevant staff (defined as those staff having day-to-day contact with SME customers). Out of a sample of 59 staff, the audit found that 31% were unable to demonstrate a satisfactory awareness of the bundling prohibition. It was also found that only 36% of staff had received any specific training in relation to the bundling prohibition within the previous 12 months. A review of these 59 staff members' credit proposals and sanction decisions did not indicate any practices which contravened the bundling prohibition.
- 3.8 A review of Barclays' policies, guidance and procedures did not indicate any statements or procedures that were not compliant with the bundling prohibition. Internal auditors did nevertheless recommend that certain guidance documents for larger loans to SME customers should include a specific

mention of the undertakings or that there should be some enhancements to current wording.

- 3.9 Using key word analysis, Barclays' internal auditors analysed all complaints between January 2013 and April 2014. This review did not identify any complaints made by SME customers with regard to product bundling. However, the audit report did note that, due to a lack of appropriate indicators and guidance to staff on how to identify and log such complaints, Barclays' management team had insufficient ability to monitor the bank's compliance with the bundling prohibition via currently produced complaint data.

#### *Audit report conclusion*

- 3.10 The Barclays audit report concludes that Barclays' processes and procedures are compliant with the bundling prohibition and that there is no indication that its relevant staff have acted in a manner inconsistent with the bundling prohibition. Nevertheless, the audit report recommends that enhancements to staff training be made in order to improve staff awareness and better systems put in place to ensure appropriate monitoring of compliance.

#### ***Clydesdale***

- 3.11 Internal auditors at Clydesdale reviewed the entirety of its new-to-bank SME business files secured by its Scottish business units between 1 July 2013 and 27 June 2014. Out of the [X] cases, three files were identified where, in paperwork supporting the loan, the transfer of the SME customer's BCA to Clydesdale was included as a 'condition' for obtaining the loan. Internal auditors reviewed correspondence related to these files and were satisfied that, in each case, there was a 'genuine rationale' for the SME customer wanting to transfer their BCA as part of the arrangement (ie Clydesdale having won a competitive tender situation or the SME customer expressing dissatisfaction with their current bank). However, internal auditors concluded that it was inappropriate for Clydesdale relationship managers to have included the transfer of the SME customer's BCA as being a 'condition' of the loan facility rather than it being the wish of the SME customer.
- 3.12 During its review of internal policies and guidance, Clydesdale's internal audit discovered a credit policy document relating to loans for SME customers towards property acquisition and investment purposes which stated that the bank should only lend to existing customers or those who would switch their BCA to Clydesdale. Internal auditors have advised the CMA that, on the basis of their file review, this policy seems not to have been followed in practice by staff. Clydesdale management have also advised that the particular loan products affected by this guidance – designed for SMEs who wished to

purchase commercial property not related to their core business – have not been commonly made by the bank.

- 3.13 Following the CMA's discussions with Clydesdale on the robustness of its original staff awareness exercise as used in the audit report, the CMA requested that the awareness test be repeated using questions similar to those directly suggested by the CMA. Internal auditor's second awareness test covered 21 relevant bank staff across all communication channels. Overall, a total of 84 questions were asked with staff achieving a 95% compliance rate.

#### *Audit report conclusion*

- 3.14 Clydesdale's audit report concludes with a 'satisfactory' rating outcome with a number of observations for improvements. These include revising standard forms so that staff must now provide a reason for why an SME customer has transferred their BCA and the removal of non-compliant wording in credit policy noted in paragraph 3.12 above. Furthermore, the audit report recommends that further educational communication be given to second line credit staff responsible for sanctioning loans and notes that, from 30 June 2014, a quarterly review of new-to-bank business will be implemented to monitor ongoing compliance with the bundling prohibition.

#### **Danske Bank**

- 3.15 Internal auditors at Danske Bank carried out a sample file review of new loans and deposits opened in 2013. Out of the total 55 applications reviewed, three loan files included a 'condition of sanction' which specified that a 're-bank of trading account' was necessary in order for the SME customer to obtain the loan from Danske Bank. Internal auditors followed up these three instances with the relevant staff members and concluded that this wording was included due to the SME customer's request for a 'full re-bank' rather than this being a requirement initiated by Danske Bank.
- 3.16 Internal auditors interviewed approximately 40% of Danske Bank's entire business banking manager population and found that staff awareness in relation to the bundling prohibition was of a 'high level'.
- 3.17 In a review of complaints between January and December 2013, the Danske Bank audit report did not identify any complaints from SME customers relating to issues which would have contravened the bundling prohibition. Product design and general product terms and conditions were consistent with Danske Bank meeting its obligations under the bundling prohibition.

### *Audit report conclusion*

- 3.18 The Danske Bank report concludes that Danske Bank is 'On track' (the bank's highest compliance rating), and that internal auditors are satisfied that its policies, procedures and levels of staff awareness are sufficient to ensure compliance with the bundling prohibition. However, the report also recommends that the bank's credit department should enhance its processes to ensure a fuller assessment of SME conditions of sanction. The report also states that the bank's business procedures have been amended in order to avoid future uncertainty over the handling of loan conditions.

### **First Trust**

- 3.19 Following the identification in December 2013 of six instances where First Trust staff contravened the bundling prohibition (as mentioned in paragraph 2.5), First Trust's audit report stated that a further five cases of bundling were identified following its previous correspondence with the OFT in February 2014. Four of these cases were identified by First Trust's management. The fifth case was identified by internal auditors during a review of a sample of 100 facility letters<sup>12</sup> issued by the bank. At the time of the audit report, First Trust had contacted all affected SME customers in order to advise them that they were under no requirement to maintain their BCA with the bank in order to retain their loan.
- 3.20 First Trust's audit report outlines how systems for the monitoring and reporting of non-compliance with the bundling prohibition were not in evidence at the bank prior to the OFT's investigation. The internal auditors also note that, at the date of their report, the requirements of the bundling prohibition did not feature in internal lending policy documents for relevant First Trust staff.
- 3.21 The audit report notes that, at the date of the report, First Trust management was introducing a number of controls designed at ensuring compliance with the bundling prohibition. These controls included strengthening monitoring processes and updating policy documents. First Trust management was also introducing a training programme for relevant staff at the time of the audit report.

### *Audit report conclusion*

- 3.22 The report states that First Trust's management is committed to performing an analysis of the breaches to the bundling prohibition identified to date in order

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<sup>12</sup> A letter in which the bank sets out the conditions on which it is willing to make the loan available to the customer.

to understand the extent of the issue and underlying root causes. The report also states that First Trust management has confirmed that all actions recommended in the audit report for ensuring compliance with the bundling prohibition will be implemented by 31 December 2014.

## **HSBC**

- 3.23 A review of manuals, guidance, documentation, policies and procedures conducted by HSBC's internal auditors did not itself reveal non-compliance with the bundling prohibition, with the exception of certain statements made on linked pages from HSBC's website. These occurred on certain pages related to HSBC's small business loan where it was stated that clients needed to have an HSBC BCA in order to obtain the loan. Internal auditors also noted non-compliant statements provided by HSBC's 'online virtual assistant' tool (as had been previously noted by OFT and CMA officers – see paragraph 2.3). HSBC has told the CMA that these non-compliant statements were corrected by HSBC management once identified.
- 3.24 Subsequently, on 10 October 2014, HSBC informed the CMA that it had found a bullet point on one of the sub-pages for its small business loan product which incorrectly stated that customers needed to have an HSBC BCA in order to obtain the loan. This statement was immediately corrected by HSBC once identified. HSBC informed the CMA that in order to ensure that no other statements appeared on its website, it was immediately carrying out a further systematic review of all potentially relevant webpages and other materials and processes.
- 3.25 Internal auditors interviewed a sample of 40 'relevant staff' (defined in the March 2014 agreement to mean HSBC staff who are responsible for the marketing and sale of business loans and business deposit accounts) from across regions, roles and communication channels to assess awareness of the bundling prohibition. All of the relevant staff sampled demonstrated sufficient understanding of the bundling prohibition in relation to loans, although this declined to 90% demonstrating sufficient understanding when asked specifically about business deposit accounts. HSBC also conducted a mystery shopping exercise among these relevant staff which demonstrated a 94% success rate for awareness of the bundling prohibition across different communication channels.
- 3.26 Although not required under the March 2014 agreement, internal auditors also conducted a 'limited' mystery shopping exercise among HSBC's customer-facing staff in five branches given that these staff members may be the point

of first contact for potential SME customers.<sup>13</sup> This work found that such branch staff were generally unaware of the bundling prohibition and action was immediately taken by HSBC to ensure that such staff had a consistent level of awareness, notwithstanding that they are not directly involved in relevant marketing or sales activities. This included staff training by business specialists to reinforce and embed awareness of the bundling prohibition. A subsequent mystery shopping exercise conducted across 20 HSBC branches found that 70% of such branch staff passed a test demonstrating awareness of the bundling prohibition. Further steps to embed awareness have since been completed.

- 3.27 The audit report also provided updates on a number of activities initiated by HSBC following its February action plan (see paragraph 2.11). In particular, the report notes that, although not required by the March 2014 agreement, mandatory training on the bundling prohibition was introduced in April 2014 and, as of 3 July 2014, 93% of relevant staff who had been assigned the training had already passed the test. For customer-facing staff with responsibilities for the marketing and sale of business products, the completion rate at the time of submission of the report was 97.7% (out of the highest achievable rate of 98.4% after accounting for leavers and long-term sickness, etc). Furthermore, the report also notes that most procedures and policies had already been reviewed and updated in compliance with the bundling prohibition.
- 3.28 HSBC's audit report did not involve a file review, nor did it contain an analysis of complaints data.

#### *Audit report conclusion*

- 3.29 HSBC's audit report outlines the steps taken by HSBC management following their February action plan. It notes that all known information and materials have been reviewed and/or amended to comply with the bundling prohibition and that management has taken all reasonable measures to ensure that relevant staff are sufficiently aware of the requirements of the bundling prohibition. As noted, internal auditors' testing of retail branch staff that do not have responsibilities for the sale and marketing of business banking products showed much lower levels of awareness, but management have taken steps which indicate a considerable improvement, notwithstanding that these staff are not relevant staff for the purposes of the March 2014 agreement with the OFT.

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<sup>13</sup> These are staff members not considered by HSBC to be 'relevant staff' under the terms of the March 2014 agreement with the OFT.

- 3.30 In a separate covering letter provided to the CMA by HSBC management on 10 July 2014, HSBC stated that it considered that the internal audit report demonstrated that the bank had adequate and appropriate policies, practices and procedures to secure compliance with the bundling prohibition as at the date of its letter.

### **Lloyds**

- 3.31 Internal auditors at Lloyds reviewed (a) [X] lending complaints; (b) [X] lending appeal cases over the preceding 12-month period; and (c) interviewed 140 relevant staff. Of the complaints and lending appeal reviewed, no complaints regarding bundling, within the meaning of the undertakings were identified. Of the staff interviewed, 99% demonstrated good awareness of the bundling prohibition. However, 12% of staff interviewed recalled seeing 'conditions of sanction' for loan applications which indicated that the SME customer needed to open a BCA at Lloyds.
- 3.32 Internal auditors also reviewed 97 recent loan applications and found 'conditions of sanction' which made reference to the transfer of the customer's BCA in 16 instances. Further inspection found that 13 of these instances related to the provision of a commercial mortgage and/or debenture and thus fell outside the scope of the bundling prohibition. In the remaining three cases, relevant staff involved in the loan application told internal auditors that the SME customer had requested to transfer its overall banking relationship to Lloyds. Staff told Lloyds' auditors that recording this on the file as a 'condition of sanction' was a way of recording this intention (albeit an incorrect one) rather than indicating a requirement on the part of the bank. As a result, the audit report concludes that its assurance for compliance with the bundling prohibition in these three instances rests upon these oral interviews with relevant staff.
- 3.33 Internal auditors concluded that while overall policies and procedures were designed to ensure compliance with the bundling prohibition, some improvements to specific credit policy guidance and training could be made. In particular, auditors found that SME credit policy documents available to relevant staff contained references to customers being 'fully banked' with Lloyds, increasing the appetite of their SME credit-sanctioning colleagues to sanction lending. Furthermore, while SME relationship management staff had received recent training on the bundling prohibition, this was not provided to Lloyd's central credit-sanctioning staff.

### *Audit report conclusion*

3.34 Lloyds' internal audit report concludes that, while no breaches of the bundling prohibition were identified, some improvements are required to Lloyds' guidance, training and credit sanctioning processes to ensure the bank's ongoing compliance. Lloyds' management has initiated a number of actions to implement the suggested improvements.

### **RBS**

3.35 Internal auditors interviewed 42 members of relevant staff drawn from a variety of geographical areas, staff grades and business types. A majority of these staff members were aware that they could not make the opening of a BCA a condition of obtaining a loan or business deposit account. However, only five members of staff referred directly to the bundling prohibition in the 2002 behavioural undertakings. The majority of staff interviewed stated that the reason for not bundling these products was a result of other banking regulations and general good practice.

3.36 Internal auditors also incorporated a limited mystery shopping exercise covering both RBS's call centre staff and its online webchat function (across both RBS and NatWest brands). Out of 14 initial phone calls to call centre staff with regard to relevant products, internal auditors determined that there were one 'fail' and four 'partial fails' on the basis of answers provided by call centre staff.<sup>14</sup> When these lines were later retested, no subsequent fails were recorded among call centre staff. Furthermore, no RBS staff member contacted by RBS internal auditors as part of this exercise had the power to open an account or grant a loan. In relation to the webchats, three tests were undertaken and no fails were observed.

3.37 Internal auditors reviewed a sample of 38 files relating to SME customers which took out a BCA at the same time as a loan or business deposit account. None of the files reviewed indicated non-compliance with the bundling prohibition. Internal auditors also reviewed [redacted] complaint files that may have had, based on relevant filtering of existing RBS categorisations, a product bundling element. Of these complaint files, none were found to contain any evidence of non-compliance with the bundling prohibition.

3.38 As part of a review of product policies, procedures and terms and conditions to ensure compliance, internal auditors identified that the terms and conditions

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<sup>14</sup> A fail being defined as a definite yes when asked whether a customer must move their BCA in order to be considered for a relevant product, and a 'partial fail' where the staff member provided an uncertain response (eg 'I don't know', 'Not necessarily' or requests that the mystery shopper speaks to a specialist member of staff).



of one business deposit account product – the Treasury Direct Reserve – included a provision stating that the SME customer was also required to open an RBS BCA. Internal auditors were informed by RBS management that this term represented an unintentional typographical error and should have read ‘current account’ rather than ‘business current account’. Furthermore, this provision was never applied and the Treasury Direct Reserve product is no longer available. A review of all product policies and procedures available for relevant loans and savings products offered to SME customers found that, while not making specific references to the bundling prohibition, such material did not contain language which was inconsistent with the bundling prohibition.

- 3.39 A review of training material provided to customer-facing staff did not identify wording which was inconsistent with the bundling prohibition. However, RBS internal auditors did note that current credit skills training (considered most relevant by the business) provided to staff did not contain any content which specifically related to the bundling prohibition but also did not contain any guidance that might lead staff to breach the bundling prohibition.

#### *Ulster Bank*

- 3.40 The RBS audit report treats Ulster Bank separately given that it is a distinct entity within the RBS group. A sample file review conducted for Ulster Bank (25 files) did not identify any concerns and a mystery shopping exercise in relation to a single SME-related telephone line did not result in any non-compliant statements being provided to internal auditors by Ulster Bank staff. However, the report found that no specific training on the bundling prohibition was maintained for staff. Finally, although no staff member (of the ten interviewed) stated that an SME customer was required to transfer their BCA when seeking a relevant product, one relationship manager did indicate that the customer having their BCA with another bank could [redacted] and that the bank may not grant a loan if [redacted].

#### *Audit report conclusion*

- 3.41 RBS’s audit report concludes that internal auditors’ testing did not provide any evidence of non-compliance with the bundling prohibition at RBS or Ulster Bank. In particular, while there were exceptions in the mystery shopping exercise of call centre staff at RBS, the report concludes that these did not result in non-compliance with the bundling prohibition as the single fail (and four partial fails) were made by members of staff who were unable to grant a loan or open an account (see paragraph 4.5 for the CMA’s conclusions and recommendation on this).

3.42 RBS's audit report included a number of recommendations to ensure continued compliance with the bundling prohibition. RBS is currently reviewing these recommendations internally to determine how they could be implemented.

### **Annual reminder**

3.43 As part of their audit reports, all the banks confirmed that the written reminder to staff about the behavioural undertakings and the bundling prohibition was appropriately communicated to relevant staff in accordance with the March agreement. In reviewing these reminders, the CMA notes that each one emphasised that the banks took its commitments seriously, with some emphasising potential consequences for employees in the event of non-compliance.

## 4. Conclusions, recommendations and next steps

### CMA view on compliance levels

- 4.1 Considerable variation exists between the banks concerned in the effectiveness of systems and procedures maintained by each bank for ensuring compliance with the bundling prohibition. This variation has afforded some banks a greater ability than others to demonstrate their previous and ongoing compliance with the bundling prohibition.
- 4.2 For some banks, the CMA considers that appropriate safeguards for ensuring compliance with the bundling prohibition were not in place prior to the OFT's initial investigation in 2013. This was particularly the case in relation to appropriate staff training, staff awareness and internal processes and guidance.
- 4.3 Overall, on the basis of both the audit reports and the OFT's investigation, the CMA's significant concerns over compliance levels relate to two banks: First Trust and HSBC.
- 4.4 In regard to First Trust and HSBC, the information gathered by the OFT and CMA indicates that both banks have previously allowed multiple breaches of the bundling prohibition to occur as a result of weaknesses in the compliance systems and procedures maintained at each bank:
- **First Trust:** First Trust has breached the bundling prohibition in relation to 11 SME customers (see paragraphs 2.5 and 3.19). The CMA welcomes the actions of First Trust management in writing to those SME customers who were affected as part of remedial actions, but the CMA believes that a previous lack of appropriate focus on the obligations of the bank under the bundling prohibition led to these breaches.
  - **HSBC:** HSBC has breached the bundling prohibition in relation to at least four SME customers (see paragraphs 2.9 and 2.10), and also by including non-compliant statements on linked pages from its website and in its 'online assistant tool' (see paragraphs 3.23 and 3.24). The CMA welcomes HSBC's February action plan to improve compliance measures and its ongoing work, but the CMA believes that a previous lack of appropriate focus on the obligations of the bank under the bundling prohibition led to these breaches. In particular, it seems that internal guidance on HSBC's preference for [✂] led to confusion among staff as to their obligations under the bundling prohibition.

- 4.5 The CMA has concerns in relation to RBS's compliance, which the CMA would expect to be improved upon. Staff awareness of the specific bundling prohibition seemed low despite a general understanding of the obligations on the bank. The CMA also expects that all relevant contact channels for potential SME customers should be compliant with the bundling prohibition. In this regard, RBS's limited mystery shopping exercise by telephone, while not providing strong evidence of systematic deficiencies in staff training and awareness, failed to provide the CMA with sufficient assurance on this matter. On the basis of evidence disclosed in RBS's audit report on the mystery shopping exercise (paragraph 3.36), there are grounds for considering that there may have been an instance of non-compliance with the bundling prohibition – namely the instance of one 'fail' identified out of 14 initial phone calls to RBS call centre staff, representing a non-compliant answer. Given both the relatively small scale of the issue identified, and the fact that subsequent retesting of affected lines did not show non-compliance, the CMA does not consider that it would be proportionate to take enforcement action in respect of this single instance, and so will not (on the basis of the evidence at present available to the CMA) issue written directions under clause 28 of the 2002 SME banking behavioural undertakings.
- 4.6 In the case of Barclays, the CMA has seen no evidence of a breach of the behavioural undertakings. However, the relatively low levels of staff awareness found in Barclays' staff survey (see paragraph 3.7) is of concern to the CMA, especially when it is considered that recent communications upon this matter had been circulated to relevant staff. The CMA believes that high levels of staff awareness with regulatory obligations of this kind is a key aspect of ensuring compliance with the bundling prohibition and we therefore welcome Barclays' intention to enhance current staff training.
- 4.7 In relation to other banks, the CMA has seen no evidence of a breach of the behavioural undertakings and the CMA's compliance concerns are of a lower order and are generally in keeping with the issues raised by the banks' internal auditors in their reports. However, the CMA remains concerned about the number of cases identified by internal auditors during case file reviews where reassurance on compliance with the bundling prohibition largely rested upon the recollections of relevant bank staff involved in the transaction (see Bank of Ireland, Clydesdale, Danske Bank, Lloyds). In future compliance reviews, the CMA would expect to see a reduction in such incidents so that it can derive greater reassurance on overall compliance levels at these banks.

## **Reasonable view of non-compliance**

4.8 As regards the concerns previously identified by the OFT (see paragraphs 2.5 to 2.10 above), the CMA considers that, in accordance with the wording of clause 28 of the behavioural undertakings, it is of the 'reasonable view' that both First Trust and HSBC had failed to comply with the bundling prohibition prior to the OFT's initial investigation into this matter.

## **Directions**

4.9 The CMA has decided to issue First Trust and HSBC with written directions under clause 28 of the behavioural undertakings. The content of these directions seeks to ensure compliance in a manner consistent with the internal processes of the banks concerned – either deriving from the audit reports' recommendations or via management initiatives. The CMA believes that incorporating these internal plans into formal written directions issued to the banks represents the most effective way to ensure future compliance with the bundling prohibition currently available to the CMA.

## **Best practice**

### ***Ensuring compliance***

4.10 Following the recommendations found in each bank's audit report, the CMA now expects all banks to move towards better systems and procedures for ensuring compliance with the bundling prohibition. Specifically, having observed certain common issues featuring in a number of the banks' audit reports, the CMA would be keen to see improvements in the following areas where relevant to a bank:

- Revisions to standard paperwork drawn up for loan applications to ensure that relevant staff consider the bundling prohibition when dealing with new-to-bank SME customers (while also assisting bank's ability to monitor compliance)
- Better guidance and education for centrally-based credit-sanctioning staff on the bundling prohibition to ensure that communications with frontline relationship managers and their SME customers are compliant with the bundling prohibition
- Changes to indicators/tags in the bank's internal complaint records to allow for better monitoring of compliance with the bundling prohibition

- 4.11 In noting these specific issues, the CMA recognises that certain examples of good practice were already in place prior to the OFT's investigation (as noted in paragraph 2.13). The CMA also recognises that since the OFT's investigation, a number of the banks seem to have made good progress in updating and improving their internal systems and procedures for ensuring compliance.
- 4.12 Finally, as detailed in paragraph 4.4, in the light of the previous significant failures of HSBC and First Trust to comply with the bundling prohibition, the CMA has decided to issue directions under clause 28 of the behavioural undertakings to these banks in order to formalise the remedial actions that they are already putting in place to ensure future compliance.

### ***Future audit reports***

- 4.13 As noted in paragraph 2.15, under the March 2014 agreement the banks' next reviews on compliance with the bundling prohibition are to be submitted to the CMA by 11 July 2015. Following the publication of this report, the CMA will seek to engage with the banks on the content and methodology of their second reviews. This will be to ensure that subsequent audit reports feature more readily comparable information between the banks and are thus able provide a greater degree of reassurance on overall compliance levels.

### **Next steps**

- 4.14 Following this report, the CMA will continue to monitor the relevant banks' compliance with the bundling prohibition consistent with the CMA's statutory duties under the Fair Trading Act 1973. This will include reviewing the relevant banks' next annual reports on compliance due to be submitted in July 2015. The CMA would also welcome any evidence from SME customers or their representative organisations in regard to compliance with the bundling prohibition. Such evidence may be submitted to the CMA by sending an email to [SMEbundling@cma.gsi.gov.uk](mailto:SMEbundling@cma.gsi.gov.uk).
- 4.15 In the event of future concerns being raised – either through subsequent audit reports or via new evidence coming directly to the CMA's knowledge – the CMA remains open to further enforcement action to ensure compliance with the bundling prohibition; this could also include seeking an injunction at Court against any non-compliant behaviours on the part of the relevant banks.