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Competition and Markets Authority (CMA): inquiry into the UK banking sector

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IPPI POLICY BRIEF

Competition and Markets Authority (CMA): inquiry into the UK banking sector; preliminary findings; October 2015

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Summary

This policy brief summarises, with some limited comments, the Provisional Findings (PFs) and Notice of Possible Remedies published by the CMA on 22nd October 2015. The CMA commenced this inquiry in November 2014 and the final report is due by May 2016.

The investigation covers the provision of personal and business current accounts and also some wider aspects of SME banking across the UK. Despite earlier comments that Scotland might be a separate market for SME lending, the whole of GB is treated as a single market for all aspects of this report. The SME sector is of major importance to the Scottish economy, accounting for over 99% of all business enterprises.

In the PFs the Group set up by the CMA provisionally determine that as a result of certain features of the markets investigated, there are adverse effects on competition (AECs). Therefore they propose a number of remedies to offset the features identified and to reduce the consumer detriment resulting from the AECs.

The key findings are summed up in this quote from the report: - *'The combination of these features means that there is weak customer response to differences in prices or service quality and established banks have incumbency advantages. As a result, the incentives on banks to compete on prices, service quality and/or innovation are reduced.'*

The proposed remedies focus on means of encouraging greater consumer response and better incentivising banks to compete. The CMA is not recommending any structural changes nor the end of 'Free-if-in-credit' current accounts. There are specific remedies to help support SME lending and 're-engineer' the process of accessing loans.

The PFs and proposed remedies are currently out to consultation, with comments required by 20 November 2015.

[1] Jeremy Peat was RBS Group Chief Economist from 1993 – 2005. He was a Panel Member of the Competition Commission (the predecessor of the CMA) from 2005 – 2014; and has since been a Panel Member of the CMA. This note is written from a purely personal and professional perspective and he has not been involved at the CMA in any aspect of the current banking inquiry.

I Introduction

In November 2014 the Competition and Markets Authority (CMA) commenced an inquiry into elements of the UK banking industry. This inquiry was to consider aspects of the retail banking sector in the United Kingdom, namely the provision of current accounts including overdrafts to personal current account customers (PCAs) and the provision of a wider range of services to small and medium scale businesses (SMEs).

As a former Group Chief Economist at RBS (1993-2005),I have been involved in a range of studies of the UK banking sector, going back to that set up under Sir Donald Cruickshank in 2000. In my view, this latest inquiry really does matter and potentially could result in real benefits for individuals and SMEs across Scotland, and the rest of the UK. Therefore it merits close attention at this stage from all interested parties if the maximum benefits are to be extracted from the detailed, informed and objective work undertaken by the CMA. Whilst they are not recommending dramatic steps such as restructuring the sector or banning 'Free-if-in-Credit' current accounts, some significant remedies are under active consideration.

As is standard for inquiries of this type, a group of five CMA Panel Members was appointed to be responsible for the inquiry. This Group is supported by a strong professional team, including *inter alia* economists, lawyers and business analysts. The Group was charged with consideration as to whether: '*any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom'*.

If the Group were to determine in its final report that such a feature or features exist, then they will have found that there is one or more AEC – an Adverse Effect on Competition. The next step would be for the Group to determine what action is then appropriate and proportionate and to find in favour of some package of 'remedies' either to be implemented by the CMA or recommended to other bodies.

Earlier this year, the Group published an 'Annotated Issues Statement' giving some indication of their direction of travel. But they have now reached a crucial stage and have published their Preliminary Findings (PFs)[2] along with a Notice of Possible Remedies. It is these documents which are the subject of this note.

[2] This note is based upon a full summary of PFs published on 22nd October: 'Retail Banking Market Investigation; summary of provisional findings'. This is available via the CMA website. The full version of PFs, including some 30 appendices, will be available shortly. However, the summary is more than sufficient to understand their findings and possible remedies.

At this time (November 2015), the Group is seeking comments from all interested parties on their PFs and on their list of possible remedies. Over the next couple of months they will hold formal hearings with key players, no doubt including the major banks, challenger banks and representatives of consumers and small and medium size enterprises. These hearings will be transcribed and summaries, excluding any confidential information, will be made available on the CMA website.

Following consultation, hearings and further consideration, the final report will be published in May 2016, 18 months after the inquiry commenced. This report will include the Group's final views on AECs and, subject to their being one or more AEC, a final list of proposed remedies[3]. It is important to note that this will be the *final* report, and will not be subject to (for example) Ministerial approval. However, it will of course be subject to due legal process and there could be (for example) appeals by parties, initially to the Competition Appeals Tribunal.

II The findings

At earlier stages of the Group's work there were suggestions that they saw the possibility of greater competition problems in the SME banking market in Scotland than elsewhere in Great Britain (they are considering Northern Ireland somewhat separately) because of more limited competition for this market north of the border. However, in their latest document they treat the whole of GB as one market for personal and SME banking purposes. To quote their report: -

> '*In relation to Scotland, while there were some differences in market share in Scotland, these were not sufficient to suggest that Scotland should be viewed as a separate geographic market to England and Wales.*'

Therefore, subject to any re-consideration of this finding, the analysis and possible AECs apply across GB and any remedies finally agreed would apply equally across GB.

In the Group's issues statement they had identified the following causes for concern: -

'(i) that there are impediments to customers' ability to shop around, choose and switch products and suppliers resulting in weak incentives on banks to compete;

(ii) that the level of concentration [in the markets] is giving rise to market power leading to adverse outcomes for customers; and

(iii) that there are barriers to entry and/or expansion leading to worse outcomes for customers'

[3] A separate note on possible remedies has been published alongside PFs. See note 4 below.

Between issues statement and Preliminary Findings (PFs) these issues have been subject to further consultation and investigation. That work included wide-ranging customer surveys of both personal and SME customers. As a result of these further investigations the issues have not gone away! Indeed the formal position in these PFs is that the Group has provisionally found that: '*there are features of the relevant markets, which alone or in combination, prevent, restrict or distort competition in the supply of PCAs in the UK and in the supply of certain retail banking services to SMEs in the UK such that there is an adverse effect on competition (AEC)*'.

They have found AECs and therefore it behoves the group to consider what actions might be required to offset the negative effects on competition and hence mitigate to some degree the consequent consumer detriment.

So far as **personal current account** holders are concerned, the features identified which together lead to this finding of AECs are as follows: -

1 *Barriers to accessing and assessing information on PCA charges and service quality*

2 *Barriers to switching PCAs*

3 *Low levels of customer engagement; and*

4 *Incumbency advantages*

Turning to the **SME market**, the Group again found a combination of features underlying an AEC. They found separate but similar AECs for Business Current Accounts and the provision of SME lending. The features identified are: -

1 *Linkages between Personal Current Accounts (PCAs) and Business Current Accounts (BCAs)*

2 *Barriers to accessing and assessing information on BCA charges and service quality*

3 *Barriers to switching BCAs*

4 *Low levels of customer engagement; and*

5 *Incumbency advantages*

For both personal and SME customers the Group states that: -

> *'The combination of these features means that there is weak customer response to differences in prices or service quality and established banks have incumbency advantages. As a result, the incentives on banks to compete on prices, service quality and/or innovation are reduced.'*

There are regular references through the CMA PFs document to 'incumbency advantages' for the long established banks, as a result of weak customer response; resulting in 'barriers to entry' so far as actual and potential new entrants are concerned. Within this context there is particular emphasis on SME banking, where the CMA suggest that SMEs tend to open business accounts at the same bank as they hold their personal accounts – and then tend to move on to seeking any required business loans from the same bank once more.

To quote further from the report, so as to provide a good indication as to where the Group is looking for remedial action, please note the following: -

- *'We found that while banks appearing to offer lower average prices and/or better quality tend to have been gaining market share this was at a very slow pace.'*
- *'… competition is focused on acquiring the primary banking relationship and targeting more affluent customers'*
- *'SME engagement was relatively low both at start-up where many SMEs did not compare banks and after the end of the free banking period where few SMEs searched or switched.'*
- *'Banks' acquisition and retention strategies tend to focus on larger SMEs (turnover of above £2 million)'.*

III The remedies under consideration

A consultation document covering possible remedies has been published at the same time as the PFs.[4] Again comments are requested. Going forward, consideration of remedies will continue to be related to consideration of features of the market and AECs. If the view on AECs were to change, then this could influence the view on remedies. Obviously, no AEC would mean no remedies. Any change in either the features of the market or the AECs would lead to re-consideration of remedies. Possible remedies will be one topic on the agenda for hearings with interested parties.

As noted in their consultation document, as is standard for CMA inquiries into sectors, '*The CMA will consider how comprehensively the possible remedy options – whether individually or as a package – address the AEC and/or its resulting detrimental effects on customers, and whether they are effective and proportionate'.*

On this occasion, what is *excluded* from possible remedies is attracting as much notice as what is included. Some commentators and some from the 'Challenger' banks have argued that the 'Free-if-in-credit' approach by the major banks to current accounts distorts the market. Provision of a current account may be 'free' to the customer who stays in credit but it is not

[4] 'Retail banking market investigation; notice of possible remedies'; this is again available on the CMA website.

costless to the provider, even if a positive balance is maintained at all times. Each transaction on that account costs the provider something! For banks to achieve the required profitability and return on capital, someone has to meet all costs. Losses related to 'free' current accounts will have to be offset by higher than normal margins/profits in other product areas. There is clearly a distortion of the market at work here. However, the CMA has determined that the provision of such 'Free-if-in-credit' current accounts is not a *sufficient* distortion to result in a requirement for intervention.

Also the Group has determined, at this stage, that no structural remedies are justified. Some such changes resulted from the Independent Commission on Banking chaired by Sir John Vickers in 2011.

It should be noted that the CMA Group is free to change its view on remedies as well as on AECs in the period between PFs and its final report. But introducing major new – and potentially contentious – remedies at that late stage would be unusual.

Below are the remedies that the Group recommends for consideration at this stage – broken down between remedies to cover the AECs for PCAs and BCAs and then those for the AECs related to SME lending. It should be noted that the list of possible remedies is lengthy and the remedies proposed in many instances appear highly technical. Nevertheless the importance of the concerns raised is such that the list of remedies merits careful consideration.

There are major costs to consumer and SMEs related to limited choice and switching so far as current accounts are concerned. Will consumers and consumer organisations agree that the possible remedies set out below could reduce these costs and work towards a more efficient and customer-friendly banking system?

The SME sector is of particular importance to the Scottish economy. In 2014, there were 332,720 small and medium-sized enterprises (SMEs) operating in Scotland, providing an estimated 1.1 million jobs. SMEs accounted for 99.3% of all private sector enterprises, 54.8% of private sector employment and 37.9% of private sector turnover.

A major issue often discussed in Scotland is with regard to possible constraints on SME access to loans and the way in which this may inhibit investment and innovation – the very life blood of a successful, high-productivity, efficient and competitive SME sector. Could the proposed remedies for SME lending really result in a dramatic change (for the better) in the means of SMEs acquiring loans, as the CMA report suggests? Or is something more substantive warranted?

The Group has proposed a range of possible remedies to deal with the issues identified for Personal Current Accounts and Business Accounts. These are categorised as follows: -

- Measures to promote engagement and prompt switching between current account providers.

  Remedy 1 – Prompt customers to review their PCA or BCA provider at times when they may have a higher propensity to consider a change

  Remedy 2 – Increase public awareness of the potential savings or rewards that could be obtained by changing one's current account provider and of the benefits of using the Current Account Switch Service to do so in terms of security and convenience

- Measures to facilitate comparisons between providers

  Remedy 3 – Facilitate price comparisons between providers by making customer-specific transaction data more easily available and usable, including by PCWs

  Remedy 4 – A PCW [Price Comparison Website] for SMEs

  Remedy 5 – Enable consumers and SMEs to make comparisons between current account providers on the basis of their service quality

- Measures to make BCA opening easier

  Remedy 6 – Standardise and simplify BCA opening procedures

- Measures to improve the switching process

  Remedy 7 – Make it easier for prospective PCA customers to find out, before initiating the switching process, whether the overdraft facilities they were seeking would be available from another provider

  Remedy 8 – Require payments into the old account to be redirected into the new one for a longer period than at present

  Remedy 9 – Require banks to retain and provide ex-customers, on demand, with details of their BCA and PCA transactions over the five years prior to their account closure

  Remedy 10 – require BACS to transfer continuous payment authorities on debit cards when switching through CASS

  Remedy 11 – Require all banks to support the partial switching service and to provide an equivalent guarantee to that offered as part of CASS

  Remedy 12 – Changes to CASS governance

At this stage in their remedies document the CMA states that it believes that: - '*The remedies we have set out here could each individually have a beneficial impact on the AECs we have provisionally found in the PCA and BCA markets. However, we believe their impact in combination, as a package, is likely to be greater than their effect in isolation.'* This emphasis on the value of remedies as a package is an important feature of the recommendations at this stage.

The remedies report then goes on to discuss potential remedies for the difficulties they have identified so far as *SME lending* is concerned. The features causing problems and hence AECs are set out above. It is these AECs which the remedies must aim to remove or substantially diminish.

Remedy 13 – Data sharing with credit reference agencies

Remedy 14 – Commercial open data and data sharing proposals

Remedy 15 – Require banks to provide a loans price and eligibility indicator

As with the set of remedies proposed for the AECs related to PCAs and BCAs, the CMA believes that these remedies related to SMR lending will '*tend to reinforce each other and be more effective as a package*'. In addition the Group believes that these SME lending remedies would work well with remedies 1, 3 and 4 above and '*taken as a whole, may enable a re-engineering of the process whereby SMEs seek and acquire loans'*.

It will be of interest to see if SMEs and relevant business organisations such as the Federation of Small Businesses and the Institute of Directors agree that a beneficial 're-engineering' of the process for acquiring loans could result from these remedies.

IV Next steps

The deadline for comments on both the provisional findings and the notice of possible remedies is 20 November 2015. The contact address is retailbanking@cma.gsi.gov.uk. Under the guidance when the CMA was established in place of the Competition Commission, the maximum time allowed for these sector inquiries was reduced from 2 years to 18 months. Therefore the final report is due to be published in May 2016 at the latest. Further information is available on the CMA website; and more papers and news on developments will be found there over the coming 6 or 7 months.

About the author:

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He has a distinguished career as an economist and economic commentator and was Group Chief Economist at the Royal Bank of Scotland (1993-2005). He is currently is a member of the Board of Scottish Enterprise and Chair of the Royal Zoological Society of Scotland and was a long-standing Director of the David Hume Institute (2004-14). He is a fellow of the Royal Society of Edinburgh, of the Chartered Institute of Bankers and the Royal Society of Arts.

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